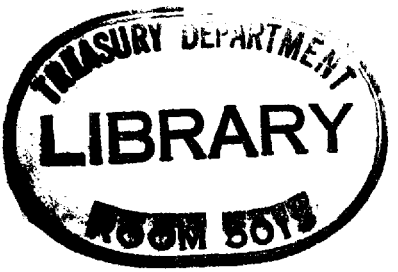
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INTERNAL REVENUE BULLETIN

CUMULATIVE BULLETIN 1953-1

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U.S. Treasury Dept. Internal Revenue Service

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INTRODUCTION

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

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

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

Each ruling is designated as a "Revenue Ruling" and should be cited by reference to the Bulletin and page where reported. Thus, Revenue Ruling No. 1 should be cited as "Rev. Rul. 1, C. B. 1953–1, 36." Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1953–1, contains all rulings, decisions, and legislation pertaining to Internal Revenue matters published in the biweekly Internal Revenue Bulletins 1 to 13, inclusive, for the period January 1 to June 30, 1953. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States, published in those Bulletins.

This Cumulative Bulletin is printed in three parts. The rulings under the Internal Revenue Code are printed as Part I, rulings pertaining to administrative matters are printed as Part II, and miscellaneous matters are printed as Part III.

ABBREVIATIONS

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

A, B, C, etc.—The names of individuals.
A. T.—Alcohol and tobacco tax ruling.
B. T. A.—Board of Tax Appeals.
C. B.—Cumulative Bulletin.
Ct. D.—Court decision.
D. C.—Treasury Department circular.
E. O.—Executive Order.
E. T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
G. C. M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I. R. B.—Internal Revenue Bulletin.
I. R. C.—Internal Revenue Code.
IR-Mim.—Published IR-Mimeograph.
I. T.—Income tax ruling.
M, N, X, Y, Z, etc.—The names of corporations, places, or businesses according to context.
M. T.—Miscellaneous tax ruling.
Mim.—Published Mimeograph.
P. L.—Public Law.
Rev. Rul.—Revenue Ruling.
S. T.—Sales tax ruling.
T. C.—The Tax Court of the United States.
T. D.—Treasury Decision.
x and y are used to represent certain numbers, and when used with the word "dollars" represent sums of money.

ANNOUNCEMENT RELATING TO DECISIONS OF THE TAX COURT OF THE UNITED STATES

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

THE TAX COURT OF THE UNITED STATES

CUMULATIVE LIST OF ANNOUNCEMENTS RELATING TO DECISIONS OF THE TAX COURT OF THE UNITED STATES PUBLISHED IN THE INTERNAL REVENUE BULLETIN FROM JANUARY 1, 1953, TO JUNE 30, 1953, INCLUSIVE

The Commissioner acquiesces in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
A			
Adda, Fernand C. A.[1]	14170	10	1291
Akely Camera & Instrument Corp. (formerly Akely Camera, Inc.)	31390	18	1045
Atwell, Laura Burgher [2]	27597 29776	17	1374
Atwell, Webster [2]	27596 29775	17	1374
B			
Bard-Parker Co., Inc	19845	18	1255
Boyt, A. J	23941	18	1057
Boyt, Barbaradina	23943	18	1057
Boyt, Dorothy F., et al, administrators of estate of Paul A. Boyt	23942	18	1057
Boyt, Elizabeth M	23944	18	1057
Boyt, J. W	23940	18	1057
Boyt, Paul A., estate of	23942	18	1057
Brown & Williamson Tobacco Corporation [3]	15020	16	432
Burton, A. C. & Company, et al	17168	18	895
Butler, Nicholas Murray, estate of [4]	32431	18	914
C			
California Casket Co	30419	19	32
Charlotte Union Bus Station, Inc	31330	19	336
Chase National Bank of the City of New York, The, executor of the estate of Louis Sternberger [4 5]	31348	18	836
Chrystie et al., T. Ludlow, executors of estate of Nicholas Murray Butler	32431	18	914
Clark, Willis W.[6]	13686	11	672
Crowder, Alpha	30307	19	329
Crowder, Ray	30306	19	329

[1] Nonacquiescence published in Cumulative Bulletin 1948–2, page 5, withdrawn.
[2] Nonacquiescence published in Cumulative Bulletin 1952–2, page 4, withdrawn.
[3] Nonacquiescence published in Cumulative Bulletin 1951–2, page 5, withdrawn.
[4] Estate tax decision.
[5] Acquiescence relates only to the issue of whether the amount paid for brokerage and legal fees is an allowable estate tax deduction.
[6] Nonacquiescence published in Cumulative Bulletin 1949–1, page 5, withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
D			
Denbigh, Basil Kennedy, administrator c. t. a. of estate of John Halliday Denbigh [1] [2]	8317	7	387
Denbigh, John Halliday, estate of [1] [2]	8317	7	387
E			
Edenfield, Ray	23491 28554	19	13
Edwards, Edward W., et ux	33702	19	275
Elliot, Charles Edward Murray, executor of estate of Harcourt Johnstone [1]	26760	19	44
Emerson, Isaac [3]	16100	12	875
Equitable Life Assurance Society of the United States, The [1]	31470	19	264
F			
Falk, Jr., et al., Leon, executors of the estate of Maurice Falk [1]	30311	18	699
Falk, Maurice, estate of [1]	30311	18	699
Faucette Co., Inc	24086	17	187
Fawn Lake Ranch Co [3]	11341	12	1139
Ferguson, Anne Belle [4]	19380	14	846
Ferguson, Jr., Walter M. [4]	19386	14	846
Forcum, Vern	9393	19	200
Ford, Clarence B	9391	19	200
Fox, Eleanor C	24455	16	854
Fox, Walter S	24454	16	854
G			
Graves Brothers Co	28809 29446	17	1499
Green, J. E	23947	18	1057
Green, Mearle N	23947	18	1057
Greer, Jr., William Wallace	30819	17	965
Guggenheimer et ux., Charles S	26684	18	81
H			
Hale, Edward E	31342	17	965
Hamilton National Bank of Knoxville, executor and trustee of estate of Nellie H. Jennings [1] [5]	6471	10	323
Hance, John A., estate of [1]	34153	18	499
Hance, Percy L., executor of estate of John A. Hance [1]	34153	18	499
Hanch, Charles C., estate of [1]	30093	19	65
Hanch, Hazel M., executrix of estate of Charles C. Hanch [1]	30093	19	65
Hens & Kelly, Inc	13993	19	305
Hopag S. A. Holding de Participation et de Gestion de Brevets Industricls [4]	17170	14	38
Howell, M. Hadden, estate of [1] [6]	19479	15	224
Howell, Florence E., executrix of estate of M. Hadden Howell [1] [6]	19479	15	224
Huntington National Bank of Columbus, Ohio, The [1] [7]	17736	13	760

[1] Estate tax decision.
[2] Nonacquiescence published in Cumulative Bulletin 1946-2, page 6, withdrawn.
[3] Nonacquiescence published in Cumulative Bulletin 1949-2, page 4, withdrawn.
[4] Nonacquiescence published in Cumulative Bulletin 1950-2, page 5, withdrawn.
[5] Nonacquiescence published in Cumulative Bulletin 1948-2, page 5, withdrawn.
[6] Not applicable to cases involving transfers after October 7, 1949.
[7] Nonacquiescence published in Cumulative Bulletin 1950-1, page 7, withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
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J			
Jennings, Nellie H., estate of [1] [2]	6471	10	323
Johnson, E. R. Fenimore	23114	19	93
Johnson, Janet Darby	23115	19	93
Johnstone, Harcourt, estate of [1]	26760	19	44
K			
Kelly, Edward J.[3]	35676	19	27
King, Jr., Willis L., estate of [1] [4]	30907	18	414
Klein, Harry	24895	18	804
Kluckhohn et ux., Frank L.	34325	18	892
Kurtz, P. J.	23946	18	1057
L			
Latimer-Looney Chevrolet, Inc.[5]	35453	19	120
Leuthesser, Edward G., alleged transferee of National Metal Products Corp.[6]	28817	18	1112
Leuthesser, Jr., Fred W, alleged transferee of National Metal Products Corp.[6]	28818	18	1112
M			
Macfarlane, Alice M.[7]	27259	19	9
Mellon National Bank & Trust Co., executor of estate of Willis L. King, Jr.[1] [4]	30907	18	414
McGay, Bonnie [4]	29387	17	1399
McGay, J. B.[4]	29386	17	1399
Moore, Madge M., executrix of estate of Wade E. Moore	9392	19	200
Moore, Wade E., estate of	9392	19	200
Muncie, Curtis H.	35472	18	849
N			
New McDermott, Inc., The [8]	99360	[8] 44	1035
Nicholson, G. E.[4]	29384	17	1399
Nicholson, Oma M.[4]	29385	17	1399
P			
Philadelphia Title Insurance Co. [9]	25942	17	1068
Q			
Quiner, B. B.	23945	18	1057
Quiner, Eva	23945	18	1057
R			
Richards, Jr., Ernest V.	25438	19	366
Richards, Loretto McKenna	25437	19	366
Robert Dollar Co., The (successor to Admiral Oriental Line)	25000	18	444

[8] Board of Tax Appeals.

[1] Estate tax decision.
[2] Nonacquiescence published in Cumulative Bulletin 1948-2, page 5, withdrawn.
[3] Gift tax decision.
[4] Nonacquiescence published in Cumulative Bulletin 1952-2, page 5, withdrawn.
[5] Nonacquiescence published on page 7, this Bulletin, withdrawn.
[6] Acquiescence relates only to issue of whether petitioner is personally liable as fiduciary.
[7] Acquiescence not applicable to payments received after December 31, 1950.
[8] Nonacquiescence published in Cumulative Bulletin 1941-2, page 22, withdrawn.
[9] Nonacquiescence published in Cumulative Bulletin 1952-1, page 6, withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
S			
Sailer, Patricia O'Leary [1]	29778, 32203	17	1374
Sailer, Wm. A.[1]	29777, 32202	17	1374
Seminole Rock and Sand Co	32645	19	259
Sharp, Madeleine N.[2 3]	[a] 110477	3	1062
Shunk Latex Products, Inc., L. E.[4]	27143	18	940
Solt, Andrew P.	27163	19	183
Spangler, Chester E.	24452	18	976
Spangler, Lucille	24603	18	976
Spencer, John Junker	32267	19	727
Spencer, Nita Murry	32268	19	727
Sternberger, Louis, estate of [5 6]	31348	18	836
Streckfus Steamers, Inc	33419, 25503	19	1
T			
Theurkauf, Edward A.[7]	15749	13	529
Thompson, "A" Trust, Jeremiah W.[1]	29781	17	1374
Thompson, III, Trust "A," Joe Clark [1]	29780	17	1374
Thompson, John P.[1]	29779	17	1374
Trammell, George Marshall, estate of [5]	27666	18	662
Trammell, Jr., George M., administrator d. b. n. of estate of George Marshall Trammell [5]	27666	18	662
Trout-Ware, Inc.[8]	14910	11	505
Twogood, Frances F., executrix of estate of Frederick John Twogood [5 9 10]	20638	15	989
Twogood, Frederick John, estate of [5 9 10]	20638	15	989
V			
Van Bergh, Maurice H.[11]	33838	18	518
W			
Wagner Manufacturing Co., E. R.[12]	28488	18	657
Walling, Hugh, et ux	30370	19	838
Wilkins, Virginia M.	30346	19	752
Wisconsin Electric Power Co	31274	18	400
Wodehouse, Pelham G.[2]	32207	19	487

[a] Board of Tax Appeals.

[1] Nonacquiescence published in Cumulative Bulletin 1952-2, page 6, withdrawn.
[2] Gift tax decision.
[3] Nonacquiescence published in Cumulative Bulletin 1944, page 48, withdrawn.
[4] Acquiescence relates only to the rate of amortization of improvements.
[5] Estate tax decision.
[6] Acquiescence relates only to the issue of whether the amount paid for brokerage and legal fees is an allowable estate tax deduction.
[7] Nonacquiescence published in Cumulative Bulletin 1950-1, page 8, withdrawn.
[8] Nonacquiescence published in Cumulative Bulletin 1949-1, page 6, withdrawn.
[9] Not applicable to cases involving transfers after October 7, 1949.
[10] Nonacquiescence published in Cumulative Bulletin 1951-2, page 6, withdrawn.
[11] Acquiescence relates only to the issue whether the petitioner was subject to the 5-year statute of limitations because of an omission from gross income.
[12] Acquiescence relates only to the result.

The Commissioner does NOT acquiesce in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
A			
American Metal Co., Ltd., The	31547	19	879
B			
Beaver Trust Company, et al., executors of estate of Lauson Stone	32250	19	872
Brodhead et ux., Thomas H	29391 29392	18	726
C			
Chase National Bank of the City of New York, The, executor of estate of Louis Sternberger [1] [2]	31348	18	836
F			
Fortee Properties, Inc	33973	19	99
G			
Glenshaw Glass Co	30821	18	860
H			
Hawkeye Petroleum Corporation	30303	18	1223
K			
Killian Manufacturing Co., The	27144	18	940
L			
Latimer-Looney Chevrolet, Inc	35453	19	120
Leuthesser, Edward G., alleged transferee of National Metal Products Corp.[3]	28817	18	1112
Leuthesser, Jr., Fred W., alleged transferee of National Metal Products Corp.[3]	28818	18	1112
M			
Macy, J. Noel, et al	27153	19	409
Macy, Jr., Valentine E	27152	19	409
McCue Bros. & Drummond, Inc	31854	19	667
S			
Shunk Latex Products, Inc., L. E.[4]	27143	18	940
Southwest Exploration Co	24872	18	961
Sternberger, Louis, estate of [1] [2]	31348	18	836
Stone, Helen D	32250	19	872
Stone, Lauson, estate of	32250	19	872
Sultan, Edward D	24513	18	715
Sultan, Olga L	24514	18	715
V			
Van Bergh, Maurice H.[5]	33838	18	518

[1] Estate tax decision.
[2] Nonacquiescence relates only to the question whether the present value of a contingent remainder to charity can be fixed where the factors to be considered include the marriage o. decedent's daughter and her having issue.
[3] Nonacquiescence relates only to the issue whether the provisions of section 276(b) or section 3780(c) of the Internal Revenue Code apply to extend the statute of limitations on assessment of tax for a year in which a tentative allowance resulting from a net operating loss carryback has been made.
[4] Nonacquiescence relates only to the allocation of partnership income.
[5] Nonacquiescence relates only to the issue whether the petitioner was entitled to a refund by reason of a net loss carryback.

PART I.—RULINGS AND DECISIONS

INTERNAL REVENUE CODE

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART I.—RATES OF TAX

SECTION 12.—SURTAX ON INDIVIDUALS

SECTION 29.12-2: Computation of surtax. (Also Section 29.12-5; Section 25, Section 29.25-3; Section 51, Section 29.51-2; Section 402, Section 29.402-1.) T. D. 5993

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 sections 301 and 310 of the Revenue Act of 1951.

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

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

On November 15, 1952, notice of proposed rule making was published in the Federal Register (17 F. R. 10462) conforming Regulations 111 [26 CFR, part 29] to sections 301 and 310 of the Revenue Act of 1951, approved October 20, 1951. After consideration of all such relevant matter as was presented by interested persons relating to the rules proposed, the amendments to Regulations 111 set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.12-1 [26 CFR 29.12-1] the following:

SEC. 301. TAX TREATMENT IN CASE OF HEAD OF HOUSEHOLD [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) SURTAX IN CASE OF HEAD OF HOUSEHOLD.—Section 12(c) is hereby amended to read as follows:

"(c) RATES OF SURTAX—HEAD OF HOUSEHOLD.—

"(1) TAXABLE YEARS BEGINNING AFTER OCTOBER 31, 1951, AND BEFORE JANUARY 1, 1954.—In the case of taxable years beginning after October 31, 1951, and before January 1, 1954, there shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual who is the head of a household the surtax shown in the following table:

"If the surtax net income is:	The surtax shall be:
Not over $2,000	19.2% of the surtax net income.
Over $2,000 but not over $4,000	$384, plus 20.4% of excess over $2,000.
Over $4,000 but not over $6,000	$792, plus 24% of excess over $4,000.
Over $6,000 but not over $8,000	$1,272, plus 26% of excess over $6,000.
Over $8,000 but not over $10,000	$1,792, plus 31% of excess over $8,000.
Over $10,000 but not over $12,000	$2,412, plus 32% of excess over $10,000.
Over $12,000 but not over $14,000	$3,052, plus 38% of excess over $12,000.
Over $14,000 but not over $16,000	$3,812, plus 41% of excess over $14,000.
Over $16,000 but not over $18,000	$4,632, plus 44% of excess over $16,000.
Over $18,000 but not over $20,000	$5,512, plus 45% of excess over $18,000.
Over $20,000 but not over $22,000	$6,412, plus 49% of excess over $20,000.
Over $22,000 but not over $24,000	$7,392, plus 51% of excess over $22,000.
Over $24,000 but not over $28,000	$8,412, plus 54% of excess over $24,000.
Over $28,000 but not over $32,000	$10,572, plus 57% of excess over $28,000.
Over $32,000 but not over $38,000	$12,852, plus 60% of excess over $32,000.
Over $38,000 but not over $44,000	$16,452, plus 63% of excess over $38,000.
Over $44,000 but not over $50,000	$20,232, plus 68% of excess over $44,000.
Over $50,000 but not over $60,000	$24,312, plus 69% of excess over $50,000.
Over $60,000 but not over $70,000	$31,212, plus 70% of excess over $60,000.
Over $70,000 but not over $80,000	$38,212, plus 74% of excess over $70,000.
Over $80,000 but not over $90,000	$45,612, plus 76% of excess over $80,000.
Over $90,000 but not over $100,000	$53,212, plus 78% of excess over $90,000.
Over $100,000 but not over $150,000	$61,012, plus 82% of excess over $100,000.
Over $150,000 but not over $200,000	$102,012, plus 85% of excess over $150,000.
Over $200,000 but not over $300,000	$144,512, plus 88% of excess over $200,000.
Over $300,000	$232,512, plus 89% of excess over $300,000.

"(2) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953.—In the case of taxable years beginning after December 31, 1953, there shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual who is the head of a household the surtax shown in the following table:

"If the surtax net income is:	The surtax shall be:
Not over $2,000	17% of the surtax net income.
Over $2,000 but not over $4,000	$340, plus 18% of excess over $2,000.
Over $4,000 but not over $6,000	$700, plus 21% of excess over $4,000.
Over $6,000 but not over $8,000	$1,120, plus 23% of excess over $6,000.
Over $8,000 but not over $10,000	$1,580, plus 27% of excess over $8,000.
Over $10,000 but not over $12,000	$2,120, plus 29% of excess over $10,000.
Over $12,000 but not over $14,000	$2,700, plus 33% of excess over $12,000.
Over $14,000 but not over $16,000	$3,360, plus 36% of excess over $14,000.
Over $16,000 bu not over $18,000	$4,080, plus 39% of excess over $16,000.
Over $18,000 but not over $20,000	$4,860, plus 40% of excess over $18,000.
Over $20,000 but not over $22,000	$5,660, plus 44% of excess over $20,000.
Over $22,000 but not over $24,000	$6,540, plus 46% of excess over $22,000.
Over $24,000 but not over $28,000	$7,460, plus 49% of excess over $24,000.
Over $28,000 but not over $32,000	$9,420, plus 51% of excess over $28,000.
Over $32,000 but not over $38,000	$11,460, plus 55% of excess over $32,000.
Over $38,000 but not over $44,000	$14,760, plus 59% of excess over $38,000.
Over $44,000 but not over $50,000	$18,300, plus 63% of excess over $44,000.
Over $50,000 but not over $60,000	$22,080, plus 65% of excess over $50,000.
Over $60,000 but not over $70,000	$28,580, plus 68% of excess over $60,000.
Over $70,000 but not over $80,000	$35,380, plus 71% of excess over $70,000.
Over $80,000 but not over $90,000	$42,480 plus 73% of excess over $80,000.
Over $90,000 but not over $100,000	$49,780, plus 77% of excess over $90,000.
Over $100,000 but not over $150,000	$57,480, plus 80% of excess over $100,000.
Over $150,000 but not over $200,000	$97,480, plus 84% of excess over $150,000.
Over $200,000 but not over $300,000	$139,480, plus 87% of excess over $200,000.
Over $300,000	$226,480, plus 88% of excess over $300,000.

"(3) DEFINITION OF HEAD OF HOUSEHOLD.—For the purposes of this chapter, an individual shall be considered a head of a household if, and only if, such individual is not married at the close of his taxable year and maintains as his home a household which constitutes for such taxable year the principal place of abode, as a member of such household, of:

"(A) A son, stepson, daughter, or stepdaughter of the taxpayer, or a descendant of a son or daughter of the taxpayer, but if such son, stepson, daughter, stepdaughter, or descendant is married at the close of the taxpayer's taxable year, only if the taxpayer is entitled to an exemption for the taxable year for such person under section 25(b); or

"(B) Any other person who is a dependent of the taxpayer, if the taxpayer is entitled to an exemption for the taxable year for such person under section 25(b).

An individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

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

"(A) a legally adopted child of a person shall be considered a child of such person by blood;

"(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;

"(C) a taxpayer shall be considered as not married at the close of his taxable year if at any time during the taxable year his spouse is a nonresident alien; and

"(D) a taxpayer shall be considered as married at the close of his taxable year if his spouse (other than a spouse described in subparagraph (C)) died during the taxable year.

"(5) NONRESIDENT ALIEN.—For the purposes of this chapter a taxpayer shall in no case be considered a head of a household if at any time during the taxable year he is a nonresident alien."

* * * * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after October 31, 1951.

PAR. 2. Section 29.12-2, as amended by Treasury Decision 5944 [C. B. 1952-2, 7], approved November 10, 1952 [26 CFR 29.12-2], is amended further by adding at the end thereof the following:

For tax treatment of head of household for taxable years beginning after October 31, 1951, see section 29.12-5.

PAR. 3. There is inserted immediately after section 29.12-4 [26 CFR 29.12-4] the following new section:

SEC. 29.12-5. SURTAX IN CASE OF HEAD OF HOUSEHOLD.—(*a*) *General rule.*—For taxable years beginning after October 31, 1951, an individual who is the head of a household under the rules prescribed in section 12(c) is subject to the surtax imposed by that section instead of the surtax imposed by section 12(b)(2) and section 12(b)(3).

(*b*) *Definition of head of household.*—(1) For the purpose of section 12(c), the taxpayer shall be considered the head of a household if, and only if, he is not married at the close of his taxable year and maintains as his home a household which constitutes for such taxable year the principal place of abode, as a member of such household, of at least one of the individuals specified in section 12(c)(3)(A) or provided for in section 12(c)(3)(B). Under no circumstances shall the same individual be used to qualify more than one taxpayer as the head of a household in the same taxable year.

(2) Section 12(c)(3)(A) specifies that any of the following persons may be used to qualify the taxpayer as the head of a household: a son, stepson, daughter, stepdaughter, or a descendant of a son or daughter of the taxpayer. If, however, such person is married at the close of the taxable year of the taxpayer, the taxpayer may qualify as the head of a household by reason of such person only if the taxpayer is entitled to an exemption for his taxable year under section 25(b) for such person, that is, only if such person has a gross income of less than $600 for the calendar year in which the taxable year of the taxpayer begins, if the taxpayer supplies more than one-half of the support of such person for such calendar year, and if such person does not make a joint return with his spouse for the taxable year beginning in such calendar year. For example, if such person is an unmarried son of the taxpayer, the taxpayer is not deprived of his status as the head of a household because the son has income in excess of $600 for the

calendar year in which the taxable year of the taxpayer begins; if, however, such son is married at the close of the taxable year of the taxpayer, the taxpayer still may qualify as the head of a household, but only if the gross income of the son is less than $600 for the calendar year in which the taxable year of the taxpayer begins and the other conditions for allowance of the dependency credit under section 25(b) are met.

(3) Section 12(c)(3)(B) provides that a person for whom the taxpayer is entitled to an exemption under section 25(b) for the taxable year may be used to qualify the taxpayer as the head of a household. Section 25(b) provides that the taxpayer may be entitled to an exemption for any of the following persons:

(i) his brother, sister, stepbrother, or stepsister;
(ii) his father or mother, or an ancestor of either;
(iii) his stepfather or stepmother;
(iv) a son or a daughter of his brother or sister;
(v) a brother or sister of his father or mother; or
(vi) his son-in-law, daughter-in-law, mother-in-law, father-in-law, sister-in-law, or brother-in-law;

if such person has a gross income of less than $600 for the calendar year in which the taxable year of the taxpayer begins, if the taxpayer supplies more than one-half of the support of such person for such calendar year and if such person does not make a joint return with his spouse for the taxable year beginning in such calendar year. For example, an unmarried taxpayer who maintains a home for himself and his widowed mother may not qualify as the head of a household by reason of his maintenance of a home for his mother if his mother has income of $600 or more in the calendar year in which the taxable year of the taxpayer begins, or if he does not furnish more than one-half of the support of his mother for such calendar year.

(4) For the purposes of this section, a taxpayer shall be considered as not married if at the close of his taxable year he is legally separated from his spouse under a decree of divorce or separate maintenance, or if at any time during the taxable year the spouse to whom the taxpayer is married at the close of his taxable year was a nonresident alien. A taxpayer shall be considered married at the close of his taxable year if his spouse (other than a spouse who is a nonresident alien) dies during such year.

(c) *Household.*—Section 12(c) is applicable only where the household actually constitutes the home of the taxpayer for his taxable year and also constitutes the principal place of abode of at least one other person specified in section 12(c)(3)(A) or provided for by section 12(c)(3)(B) for such taxable year, without regard to the fact that the physical location of such household may have changed during such taxable year. It is not sufficient that the taxpayer maintain the household without being its occupant. The taxpayer and such other person must occupy the household for the entire taxable year of the taxpayer. They will be considered as occupying the household for such entire taxable year notwithstanding temporary absences from the household due to special circumstances. A nonpermanent failure to occupy the common abode by reason of illness, education, business, vacation, military service, or a custody agreement under which a child or stepchild is absent for less than 6 months in the taxable year of the taxpayer, shall be considered a temporary absence due to special circumstances. Such absence will not prevent the taxpayer from qualifying as the head of a household if (1) it is reasonable to assume that the taxpayer or such other person will return to the household, and (2) the taxpayer continues to maintain such household or a substantially equivalent household in anticipation of such return. The taxpayer will not be deprived of the benefits of section 12(c) because such other person dies during the taxable year of the taxpayer if the household constitutes the principal place of abode of such other person during that part of such taxable year preceding death.

(d) *Cost of maintaining a household.*—The taxpayer shall be considered as maintaining a household only if he pays more than one-half the cost thereof for his taxable year. The cost of maintaining a household shall be the expenses incurred for the mutual benefit of the occupants thereof by reason of its operation as the principal place of abode of such occupants for such taxable year. Such expenses include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance, and food consumed on the premises. The cost

of maintaining a household shall not include expenses otherwise incurred. Thus, such cost does not include expenses incurred for clothing, education, medical treatment, vacations, life insurance, and transportation. In addition, the cost of maintaining a household shall not include any amount which represents the value of services rendered in the household by the taxpayer or by a person specified in sections 12(c)(3)(A) or provided for by section 12(c)(3)(B).

PAR. 4. There is inserted immediately preceding section 29.25-1 [26 CFR 29.25-1] the following:

SEC. 310. GROSS INCOME OF DEPENDENT OF TAXPAYER [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) INCREASE IN AMOUNT OF GROSS INCOME PERMITTED.—Section 25(b)(1)(D) (relating to exemptions for dependents of taxpayer) is hereby amended by striking out "$500" and inserting in lieu thereof "$600".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall be applicable only with respect to taxable years beginning after December 31, 1950.

PAR. 5. Section 29.25-3, as amended by Treasury Decision 5893 [C. B. 1952-1, 126], approved April 4, 1952 [26 CFR 29.25-3], is amended further as follows:

(A) By striking "as amended by the Revenue Act of 1948" from the first sentence of paragraph (*d*)(1); and

(B) By striking "$500," from the first sentence of paragraph (*d*)(5), relating to exemption for dependents whose gross income is less than a certain figure, and inserting in lieu thereof the following: "$600 ($500 for a calendar year beginning after December 31, 1947, and before January 1, 1951),".

PAR. 6. There is inserted immediately preceding section 29.51-1 [26 CFR 29.51-1] the following:

SEC. 301. TAX TREATMENT IN CASE OF HEAD OF HOUSEHOLD [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) COMPUTATION OF TAX BY COLLECTOR.—

(1) Section 51(f)(1) (relating to tax computed by collector in case of wage earners) is hereby amended by adding at the end thereof the following: "In the case of a head of a household electing the benefits of this subsection, the tax shall be computed by the collector under Supplement T without regard to the taxpayer's status as head of a household."

* * * * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after October 31, 1951.

PAR. 7. Section 29.51-2(*c*), as added by Treasury Decision 5649 [C. B. 1948-2, 57], approved August 25, 1948 [26 CFR 29.51-2(c)], is amended by adding immediately after subparagraph (3), thereof, the following new subparagraph:

(4) *Head of household.*—In the case of a head of a household electing to make his return on Form 1040A in accordance with the rules prescribed in this section, the tax shall be computed under Supplement T without regard to the status of the taxpayer as the head of a household.

PAR. 8. There is inserted immediately preceding section 29.402–1 [26 CFR 29.402–1] the following:

SEC. 301. TAX TREATMENT IN CASE OF HEAD OF HOUSEHOLD [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) COMPUTATION OF TAX BY COLLECTOR.—

* * * * * * *

(2) Section 402 (relating to effect of election to pay the tax imposed by Supplement T) is hereby amended by adding at the end thereof the following: "In the case of a head of a household electing to have his tax computed by the collector pursuant to the provisions of section 51(f), the tax imposed by section 400 shall be computed without regard to the status of the taxpayer as a head of a household."

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after October 31, 1951.

PAR. 9. Section 29.402–1, as amended by Treasury Decision 5965 [page 60, this Bulletin], approved December 22, 1952 [26 CFR 29.402–1], is further amended by adding at the end of (*b*) thereof, the following: "In the case of a head of household electing to make his return on Form 1040A, see section 29.51–2(c) (4)."

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 18, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 26, 1953, 8:45 a. m.)

SECTION 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. Rev. Rul. 18

INTERNAL REVENUE CODE

Schedule for simplified computation of total tax liability in the case of married persons filing a joint return for the calendar year 1952.

There is set forth below a schedule designed to simplify the computation of the tax liability, in the case of married persons filing a joint income tax return (Form 1040) for the calendar year 1952. Such schedule eliminates the necessity for computing the tax on one-half of the amount shown on line 5, page 3, of the return and multiplying the result by 2.

This table may not be used if income includes partially tax-exempt interest. In such cases the instructions which accompany the return (Form 1040) should be followed.

TAX RATE SCHEDULE FOR CALENDAR YEAR 1952

Married persons filing joint returns

If amount in line 5, page 3, Form 1040 is—		The amount of tax line 8(c), page 3, Form 1040 is—		
Over	Not over	Amount plus	Rate %	On excess over
---	$4,000	---	22.2	---
$4,000	8,000	$888	24.6	$4,000
8,000	12,000	1,872	29	8,000
12,000	16,000	3,032	34	12,000
16,000	20,000	4,392	38	16,000
20,000	24,000	5,912	42	20,000
24,000	28,000	7,592	48	24,000
28,000	32,000	9,512	53	28,000
32,000	36,000	11,632	56	32,000
36,000	40,000	13,872	59	36,000
40,000	44,000	16,232	62	40,000
44,000	52,000	18,712	66	44,000
52,000	64,000	23,992	67	52,000
64,000	76,000	32,032	68	64,000
76,000	88,000	40,192	72	76,000
88,000	100,000	48,832	75	88,000
100,000	120,000	57,832	77	100,000
120,000	140,000	73,232	80	120,000
140,000	160,000	89,232	83	140,000
160,000	180,000	105,832	85	160,000
180,000	200,000	122,832	88	180,000
200,000	300,000	140,432	90	200,000
300,000	400,000	230,432	91	300,000
400,000	600,000	321,432	92	400,000
600,000	---	505,432	92	[1] 600,000

[1] The final tax shall not exceed 88 percent of net income on line 3, page 3, Form 1040.

PART II.—COMPUTATION OF NET INCOME

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

SECTION 29.22(a)-1: What included in gross income. Rev. Rul. 38

(Also Section 112(f), Section 29.112(f)-1.)

INTERNAL REVENUE CODE

Acquisition by the United States Government, through condemnation proceedings, of the use of a taxpayer's warehouse for 5 years in consideration of just compensation, whether paid in a lump sum or annual sums, constitutes the taking of a leasehold interest and the compensation is rent, taxable as ordinary income under section 22(a) of the Internal Revenue Code.

Advice is requested, where the United States Government acquires, through condemnation proceedings, the use of a taxpayer's warehouse for a term of 5 years in consideration of just compensation which the Government proposes to pay in annual amounts but which the taxpayer requests be paid in a lump sum, whether such compensation constitutes rent, taxable as ordinary income under section 22(a) of the Internal Revenue Code, or is an amount (or amounts) realized upon disposition of property and subject to the provisions of section 112(f) of the Code.

The taxpayer owns in fee certain improved real property used as a warehouse in the regular course of his business. The United States

Government instituted condemnation proceedings to acquire the right to take immediate possession, occupy, use, and further improve such property for military and defense purposes for a term of 5 years in consideration of just compensation. The taxpayer, pursuant to a court order, delivered immediate possession, and the Government is using the property. The Government caused to be deposited in the register of the court a certain sum estimated to be just compensation for the use of the property for the first year of the 5-year term, but the taxpayer has petitioned the court to require the Government presently to pay a sum as just compensation for the entire 5-year use.

Since use of a warehouse is essential in the taxpayer's business, he will be obliged to take steps toward obtaining the use of another suitable warehouse. He states that he can obtain such use only by purchasing another warehouse. Therefore, he contends that the taking by the Government of the use of his present warehouse, through institution of condemnation proceedings, constituted involuntary conversion of his property within the meaning of section 112(f), *supra*, and that any gain realized by him from such disposition should be accorded nonrecognition if he replaces the "converted" property. He asserts that the compensation for the use of his present warehouse will be specifically for his loss of the use and occupancy thereof and not for loss of profits.

It is well established that the substance rather than the form of a transaction is to be regarded for Federal income tax purposes. The acquisition by the Government through institution of condemnation proceedings of the use of the taxpayer's property is not, of itself, determinative of whether compensation received therefor, in a lump sum or in annual sums, constitutes ordinary rental income or an amount (or amounts) realized upon disposition of property and subject to the provisions of section 112(f), *supra*. While it has not been determined whether such compensation will be paid in one lump sum or several annual sums, it is clear that, in either event, it will represent remuneration for the use for a certain period of years of property owned in fee by the taxpayer and, hence, will constitute ordinary rental income to him. Manifestly, by such transaction, the Government acquires merely a leasehold interest in the taxpayer's property for 5 years and he disposes of no property and realizes no gain from its involuntary conversion within the meaning of section 112(f), *supra*.

In view of the foregoing, it is held that the acquisition by the United States Government, through condemnation proceedings, of the use of the taxpayer's warehouse for 5 years in consideration of just compensation, whether paid in a lump sum or annual sums, constitutes the taking of a leasehold interest and the compensation is rent, taxable as ordinary income under section 22(a), *supra*.

SECTION 29.22(a)-1: What included in gross income. Rev. Rul. 61

INTERNAL REVENUE CODE

The finder of treasure-trove is in receipt of taxable income, for Federal income tax purposes, to the extent of its value in United States currency, for the taxable year in which it is reduced to undisputed possession.

SECTION 29.22(a)–1: What included in gross income. Rev. Rul. 78
(Also Section 23(m), Section 29.23(m)–1; Section 114, Section 29.114–1.)

INTERNAL REVENUE CODE

Soil in place is a natural deposit within the meaning of section 23(m) of the Internal Revenue Code. If such soil is severed and sold by the landowner, the proceeds are ordinary income subject to a depletion allowance, computed in the manner set forth in section 29.23(m)–2 of Regulations 111.

In the case of a sale by one other than the holder of the fee, see section 29.23(m)–1 of Regulations 111.

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

INTERNAL REVENUE CODE

Dividend payments to minority stockholders, majority stockholder having waived dividends for a certain period of time. (See Rev. Rul. 45, page 178.)

SECTION 29.22(a)–2: Compensation for personal services. Rev. Rul. 71

INTERNAL REVENUE CODE

> Amounts paid for services rendered are taxable to the individual performing the services, even though paid to an organization described in section 23(o) of the Code either by agreement between the individual and the payor or by an anticipatory arrangement in which the individual agrees with the organization to render services to it and the organization in turn makes his services available to a third party. However, if an individual is under a contract of employment entered into in good faith for purposes other than avoiding the percentage limitation of section 23(o) and his employer makes his services available to a third party merely as an incident of his normal duties, and if the individual does not participate directly or indirectly in the contract with the third party and has no right to receive or direct the use or disposition of any amounts paid, such amounts are not includible in the income of the individual.

Advice has been requested relative to circumstances in which the second sentence of the last paragraph of section 29.22(a)–2 of Regulations 111 will apply. The first and second sentences of such paragraph are as follows:

> The value of services need not be included in gross income when rendered directly and gratuitously to an organization described in section 23(o). Where, however, pursuant to an agreement or understanding services are rendered to a person for the benefit of an organization described in section 23(o) and an amount for such services is paid to such organization by the person to whom the services are rendered, the amount so paid constitutes income to the person performing the services even though at the time of the agreement or understanding the person making the payment acknowledges his liability to make payment to such organization.

The typical case in which the second sentence of the above paragraph is applicable is one in which a radio sponsor or motion picture

producer engages the services of an artist and by agreement with the artist turns over the payment for those services to a charitable organization designated by the artist.

Instances also arise in which an artist enters into an agreement with a charitable organization to render services to it, and the charitable organization in turn agrees with a sponsor or producer to make those services available to such sponsor or producer in consideration of a sum to be paid to the charitable organization. Such an arrangement often constitutes an attempt, by act of the parties, to channel to an exempt organization income which would normally be that of the individual artist and thereby to avoid the percentage limitation on the deduction of charitable contributions provided in section 23(o) of the Code. In such situation the tax consequences will be the same as those attending the type of transaction described in the preceding paragraph. The rule that income is taxable to the one who earns it cannot be avoided by such an anticipatory arrangement.

Thus, for example, if an actor, whose contract with the studio regularly employing him permits, enters into a contract with a university, under which the actor may or may not have nominal duties at the university but in fact renders services principally to a third party, such as a radio sponsor or motion picture producer, payment for his services to be made to the university, such an arrangement constitutes an attempt to do indirectly the same thing that is done in the typical case hereinabove described. Accordingly, it is held that in such circumstances the sums paid to the charitable organization are includible in gross income of the individual rendering the services.

There are instances, however, in which an individual is under contract of employment or other obligation entered into in good faith for purposes other than avoidance of the percentage limitation imposed on the deduction of contributions by section 23(o) of the Code, and, as an incident of his normal duties and obligations, his employer or other superior makes his services available to a third party, payment being made to the employer or other superior. In such a case, if the individual does not participate directly or indirectly in the contract pursuant to which his services are made available to the third party and if he has no right to receive, or direct the use or disposition of, the amounts so paid, such amounts are not includible in his gross income. This conclusion would be the same whether the employer or other superior having control of the services is a commercial organization or an organization described in section 23(o) of the Code. However, it must be clearly shown that the relationship was entered into in good faith for purposes other than avoidance of the percentage limitation imposed by section 23(o) on deduction of contributions, and that the organization is entitled, in substance as well as form, to the services which it makes available to the third party. The execution of a legally sufficient contract of employment or other document purporting to establish the obligation contemplated is a fact with evidentiary value, but is not necessarily dispositive of any case. Good faith and reality are not ascertained by any mechanical or formalistic test. The effect for tax purposes of the contract of employment or other obligation will be determined by a consideration of all the circumstances.

SECTION 29.22(a)-3: Compensation paid other than in cash.

INTERNAL REVENUE CODE

Costs attributable to meals, lodging, and other personal accommodations of the resident owner or managing partner of a hotel business. (See Rev. Rul. 80, page 62.)

SECTION 29.22(a)-5: Gross income from business. (Also Section 24; Section 29.24-1.) Rev. Rul. 28

INTERNAL REVENUE CODE

A merchant who withdraws goods from his stock for personal or family use and pays for them with his private funds in an amount at least equal to their cost, or their then selling price to customers if less than their cost, is not required to exclude their cost from Schedule C—Profit (or Loss) From Business or Profession accompanying his Federal income tax return Form 1040. (See O. D. 998, C. B. 5, 86.) A merchant must keep a separate account for examination by an internal revenue agent with respect to any goods withdrawn from his stock for his personal or family use.

SECTION 29.22(a)-23: Allocations by cooperative associations; tax treatment as to patrons.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 6014, page 110.)

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

Rev. Rul. 103

INTERNAL REVENUE CODE

Payments, in excess of workmen's compensation under a plan which is not in itself a plan of accident or health insurance within the purview of section 22(b)(5) of the Internal Revenue Code and which are not made pursuant to a court-sanctioned agreement which, according to statute, is in lieu of workmen's compensation, are includible in the gross income of the recipient and are subject to withholding of income tax at the source on wages under section 1622 of the Code unless such payments are made by the employer as damages for personal injuries or sickness following a suit or an agreement in satisfaction of a tort or tort type liability other than a liability under a workmen's compensation act.

I. T. 3306, C. B. 1939-2, 149, revoked.

Advice is requested whether benefits received by employees under a plan established by an employer, an Alabama corporation, to provide for the payment to its employees of disability benefits in excess of workmen's compensation, hereinafter referred to as "differential payments," are excludable from gross income under section 22(b)(5) of the Internal Revenue Code.

In the instant case the plan, which is not in itself a plan of accident or health insurance within the purview of section 22(b)(5) of the Code, was established by the employer to provide for payments of amounts in addition to workmen's compensation to employees on weekly or monthly salary who lose time because of compensable accident. (See I. T. 4107, C. B. 1952–2, 73.) The plan, revised February 18, 1952, provides in part as follows:

1. A worker who chooses to take compensation and such compensation is in excess of the amount of his salary for the time lost from his job will receive no salary for such time lost from the job.

2. A worker who receives compensation for a compensable injury will be paid the difference between the amount of compensation and his salary for the period of his lost time up to one month. In special cases the difference between the amount of compensation and salary may be paid to him for longer periods upon approval by a Vice-President.

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

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

* * * * * * *

(5) COMPENSATION FOR INJURIES OR SICKNESS.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23(x) in any prior taxable year, amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, *plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness* * * * [Italics supplied.]

The pertinent provisions of the Alabama Workmen's Compensation Act contained in chapter 5, title 26 of the Code of Alabama provide in part as follows:

SEC. 253. CIRCUMSTANCES UNDER WHICH COMPENSATION BECOMES DUE; DEFENSES; WILFUL NEGLIGENCE.—When personal injury * * * is caused to an employee by an accident arising out of and in the course of his employment, of which injury the actual or lawfully imputed negligence of the employer is the natural and proximate cause, he * * * shall receive compensation by way of damages therefor from the employer, provided the injury * * * was not caused by the wilful misconduct of the employee, or was not due to misconduct on his part, * * *

SEC. 272. EXCLUDING OTHER REMEDIES.—The rights and remedies herein granted to an employee shall exclude all other rights and remedies of said employee * * * at common law, by statute or otherwise on account of * * * injury, loss of services * * * no employer included within the term of this chapter, shall be held civilly liable for any personal injury to * * * any workman due to accident while engaged in the service or business of the employer, the cause of which accident originates in the employment; * * *

SEC. 273. PRESUMPTION AS TO ACCEPTANCE OF PROVISIONS OF ARTICLE; ELECTION NOT TO ACCEPT; NOTICE.—* * * Every employer and every employee shall be presumed to have accepted and come under this article and the provisions thereof relating to the payment and acceptance of compensation, unless, prior to the accident resulting in personal injury * * * he shall have given notice, * * * of his election not to accept or be bound by the provisions of said article.

SEC. 278. SETTLEMENTS BETWEEN PARTIES.—The interested parties shall have the right to settle all matters of compensation and all questions arising hereunder between themselves; but all settlements made hereunder must be in amount substantially the same as the amounts or benefits stipulated in this article, unless a judge of the circuit court of the county where the claim for compensation under this chapter is entitled to be made, or upon the written consent of the parties, a judge of the circuit court, or a judge of the probate court of any county determines that it is for the interest of the employee to accept a lesser sum and approves such settlement. Any settlements hereunder may be vacated for fraud,

undue influence or coercion, upon application made to the judge approving the settlement, at any time not later than six months after the date of the settlement. Upon such settlements being approved, judgment shall be rendered thereon and duly entered on the records of said court in the same manner and to have the same effect as other judgments or as an award if the settlement is not for a lump sum. * * *.

In the instant case both the employer and the employee have accepted the exclusive remedies of the Alabama Workmen's Compensation Act. Therefore, the employees injured in the performance of their duties do not possess legal rights against the employer other than the rights granted by the workmen's compensation act. The employer does not make the differential payments under either the compulsion or the authority of that statute. The facts also indicate that the differential payments do not constitute all or part of an amount fixed by a court-sanctioned agreement in lieu of a workmen's compensation award as permitted by the Alabama Workmen's Compensation Act.

In I. T. 3306, C. B. 1939-2, 149, it is held that accident disability benefits received under a plan which expressly provides that the employee may elect to accept the benefits under the plan or to prosecute such legal claims as he may have under applicable State law, constitute damages received by agreement within the contemplation of section 22(b)(5) of the Revenue Act of 1938. In that case as in the instant case whatever legal rights the emloyees possessed against their employer were those rights exclusively granted by the terms of the applicable workmen's compensation act; moreover, the amounts received under the plan in that case were not received pursuant to a court-sanctioned agreement in lieu of workmen's compensation. Although the instant employer's plan for differential payments does not require an election between benefits under the plan and any other legal rights, which in Alabama are limited to rights under a workmen's compensation statute, the difference is immaterial. The character of the payments is the same in either case and the consequences are the same.

The association of the word "suit" with the word "agreement" in section 22(b)(5) of the Code clearly indicates an intent to exclude from gross income amounts received by way of a settlement agreement entered into in lieu of prosecution of a suit or other claim which the injured party may have. The fact that "plus" prefaces the damage clause in section 22(b)(5) shows that the damages contemplated are the product of a suit or a settlement agreement involving tort or tort type rights other than those afforded by workmen's compensation acts. ("Tort or tort type," as used in this ruling, refers to legal rights which, if exercised, could result in "an award which is made to a person by a competent judicial tribunal in a proceeding in law or equity because of a legal wrong done him by another." Restatement of the Law of Torts (1939), section 902(a).) This interpretation is buttressed by the use of the word "damages" instead of "compensation," which is employed in the preceding part of section 22(b)(5). Furthermore, a contrary interpretation of "damages" for purposes of section 22(b)(5) would allow, in the case of an occupational injury or sickness covered by a workmen's compensation act, the exclusion from gross income as "damages" received through an "agreement" of amounts which exceed the amounts that could have been received

and that would have been exempt as workmen's compensation in a case where the only legal rights which the employee possessed and could have surrendered or exercised were contained in the workmen's compensation act.

In view of the foregoing, it is held that payments, in excess of workmen's compensation under a differential payments plan which is not in itself a plan of accident or health insurance within the purview of section 22(b)(5) of the Internal Revenue Code, and which are not paid pursuant to a court-sanctioned agreement which, according to state statute, is in lieu of workmen's compensation, are includible in the gross income of the recipient and are subject to withholding of income tax at the source on wages under section 1622 of the Code unless such payments are made by the employer as damages for personal injuries or sickness under an agreement in satisfaction of a tort or tort type liability other than a liability under a workmen's compensation act. I. T. 3306, *supra*, is hereby revoked.

Pursuant to authority contained in section 3791(b) of the Code, the instant ruling will not be applied with respect to benefits received prior to August 1, 1953, under a differential payments plan.

SECTION 29.22(b)(1)-1: Life insurance—Amounts paid by reason of the death of the insured. (Also Section 29.22(b)(2)-3; Section 113(a)(13), Section 29.113(a)(13)-1.) Rev. Rul. 72

INTERNAL REVENUE CODE

Amounts received by a partnership as beneficiary under life insurance policies which have been transferred to the partnership as a part of the capital contributions of certain partners will be exempt from Federal income tax under section 22(b)(1) of the Internal Revenue Code.

Advice is requested whether the transfer of life insurance policies owned by certain partners to the partnership as a part of their capital contributions will subject the proceeds thereof, payable upon the death of any of such partners, to Federal income tax under section 22(b)(2) of the Internal Revenue Code.

In the instant case, it was agreed that the partnership would acquire and own life insurance in the same amount upon the life of each of its partners, in order to retire the interest of any partner who might die during the existence of the partnership. Two of the partners wished to contribute, as a part of their capital contributions, policies which they owned, using their value for Federal gift tax purposes as of April 1, 1952, the date the partnership was formed, to determine the value of such contributions.

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

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

(1) LIFE INSURANCE, ETC.—Amounts received—

(A) under a life insurance contract, paid by reason of the death of the insured; * * *

* * * * * * *

(2) ANNUITIES, ETC.—

(A) In General.—* * * In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph. The preceding sentence shall not apply in the case of such a transfer if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor. * * *

Section 113(a)(13) of the Code provides in part as follows:

(a) BASIS (UNADJUSTED) OF PROPERTY.—The basis of property shall be the cost of such property; except that—

* * * * * * *

(13) PARTNERSHIPS.—If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any other paragraph of this subsection, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

Thus under section 113(a)(13) the basis of each insurance policy contributed to the partnership would be the same as its basis in the hands of the transferor. See Regulations 111, section 29.113(a)(13)-1.

In view of the foregoing, it is immaterial whether or not such a transfer constitutes a transfer for a valuable consideration within the scope of section 22(b)(2)(A). Accordingly, it is held that any amounts received by the partnership under the policies by reason of the death of those insured will be exempt from income tax.

SECTION 29.22(b)(4)-4: Interest upon United States obligations.

INTERNAL REVENUE CODE

Redemption of Series F and G savings bonds for acquisition of 3¼ percent Treasury bonds of 1978-83. (See Rev. Rul. 105, page 76.)

SECTION 29.22(b)(9)-1: Income from discharge of indebtedness. T. D. 6003

(Also Sections 29.22(b)(9)-2, 29.22(b)(10)-1; Section 113(b), Sections 29.113(b)(3)-1, 29.113(b)(3)-2.)

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 section 304 of the Revenue Act of 1951, relating to income from discharge of indebtedness.

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

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

On December 4, 1952, notice of proposed rulemaking, regarding amendments to conform Regulations 111 [26 CFR, part 29] to section

304 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 10969). After consideration of all relevant matter presented by interested persons regarding the rules proposed, the amendments to Regulations 111 set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.22(b)(9)-1 [26 CFR 29.22(b)(9)-1] the following:

SEC. 304. INCOME FROM DISCHARGE OF INDEBTEDNESS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 22(b)(9).—Effective with respect to discharges of indebtedness occurring within taxable years ending after December 31, 1950, section 22(b)(9) (relating to income from discharge of indebtedness) is hereby amended (1) by striking out "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" and inserting in lieu thereof "if the taxpayer, at such time and in such manner as the Secretary by regulations prescribes, makes and files its consent", and (2) by striking out the last sentence thereof.

* * * * * * *

PAR. 2. Section 29.22(b)(9)-1, as amended by Treasury Decision 5839 [C. B. 1951-1, 7], approved April 17, 1951 [26 CFR 29.22(b)(9)-1] is further amended as follows:

(A) By striking from the first paragraph "and before January 1, 1952," and by striking from the third paragraph "and prior to January 1, 1952,".

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

To be entitled to the benefits of the provisions of section 22(b)(9) for years beginning after December 31, 1941, a corporation must file with its return for the taxable year a consent to the provisions of the regulations, in effect at the time of the filing of the return, prescribed under section 113(b)(3) (see sections 29.113(b)(3)-1 and 29.113(b)(3)-2, relating to adjustments of basis). However, with respect to discharges of indebtedness occurring within taxable years ending after December 31, 1950, the consent may be filed with an amended return or claim for credit or refund, where the taxpayer establishes to the satisfaction of the Commissioner reasonable cause for failure to file the consent with its original return.

PAR. 3. Section 29.22(b)(9)-2 [26 CFR 29.22(b)(9)-2] is amended by adding at the end thereof the following:

In a case where a consent is permitted (under section 29.22(b)(9)-1) after the original return has been filed, the original and duplicate of Form 982 shall be filed with the amended return or claim for credit or refund, as the case may be, and the consent shall be to the regulations which, at the time of the filing of the consent, are applicable to the taxable year for which such consent is filed.

PAR. 4. There is inserted immediately preceding section 29.22(b)(10)-1 [26 CFR 29.22(b)(10)-1] the following:

SEC. 304. INCOME FROM DISCHARGE OF INDEBTEDNESS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) AMENDMENT OF SECTION 22(b)(10).—Section 22(b)(10) (relating to income from discharge of indebtedness of a railroad corporation) is hereby amended by striking out "December 31, 1951" and inserting in lieu thereof "December 31, 1954".

PAR. 5. Section 29.22(b)(10)-1, as amended by Treasury Decision 5839 [26 CFR 29.22(b)(10)-1], is further amended by striking from

the first sentence and from the last sentence "January 1, 1952" and inserting in lieu thereof in each instance "January 1, 1955".

PAR. 6. Section 29.113(b)(3)-1 as amended by Treasury Decision 5402 [C. B. 1944, 229], approved September 5, 1944, is further amended by inserting immediately following the paragraph thereof denominated (F) [26 CFR 29.113(b)(3)-1(e)(6)] the following:

(G) Effective with respect to a discharge of indebtedness occurring within a taxable year ending after December 31, 1950, except in the case of a consent filed prior to the effective date of the Treasury Decision which adds this paragraph (G) to the regulations, any reduction in basis which remains to be taken (by reason of an exclusion from gross income under section 22(b)(9)) after the application of (1) shall be applied first against property of a character subject to the allowance for depreciation under section 23(l), property with respect to which a deduction for amortization is allowable under section 23(t), and property with respect to which a deduction for depletion is allowable under section 23(m) (but not including property specified in section 114(b)(2), (3), or (4)), in the order in which such property is described in (2) and (3), above. Any further adjustment in basis required to be made under section 22(b)(9) shall be applied against other property in the order prescribed in (2), (3), and (4), above.

PAR. 7. Section 29.113(b)(3)-2 [26 CFR 29.113(b)(3)-2] is amended as follows:

(A) By inserting immediately after the second sentence thereof the following:

Such adjustment, however, shall be consistent with the principles of section 29.113(b)(3)-1(G) where the discharge of indebtedness occurs within a taxable year ending after December 31, 1950.

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

A request for variations from the general rule prescribed in section 29.113(b)(3)-1 shall be filed by the taxpayer with its return for the taxable year in which the discharge of indebtedness occurred unless a consent is permitted (under section 29.22(b)(9)-1) after the original return has been filed, in which case such request shall be filed with the amended return or claim for credit or refund, as the case may be.

(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).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved April 2, 1953.

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

(Filed with the Division of the Federal Register April 7, 1953, 8:52 a. m.)

SECTION 29.22(b)(13)-2: Compensation of members of the Armed Forces of the United States for service in a combat zone after June 24, 1950, and prior to January 1, 1954, or for service while hospitalized as a result of such combat-zone service. T. D. 5976

(Also Section 154, Section 29.154-1.)

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 sections 305 and 334 of the Revenue Act of 1951, relating to compensation of certain members of the Armed Forces, and to abatement of income tax for such members upon death.

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

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

On December 13, 1952, notice of proposed rule making, regarding amendments to the income tax regulations made necessary by sections 305 and 334 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 11340). No objection to the rules proposed having been received, the amendments to Regulations 111 [26 CFR, part 29] set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 29.22(b)(13)-1 [26 CFR 29.22(b)(13)-1] the following:

SEC. 305. COMPENSATION OF CERTAIN MEMBERS OF THE ARMED FORCES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 22(b)(13).—Section 22(b)(13) (relating to exclusion from gross income of compensation of certain members of the Armed Forces) is hereby amended by striking out subparagraphs (A) and (B) and inserting in lieu thereof the following:

"(A) Enlisted Personnel.—Compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which such member—

"(i) served in a combat zone after June 24, 1950, and prior to January 1, 1954, or

"(ii) was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone prior to January 1, 1954; but this clause shall not apply for any month during any part of which there are no combatant activities in any combat zone as determined under subparagraph (C)(iii) of this paragraph.

"(B) Commissioned Officers.—So much of the compensation as does not exceed $200 received for active service as a commissioned officer in the Armed Forces of the United States for any month during any part of which such officer—

"(i) served in a combat zone after June 24, 1950, and prior to January 1, 1954, or

"(ii) was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone prior to January 1, 1954; but this clause shall not apply for any month during any part of which there are no combatant activities in any combat zone as determined under subparagraph (C)(iii) of this paragraph."

(b) DEFINITION OF SERVICE IN COMBAT ZONE.—Clause (iii) of section 22(b)(13)(C) is hereby amended by striking out "such zone; and" and inserting in lieu thereof "such zone, except that June 25, 1950, shall be considered the date of the commencing of combatant activities in the combat zone designated in Executive Order 10195; and".

* * * * * * *

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) shall be applicable to taxable years ending after June 24, 1950. * * *.

PAR. 2. Section 29.22(b)(13)-2, as added by Treasury Decision 5832 [C. B. 1951-1, 8], approved March 8, 1951 [26 CFR 29.22(b)(13)-2], is hereby amended as follows:

(A) By changing the heading and the first two paragraphs thereof to read as follows:

COMPENSATION OF MEMBERS OF THE ARMED FORCES OF THE UNITED STATES FOR SERVICE IN A COMBAT ZONE AFTER JUNE 24, 1950, AND PRIOR TO JANUARY 1, 1954, OR FOR SERVICE WHILE HOSPITALIZED AS A RESULT OF SUCH COMBAT-ZONE SERVICE.—In addition to the exemptions and credits otherwise applicable, section 22(b)(13) provides that there shall be excluded from gross income:

(a) Compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which such member (1) served in a combat zone after June 24, 1950, and prior to January 1, 1954, or (2) was hospitalized at any place as a result of wounds, disease, or injury incurred while so serving provided that during all of such month there are combatant activities in some combat zone.

(b) In the case of compensation received for active service as a commissioned officer in the Armed Forces of the United States for any month during any part of which such officer (1) served in a combat zone after June 24, 1950, and prior to January 1, 1954, or (2) was hospitalized at any place as a result of wounds, disease, or injury incurred while so serving provided that during all of such month there are combatant activities in some combat zone, so much of such compensation as does not exceed $200.

The exclusions under section 22(b)(13) and this section are applicable only if active service is performed in a combat zone after June 24, 1950, and prior to January 1, 1954. Compensation is subject to exclusion whether or not it is received outside a combat zone or while the recipient is hospitalized or in a year (including a year after 1953) different from that in which the service was rendered for which the compensation is paid. Service is performed in a combat zone only if it is performed in an area which the President of the United States has designated by Executive order, for the purpose of section 22(b)(13), as an area in which Armed Forces of the United States are or have (after June 24, 1950) engaged in combat, and only if it is performed on or after the date designated by the President by Executive order as the date of the commencing of combatant activities in such zone (except that the date June 25, 1950, in the combat zone designated in Executive Order 10195, shall be considered the date of the commencing of combatant activities in such zone) and on or before the date designated by the President by Executive order as the date of the termination of combatant activities in such zone. If a member of the Armed Forces serves in a combat zone or is hospitalized for any part of a month, he is entitled to the exclusion for such month to the same extent as if he had served in such zone, or had been hospitalized, for the entire month.

(B) By adding after the second paragraph thereof the following:

If an individual is hospitalized for a wound, disease, or injury while serving in a combat zone, the wound, disease, or injury will, unless the contrary clearly appears, be presumed to have been incurred while serving in a combat zone. In certain cases, however, a wound, disease, or injury may have been incurred while serving in a combat zone even though the individual was not hospitalized for it while so serving. And, in exceptional cases, a wound, disease, or injury will not have been incurred while serving in a combat zone even though the individual was hospitalized for it while so serving.

These principles may be illustrated by the following examples:

Example (1). An individual is hospitalized in a combat zone for a specific disease after having served in such zone for 3 weeks. The incubation period of such disease is from 2 to 4 weeks. Such disease was incurred while serving in the combat zone.

Example (2). The facts are the same as in example (1) except that the incubation period is 1 year. Such disease was not incurred while serving in the combat zone.

Example (3). A member of the Air Force, stationed outside the combat zone, is shot while participating in an aerial flight over the combat zone, but is not hospitalized until he returns to his home base. Such injury was incurred while serving in a combat zone.

Example (4). An individual is hospitalized for a specific disease 3 weeks after having departed from a combat zone. The incubation period of such disease is from 2 to 4 weeks. Such disease was incurred while serving in a combat zone.

An individual is hospitalized only until such time as his status as a hospital patient ceases by reason of his discharge from the hospital.

PAR. 3. There is inserted immediately following section 29.153-4, as added by Treasury Decision 5838 [C. B. 1951-1, 35], approved April 17, 1951 [26 CFR 29.153-4], the following:

SEC. 334. ABATEMENT OF INCOME TAX FOR CERTAIN MEMBERS OF ARMED FORCES UPON DEATH [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Supplement D of chapter 1 of the Internal Revenue Code (relating to returns and payment of tax) is hereby amended by adding at the end thereof the following new section:

"SEC. 154. INCOME TAXES OF MEMBERS OF ARMED FORCES UPON DEATH.

"In the case of any individual who dies after June 24, 1950, and prior to January 1, 1954, while in active service as a member of the Armed Forces of the United States, if such death occurred while serving in a combat zone (as determined under section 22(b)(13)) or as a result of wounds, disease, or injury incurred while so serving—

"(a) the tax imposed by this chapter shall not apply with respect to the taxable year in which falls the date of his death, or with respect to any prior taxable year ending on or after the first day he so served in a combat zone after June 24, 1950; and

"(b) the tax under this chapter and under the corresponding title of each prior revenue law for taxable years preceding those specified in clause (a) which is unpaid at the date of his death (including interest, additions to the tax, and additional amounts) shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment."

SEC. 29.154-1. ABATEMENT OF INCOME TAXES OF CERTAIN MEMBERS OF THE ARMED FORCES OF THE UNITED STATES UPON DEATH.—(*a*) If an individual dies after June 24, 1950, and prior to January 1, 1954, while in active service as a member of the Armed Forces of the United States, and such death occurs while serving in a combat zone, as determined under section 22(b)(13), or at any place as a result of wounds, disease, or injury incurred while so serving, then—

(1) the tax liability of such individual under chapter 1 for the taxable year ending on the date of his death, or for any prior taxable year ending on or after the first day he so served in a combat zone after June 24, 1950, is canceled and if the tax (including interest, additions to the tax, and additional amounts) is assessed, the assessment shall be abated, and if the amount of such tax is collected (regardless of the date of collection) the amount so collected shall be credited or refunded as an overpayment; and

(2) that amount of tax of such individual for taxable years preceding those specified in (1) above under chapter 1, or corresponding provisions of prior revenue laws, which remains unpaid as of the date of death shall not be assessed, and if any such unpaid tax (including interest, additions to the tax, and additional amounts) has been assessed, such assessment shall be abated, and if the amount of any such unpaid tax is collected subsequent to the date of death, the amount so collected shall be credited or refunded as an overpayment.

(*b*) If such an individual and his spouse have for any such year filed a joint return, the tax abated, credited, or refunded pursuant to the provisions of section 154 for such year shall be an amount equal to that portion of the joint tax liability which is the same percentage of such joint tax liability as a tax computed upon the separate income of such individual is of the sum of the taxes computed upon the separate income of such individual and his spouse, but with respect to taxable years ending prior to June 24, 1950, and with respect to taxable years ending prior to the first day such individual served in a combat zone, as determined under section 22(b)(13), the amount so abated, credited, or refunded shall not exceed the amount unpaid at the date of death. For such purpose, the separate tax of each spouse shall be the tax computed under chapter 1 before the application of sections 32, 35, and 322(a), but after the application of section 31, as if such spouse were required to make a separate return.

(*c*) If such an individual and his spouse filed a joint declaration of estimated tax for the taxable year ending with the date of his death, the estimated tax paid

pursuant to such declaration may be treated as the estimated tax of either such individual or his spouse, or may be divided between them, in such manner as his legal representative and such spouse may agree. Should they agree to treat such estimated tax, or any portion thereof, as the estimated tax of such individual, the estimated tax so paid shall be credited or refunded as an overpayment for the taxable year ending with the date of his death.

(*d*) For the purpose of determining the tax which is unpaid at the date of death, any amounts deducted and withheld under subchapter D of chapter 9 constitute payment of a tax imposed under chapter 1.

(*e*) This section shall have no application whatsoever with respect to the liability of an individual as a transferee of property of a taxpayer where such liability relates to the tax imposed upon the taxpayer by chapter 1.

(*f*) As to what constitutes active service as a member of the Armed Forces, service in a combat zone, and wounds, disease, or injury incurred while serving in a combat zone, see section 29.22(b)(13)-2. As to who are members of the Armed Forces, see section 29.3797-11.

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved January 28, 1953.

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

(Filed with the Division of the Federal Register February 3, 1953, 8:52 a.m.)

SECTION 29.22(b)(15)-1: Payments to encourage exploration, development, and mining for defense purposes. T. D. 6006

(Also Section 22(a), Section 29.22(a)-13; Section 23(a), Section 29.23(a)-1; Section 113(a), Section 29.113(a)-1; Section 113(b), Section 29.113-(b)(1)-1; Section 433, Section 40.433(a)-2, Regulations 130.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29 AND PART 40

Regulations 111 amended to conform to section 306 of the Excess Profits Tax Act of 1950; and Regulations 130 amended to conform to section 433(a)(1)(P) of the Internal Revenue Code, as added by section 101 of the Excess Profits Tax Act of 1950.

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

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

On November 15, 1952, a notice of proposed rulemaking, regarding amendments to conform Regulations 111 [26 CFR, part 29] to section 306 of the Excess Profits Tax Act of 1950, approved January 3, 1951, and to conform Regulations 130 [26 CFR, part 40] to section 433(a)-(1)(P) of the Internal Revenue Code, as added by section 101 of the Excess Profits Tax Act of 1950, was published in the Federal Register (17 F. R. 10465). After consideration of all such relevant matter

as was presented by interested persons regarding the rules proposed, the amendments to Regulations 111 and 130 set forth below are hereby adopted.

REGULATIONS 111 [26 CFR, PART 29]

PARAGRAPH 1. There is inserted immediately after section 29.22(b)-(14)-1, as added by Treasury Decision 5371 [C. B. 1944, 80], approved May 11, 1944, the following:

[SEC. 22. GROSS INCOME.]

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

SEC. 306. PAYMENTS TO ENCOURAGE EXPLORATION, DEVELOPMENT, AND MINING FOR DEFENSE PURPOSES [EXCESS PROFITS TAX ACT OF 1950, APPROVED JANUARY 3, 1951].

Effective with respect to taxable years beginning after December 31, 1950, section 22(b) of the Internal Revenue Code is amended by adding the following new paragraph:

"(15) PAYMENTS TO ENCOURAGE EXPLORATION, DEVELOPMENT, AND MINING FOR DEFENSE PURPOSES.—An amount paid to a taxpayer by the United States (or any agency or instrumentality thereof), whether by grant or loan, and whether or not repayable, for the encouragement of exploration, development or mining of critical and strategic minerals or metals pursuant to or in connection with any undertaking approved by the United States (or any of its agencies or instrumentalities) and for which an accounting is made or required to be made to an appropriate governmental agency, and the forgiveness or discharge of any of such amount. Any expenditures (other than expenditures made after the repayment of such grant or loan) attributable to such grant or loan shall not be deductible by the taxpayer as an expense nor increase the basis of the taxpayer's property either for determining gain or loss on sale, exchange, or other disposition or for computing depletion or depreciation, but upon the repayment of any portion of any such grant or loan which has been expended in accordance with the terms thereof such deductions and such increase in basis shall to the extent of such repayment be allowed as if made at the time of such repayment."

SEC. 29.22(b)(15)-1. PAYMENTS TO ENCOURAGE EXPLORATION, DEVELOPMENT, AND MINING FOR DEFENSE PURPOSES.—(*a*) *Applicability of section 22(b)(15).*—Section 22(b)(15) is applicable only to amounts (1) which are paid to a taxpayer (i) by the United States or by an agency or instrumentality of the United States; (ii) as a grant, gift, bounty, bonus, premium, incentive, subsidy, loan, or advance; (iii) for the encouragement of exploration for, or development or mining of, a critical and strategic mineral or metal; and (iv) pursuant to or in connection with an undertaking by the taxpayer to explore for, or develop or produce, such mineral or metal and to expend or use any amounts so received for the purpose and in accordance with the terms and conditions upon which such amounts are paid, which undertaking has been approved by the United States or by an agency or instrumentality of the United States; and (2) for which the taxpayer has accounted, or is required to account, to an appropriate agency of the United States Government for the expenditure or use thereof for the purpose and in accordance with the terms and conditions upon which such amounts are paid. Section 22(b)(15) is applicable only to an amount which meets each test or requirement set forth above. The section is applicable whether or not the payee is obligated to repay to the United States any portion or all of the amount so received. However, section 22(b)(15) is not applicable to any loan or advance for the repayment of which the borrower's liability is unconditional and legally enforceable. Nor is section 22(b)(15) applicable to any part of the purchase price of a critical and strategic mineral or metal received, whether before, on, or after

delivery, by the seller from the United States or any agency or instrumentality thereof, irrespective of whether such purchase price is below, at, or above the established ceiling or currently prevailing market price. A payment of a separate and specific amount for the encouragement of exploration for, or development or mining of, a critical and strategic mineral or metal shall not be considered to be a part of the purchase price of such mineral or metal merely because such payment is added to, or included with, the payment of such purchase price. As used in section 22(b)(15) and this section, the term "critical and strategic minerals or metals" means those minerals and metals listed in section 450(b), as well as such other minerals and metals as are certified pursuant to such section as being essential to the defense effort of the United States and as not having been normally produced in appreciable quantities within the United States, and such other minerals and metals as are considered by those departments, agencies, and instrumentalities of the United States charged with the encouragement of exploration for, and development and mining of, critical and strategic minerals and metals to constitute critical and strategic minerals and metals for that purpose. See, for example, section 7 of Order-1 of the Defense Minerals Exploration Administration, March 7, 1952, 17 F. R. 2090.

(*b*) *Exclusion from gross income.*—For any taxable year beginning after December 31, 1950, any amount to which section 22(b)(15) is applicable is, by the terms of such section, excluded from gross income. Section 22(b)(15) also excludes from gross income for such taxable year any income attributable to the forgiveness or discharge of any indebtedness to which such section is applicable.

(*c*) *Expense deduction; basis for gain or loss, depletion, or depreciation.*—Except as hereinafter provided, any expenditure attributable to an amount received by a taxpayer to which section 22(b)(15) is applicable shall not be deductible by the taxpayer as an expense under section 23, nor shall any such expenditure increase the basis under section 113 of the taxpayer's property either for determining gain or loss on sale, exchange, or other disposition or for computing depletion or depreciation (including amortization under section 124A). Upon the repayment of any portion of any amount to which section 22(b)(15) is applicable and which has been expended for the purpose and in accordance with the terms and conditions upon which it was paid to the taxpayer, any expenditures attributable to such amount made by the taxpayer shall, as provided in section 23, be allowed to the taxpayer as a deduction, and any such expenditures shall, as provided in section 113, increase the basis of the taxpayer's property, to the extent of such repayment as if such expenditures had been made at the time of such repayment. Such expenditures shall to the extent of the repayment be expensed or capitalized, as the case may be, in the order in which they were actually made, or in such other manner as may be adopted by the taxpayer with the approval of the Commissioner. This paragraph shall be applicable only with respect to taxable years beginning after December 31, 1950.

PAR. 2. Section 29.22(a)-13(*a*) is amended by adding at the end thereof the following:

For exclusion from gross income of income attributable to the forgiveness or discharge of a grant or loan made to a taxpayer by the United States for the encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, see section 29.22 (b)(15)-1.

PAR. 3. Section 29.23(a)-1 is amended by adding at the end thereof the following:

As to the deductibility of expenditures attributable to a grant or loan made to a taxpayer by the United States for the encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, see section 22(b)(15) and section 29.22(b)(15)-1.

PAR. 4. Section 29.113(a)-1, as amended by Treasury Decision 5911 [C. B. 1952-1, 76], approved June 5, 1952, is further amended by adding at the end thereof the following:

For special rules for determining the basis, both unadjusted and adjusted, of property acquired or improved with the proceeds of a grant or loan made to a taxpayer by the United States for the encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, see section 22(b)(15) and section 29.22(b)(15)-1.

PAR. 5. Section 29.113(b)(1)–1, as amended by Treasury Decision 5991 [page 146, this Bulletin], approved February 17, 1953, is further amended by adding at the end thereof the following:

For adjustment to basis on account of expenditures attributable to a grant or loan made to a taxpayer by the United States for the encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, see section 22(b)(15) and section 29.22(b)(15)–1.

REGULATIONS 130 [26 CFR, PART 40]

PAR. 6. Section 40.433(a)–2(p) is amended to read as follows:

(p) (1) Section 433(a)(1)(P) is applicable only to amounts (i) which are paid to a taxpayer (*a*) by the United States or by an agency or instrumentality of the United States; (*b*) as a grant, gift, bounty, bonus, premium, incentive, subsidy, loan, or advance; (*c*) for the encouragement of exploration for, or development or mining of, a critical and strategic mineral or metal; and (*d*) pursuant to or in connection with an undertaking by the taxpayer to explore for, or develop or produce, such mineral or metal and to expand or use any amounts so received for the purpose and in accordance with the terms and conditions upon which such amounts are paid, which undertaking has been approved by the United States or by an agency or instrumentality of the United States; and (ii) for which the taxpayer has accounted, or is required to account, to an appropriate agency of the United States Government for the expenditure or use thereof for the purpose and in accordance with the terms and conditions upon which such amounts are paid. Section 433(a)(1)(P) is applicable only to an amount which meets each test or requirement set forth above. The section is applicable whether or not the payee is obligated to repay to the United States any portion or all of the amount so received. However, section 433(a)(1)(P) is not applicable to any loan or advance for the repayment of which the borrower's liability is unconditional and legally enforceable. Nor is section 433(a)(1)(P) applicable to any part of the purchase price of a critical and strategic mineral or metal received, whether before, on, or after delivery, by the seller from the United States or any agency or instrumentality thereof, irrespective of whether such purchase price is below, at, or above the established ceiling or currently prevailing market price. A payment of a separate and specific amount for the encouragement of exploration for, or development or mining of, a critical and strategic mineral or metal shall not be considered to be a part of the purchase price of such mineral or metal merely because such payment is added to, or included with, the payment of such purchase price. As used in section 433(a)(1)(P) and (p) of this section, the term "critical and strategic minerals or metals" means those minerals and metals listed in section 450(b), as well as such other minerals and metals as are certified pursuant to such section as being essential to the defense effort of the United States and as not having been normally produced in appreciable quantities within the United States, and such other minerals and metals as are considered by those departments, agencies, and instrumentalities of the United States charged with the encouragement of exploration for, and development and mining of, critical and strategic minerals and metals to constitute critical and strategic minerals and metals for that purpose. See, for example, section 7 of Order–1 of the Defense Minerals Exploration Administration, March 7, 1952, 17 F. R. 2090.

(2) For any taxable year beginning before January 1, 1951, and ending after June 30, 1950, any amount to which section 433(a)(1)(P) is applicable is, by the terms of such section, excluded in determining excess profits net income. Section 433(a)(1)(P) also excludes in determining excess profits net income for such taxable year any income attributable to the forgiveness or discharge of any indebtedness to which such section is applicable. For similar provisions with respect to exclusions from gross income for taxable years beginning after December 31, 1950, see section 22(b)(15) and the regulations thereunder.

(3) Except as hereinafter provided, any expenditure attributable to an amount received by a taxpayer to which section 433(a)(1)(P) is applicable shall not be deductible by the taxpayer as an expense under section 23 in determining normal-tax net income for the purpose of computing excess profits net income, nor shall any such expenditure increase the basis under section 113 of the taxpayer's property for such purpose either in determining gain or loss on sale, exchange, or other disposition or in computing depletion or depreciation (including amortization under section 124A). Upon the repayment of any portion of any amount

to which section 433(a)(1)(P) is applicable and which has been expended for the purpose and in accordance with the terms and conditions upon which it was paid to the taxpayer, any expenditures attributable to such amount made by the taxpayer shall, as provided in section 23, be allowed to the taxpayer as a deduction in determining normal-tax net income for the purpose of computing excess profits net income, and any such expenditures shall, as provided in section 113, increase the basis of the taxpayer's property for such purpose, to the extent of such repayment as if such expenditures had been made at the time of such repayment. Such expenditures shall to the extent of the repayment be expensed or capitalized, as the case may be, in the order in which they were actually made, or in such other manner as may be adopted by the taxpayer with the approval of the Commissioner. This subparagraph shall be applicable only with respect to taxable years beginning before January 1, 1951, and ending after June 30, 1950. For similar provisions with respect to deductions and basis in determining net income for taxable years beginning after December 31, 1950, see section 22(b)(15) and the regulations thereunder.

(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).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved April 10, 1953.

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

(Filed with the Division of the Federal Register April 15, 1953, 8:53 a. m.)

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

SECTION 29.22(d)-1: Inventories under elective method. Rev. Rul. 23

INTERNAL REVENUE CODE

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

In Mimeograph 6244, C. B. 1948-1, 21, dated March 9, 1948, the Commissioner accepted as applicable for use, without supporting evidence, by department stores employing the retail inventory and elective inventory methods, under section 22(d) of the Internal Revenue Code, the department store inventory price indexes compiled and published semiannually by the United States Bureau of Labor Statistics. Retail stores other than department stores that have decided to use these indexes as reflecting price changes for determining their inventories under the elective inventory method have been required to demonstrate that such indexes are actually representative of the inventories carried by such stores. In connection with that requirement, question has arisen as to the meaning of the term "department store" as used in the above-mentioned mimeograph.

A retail store may qualify as a "department store" for the purposes of such mimeograph if it has a reasonable number and variety of departments, though not necessarily all of the departments of the

most elaborate department store, and if the goods carried in its various departments are reasonably similar to those carried in corresponding departments by a typical department store in its general locality. It is not intended that an extremely specialized store carrying a single line of goods, such as a shoe store, a radio and television store, or an electrical appliance store, which would use only a single group index as compiled by the Bureau of Labor Statistics, could use such a single index without showing that such an index is adequately representative of its whole inventory. But a retail establishment known in the trade as a "specialty store," carrying a variety of ladies' wear and accessories, or men's clothing and furnishings, or a store carrying a reasonable full line of furniture and homefurnishings, covering a reasonable field of the groups included in the indexes published by the Bureau of Labor Statistics in its series of department store inventory price indexes, may qualify, if it employs the retail inventory method, for the use of these indexes under the elective inventory method of section 22(d) of the Code without further proof if its departmental inventories are reasonably similar to those carried by department stores. Facts of similarity will be considered by the examining agent upon audit of returns.

SECTION 29.22(d)-1: Inventories under elective method. Rev. Rul. 81

INTERNAL REVENUE CODE

Price indexes for January 1953, published by the Bureau of Labor Statistics on March 3, 1953, for use by department stores employing the retail inventory and elective inventory methods.

The following price indexes for January 1953, published by the Bureau of Labor Statistics on March 3, 1953, 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, 1952, and January 31, 1953.

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

[January 1941=100]

Group	January 1952	January 1953	Percent change from January 1952 to January 1953
I. Piece goods, domestics, and draperies	211.7	202.8	−4.2
II. Shoes	213.7	211.2	−1.2
III. Ladies' underwear	177.3	173.9	−1.9
IV. Ladies' outerwear and girls' wear	180.2	179.2	−0.6
V. Men's and boys' wear	207.5	200.9	−3.2
VI. Furniture and bedding	208.4	206.1	−1.1
VII. Homefurnishings	192.2	193.7	+0.8
VIII. Major appliances and electrical goods	162.8	158.4	−2.7
IX. Notions and toilet articles	159.0	161.7	+1.7
X. Ladies' accessories	170.5	168.9	−0.9
Total, Groups I, II, III, IV, V, IX, and X	192.0	188.8	−1.7
Total, Groups VI, VII, and VIII	189.5	188.4	−0.6
Store total	191.1	188.6	−1.3

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

SECTION 29.23(a)-1: Business expenses. Rev. Rul. 1

INTERNAL REVENUE CODE

Legal expenses incurred by a taxpayer, both before and after being sworn in as a public officer, to establish that he was fairly elected and entitled to hold such office are not deductible under either section 23(a)(1)(A) or section 23(a)(2) of the Internal Revenue Code.

Advice is requested whether legal expenses incurred by the taxpayer, both before and after he was installed as a public officer, in a successful defense of a contested election are deductible, for Federal income tax purposes, under either section 23(a)(1)(A) or section 23(a)(2) of the Internal Revenue Code.

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

(1) TRADE OR BUSINESS EXPENSES.—

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

* * * * * * *

(2) NON-TRADE OR NON-BUSINESS EXPENSES.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Both the courts and the Bureau have consistently held that amounts expended by taxpayers in seeking public office are not deductible for Federal income tax purposes.

In *Michael F. McDonald* v. *Commissioner* (323 U. S. 57, Ct. D. 1617, C. B. 1944, 94), the Supreme Court of the United States held that expenditures made by a judge appointed to an interim judgeship in seeking election for a full term were not deductible under section 23(a)(1)(A) of the Code since such expenditures were not incurred in carrying on the taxpayer's business of judging. The Court held further that such expenditures were not deductible under section 23(a)(2) of the Code. In reviewing the legislative history of section 23(a)(2), the Court said that this section merely enlarged the category of incomes with reference to which expenses are deductible, and did not enlarge the range of allowable deductions of "business" expenses; and that such provision in no wise affected the disallowance of campaign expenses as consistently reflected by legislative history, court decision, Treasury practice, and Treasury regulations.

In O. D. 864 (C. B. 4, 211 (1921)) it is held that campaign expenses defrayed by a Congressman are not ordinary and necessary expenses incurred in carrying on a trade or business and are therefore not deductible. Although section 48(d) of the Internal Revenue Code provides that the term "trade or business", for Federal income tax purposes, includes the performance of the functions of a public office, expenditures made to obtain such office are not to be considered as incurred in the conduct of a trade or business.

Section 29.23(a)-15 of Regulations 111, expressly provides that campaign expenses of a candidate for public office do not constitute an allowable deduction under section 23(a)(2) of the Code.

The legal expenses herein were incurred by the taxpayer in a successful defense of a contested election, which was litigated in a county court before he took office and appealed to a higher court after he took office. Such expenses relate to the original contest in which he sought public office and to his efforts to establish his right to that office. They are not expenses relating to the discharge of the duties of such office.

In view of the foregoing, it is held that the legal expenses incurred by the taxpayer, both before and after being sworn in as a public officer, to establish that he was fairly elected and entitled to hold such office, are not deductible in computing net income under either section 23(a)(1)(A) or section 23(a)(2) of the Internal Revenue Code.

SECTION 29.23(a)-1: Business expenses.

INTERNAL REVENUE CODE

Premiums paid by a member of a partnership on life insurance policies naming his copartners as beneficiaries. (See Rev. Rul. 73, page 63.)

SECTION 29.23(a)-15: Nontrade or nonbusiness expenses. Rev. Rul. 3
(Also Section 24, Section 29.24-2.)

INTERNAL REVENUE CODE

Treatment for Federal income tax purposes of custody and creation fees paid by subscribers in a sponsored investment plan to the custodian and sponsor of the plan for services rendered in developing the plan, making investments, and keeping necessary records.

Advice is requested as to the deductibility, for Federal income tax purposes, of custody and creation fees paid by subscribers in a sponsored investment plan to the custodian and sponsor of the plan for services rendered in developing the plan, making investments, and keeping necessary records.

The M Company is the custodian, and the N Company is the sponsor, of an investment plan established for the purpose of enabling investors to acquire and accumulate common stock of the X Corporation. The unit of investment is termed a "deposit" and the plan contemplates that a participant will make 120 monthly deposits over a period of 10 years. Deposits are paid directly to the custodian which, after deducting both the "creation" and "custody" fees, invests the balance in common stock of the X Corporation. The shares and decimal shares so acquired for each depositor's account are held by the custodian, which collects all cash dividends and reinvests the same in additional stock. The custodian maintains individual records and mails each depositor detailed statements of his account. For its services the custodian retains the "custody" fee, consisting of a fixed percentage of each deposit. The "creation" fee, also deducted by the custodian, is paid to the sponsor, N Company, for its services in connection with the development, sale, and administration of the

plan. The sponsor, in turn, pays certain percentages of the creation fees as commissions to its distributors and other salesmen.

Section 23(a)(2) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions:

(a) EXPENSES.—

* * * * * * *

(2) NON-TRADE OR NON-BUSINESS EXPENSES.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

An analysis of the investment plan from a subscriber's point of view indicates that its purpose is twofold: (1) the acquisition of common stock in a particular corporation; and (2) the management of such stock for the purpose of accumulating the maximum number of additional shares over the life of the plan.

The services performed by the custodian in holding the shares acquired through the plan, collecting and reinvesting cash dividends, etc., relate to the second purpose of the plan. Accordingly, it is held that the subscriber may deduct the "custody" fee as a nonbusiness expense under section 23(a)(2) of the Internal Revenue Code. (See section 29.23(a)-15 of Regulations 111.)

On the other hand, the dominant service performed by the sponsor in developing, selling, and administering the investment plan is to make possible the acquisition of shares of stock in the X Corporation under the favorable terms of the plan. In effect, a subscriber pays the "creation" fee for the privilege of acquiring stock through the plan. Therefore, it is held that the "creation" fee does not constitute a deductible expense under section 23(a)(2) of the Code, but is a capital expenditure which must be added to the cost of the shares acquired through the investment plan.

SECTION 29.23(a)-15: Nontrade or nonbusiness expenses.

INTERNAL REVENUE CODE

Legal expenses incurred in obtaining a public office. (See Rev. Rul. 1, page 36.)

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

SECTION 29.23(c)-1: Taxes.

INTERNAL REVENUE CODE

Accrual date of Michigan property taxes, I. T. 2995, C. B. XV-2, 137 (1936), inapplicable after December 31, 1949. (See Rev. Rul. 39, page 79.)

SECTION 29.23(c)-1: Taxes.

INTERNAL REVENUE CODE

Accrual date of Massachusetts corporate franchise tax. (See Rev. Rul. 74, page 81.)

SECTION 23(d).—DEDUCTIONS FROM GROSS INCOME: TAXES OF SHAREHOLDER PAID BY CORPORATION

SECTION 29.23(d)-1: Tax on bank or other stock. Rev. Rul. 92
(Also Section 43, Section 29.43-2.)

INTERNAL REVENUE CODE

With respect to corporations on the accrual basis of accounting, the tax on the shares of banks and certain other corporations imposed by the Commonwealth of Pennsylvania is an allowable deduction under section 23(d) of the Internal Revenue Code in the year for which imposed even though paid in a later year.
G. C. M. 21329, C. B. 1939-2, 179, revoked.

Reconsideration has been given to G. C. M. 21329, C. B. 1939-2, 179, in the light of the decision in *Philadelphia Title Insurance Co.* v. *Commissioner*, 17 T. C. 1068, acquiescence, page 5, this Bulletin.

In G. C. M. 21329, *supra*, it was held that the tax on bank shares in Pennsylvania under the State statute then applicable was an allowable deduction in the year in which paid regardless of the bank's method of accounting.

The Pennsylvania law imposing the shares tax was amended on May 22, 1945. The pertinent provisions of law, as amended (section 2002 of title 72, Purdon's Pennsylvania Statutes Annotated), read as follows:

It shall be the duty of every such company * * * at its option to pay the amount of said tax to the State Treasurer, through the Department of Revenue from its general fund, or, to collect the amount of said tax from its shareholders and pay the same to the State Treasurer, through the Department of Revenue. * * *

Under the present law, it seems clear that the shares tax is a fixed liability of the corporations.

In the Philadelphia Title Insurance Co. case, the court held that the shares tax was accruable as of the year for which imposed. This decision appears to be in line with general principles of accrual and the principles enunciated by the Supreme Court of the United States in *United States* v. *P. Chauncey Anderson et al.*, 269 U. S. 422, T. D. 3839, C. B. V-1, 179, and *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516, Ct. D. 1598, C. B. 1944, 509.

In view of the foregoing, it is held that with respect to corporations on the accrual basis of accounting, the tax on the shares of banks and certain other corporations imposed by the Commonwealth of Pennsylvania is an allowable deduction under section 23(d) of the Internal Revenue Code in the year for which imposed even though paid in a later year.

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

SECTION 29.23(e)-1: Losses by individuals. Ct. D. 1754
(Also Section 23(f), Section 29.23(f)-1;
Section 43, Section 29.43-2.)

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

GROSS INCOME—DEDUCTIONS—LOSSES FROM EMBEZZLEMENT.

Taxpayers had money embezzled by trusted agents and employees. The defalcations had been going on for many years before they were

discovered. In the Alison case, the books revealed the thief and the precise amounts taken each year from 1931 to 1940. In the Stevenson-Chislett, Inc., case, investigation failed to reveal who took the funds or the time when the funds were taken. Each taxpayer claimed a tax reduction for the year the losses were discovered and their amounts ascertained. *Held:* Whether and when a deductible loss results from an embezzlement is a factual question, a practical one to be decided according to surrounding circumstances. The special factual circumstances found by the district courts in both these cases justify the allowance of deductions under section 23 (e) and (f) of the Internal Revenue Code and the long-standing Treasury regulations applicable to embezzlement losses.

SUPREME COURT OF THE UNITED STATES

Martha L. Alison v. *The United States of America*

and

The United States of America v. *Stevenson-Chislett, Inc.*

On certificate from the United States Court of Appeals for the Third Circuit

[December 8, 1952]

OPINION

Mr. Justice BLACK delivered the opinion of the Court.

The questions in these two income tax cases are so much alike that they can be treated in one opinion. Both taxpayers had moneys embezzled by trusted agents and employees. As usual, the defalcations had been going on for many years before they were discovered. On discovery, efforts were made immediately to identify the takers and fix the dates and amounts of the thefts. In the Alison case, No. 79, the books revealed the thief and the precise amounts taken each year from 1931 to 1940. In No. 80, Stevenson-Chislett, Inc., the cover-up had been so successful that painstaking investigation failed to reveal who took the funds or the time when the unascertained person or persons took them. Each taxpayer claimed a tax deduction for the year the losses were discovered and their amounts ascertained. The Government objected, claiming that the deduction should have been taken in each of the prior years during which the moneys were being surreptitiously taken. In the Stevenson-Chislett case, the district court held that the uncertain circumstances of the embezzlement entitled the taxpayer to take its losses the year the loss was discovered and the amount ascertained. 98 Fed. Supp. 252. The district judge decided the other way in the Alison case and denied her declarations. 97 Fed. Supp. 959. His holding, however, was not in accord with his own views, but was compelled, he thought, by the Third Circuit's decision in *First National Bank of Sharon, Pa.* v. *Heiner*, 66 Fed. (2d) 925. The Court of Appeals for the Third Circuit certified to us the question of deductibility in both cases. Pursuant to 28 U. S. C. section 1254(3), we ordered the complete records sent up so that we might decide the entire matters in controversy.

Internal Revenue Code section 23 (e) and (f) authorize deductions for "* * * losses sustained during the taxable year * * *." The Government reads this section as requiring a taxpayer to take a deduction for loss from embezzlement in the year in which the theft occurs, even though inability to discover in time might completely deprive the taxpayer of the benefit of this statutory deduction. Only at the time the money is stolen, so it is argued, is a loss "sustained." But Treasury practice itself belies this rigid construction. For more than 30 years the regulations have provided that "A loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained." 26 CFR section 29.43–2. (Emphasis supplied.) Information contained in a letter from the Commissioner attached as an appendix to the Government's brief cites many instances in which the Treasury has allowed deductions for embezzlement losses in years subsequent to those in which the thefts occurred. Apparently the Department has felt constrained to do this in order to prevent hardships and injustice. These have been departures from the "ordinary" rule of attributing embezzlement losses to the year of theft.

This Treasury practice evidently stems at least in part from the special nature of the crime of embezzlement. Its essence is secrecy. Taxpayers are usually well aware of all the circumstances of financial losses for which tax deductions are allowed. Not so when a trusted adviser or employee steals. For years his crime may be known only to himself. He may take money planning to return it and he may return it before there is discovery. Furthermore, the terms embezzlement and loss are not synonymous. The theft occurs, but whether there is a loss may remain uncertain. One whose funds have been embezzled may pursue the wrongdoer and recover his property wholly or in part. See *Commissioner* v. *Wilcox*, 327 U. S. 404 [Ct. D. 1668, C. B. 1946-1, 6]. Events in the Alison case show the practical value of this right of recovery.. A substantial proportior. of the embezzled funds was recovered in 1941, 10 years after the first emblezzlement occurred. This recovery alone is ample refutation of the view that a loss is inevitably "sustained" at the very time an embezzlement is committed.

Whether and when a deductible loss results from an embezzlement is a factual question, a practical one to be decided according to surrounding circumstances. See *Boehm* v. *Commissioner*, 326 U. S. 287 [Ct. D. 1652, C. B. 1945, 353]. An inflexible rule is not needed; the statute does not compel it. For years the Treasury has administered the tax law under regulations saying that deductions shall "ordinarily" be taken in the year of embezzlement. Ordinarily does not mean always.

We hold that the special factual circumstances found by the district courts in both these cases justify deductions under I. R. C. section 23 (e) and (f) and the long-standing Treasury regulations applicable to embezzlement losses. See *Boston Consolidated Gas Co.* v. *Commissioner*, 128 Fed. (2d) 473; *Gwinn Bros. & Co.* v. *Commissioner*, 7 T. C. 320. Accordingly, the judgment in No. 79 is reversed and the judgment in No. 80 is affirmed.

It is so ordered.

Mr. Justice DOUGLAS and Mr. Justice BURTON dissent.

SECTION 29.23(e)-1: Losses by individuals. (Also Section 24, Section 29.24-2.) Rev. Rul. 79

INTERNAL REVENUE CODE

Losses sustained because of high water or flood damage to property on the Great Lakes are deductible for Federal income tax purposes only where such losses are directly attributable to damage from storm or other casualty. Damage or loss of value due to gradual erosion or inundation occurring at still water levels is not deductible as a casualty loss within the meaning of section 23(e)(3) of the Internal Revenue Code. Amounts expended for the construction of protective works or for moving homes to prevent probable losses from future storms are not allowable deductions under section 24(a)(2) of the Code.

Advice is requested whether losses from damage to property caused by abnormally high water levels on the Great Lakes and amounts expended for the construction of protective works or for moving homes back from their original locations to prevent probable losses from future storms are allowable deductions for Federal income tax purposes.

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

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

* * * * * * *

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

Section 24(a) of the Code provides that in computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses except extraordinary medical expenses deductible under section 23(x);
(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate except expenditures for the development of mines or deposits deductible under section 23(cc);
(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made. * * *

The above and similar provisions have been in the Federal income tax laws for many years. Court decisions and Bureau rulings have established standards for their application and have developed the overall concept that the term "casualty" as used in such provisions refers to an identifiable event of a sudden, unexpected, or unusual nature and that damage or loss resulting from progressive deterioration of property through a steadily operating cause would not constitute a casualty loss. (See *Hugh M. Matheson et al.* v. *Commissioner*, 54 Fed. (2d) 537, Ct. D. 510, C. B. XI-2, 392 (1932); *Charles J. Fay* v. *Helvering*, 120 Fed. (2d) 253; and *Ray Durden* v. *Commissioner*, 3 T. C. 1.)

In O. D. 698, C. B. 3, 159 (1920), in a situation substantially similar to that involved in the present inquiry, it is held that all damages directly attributable to a storm constitute a casualty loss and are deductible for Federal income tax purposes, and that the expense incurred in moving a structure, for the purpose of preventing probable losses from future storms, is to be regarded as a capital expenditure to be added to the cost of the building in computing profit or loss in the event of sale, since the removal to a safer locality presumably increased its value.

Accordingly, losses due to physical damage to buildings, boathouses, docks, seawalls, etc., on the Great Lakes as a result of their being battered by wave action and wind during a storm are deductible as casualty losses under section 23(e)(3) of the Code, *supra*. Likewise, the flooding of buildings and basements as a result of storms and the complete destruction of buildings, occurring as a result of storm damage, will also constitute deductible casualty losses.

However, there are areas in which some damage or expenditure may be incurred due to high water on the Great Lakes which may not be considered as casualty losses under the Internal Revenue Code. One situation is damage or loss of value due to gradual erosion or inundation occurring at still water levels. The rise and fall of water levels of the Great Lakes (and of other bodies of water) is a normal process, and damage resulting from high water levels alone lacks the characteristics of a casualty loss under the Code. Thus, where the taxpayer's loss was due to progressive deterioration rather than some sudden, unexpected, or unusual cause, such loss does not constitute a deductible casualty loss for Federal income tax purposes.

A second situation involves expenditures by taxpayers for the construction of protective works or for moving their homes back from the original locations to prevent probable losses from future storms. In such cases the Bureau is governed by section 24(a)(2) of the Code,

which provides that no deduction shall in any case be allowed in respect of any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Where a casualty loss is allowed for the loss of property, the amount of loss to be deducted is measured by the value of the property just before the casualty less its value immediately after the casualty (but not more than the cost or other adjusted basis of the property), reduced by any insurance or compensation received. (See I. T. 4032, C. B. 1950-2, 21.)

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

SECTION 29.23(f)-1: Losses by corporations.

INTERNAL REVENUE CODE

Loss of embezzled funds. (See Ct. D. 1754, page 39.)

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

SECTION 29.23(l)-1: Depreciation. Rev. Rul. 90*

INTERNAL REVENUE CODE

Policy with respect to depreciation adjustments

1. The internal revenue laws allow as a deduction in computing net income a reasonable allowance for depreciation of property used in trade or business or of property held for the production of income. The purpose of the deduction is to permit taxpayers to recover through annual deductions the cost (or other basis permitted by law) of the property over the useful life of the property. The determination of the amount of the deduction is largely a matter about which there may be reasonable differences of informed judgment, but the impact on the revenues resulting from these differences may be negligible one way or the other over the years involved.

2. Accordingly, effective May 12, 1953, and as respects all open years for which agreement as to the tax liability has not been reached at any level within the Internal Revenue Service as of that date, it shall be the policy of the Service generally not to disturb depreciation deductions, and revenue employees shall propose adjustments in the depreciation deduction only where there is a clear and convincing basis for a change. This policy shall be applied to give effect to its principal purpose of reducing controversies with respect to depreciation.

*Originally issued as IR-Mimeograph 183, dated May 11, 1953.

SECTION 29.23(l)-1: Depreciation. Rev. Rul. 91*

INTERNAL REVENUE CODE

Instructions relating to policy with respect to depreciation adjustments.

1. The purpose of this Revenue Ruling is to furnish guidance with respect to the application of Revenue Ruling 90, page 43, which sets forth the policy with respect to depreciation adjustments.

2. Among the factors which should be given careful consideration in order to give full force and effect to the announced policy are the following:

(*a*) Whether depreciation rates used by the taxpayer are fair and reasonable under the circumstances;

(*b*) Whether the taxpayer has followed a consistent practice in arriving at the amount of depreciation deductions;

(*c*) Whether in considering all factors, including reasonable tolerances, any adjustments proposed are substantial.

3. In the establishment of the depreciation rates for a taxpayer, careful consideration shall be given to facts and arguments presented by the taxpayer with respect to obsolescence, as well as to the repair and maintenance policy of the taxpayer.

4. If the proposed depreciation changes are material and the revenue employee and the taxpayer cannot reach an agreement the issue may be referred, prior to the issuance of a 30-day letter, to a valuation engineer, if available, for consideration; otherwise the Engineering and Valuation Branch, Washington, D. C., Attention: T:S:E:, should be requested to furnish the required engineering service.

5. Responsibility for effectuating the policy announced in Revenue Ruling 90 will rest upon each district commissioner, who shall take all appropriate steps necessary to insure that there is a clear understanding of the policy and the importance which is attached to its prompt effectuation on the part of the assistant district commissioners, audit and appellate, and the directors. In turn, each director shall communicate the policy immediately to the heads of all audit divisions, reviewers, group chiefs, and examining officers, to the end that application of the policy will be reflected promptly in the examination and disposition of cases. To the greatest extent practicable, this shall be accomplished by the heads of audit divisions personally meeting with the reviewers and group chiefs for a discussion of the policy. Group chiefs, in turn, should arrange to conduct personal meetings with their examining officers for such discussions.

6. District commissioners are requested to advise this office (attention: O:A) at the earliest practicable date as to the steps that they have taken to insure that the policy will be promptly adopted at all levels of case examination and settlement in their districts.

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*Originally issued as IR-Circular 144, dated May 11, 1953.

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

SECTION 29.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements. (Also Section 114, Section 29.114-1; Section 453, Section 40.453-2, Regulations 130.) T. D. 6004

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29 AND PART 40

Regulations 111 and Regulations 130 amended to conform to section 207 of the Revenue Act of 1950 and to section 304(d) of the Excess Profits Tax Act of 1950 which sections relate to the definition of the term "mining" and to the computation of gross income from mining.

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

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

On November 15, 1952, notice of proposed rulemaking with respect to amendments conforming the income tax and excess profits tax regulations to section 207 of the Revenue Act of 1950, approved September 23, 1950, and to section 304(d) of the Excess Profits Tax Act of 1950, approved January 3, 1951, was published in the Federal Register (17 F. R. 10467). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, the following amendments to Regulations 111 [26 CFR, part 29] and Regulations 130 [26 CFR, part 40] are hereby adopted:

REGULATIONS 111

PARAGRAPH 1. Section 29.23(m)-1(*f*) of Regulations 111, as amended by Treasury Decision 5461 [C. B. 1945, 284], approved July 9, 1945, is further amended as follows:

(A) By inserting at the end of the third paragraph thereof (which paragraph begins with the words "In the case of a crude mineral product") the following:

For taxable years beginning after December 31, 1949, the term "mining" as used herein also includes so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles, and, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, the transportation over such greater distance. The taxpayer shall file an original and one copy of an application for the inclusion of such greater distance in the computation of his gross income from mining with the Commissioner of Internal Revenue, Washington 25, D. C., attention of the Special Technical Services Division, Engineering and Valuation Branch. The application must include a statement setting forth in detail such facts concerning the physical and other requirements for the construction and operation of a treatment plant at a place nearer to the point of extraction from the ground as are sufficient to apprise the Commissioner of the exact basis of

the application. If the taxpayer's return is filed prior to receipt of notice of the Commissioner's action upon the application, a copy of such application shall be attached to the return. If, after an application is approved by the Commissioner, there is a material change in any of the facts relied upon in such application, a new application must be submitted by the taxpayer.

(B) By inserting in the fourth paragraph thereof, after the words "transportation of such product" in the first sentence and after the word "transportation" in the second sentence, the following: "(other than transportation treated, for the taxable year, as mining)", and by inserting at the end of such paragraph the following new sentence: "For a description of transportation which is treated, for taxable years beginning after December 31, 1949, as mining, see the preceding paragraph and section 114(b)(4)(B), as amended."

(C) By striking the word "In" at the beginning of the sixth paragraph, and by inserting in lieu thereof the following: "For taxable years beginning before January 1, 1950, in".

(D) By inserting immediately after the first sentence of the sixth paragraph the following:

For taxable years beginning after December 31, 1949, in determining "gross income from the property", the sale price of the product shall not be reduced by the costs and proportionate profits attributable to the transportation which is treated for such taxable year as mining, that is, so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles (or, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, such greater distance). Where such plants or mills are in excess of 50 miles (or of such greater distance) from the point of extraction from the ground, then costs incurred for transportation in excess of 50 miles (or of such greater distance) to the treatment plant and, if transported by the taxpayer, the proportionate profits attributable to such excess transportation should be subtracted from the sale price of the product to determine "gross income from the property". In the absence of methods which will clearly reflect costs of the various phases of transportation, the costs attributable to such excess transportation shall be an amount which is in the same ratio to the costs incurred for the total transportation to the treatment plant as the excess transportation is to such total transportation.

PAR. 2. There is inserted immediately before section 29.114–1 of such regulations the following:

SEC. 207. PERCENTAGE DEPLETION [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

(a) TRANSPORTATION FROM MINE.—The second sentence of section 114(b)(4)(B) (relating to the definition of gross income from property) is hereby amended to read as follows: "The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1949.

SEC. 304. TECHNICAL AMENDMENTS [EXCESS PROFITS TAX ACT OF 1950, APPROVED JANUARY 3, 1951].

* * * * * * *

(d) Section 114(b)(4)(B) of such Code [Internal Revenue Code] is hereby amended by striking out "731 and 735" and inserting in lieu thereof "450 and 453".

* * * * * * *

(g) The amendments made by this section shall be applicable with respect to taxable years ending after June 30, 1950.

REGULATIONS 130

PAR. 3. Section 40.453-2(j)(3) of Regulations 130 is amended as follows:

(A) By striking the words "taxpayer establishes to the satisfaction of the Commissioner that" in the second sentence of subdivision (i) and in the first sentence of subdivision (iv) and substituting in lieu thereof the following: "Commissioner finds that both".

(B) By striking the words "taxpayer fails to establish to the satisfaction of the Commissioner that" in the second sentence of subdivision (iv) and substituting in lieu thereof the following: "Commissioner does not find that both".

(C) By inserting at the end of subdivision (i) of such section the following:

See section 29.23(m)-1(*f*) of Regulations 111 as to the application to be filed with the Commissioner with respect to transportation in excess of 50 miles.

(D) By inserting in subdivision (ii) thereof, after the words "transportation of such product" in the first sentence and after the word "transportation" in the second sentence, the following: "(other than transportation treated, for the taxable year, as mining)", and by inserting at the end of such subdivision the following new sentence:

For a description of transportation which is treated as mining, see subdivisions (i), (iv), and (ix) and section 114(b)(4)(B), as amended.

(E) By inserting immediately preceding the last sentence of subdivision (iv) of such section the following:

See section 29.23(m)-1(*f*) of Regulations 111 as to the application to be filed with the Commissioner with respect to transportation in excess of 50 miles. In the absence of methods which will clearly reflect costs of the various phases of transportation, the costs attributable to such excess transportation shall be an amount which is in the same ratio to the costs incurred for the total transportation to the treatment plant as the excess transportation is to such total transportation.

(F) By inserting immediately after subdivision (viii) of said section the following:

(ix) The provisions of subdivisions (i), (ii), and (iv), above, with respect to transportation of ores or minerals in determining "gross income from the property" shall not be applicable in computing the tax for a taxable year beginning prior to January 1, 1950, and ending after June 30, 1950. In the case of such a taxable year, the provisions applicable to transportation of the ores or minerals shall be those provided in section 29.23(m)-1(*f*) of Regulations 111 for taxable years beginning before January 1, 1950.

(This Treasury Decision is issued under the authority contained in sections 23(m) and 62 of the Internal Revenue Code (53 Stat. 14, 32; 26 U. S. C. 23(m), 62).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved April 2, 1953.

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

(Filed with the Division of the Federal Register April 7, 1953, 8:52 a. m.)

SECTION 29.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements. Rev. Rul. 4

INTERNAL REVENUE CODE

Consistent with the outstanding nonacquiescence (C. B. 1941-1, 16) in *Kennedy Mining and Milling Co.* v. *Commissioner* (43 B. T. A. 617, affirmed, 125 Fed. (2d) 399), depletion is not allowable on tailings piles, culm banks, or other mine dumps of waste material.

Advice is requested as to the policy of the Bureau with respect to the allowance of depletion, under section 23(m) of the Internal Revenue Code, on tailings piles, culm banks, or other mine dumps of waste material.

It is the understanding of the Bureau that tailings piles, culm banks, and other mine dumps consist of deposits of refuse remaining after some, but not all, of the mineral content has been removed. When the price of the mineral rises, or when through improved processes it is possible to salvage some of the remaining mineral, the refuse is reworked and the mineral from such piles or dumps is sold.

In *Kennedy Mining and Milling Co.* v. *Commissioner* (43 B. T. A. 617), the United States Board of Tax Appeals (now The Tax Court of the United States) allowed percentage depletion to the mine owner-operator measured by income received from the sale of additional minerals extracted by such owner-operator from tailings piles, consisting of the residue of ores previously mined and treated by him for the extraction of minerals. The nonacquiescence (C. B. 1941-1, 16) in the Kennedy Mining and Milling Co. decision, was not withdrawn even though the United States Circuit Court of Appeals for the Ninth Circuit affirmed (125 Fed. (2d) 399) the decision of the Board.

In discussing the philosophy of the Kennedy case, the United States Circuit Court of Appeals for the Ninth Circuit (the same court which decided the Kennedy case), in *Consolidated Chollar Gould & Savage Mining Co.* v. *Commissioner* (133 Fed. (2d) 440), said (page 441):

* * * There we held the depletion deduction allowable because the recovery of mineral was from tailings of partially worked ore from a mine and mill owned by a taxpayer, deposited on taxpayer's land adjacent to the mine and mill from which they came, and hence the recovery was a mere continuation and completion of the processing of mineral extraction begun in the removal of the deposited material from the mine to the tailing dump. We distinguished that case from Atlas Milling Co. v. Jones, 10 Cir., 115 F. 2d 61. There the

deduction was disallowed. The taxpayer extracting the ore from the tailings did not own the mine from which the tailings had come, and the tailings were held not a mine or other natural deposit.

In *Chicago Mines Co. et al.* v. *Commissioner* (164 Fed. (2d) 785, certiorari denied, 333 U. S. 881), the United States Circuit Court of Appeals for the Tenth Circuit held that the taxpayer was not entitled to an allowance for depletion. There the taxpayer claimed continuity of ownership from the time of original extraction of the mineral to the time of further extraction from the mine dump. The court held, despite the taxpayer's contention regarding continuity of ownership, that the dump itself was not a mine and that the reworking of tailings in a dump, created without the accompanying intent to work it at a future time, did not constitute "an integrated step in the original mining operation." In interpreting the Kennedy case, the court said (page 788):

* * * Our analysis of these decisions [Kennedy and a later decision] by the Ninth Circuit leads us to conclude that it adheres to the principle that a taxpayer, working a dump, may take depletion allowances only in those cases in which the operation is an integrated step in a mining operation, and which is the final step in the process which had its beginning when the ore was removed from the original vein.

In the Kennedy case, the taxpayer constructed a dam in 1914 on its property for the purpose of depositing behind it the crushed rock and residue of ore materials, referred to as tailings, which resulted from its milling operations. Prior to building the dam, the taxpayer had been dumping its tailings in a stream, and the dam was built primarily to avoid possible liability to lower riparian owners for pollution of the stream. Although the owner knew that the tailings retained a gold content, such content was not considered sufficient to be extracted profitably. The extracting process did not occur until 1935, in which year a cyanide plant was constructed on the property for the purpose of reworking the tailings which had been deposited since 1915. From the facts of the case as reported, it does not appear that the owner, at the time of depositing ore, had any intention to rework it. On the contrary, as stated above, the taxpayer's intention from the beginning was to avoid possible liability to lower riparian owners for pollution of the stream. Thus, it is difficult to conclude that the reworking many years later constituted an integrated step in the mining operation.

In *Chicago Mines Co. et al.* v. *Commissioner*, *supra*, the court stated (page 787):

A "mine" is an excavation in the earth from which minerals are removed by digging or other mining processes. In its broader sense, it is understood to mean the vein lode or deposit of minerals. This seems to be the sense in which the term "mine" is used in section 23(m). The language employed is "Mines, oil and gas wells, *other natural deposits* * * *." Mining thus connotes the removal of minerals from a natural deposit and does not include the reworking of mineral dumps from the surface of the earth artificially created and resulting from mining operations. Tailings from a mine, consisting of waste material and low-grade ore placed upon the surface of land, become personal property, and the dump in a true sense does not become a mine. We adhere to what we said in the Atlas case [115 F. 2d 63] that, "The word 'mines' as used in paragraph 23(m) * * * is limited to natural deposits and does not include a tailings dump deposited on the surface of land, consisting of the residue of ore that has been severed and milled".

(See also *Kohinoor Coal Co.* v. *Commissioner*, 171 Fed. (2d) 880, certiorari denied, 337 U. S. 924.)

In view of the foregoing, it is held that consistent with the outstanding nonacquiescence (C. B. 1941-1, 16) in *Kennedy Mining and Milling Co.* v. *Commissioner*, *supra*, depletion is not allowable on tailings piles, culm banks, or other mine dumps of waste material.

SECTION 29.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

INTERNAL REVENUE CODE

Ad valorem property taxes paid for lessor by lessee with respect to mineral-bearing lands. (See Rev. Rul. 16, page 173.)

SECTION 29.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

INTERNAL REVENUE CODE

Percentage depletion in the case of pyrites and similar ores containing two or more minerals. (See Rev. Rul. 76, page 176.)

SECTION 29.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

INTERNAL REVENUE CODE

Depletion allowance with respect to income received from the sale of top soil. (See Rev. Rul. 78, page 18.)

SECTION 29.23(m)-15: Allowable capital additions in case of mines. Ct. D. 1753

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF COURT

1. GROSS INCOME—DEDUCTIONS—ORDINARY AND NECESSARY BUSINESS EXPENSES—CAPITAL EXPENDITURES—DEPRECIATION—LOSSES.

A coal mining corporation charged to expense the costs of building a slate chute and of certain mining machinery and equipment such as conveyors, loaders, cutting machines, mine cars, and electric mine jeeps purchased in 1944 and 1945, and claimed increased depreciation deductions for the years 1942 through 1945 because of an increase in the hours of work and in the use of equipment in its mine. It also claimed a deductible loss on the sale of its tipple track, essential to the operation of the mine, for a consideration of $1 upon an agreement that the purchaser maintain it and that the corporation continue to have its use.

Held: (1) The expenditures for machinery and equipment were in the nature of capital expenditures, except the cost of so many of the mine cars as were needed because of the greater haul necessitated by the receding faces of the coal. The expenditures were necessitated not by the removal of the coal during the years in which they were made, but by the thinness of one of the seams, the radical changes in the nature of another, and the shortage of

available manpower. Such expenditures should be amortized like other capital investments made in the interest of economy and efficiency rather than charged off as expense of a single year. With respect to the mine cars, only the purchase price of those the purchase of which was made necessary by the recession of the working faces of the mine is allowable as ordinary and necessary expense, with no such allowance for those whose purchase was necessitated by the greater productivity of the mechanized equipment.

(2) If a taxpayer normally employs the straight line method of computing depreciation, as here, increased usage and other operating conditions do not warrant an allowance for abnormal or accelerated depreciation absent a showing that the useful life of the depreciable asset was, in fact, thereby shortened. The corporation has failed to make this showing.

(3) The corporation did not sustain a deductible loss on the sale of its tipple track. The sole effect of the transaction was the transfer of legal title to personal property which had no use other than to serve the mine. The corporation has not shown that the consideration received for such transfer was less than its adjusted basis or that any loss was actually sustained by it.

2. DECISION AFFIRMED IN PART AND REVERSED IN PART.

Decision of The Tax Court of the United States (16 T. C. 587 (1951)) affirmed in part and reversed in part and remanded with directions.

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Commissioner of Internal Revenue, petitioner and cross-respondent, v. *H. E. Harman Coal Corporation, respondent and cross-petitioner*

On cross-petitions to review the decision of The Tax Court of the United States

Before PARKER, Chief Judge, and SOPER and DOBIE, Circuit Judges

[September 17, 1952]

OPINION

PARKER, Chief Judge: These are cross petitions to review a decision of the Tax Court reported in 16 T. C. 781, where the facts are fully stated. Taxpayer is a coal mining corporation operating a mine at Harman, Virginia, and the case relates to income and excess profits taxes for the years 1944 and 1945. The questions presented by the petitions are (1) whether the cost of certain mining machinery was deductible as an ordinary and necessary business expense, (2) whether expenditures in building a slate chute were so deductible, (3) whether taxpayer was entitled to increase depreciation deduction because of increased operation of its mine, and (4) whether taxpayer sustained a deductible loss on the sale of its tipple tracks in 1945. The Tax Court decided the first question in favor of the taxpayer and the others in favor of the Commissioner. We think that there was error only with respect to the decision of the first question.

On the first two questions, it appears that taxpayer in its returns for 1944 and 1945 charged to expense the following items:

"Purchased in 1944	
2 Goodman shaker conveyors	$10,899.30
3 Joy loaders	24,987.32
Payments on slate chute in process of construction	6,634.92
Total	42,521.54
Purchased in 1945	
Balance of cost of slate chute completed	13,823.98
8 Goodman short-wall cutting machines	23,294.45
10 Conveyors	15,490.08
1 Slabbing machine or arc-wall cutting machine	7,139.00
50 Mine cars	17,101.06
2 Electric mine jeeps	2,040.00
Total	78,888.57"

The Commissioner disallowed the deduction of these items as expense but treated them as capital expenditures and allowed deduction of depreciation on account thereof of $7,280.36. The Tax Court found that the expenditures were made because of shortage of manpower, need of equipment suitable for mining thin seam coal and "the radical change in the natural condition of the coal seam in the sections of the mine in which operations were then being conducted".[1]

The court found, also, that prior to 1944 the mine had been developed to full capacity, that all of the mine equipment was purchased "to maintain production as the mine spread out and the working faces of the mine receded", that "none of the equipment replaced other machinery or added to the value of the mine" and that, despite the best efforts of taxpayer, the production of the mine had decreased and its overall cost of production per ton had increased every year since 1944. It held that the Commissioner had properly treated the expenditures for the slate chute as capital expenditures on the ground that they constituted capital improvements but allowed the deduction of the cost of the equipment as ordinary and necessary business expense under Regulations 111 section 29.23(m)-15(*b*).

We think that the position of the Commissioner should be sustained with respect to all the items involved, except the cost of so many of the mine cars as may be found to have been necessary because of the greater haul necessitated by the receding faces of the coal. It is admitted that all of the items had a life of more than 1 year; and ordinarily "items of plant equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account". Regulations 111 section 29.41-3(2). The general rule, with the exception allowed in the case of mining equipment properly chargeable as current expense of coal mined, is set forth in Regulations 111 29.23(m)-15(*b*), as follows:

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[1] The purpose of these expenditures was correctly set forth by the Tax Court in its findings of fact as follows: "The conveyors were used in conjunction with the shortwall cutting machines by petitioner to mine a thin-seam of coal less than 39 inches high—which seam was first encountered in 1944 in a large area then being developed. Petitioner's regularly used equipment could not be utilized in seams less than 40 inches high, and petitioner's leases required that all mineable and merchantable coal be mined.

"The joy loaders were purchased because of a shortage of manpower and because of the increased number of widely separated sections being worked which made additional equipment necessary in order to avoid the uneconomic delay which would result from the moving of the equipment back and forth between working places a mile or so apart. Petitioner's actual experience with like Joy loaders purchased by it in 1939 and 1941 proved that the use thereof resulted in substantial savings in the production cost of units of coal produced with the aid of those machines as compared with hand loaded coal. The slabber machine, or arc-wall cutting machine, is used in conjunction with two Joy loading machines, and the machine purchased in 1945 was an additional machine needed because of the expansion of the mine.

"The conveyors, shortwall cutting machines, Joy loaders and arc-wall cutting machines, are in the active mining area at all times. They are used in close proximity to the working place in the mine, and are in use continuously. The cutting machines are used in the process of preparing the coal for the blasting operation. After the coal is shot down, the conveyors in the low seam area carry it out of the rooms to be loaded into mine cars for transportation to the tipple. The Joy loaders load the coal directly into the mine cars. As the working face recedes, the cutting machines and loaders are moved with it. When a section is completely worked out, the machines are moved to a new section which has been previously prepared, but which may be some distance away. As the sections being worked spread out, more machinery, more locomotives, more cars, more of other equipment are needed. Insofar as the cutting and loading machines (including conveyors) are concerned, it makes no difference how far the tipple is located from the working place in the mine. The distance between two working sections is determinative of the number of cutting and loading machines needed.

"Construction of the slate-bin, or slate-chute, was started in 1944 and was completed in 1945. It is a part of the tipple, and it enables petitioner to bring the slate and other mine refuse out of the mine with the regular coal trains, thereby eliminating the need for the storing thereof in mine cars, and makes such cars immediately available for the hauling of more slate or for more productive use. * * *.

"The mine jeeps acquired by petitioner in 1945 ran on the tracks in the mine and were powered by electricity taken by trolley from the regular electric lines in the mines. These jeeps were used by petitioner's supervisory employees for the purpose of getting to the widely separated sections being worked without the delay of waiting for the regular coal trains to go to a particular location.

"The mine cars purchased in 1945 were needed because of extended hauls, the necessity for removing a greater amount of slate and other mine refuse caused by a change in the natural character of the seam being mined, as well as by the federal regulations with respect to slate removal, and the requirement of additional cars to serve each of the working places being worked in widely separate areas of the mine. * * *

"The conveyors which were purchased in 1945 were needed to operate with the shortwall cutting machines and were used in the same low vein of coal. It was practically impossible to employ miners to do hand work in a seam as thin as that encountered by petitioner in this area, and petitioner was required by its leases to mine all the mineable and merchantable coal. The slabber machine purchased in 1945 was another arc-well cutting machine needed because of the expansion of the mine."

"(b) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to maintain the normal output *solely because of the recession of the working faces of the mine*, and which (1) do not increase the value of the mine, or (2) do not decrease the cost of production of mineral units, or (3) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses." [Italics supplied.]

The reasoning underlying this regulation was expressed by this court in *Marsh Fork Coal Co.* v. *Lucas* 4 Cir. 42 Fed. (2d) 83, upon which it is said the regulation was based, in the following language:

"Ordinarily it is true that the purchase of machinery having a life greater than one year is to be charged to capital and not to expense, for ordinarily such machinery is purchased either to increase production or to decrease cost and in either event to add to the value of the property. Expenditures such as those here involved, however, are not made either to increase production or to decrease cost of operation. They do not add to the value of the property, and are not made for that purpose. They are made solely for the purpose of maintaining the capacity of the mine as the working faces of the coal recede. They represent the cost, as it were, of bringing forward the working plant of the operator, which is made necessary as the coal is removed from the mine and the tunnels increase in length.

"It is possible, of course, to think of the increased trackage and the increased number of mine cars and locomotives made necessary by the lengthening tunnels as an increase of the capital investment in the mine; but the trouble is that this theory leads to the ridiculous result that, with the increase of investment, the property becomes less valuable, and that, when the investment is complete, the property is practically worthless. *It is much more reasonable, we think, to consider expenditures for trackage, cars, and locomotives to maintain normal output as being an expense necessitated by the removal of the coal which has lengthened the tunnels, and an expense which, in any fair system of accounting, should be charged against the coal so removed.*

"When an operator has removed sufficient coal to extend his tunnels so that he cannot maintain production with the equipment which he has, he must as a matter of course lay down more track and put in more cars and locomotives. The question is, shall the expense thereby incurred be charged against the coal, the removal of which necessitated the expenditure to maintain normal operation, or against the coal yet unmined? *We think it is but fair to charge against the coal which has been mined the expense which its removal has necessitated.* We think, also, that this is the only practicable method of accounting. To capitalize the expenditures made to maintain normal output means that the cost of removal is pyramided against the coal farther back in the mine, with the result that the coal nearest the head house will appear to have been mined at abnormal profit and that farther back at a loss. [Italics supplied.]

It is clear that neither the language of the regulation nor the reasoning of the Marsh Fork case has application to the expenditures here involved. They have been necessitated not by the removal of the coal during the years in which they were made but by the thinness of one of the seams, the radical change in the nature of another and the shortage of available manpower. They were thus expenditures made in the interest of economy and efficiency and not "solely because of the recession of the working faces of the mine". They unquestionably added to what the value of the mine would have been without them and they decreased "the cost of production of mineral units" within the meaning of the regulation. We think that it is not only required by the regulation but by principles of sound accounting that they be capitalized and their cost spread over the years of their effective life rather than charged off as expense of a single year.

We do not think it determinative that the mine had been developed to full capacity prior to 1944 or that the equipment was purchased in an effort to maintain production. The thin seam of coal, the greater amount of slate and other refuse encountered as a result of the change in the character of the seam being

mined and the increasing difficulty of obtaining manpower necessitated additional capital investment as additional mechanization was required for the proper working of the mine; and there is no reason why such investment should be charged against the coal mined during the current year instead of being amortized like other capital investments made in the interest of economy and efficiency.

Coming to the third question, that of increased depreciation, taxpayer had been claiming normal depreciation on the straight line basis over the estimated useful life of assets in terms of years. Prior to 1941 its operations had been on the basis of two shifts of 7 hours each. Beginning with 1941 it increased the hours of work and use of equipment in its mine and its claim is that this entitles it to an increased allowance for depreciation. It makes no additional claim for 1941 but asks increases of 33 percent for 1942, 50 percent for 1943 and 90 percent for 1944 and 1945. There is nothing in the evidence, however, to show that the effective life of the equipment was decreased as a result of this increased use. See Montgomery's Federal Taxes (1951-1952) vol. 1 pp. 914-916. There was evidence that it resulted in increased cost of repairs, but these were admittedly charged to ordinary and necessary expense of the business. While Taxpayer's president testified generally that the increased wear had shortened the life of the equipment, he admitted on cross examination that its overall life would not be shortened and that it would last as long as taxpayer expected to use it. Under the circumstances, we think that the Tax Court properly denied the increased depreciation and we approve what the court said with regard thereto, as follows:

> "This Court has held in a number of cases that if a taxpayer normally employs the straight line method of computing depreciation, as here, evidence of increased usage and other operating conditions do not warrant an allowance for abnormal or accelerated depreciation absent a showing that the useful life of the depreciable asset was, in fact, thereby shortened. * * * Petitioner has failed to make this showing. It has shown in general terms that its mine was operated at an excessive pace and that proper maintenance for its equipment was not available. These two factors, however, do not prove that the remaining useful life of such equipment was necessarily shortened. To the contrary, there was no actual worthlessness or abandonment of the property, *nor is there evidence that any such eventuality was likely.* Assuming that there was an excessive amount of wear and tear, the indications were that this would be but temporary and petitioner so regarded it. We cannot appropriately find that the economic life of petitioner's equipment had been materially shortened or was in any danger of being exhausted." [Italics supplied.]

On the fourth question, the deduction of alleged loss resulting from the sale of tipple track, we think that the decision of the court was unquestionably correct. That track, which was essential to taxpayer's operations, had been built by it at a cost of $29,434.21, and depreciation had been taken on it in the sum of $7,796.63. The cost of maintaining this track rested on taxpayer and it received no benefit by way of freight reduction on account thereof. The track was sold to the Norfolk & Western Railway Company for a consideration of $1.00 upon an agreement that the railway company maintain it and taxpayer continue to have its use. In other words, as a result of the sale, taxpayer continued to enjoy the exclusive use of the track for its mine just as when the track belonged to it and was relieved of the cost of maintenance, which was assumed by the railway company. It is clear that instead of sustaining a loss taxpayer realized a benefit as the result of this transaction. We agree with what was said by the Tax Court in sustaining the Commissioner's disallowance of the loss claimed, viz:

> "Consideration of the substance of the transaction here in question discloses petitioner's beneficial use of the tipple tracks was substantially the same after the sale as it was before. The agreement of Norfolk & Western to permit the use of such tracks to petitioner without the burden of maintaining them, if anything, resulted in an improvement of petitioner's economic position. Actually, the sole effect of the transaction was the transfer of legal title to personal property which had no use other than to serve petitioner's mine. Petitioner has failed to show that its economic position has been in any way adversely affected as a result of this transaction. The record does not contain information which will enable us to place any evaluation upon the agreement of Norfolk & Western to maintain the tracks.

Therefore, petitioner has not shown that the consideration received by it for the transfer of legal title to the tracks was less than its adjusted basis and that any loss was actually sustained by it."

Taxpayer argues that it is entitled to the deduction because its books show the disappearance of an asset upon which it was entitled to take depreciation during the ensuing years. The answer is obvious: entries in books should be made to conform to economic realities; economic realities cannot be ignored because of entries in books. Taxpayer has secured a valuable right in the nature of a lease of the tipple track for which it has exchanged the ownership of that property. This should be taken account of by proper entries and depreciation allowed under the rules applicable in such a situation.

The decision of the Tax Court will be affirmed except with respect to the items of equipment allowed as ordinary and necessary expense. As to these items it will be reversed and the cause will be remanded to the Tax Court with direction that none of them, with the exception of the amounts paid for mine cars, be allowed as ordinary and necessary expense of the business, and, as to the mine cars, that only the purchase price of those the purchase of which was made necessary by the recession of the working faces of the mine be allowed as ordinary and necessary expense, with no such allowance for those whose purchase was necessitated by the greater productivity of the mechanized equipment.

Affirmed in Part, Reversed in Part and Remanded with Directions.

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

SECTION 29.23(p)-2: Information to be furnished by employer claiming deductions.

INTERNAL REVENUE CODE

Information required for rulings. (See Rev. Rul. 32, page 265.)

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

SECTION 29.23(q)-1: Contributions or gifts by corporations. T. D. 5979

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

Regulations 111 amended to provide that after January 1, 1953, a copy of the resolution of the board of directors shall be submitted as evidence of charitable contribution claimed as deduction in taxable year preceding year of contribution.

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

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

On November 15, 1952, notice of proposed rule making, regarding amendments to Regulations 111 (26 CFR, part 29), was published in the Federal Register (17 F. R. 10464). No objection to the rules proposed having been received, the amendments set forth below are hereby adopted.

PARAGRAPH 1. Section 29.23(q)–1 of Regulations 111 as amended by Treasury Decision 5924 [C. B. 1952–2, 100], approved August 4, 1952 [26 CFR 29.23(q)–1], is further amended as follows:

(A) By inserting in lieu of the second and third sentences of the last paragraph thereof the following:

For taxable years beginning after December 31, 1948, such election shall be made only at the time of the filing of the return for the taxable year and shall be signified by reporting such contribution or gift on the return. There shall be attached to such return a written declaration that the resolution authorizing the contribution or gift was adopted by the board of directors during the taxable year, and such declaration shall be verified by a statement signed by the president or other principal officer of the corporation that it is made under the penalties of perjury. With respect to contributions or gifts authorized on or after January 1, 1953, there shall be attached to the return, in addition to the written declaration referred to in the preceding sentence, a copy of the resolution of the board of directors authorizing such contribution or gift.

(B) By inserting in lieu of the fifth and sixth sentences of the last paragraph thereof the following:

For taxable years beginning after December 31, 1942, and before January 1, 1949, the election shall be signified by a written statement filed with the consent hereinbefore described in which the contribution or gift shall be specified together with a written declaration that the resolution authorizing the contribution or gift was adopted by the board of directors during the taxable year with respect to which the deduction is claimed, and such declaration shall be verified by a statement signed by the president or other principal officer of the corporation that it is made under the penalties of perjury.

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 3, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 6, 1953, 8:50 a. m.)

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

SECTION 29.23(x)–1: Medical, dental, etc., expenses. T. D. 5984

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 section 307 of the Revenue Act of 1951, relating to removal of the 5 percent limitation in the deduction of medical expenses for taxpayers aged 65 or over.

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

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

On December 2, 1952, notice of proposed rule making, regarding amendments to conform Regulations 111 (26 CFR, part 29) to section

307 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 10869). No objection to the rules proposed having been received, the amendments to Regulations 111 set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.23(x)-1 [26 CFR 29.23(x)-1] the following:

SEC. 307. MEDICAL EXPENSES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 23(x).—Section 23(x) (relating to medical, dental, etc., expenses) is hereby amended to read as follows:

"(x) MEDICAL, DENTAL, ETC., EXPENSES.—Expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent specified in section 25(b)(3)—

"(1) If neither the taxpayer nor his spouse has attained the age of 65 before the close of the taxable year, to the extent that such expenses exceed 5 per centum of the adjusted gross income; or

"(2) If either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year, (A) the amount of such expenses for the care of the taxpayer and his spouse, and (B) the amount by which such expenses for the care of such dependents exceed 5 per centum of the adjusted gross income.

The deduction under this subsection 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). The term 'medical care', as used in this subsection, shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance). The determination of whether an individual is married at any time during the taxable year shall be made in accordance with the provisions of section 51(b)(5)."

(b) EFFECTIVE DATE.—The amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1950.

PAR. 2. Section 29.23(x)-1, as amended by Treasury Decision 5687 [C. B. 1949-1, 9], approved February 16, 1949 [26 CFR 29.23(x)-1], is further amended as follows:

(A) By striking therefrom the third paragraph and inserting in lieu thereof the following:

In the case of medical expenses for the care of a person who is the taxpayer's spouse or dependent, the deduction under section 23(x) is allowable if the status of such person as "spouse" or "dependent" of the taxpayer exists either at the time the expenses were incurred or at the time the payment of the expenses was made. Thus, payments made in June 1942, by A, for medical services rendered B, his wife, in 1941 may be deducted by A for 1942 even though prior to payment for that year B died or secured a divorce; and payments made in July 1942, by C for medical services rendered D in 1941 may be deducted by C for 1942 even though C and D were not married until June 1942. However, with respect to taxable years beginning after December 31, 1950, the status of a person as the "spouse" of the taxpayer must exist as of the close of the taxable year of the taxpayer in which either the expenses were incurred or the payment was made, or, in the case of the death of the spouse in either such year, as of the time of such death. In determining whether such status exists a taxpayer who is legally separated from his spouse under a decree of separate maintenance is not considered as married.

(B) By inserting in the first sentence of the fifth paragraph, immediately following "after December 31, 1943," the following: "and before January 1, 1951,".

(C) By striking the last sentence of the fifth paragraph and inserting in lieu thereof the following new paragraphs:

For taxable years beginning after December 31, 1950, there is no 5 percent limitation on the deduction for medical expenses, not compensated for by insurance or otherwise, expended for the care of taxpayer or his spouse, where either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year. In such cases the taxpayer may deduct (subject to the maximum deduction allowable as described above for taxable years beginning after December 31, 1947): (*a*) the amount of all payments for the medical care of the taxpayer and his spouse; and (*b*) the amount by which his payments for the medical care of his dependents exceeds 5 percent of his adjusted gross income. In determining the amount of medical expenses deductible under (*b*) (see section 23(x)(2)(B)) the amount deductible under (*a*) (see section 23(x)(2)(A)) shall not be included for the purpose of meeting the 5 percent limitation. (For computations illustrating this rule, see examples (6) and (7) at the end of this section.) In determining the age of an individual for the purposes of the unlimited deduction of medical payments for old age, the last day of the taxable year of the taxpayer is the controlling date. Thus, a taxpayer who has not attained the age of 65 at the end of the taxable year may not claim the unlimited deduction with respect to payments made for the medical care of himself or his spouse if the spouse 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.

The deduction for medical expenses shall not be deemed to have been allowed for any taxable year for which the taxpayer claimed and was allowed the standard deduction under section 23(aa).

(D) By inserting after example 5 the following:

Example (6). Taxpayer E, who attained the age of 65 years on February 22, 1951, makes his return on the basis of the calendar year. During the year 1951, E has adjusted gross income of $8,000, and pays the following medical bills: (*a*) $240 (3 percent of adjusted gross income) for the medical care of himself and his spouse, and (*b*) $320 (4 percent of adjusted gross income) for the medical care of his dependent son. The allowable deduction under section 23(x) is $240. No deduction is allowable for the amount of $320 paid for medical care of the dependent son since the amount of such payment (determined without regard to the payments for the care of the taxpayer and his spouse) does not exceed 5 percent of adjusted gross income.

Example (7). H and W make a joint return for the calendar year 1951 on which four exemptions are allowed (exclusive of exemptions under section 25(b)(1)(B) or (C), one for each taxpayer and two for their dependent minor children. W became 65 years of age on August 15, 1951. The adjusted gross income of H and W in 1951 is $40,000 and they pay in such year the following amounts for medical care: (*a*) $1,500 for the medical care of H; (*b*) $2,500 for the medical care of W; and (*c*) $3,500 for the medical care of the children. The allowable deduction under section 23(x) for medical expenses paid in 1951 is $5,000 computed as follows:

Payment for medical care of H and W in 1951		$4,000
Payment for medical care of children in 1951	$3,500	
Less 5 percent of $40,000 (adjusted gross income)	2,000	
		1,500
		5,500
Maximum allowable deduction in 1951		5,000

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 10, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 13, 1953, 8:53 a. m.)

SECTION 29.23(x)-1: Medical, dental, etc., expenses. Rev. Rul. 19

INTERNAL REVENUE CODE

The amount of annual premium paid for accident and health insurance which does not provide reimbursement to the insured for medical expenses does not constitute a proper deduction under section 23(x) of the Internal Revenue Code.

Advice is requested whether a premium paid by a taxpayer for accident and health insurance providing benefits for (1) accidental loss of life, (2) loss of eyes or limbs, and (3) loss of time resulting from incapacity due to illness or accident constitutes a deductible medical expense within the meaning of section 23(x) of the Internal Revenue Code. The letter of inquiry states that there is no premium breakdown with respect to the benefits obtainable, all benefits being available upon payment of a single annual premium.

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

(x) MEDICAL, DENTAL, ETC., EXPENSES.—Expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent specified in section 25(b)(3)—

* * * * * * *

* * * The term "medical care," as used in this subsection, shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (*including amounts paid for accident or health insurance*). * * * [Italics supplied.]

I. T. 3967 (C. B. 1949-2, 33) holds (in a case which arose under California law) that amounts contributed by employees to a fund established under a voluntary plan for the payment of unemployment compensation disability benefits to employees to compensate them only for loss of earnings due to sickness or injury are not deductible as medical expenses under section 23(x) of the Code, but are nondeductible personal expenses under section 24(a)(1) of the Code. That conclusion was based on the premise that the only premiums for accident and health insurance which are deductible under section 23(x) of the Code are those paid for a type of insurance the proceeds of which will reimburse the insured for medical expenses and thus reduce his otherwise allowable deduction on account of the payments. In *Robert O. Deming, Jr.*, v. *Commissioner* (9 T. C. 383, acquiescence, C. B. 1948-1, 1) it was held that the amount paid to a taxpayer under an insurance contract as partial reimbursement for loss of earnings due to accident or illness need not be applied as a reduction of the amount claimed as a medical expense deduction.

Accordingly, it is held that the amount of annual premium paid for accident and health insurance which does not provide reimbursement to the insured for medical expenses does not constitute a proper deduction under section 23(x) of the Internal Revenue Code.

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

SECTION 29.23(aa)-1: Standard deduction. T. D. 5965
(Also Section 402, Section 29.402-1.)

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 section 308 of the Revenue Act of 1951, relating to the standard deduction.

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

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

On October 29, 1952, notice of proposed rule making, regarding amendments to the income tax regulations made necessary by section 308 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 9744). No objection to the rules proposed having been received, the amendments to Regulations 111 [26 CFR, part 29] set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 29.23(aa)-1 [26 CFR 29.23(aa)-1] the following:

SEC. 308. STANDARD DEDUCTION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) METHOD OF ELECTION.—Subparagraphs (A) and (B) of section 23(aa)(3) (relating to optional standard deduction for individuals) are hereby amended by striking out the word "only"; and subparagraph (C) of section 23 (aa)(3) is hereby amended to read as follows:

"(C) If the taxpayer upon making his return fails to signify, in the manner provided by subparagraph (A) or (B), his election to take the standard deduction, such failure shall be considered his election not to take the standard deduction."

(b) CHANGE OF ELECTION.—Section 23(aa) is hereby amended by adding at the end thereof the following new paragraph:

"(7) CHANGE OF ELECTION.—Under regulations prescribed by the Secretary, a change of an election to take, or not to take, the standard deduction for any taxable year may be made after the filing of the return for such year. If the spouse of the taxpayer filed a separate return for any taxable year corresponding, for the purposes of paragraph (4), to the taxable year of the taxpayer, the change shall not be allowed unless, in accordance with such regulations—

"(A) the spouse makes a change of election with respect to the standard deduction for the taxable year covered in such separate return, consistent with the change of election sought by the taxpayer, and

"(B) the taxpayer and his spouse consent in writing to the assessment, within such period as may be agreed upon with the Secretary, of any deficiency, to the extent attributable to such change of election, even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

This paragraph shall not apply if the tax liability of the taxpayer's spouse, for the taxable year corresponding (for the purposes of paragraph (4)) to the taxable year of the taxpayer, has been compromised under the provisions of section 3761."

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1949.

PAR. 2. Section 29.23(aa)-1, as amended by Treasury Decision 5687 [C. B. 1949-1, 9], approved February 16, 1949 [26 CFR 29.23(aa)-1], is hereby amended as follows:

(A) By striking out the word "only" in the first sentence of (b)(1) thereof.

(B) By striking out the fourth sentence of (b)(1) thereof.

(C) By striking out the word "irrevocable" in (b)(1)(i) thereof.

(D) By striking out the word "irrevocably" in (b)(1)(ii) thereof.

(E) By striking out the word "only" in the first sentence of (b)(2) thereof.

(F) By adding at the end thereof the following:

(d) *Change of election to take, or not to take, the standard deductions.*—With respect to taxable years beginning before January 1, 1950, the election to take, or not to take, the standard deduction for any taxable year shall be irrevocable after the time prescribed for filing the return for the taxable year. With respect to taxable years beginning after December 31, 1949, a change of the election to take, or not to take, the standard deduction for any taxable year may be made before or after the time prescribed for filing the return for the taxable year. However, the period of time prescribed in section 322 within which claim for credit or refund of tax must be made is not extended by the right to effect a change of election. (See section 29.322-7.)

If the spouse of the taxpayer filed a separate return for any taxable year that corresponds, for the purpose of section 23(aa)(4) (see (c) of this section), to the taxable year of the taxpayer, a change of election may not be made by the taxpayer unless (1) the spouse makes a change of election in such separate return with respect to the standard deduction consistent with the change of election sought by the taxpayer, and (2) the taxpayer and his spouse file a consent in writing to the assessment, within such period of time as may be agreed upon, of any deficiency of either to the extent attributable to such change of election even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

A change of election for any taxable year shall not be permitted if the tax liability of the taxpayer for the taxable year, or of the taxpayer's spouse for the taxable year corresponding, for the purpose of section 23(aa)(4) (see (c) of this section), to the taxable year of the taxpayer, has been compromised under the provisions of section 3761.

PAR. 3. Section 29.402-1, as amended by Treasury Decision 5687, approved February 16, 1949 [26 CFR 29.402-1], is hereby amended by changing the second paragraph of (*b*) thereof to read as follows:

With respect to taxable years beginning before January 1, 1950, 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; and, 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. With respect to taxable years beginning after December 31, 1949, an election under Supplement T, or the making of a return without regard to Supplement T, for any taxable year may be changed under the same circumstances that an election to take, or not to take, the standard deduction may be changed (see section 29.23(aa)-1(d)).

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 22, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 29, 1952, 8:52 a. m.)

SECTION 23(cc).—DEDUCTIONS FROM GROSS INCOME: DEVELOPMENT OF MINES

INTERNAL REVENUE CODE

Expenditures in the development of uranium mines. (See Rev. Rul. 106, page 177.)

SECTION 23(ff).—DEDUCTIONS FROM GROSS INCOME: DEDUCTION OF EXPLORATION EXPENDITURES

INTERNAL REVENUE CODE

Expenditures in the exploration of uranium mines. (See Rev. Rul. 106, page 177.)

SECTION 24.—ITEMS NOT DEDUCTIBLE

SECTION 29.24-1: Personal and family expenses. Rev. Rul. 80
(Also Section 22(a), Sections 29.22(a)-3, 29.22(a)-5; Section 183, Section 29.183-1.)

INTERNAL REVENUE CODE

Where the owner of a hotel business lives on the premises, the costs (including cost of goods, wages, general expenses, taxes, depreciation, etc.) attributable to meals, lodging, and other personal or living accommodations of the owner and his family must be eliminated, for Federal income tax purposes, from the costs and expenses of operating the hotel. (See O. D. 998, C. B. 5, 86 (1921); *cf.* Rev. Rul. 28, page 20, this Bulletin.) Where a partnership operates a hotel and the managing partner lives on the premises, it is the position of the Bureau (in line with the nonacquiescence, C. B. 1952-2, 5, in the decision in *George A. Papineau* v. *Commissioner*, 16 T. C. 130) that not only must the costs attributable to such accommodations of the resident partner and his family be eliminated from operating costs and expenses, but also the resulting increase in partnership income must be included in the resident partner's share of the net profits of the hotel business. For the above purposes, the Bureau will accept a reasonable approximation of the costs attributable to such personal items.

SECTION 29.24-1: Personal and family expenses.

INTERNAL REVENUE CODE

Deductibility of goods withdrawn from stock by a merchant for family of personal use. (See Rev. Rul. 28, page 20.)

SECTION 29.24-2: Capital expenditures.

INTERNAL REVENUE CODE

Creation fees paid by subscribers in a sponsored investment plan. (See Rev. Rul. 3, page 37.)

SECTION 29.24-2: Capital expenditures.

INTERNAL REVENUE CODE

Amounts expended for construction of protective works or for moving homes safely back from original locations on the shores of Great Lakes to prevent probable losses from future storms. (See Rev. Rul. 79, page 41.)

SECTION 29.24-3: Premiums on business insurance. Rev. Rul. 73
(Also Section 29.24-1; Section 23(a), Section 29.23(a)-1.)

INTERNAL REVENUE CODE AND PRIOR REVENUE LAWS

A taxpayer, the principal member of a partnership, who purchases insurance policies on his life and irrevocably designates the copartners as sole beneficiaries to induce them to retain their investments in the partnership is a direct or indirect beneficiary under such policies, within the meaning of section 24(a)(4) of the Internal Revenue Code. Premiums paid by the taxpayer on such life insurance policies are not deductible under the provisions of section 23(a)(1) of the Code.

I. T. 1340, C. B. I-1, 119 (1922), revoked.

Advice is requested relative to the deductibility under section 23(a)(1) of the Internal Revenue Code of premiums paid on life insurance policies covering the life of the taxpayer, the principal member of a partnership, where such policies irrevocably designate his copartners as sole beneficiaries to protect them against losses which might occur in the event of the taxpayer's death and to induce them to retain their interest in the partnership.

In the instant case, the taxpayer is the principal member of a partnership engaged in a venture in which his personal efforts and experience are mainly responsible for the success of the business. The copartners have expressed intentions to withdraw their investments from the business unless some manner of protection is provided against losses which would inure to them in the event of the taxpayer's death. The taxpayer's own interest in the business would be jeopardized should the copartners withdraw their investments since it appears extremely improbable that such withdrawals could be replaced by

borrowing like sums on favorable terms without risking his entire capital interest in the event of default. In order to remove this jeopardy and to induce the copartners to retain their investments in the business the taxpayer purchased insurance policies on his life irrevocably naming his copartners as sole beneficiaries and retained no rights in the policies to himself or his heirs.

In connection with the instant case reconsideration has been given to I. T. 1340, C. B. I–1, 119 (1922), which holds that premiums paid by a taxpayer on insurance policies on his own life, payable to each of his partners, are allowable deductions as business expenses, when the policies were purchased at the insistence of the partners to induce them to make investments in the business.

Section 24(a) (4) of the Code provides that in computing net income no deduction shall in any case be allowed in respect to premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy. In the case of *J. H. Parker* v. *Commissioner*, 13 B. T. A. 115, presenting a situation similar to that of the instant case, the term "beneficiary" as used in section 215(a) (4) of the Revenue Act of 1921 (now section 24(a) (4) of the Internal Revenue Code) was construed as not being necessarily confined to the person named in the policy, but that it could include one whose interests are indirectly favorably affected thereby. In that case it was held that a taxpayer was directly or indirectly a beneficiary on a life insurance policy taken out by him to protect his creditors and avoid bankruptcy.

In *Ernest J. Keefe* 15 T. C. 947, the court stated that section 24 (a) (4) of the Code does not speak of one who is directly or indirectly *the* beneficiary; it merely refers to one who is directly or indirectly *a* beneficiary under the policy.

In the case herein considered the premiums paid by the taxpayer fall within the prohibition of section 24(a) (4) of the Code, as that section was interpreted in the Parker case, *supra*, since the insurance policies were purchased, designating the copartners as sole beneficiaries thereunder, for the purpose of inducing them to retain their investments in the partnership. In accomplishing this purpose the jeopardy to the taxpayer's own capital interest in the partnership was removed and his interest in the partnership was favorably affected thereby. Moreover, the very reasons urged by the taxpayer for the applicability of section 23(a) of the Code moves the transaction in the direction of section 24(a) (4) of the Code. See *Semon Bache & Co.*, 22 B. T. A. 200.

In view of the foregoing, it is held that a taxpayer, the principal member of a partnership, who purchases insurance policies on his life and irrevocably designates the copartners as sole beneficiaries to induce them to retain their investments in the partnership is a direct or indirect beneficiary under such policies, within the meaning of section 24(a) (4) of the Internal Revenue Code. Premiums paid by the taxpayer on such life insurance policies are not deductible under the provisions of section 23(a) (1) of the Code. Accordingly, I. T. 1340, *supra*, is hereby revoked.

SECTION 29.24-10: Items attributable to an unharvested crop sold with the land. T. D. 5980
(Also Section 113(b), Section 29.113(b)(1)-1; Section 117, Section 29.117-7.)

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 section 323 of the Revenue Act of 1951, relating to sale of land with unharvested crop.

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

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

On December 4, 1952, notice of proposed rule making, regarding amendments to the income tax regulations made necessary by section 323 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 10970). No objection to the rules proposed having been received, the amendments to Regulations 111 [26 CFR, part 29] set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 29.24-1 [26 CFR 29.24-1] the following:

SEC. 323. SALE OF LAND WITH UNHARVESTED CROP [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TREATMENT OF DEDUCTIONS.—

(1) AMENDMENT OF SECTION 24.—Section 24 (relating to items not deductible is hereby amended by adding at the end thereof a new subsection to read as follows:

"(f) SALE OF LAND WITH UNHARVESTED CROP.—Where an unharvested crop sold by the taxpayer is considered under the provisions of section 117(j)(3) as 'property used in the trade or business', in computing net income no deduction (whether or not for the taxable year of the sale and whether for expenses, depreciation, or otherwise) attributable to the production of such crop shall be allowed."

* * * * * * *

(c) EFFECTIVE DATE.—* * * The amendments made by subsections (b) shall be applicable to any taxable year for which a deduction is disallowed by reason of sales, exchanges, or conversions to which subsection (a) is applicable.

PAR. 2. There is inserted immediately after section 29.24-9 [26 CFR 29.24-9] the following:

SEC. 29.24-10. ITEMS ATTRIBUTABLE TO AN UNHARVESTED CROP SOLD WITH THE LAND.—In computing net income no deduction shall be allowed in respect of items attributable to the production of an unharvested crop which is sold, exchanged, or involuntarily converted in a taxable year beginning after December 31, 1950, with the land and which is considered as property used in the trade or business under section 117(j)(3). See section 29.117-7. Such items shall be so treated whether or not the taxable year involved is that of the sale, exchange, or conversion of such crop and whether they are for expenses, depreciation, or otherwise. If the taxable year involved is not that of the sale, exchange, or conversion of such crop, a recomputation of the tax liability for such year shall be made; such recomputation should be in the form of an "amended return" if necessary. For the adjustments to basis as a result of such disallowance, see section 29.113(b)(1)-1.

PAR. 3. There is inserted immediately preceding section 29.113(b)(1)–1 [26 CFR 29.113(b)(1)–1] the following:

SEC. 323. SALE OF LAND WITH UNHARVESTED CROP [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TREATMENT OF DEDUCTIONS.—

* * * * * * *

(2) AMENDMENT OF SECTION 113(b)(1).—Section 113(b)(1) relating to adjustments to basis) is hereby amended by adding at the end thereof a new subparagraph to read as follows:

"(L) for deductions to the extent disallowed under section 24(f), notwithstanding the provisions of any other subparagraph of this paragraph."

(c) EFFECTIVE DATE.—* * * The amendments made by subsection (b) shall be applicable to any taxable year for which a deduction is disallowed by reason of sales, exchanges, or conversions to which subsection (a) is applicable.

PAR. 4. Section 29.113(b)(1)–1, as amended by Treasury Decision 5967 [page 163, this Bulletin], approved December 30, 1952 [26 CFR 29.113(b)(1)–1], is hereby amended by adding at the end thereof the following:

In the case of an unharvested crop which is sold, exchanged, or involuntarily converted in a taxable year beginning after December 31, 1950, with the land and which is considered as property used in the trade or business under section 117(j)(3), the basis of such crop shall be increased by the amount of the items which are attributable to the production of such crop and which are disallowed, under sections 24(f) and 29.24–10, as deductions in computing net income. See sections 29.24–10 and 29.117–7. The basis of any other property shall be decreased by the amount of any such items which are attributable to such other property, notwithstanding any provision of section 113(b)(1) or of this section to the contrary. For example, if the items attributable to the production of an unharvested crop consist only of fertilizer costing $100 and $50 depreciation on a tractor used only to cultivate such crop and such items are disallowed under sections 24(f) and 29.24–10, the adjustments to the basis of such crop shall include an increase of $150 for such items and the adjustments to the basis of the tractor shall include a reduction of $50 for the depreciation on the tractor.

PAR. 5. There is inserted immediately preceding section 29.117–1 [26 CFR 29.117–1] the following:

SEC. 323. SALE OF LAND WITH UNHARVESTED CROP [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) TREATMENT OF GAIN OR LOSS.—Section 117(j) (relating to sale or exchange of property used in the trade or business) is hereby amended—

(1) By inserting immediately before the period at the end of the second sentence of paragraph (1) thereof the following: "and unharvested crops to which paragraph (3) is applicable"; and

(2) By adding at the end thereof a new paragraph to read as follows:

"(3) SALE OF LAND WITH UNHARVESTED CROP.—In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted as described in paragraph (2)) at the same time and to the same person, the crop shall be considered as 'property used in the trade or business'."

* * * * * * *

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall be applicable only with respect to sales, exchanges, and conversions, occurring in taxable years beginning after December 31, 1950. * * *

PAR. 6. Section 29.117-7, as amended by Treasury Decision 5970 [page 183, this Bulletin], approved January 6, 1953 [26 CFR 29.117-7], is hereby amended as follows:

(A) By adding at the end of (a) (1) (iv) thereof the following:

(v) Gains and losses from the sale, exchange, or involuntary conversion in a taxable year beginning after December 31, 1950, of an unharvested crop under the conditions specified in (d) hereof.

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

(d) *Unharvested crops.*—The conditions referred to in (a)(1)(v) above are: (1) the unharvested crop is on land which is "section 117(j) property", as defined in (a)(3) above, and such land has been held for more than six months; (2) such crop and such land are sold, exchanged, or converted at the same time and to the same person; and (3) no right or option is retained by the taxpayer, at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land (other than one customarily incident to a mortgage or other security transaction). The length of time for which the crop, as distinguished from the land, has been held is immaterial. A leasehold or estate for years is not "land" for the purpose of this section.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved February 3, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 6, 1953, 8:50 a. m.)

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME

SECTION 29.25-3: Personal exemption, surtax exemptions, and exemptions for both normal tax and surtax. (Also Section 51, Section 29.51-1.) — Rev. Rul. 29

INTERNAL REVENUE CODE

A wife divorced her husband in the State of Alabama. The divorce decree stipulated that there shall be a waiting period of 60 days before either party could remarry except to each other. The State of New York waived the 60-day waiting period and issued a license to the wife to remarry a third party prior to the expiration of such period. The State of New York recognizes the legality of the marriage performed under the license which it issued. The parties to the second marriage maintained a marital status on the last day of the taxable year. In the circumstances stated the Bureau recognizes the marital status of the parties for Federal income tax purposes.

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

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5993, page 9.)

SECTION 26.—CREDITS OF CORPORATIONS

SECTION 29.26-6: Credit for dividends received. Rev. Rul. 104

INTERNAL REVENUE CODE

The credit for dividends received provided in section 26(b)(1) of the Internal Revenue Code is based upon the theory that a corporate tax has already been paid upon the earnings out of which the dividends are distributed, and such a credit for dividends received is not applicable in any case to dividends which are deductible in computing the net income of a distributing corporation under section 23(r) of the Code.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

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

SECTION 29.42-1: When included in gross income. Ct. D. 1756
(Also Section 43, Section 29.43-2.)

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS INCOME—DEDUCTIONS—YEAR FOR WHICH DEDUCTION TAKEN—TRANSFEREE LIABILITY—EXCESSIVE COMPENSATION PAID TO CORPORATE OFFICERS.

Taxpayers, who reported income on cash receipts and disbursements basis, received salaries from closely held corporations in which they were both officers and stockholders, and reported such salaries as income for the year received. Subsequently, the Commissioner disallowed deductions by the corporations of parts of the salaries as exceeding reasonable compensation, determined deficiencies against the corporations, and also determined that the officers were liable as transferees under section 311 of the Internal Revenue Code for the corporate deficiencies. The receipt of excessive salary was the transfer upon which the transferee liability was predicated. The determination of the amounts of corporate deficiencies and of transferee liabilities of the officers occurred after the end of the year in which the salaries were received and reported. Taxpayers contend that an adjustment should be made in the year of original receipt of the salary; the Government contends that an adjustment should be made in the year of payment of the transferee liability. *Held:* The salaries were received under a claim of individual right—not under a claim of right as trustees, and were therefore taxable in the year received. Each taxpayer is entitled to a deduction for a loss in the year of repayment of the amount earlier included in income. It would be disruptive of an orderly collection of the revenue to rule that the counting of annual income must be done over again to reflect events occurring after the year for which the count is made, and would violate the spirit of the annual accounting system.

2. DECISIONS AFFIRMED AND REVERSED.

Decision of the United States Court of Appeals, 2d Circuit, 194 F. 2d 662 (1952) affirmed; decision of the United States Court of Appeals, 6th Circuit, 194 F. 2d 536 (1952) reversed.

SUPREME COURT OF THE UNITED STATES

76. *Edwin E. Healy and Gordon W. Hartfield, petitioners,* v. *Commissioner of Internal Revenue*

On writ of certiorari to the United States Court of Appeals for the Second Circuit

138. *Commissioner of Internal Revenue, petitioner,* v. *Hall C. Smith*

On writ of certiorari to the United States Court of Appeals for the Sixth Circuit

[April 6, 1953]

OPINION

Mr. Chief Justice VINSON delivered the opinion of the Court.

The income tax liability of three individual taxpayers for a given year is here before the Court. Only a single question, common to all the cases, is involved. The Tax Court held a view favorable to the taxpayers.[1] The Commissioner of Internal Revenue sought review before the appropriate courts of appeals. As to two of the taxpayers, the Court of Appeals for the Second Circuit reversed,[2] while the Court of Appeals for the Sixth Circuit took a contrary view of the law.[3] We granted certiorari to resolve the conflict.[4]

All controlling facts in the three situations are similar. Each taxpayer reports his income on the cash receipts and disbursements method. Each, in the respective years involved, received a salary from a closely held corporation in which he was both an officer and a stockholder. The full amount of salary so received was reported as income for the year received. Subsequently, after audit of the corporate returns, the Commissioner disallowed the deduction by the corporations of parts of the salaries as exceeding reasonable compensation. As a result, deficiencies in income taxes were determined against the corporations. The Commissioner also determined that the officers were liable as transferees under section 311 of the Internal Revenue Code for the corporate deficiencies. The receipt of excessive salary was the transfer upon which the transferee liability was predicated. As a result of either litigation[5] or negotiation, various amounts became established as deficiencies of the corporations and as transferee liabilities of each of the three officers. In each case, the entire process of determining these amounts—from the start of the audit by agents of the Commissioner to the final establishment of the liabilities—occurred after the end of the year in which the salary was received and reported.

The question before the Court is whether part of the salary should be excluded from taxable income in the year of receipt since part was excessive salary and led to transferee liability for the unpaid taxes of the corporations. The taxpayers contend that an adjustment should be made in the year of original receipt of the salary; the Government that an adjustment should be made in the year of payment of the transferee liability.

One of the basic aspects of the Federal income tax is that there be an annual accounting of income.[6] Each item of income must be reported in the year in which it is properly reportable and in no other. For a cash basis taxpayer, as these three are, the correct year is the year in which received.[7]

Not infrequently, an adverse claimant will contest the right of the recipient to retain money or property, either in the year of receipt or subsequently. In *North American Oil* v. *Burnet*, 286 U. S. 417 (1932) [Ct. D. 499, C. B. XI-1, 293 (1932)], we considered whether such uncertainty would result in an amount otherwise includible in income being deferred as reportable income beyond the annual period in which received. That decision established the claim of right doctrine "now deeply rooted in the Federal tax system."[8] The usual statement of the rule is that by Mr. Justice Brandeis in the *North American Oil* opinion:

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[1] *Gordon W. Hartfield and Edwin E. Healy,* 16 T. C. 200 (1951) (consolidated proceedings); *Hall C. Smith,* 11 T. C. 174 (1948).

[2] *Commissioner* v. *Hartfield,* 194 F 2d 662 (1952).

[3] *Commissioner* v. *Smith,* 194 F. 2d 536 (1952).

[4] 344 U. S. 811, 813 (1952).

[5] *Charles E. Smith & Sons Co.* v. *Commissioner,* 184 F. 2d 1011 (1950).

[6] *Reo Motors* v. *Commissioner,* 338 U. S. 442 (1950) [Ct. D. 1728, C. B. 1950-1, 59]; *Heiner* v. *Mellon,* 304 U. S. 271 (1938) [Ct. D. 1345, C. B. 1938-1, 349]; *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359 (1931) [Ct. D. 277, C. B. X-1, 363 (1931)]. See I. R. C., sec. 41.

[7] I. R. C., sec. 42(a). Other permissive methods of accounting for tax purposes are the accrual basis, I. R. C., secs. 41 and 42, and the installment basis, I. R. C., sec. 44.

[8] *United States* v. *Lewis,* 340 U. S. 590, 592 (1951).

"If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." 286 U. S., at 424.

The phrase "claim of right" is a term known of old to lawyers. Its typical use has been in real property law in dealing with title by adverse possession, where the rule has been that title can be acquired by adverse possession only if the occupant claims that he has a right to be in possession as owner.[9] The use of the term in the field of income taxation is analogous. There is a claim of right when funds are received and treated by a taxpayer as belonging to him. The fact that subsequently the claim is found to be invalid by a court does not change the fact that the claim did exist. A mistaken claim is nonetheless a claim, *United States* v. *Lewis*, 340 U. S. 590 (1951) [Ct. D. 1738, C. B. 1951-1, 21].

However, we are told that the salaries were not received as belonging to the taxpayers, but rather they were received by the taxpayers as "constructive trustees" for the benefit of the creditors of the corporation. Admittedly, receipts by a trustee expressly for the benefit of another are not income to the trustee in his individual capacity, for he "has received nothing * * * for his separate use and benefit." *Eisner* v. *Macomber*, 252 U. S. 189, 211 (1920) [T. D. 3010, C. B. 3, 25 (1920)].

We do not believe that these taxpayers were trustees in the sense that the salaries were not received for their separate use and benefit. Under the equitable doctrine that the funds of a corporation are a trust fund for the benefit of creditors, a stockholder receiving funds without adequate consideration from an insolvent corporation may be held, in some jurisdictions, to hold the funds as a constructive trustee.[10] So it was that these taxpayers were declared constructive trustees and were liable as transferees in equity. A constructive trust is a fiction imposed as an equitable device for achieving justice.[11] It lacks the attributes of a true trust, and is not based on any intention of the parties. Even though it has a retroactive existence in legal fiction, fiction cannot change the "readily realizable economic value"[12] and practical "use and benefit"[13] which these taxpayers enjoyed during a prior annual accounting period, antecedent to the declaration of the constructive trust.

We think it clear that the salaries were received under a claim of individual right—not under a claim of right as a trustee. Indeed one of the parties concedes, as is manifestly so, that the reporting of the salary on the income tax returns indicated that the income was held under a claim of individual right. The taxpayers argue that the salary was subject to a restriction on its use.[14] Since all the facts which ultimately gave rise to the transferee liability were in existence at the end of the taxable year, we are told those facts were a legal restriction on the use of the salary. Actually it could not have been said at the end of each of the years involved that the transferee liability would materialize. The Commissioner might not have audited one or all of these particular returns; the Commissioner might not have gone through the correct procedure or have produced enough admissible evidence to meet his burden of proving transferee liability;[15] or, through subsequent profitable operations, the corporations might have been able to have paid their taxes obviating the necessity of resort to the transferees.[16]

There is no need to attempt to list hypothetical situations not before us which put such restrictions on use as to prevent the receipt under claim of right from giving rise to taxable income. But a potential or dormant restriction, such as here involved, which depends upon the future application of rules of law to present facts, is not a "restriction on use" within the meaning of *North American Oil* v. *Burnet, supra.*

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[9] 4 Tiffany, Real Property, sec. 1147.

[10] 15A Fletcher, Cyclopedia Corporations, secs. 7369–7389.

[11] 3 Scott on Trusts, sec. 462.1; 3 Bogert, Trusts and Trustees, sec. 471.

[12] *Rutkin* v. *United States*, 343 U. S. 130, 137 (1952) [Ct. D. 1742, C. B. 1952-1, 9].

[13] *Eisner* v. *Macomber*, 252 U. S. 189, 211 (1920).

[14] The rule announced in *North American Oil* v. *Burnet, supra,* requires a receipt without "restriction on use" as well as under a claim of right.

[15] I. R. C., sec. 1119 imposes upon the Commissioner the burden of proving transferee liability. This may be contrasted to the rule that normally the burden of proof is on the taxpayer contesting the determination of the Commissioner. I. R. C., sec. 1111; rule 32, Tax Court of United States.

[16] Transferee liability is secondary to the primary liability of the transferor. To sustain transferee liability the Commissioner must prove that he is unable to collect the deficiency from the transferor. 9 Mertens, Law of Federal Income Taxation, sec. 53.29.

The inequities of treating an amount as income which eventually turns out not to be income are urged upon us. The Government concedes that each of these taxpayers is entitled to a deduction for a loss in the year of repayment of the amount earlier included in income.[17] In some cases, this treatment will benefit the taxpayer; in others it will not. Factors such as the tax rates in the years involved and the brackets in which the income of the taxpayer falls will be controlling. A rule which required that the adjustment be made in the earlier year of receipt instead of the later year of repayment would generally be unfavorable to taxpayers, for the statute of limitations would frequently bar any adjustment of the tax liability for the earlier year.[18] Congress has enacted an annual accounting system under which income is counted up at the end of each year. It would be disruptive of an orderly collection of the revenue to rule that the counting must be done over again to reflect events occurring after the year for which the count is made, and would violate the spirit of the annual accounting system. This basic principle cannot be changed simply because it is of advantage to a taxpayer or to the Government in a particular case that a different rule be followed.

The judgment of the Court of Appeals for the Second Circuit in No. 76, being consistent with this opinion, is affirmed, while the contrary judgment of the Court of Appeals for the Sixth Circuit in No. 138 is reversed.

It is so ordered.

Mr. Justice DOUGLAS dissents.

SECTION 29.42-1: When included in gross income. Rev. Rul. 62

INTERNAL REVENUE CODE

Amounts "credited," under section 7(d) of the Federal Deposit Insurance Act, pro rata to insured banks by the Federal Deposit Insurance Corporation "as of December 31, 1950, and as of December 31, of each calendar year thereafter" based upon 60 percent of the Corporation's "net assessment income" for each such year, are includible in the gross income of a bank, on the cash receipts and disbursements basis, for its taxable year or years in which and to the extent each such credit is applicable toward payment of a deposit-insurance assessment or assessments or is refundable or assignable.

Each such credit, being ultimately realizable by the bank in full, is includible in its gross income, on the accrual basis, in entirety for its taxable year in which it is definitely advised by the Corporation of the amount thereof.

Advice is requested relative to when and how amounts "credited," under section 7(d) of the Federal Deposit Insurance Act, "as of December 31, 1950", by the Federal Deposit Insurance Corporation to "insured banks" are includible in their Federal income tax returns.

The Federal Deposit Insurance Corporation, the management of which is vested in a Board of Directors composed of three members, one of whom is the Comptroller of the Currency, was created June 16, 1933, under section 8 of the Banking Act of 1933 (chapter 89, 48 Stat. 162, at 168, 179; which amended the Federal Reserve Act as previously amended, by inserting therein, *inter alia*, section 12B), to purchase, hold, and liquidate assets of certain closed banks, and to insure temporarily certain bank deposits, operative January 1, 1934. See I. T. 2764, C. B. XIII-1, 45 (1934). Section 101 of the Banking Act of 1935 (chapter 614, 49 Stat. 684, at 688, amending section 12B, *supra*), effective August 23, 1935, provided for permanent Federal insurance of certain bank deposits with an assessment rate of one-twelfth of 1 per centum (section 12B(h)(1)). See I. T. 2940, C. B.

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[17] G. C. M. 16730; C. B. XV-1, 179 (1936).
[18] I. R. C., sec. 322(b). See also I. R. C., secs. 275 and 311(b).

XIV–2, 63 (1935). Section 12B, as amended, *supra*, was withdrawn from the Federal Reserve Act and made the Federal Deposit Insurance Act, and further amended by Public Law 797, Eighty-first Congress, chapter 967, second session, approved September 21, 1950, 64 Stat. 873. The deposit-insurance assessment rate was not changed in the new Act, but section 7(d) thereof (U. S. C., title 12, section 1817(d)), providing as follows, was added:

As of December 31, 1950, and *as of* December 31, of each calendar year thereafter, the Corporation shall transfer 40 per centum of *its net assessment income* to its capital account and the balance of the net assessment income shall be *credited* pro rata to the insured banks based upon the assessments of each bank becoming due during said calendar year. Each year such credit *shall be applied* by the Corporation *toward the payment of the total assessment becoming due for the semiannual assessment period beginning the next ensuing July 1* and any excess credit shall be applied upon the assessment next becoming due. The term "net assessment income" as used herein means the total assessments which become due during the calendar year less (1) the operating costs and expenses of the Corporation for the calendar year; (2) additions to reserve to provide for insurance losses during the calendar year, except that any adjustments to reserve which result in a reduction of such reserve shall be added; and (3) the insurance losses sustained in said calendar year plus losses from any preceding years in excess of such reserves. If the above deductions exceed in amount the total assessments which become due during the calendar year, the amount of such excess shall be restored by deduction from total assessments becoming due in subsequent years. (Italics supplied.)

As provided in section 3(h) of such Act, "The term 'insured bank' means any bank the deposits of which are insured in accordance with the provisions of this Act".

Attention has been invited to section 7(e) of such Act (U. S. C., title 12, section 1817(c)) which provides that:

The Corporation (1) may refund to an insured bank any payment of assessment in excess of the amount due to the Corporation or (2) may credit such excess toward the payment of the assessment next becoming due from such bank and upon succeeding assessments until the credit is exhausted.

However, such provisions expressly relate to refunds or credits by the Corporation of "excess" payments (i. e., overpayments) by insured banks of deposit-insurance assessments. Also, it may be noted that section 12B(h)(5) of the Federal Reserve Act, as previously amended (U. S. C., title 12, section 264(h)(5)), discussed in I. T. 2940, *supra*, provided that:

Each bank which shall be and continue without application or approval an insured bank in accordance with the provisions of subsection (e) or (f) of this section, shall, in lieu of all right to refund (except as authorized in paragraph (3) of subsection (i) of this section) be credited with any balance to which such bank shall become entitled upon the termination of the said Temporary Federal Deposit Insurance Fund or the Fund for Mutuals. The credit shall be applied by the Corporation toward the payment of the assessment next becoming due from such bank and upon succeeding assessments until the credit is exhausted.

Section 7(a) of the Federal Deposit Insurance Act (U. S. C., title 12, section 1817(a)) provides for semiannual deposit-insurance assessment of insured banks, and prescribes a base therefor of the average of a bank's liability for certain defined deposits as of the close of business on 2 specified days in each preceding semiannual period. Section 12B(h)(1) of the Federal Reserve Act, as previously amended (U. S. C., title 12, section 264(h)(1)), also provided for semiannual

deposit-insurance assessment of insured banks on a prescribed base. Section 7(b) of the Federal Deposit Insurance Act (U. S. C., title 12, section 1817(b)) provides that:

> On or before the 15th day of July of each year, each insured bank shall file with the Corporation a certified statement showing for the six months ending on the preceding June 30 the amount of the assessment base and the amount of the semiannual assessment due to the Corporation for the period ending on the following December 31, determined in accordance with subsection (a) of this section, which shall contain or be verified by a written declaration that it is made under the penalties of perjury. Each insured bank shall pay to the Corporation the amount of the semiannual assessment it is required to certify. On or before the 15th day of January of each year, each insured bank shall file with the Corporation a similar certified statement for the six months ending on the preceding December 31 and shall pay to the Corporation the amount of the semiannual assessment for the period ending on the following June 30 which it is required to certify.

Section 12B(h)(2) of the Federal Reserve Act, as previously amended (U. S. C., title 12, section 264(h)(2)), contained similar provisions. Under section 7(a), *supra*, "The assessment payments * * * shall be made in such manner and at such time or times as the Board of Directors shall prescribe, * * * not * * * later than 60 days after filing the certified statement setting forth the amount of the assessment". And sections 304.01 and 327.4 of the Corporation's Regulations (1951) prescribe that the semiannual assessments shall be paid at the time such semiannual statements are required to be filed, under section 7(b), *supra*.

It is evident that amounts "credited," under section 7(d), *supra*, "as of December 31, 1950," to insured banks, and applied thereunder, do not represent adjustments for overpayments of deposit-insurance assessments for that year or prior years, nor specific reductions of any particular assessments, but rather are reimbursements or recoveries, in the nature of business insurance rebates, dependent upon the operations and "net assessment income" of the Federal Deposit Insurance Corporation for that calendar year. Therefore, such credits, to the extent actually or constructively received, or accrued, are properly taken into account, in computing net income for Federal income tax purposes, as gross income rather than as adjustments or reductions of deductions for deposit-insurance assessments. See, generally, G. C. M. 10798, C. B. XI-2, 58 (1932); I. T. 2646, C. B. XI-2, 59 (1932); I. T. 2764, *supra; Wichita State Bank & Trust Co.* v. *Commissioner*, C. C. A.-5, 69 F. (2d) 595, Ct. D. 947, C. B. XIII-2, 187 (1934), certiorari denied 293 U. S. 563; I. T. 2940, *supra*; and I. T. 3770, C. B. 1945, 138.

Section 42(a) of the Internal Revenue Code provides, as a general rule, that "The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period." Section 41 of the Code provides, in part, for the computation of "net income * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer". Under sections 29.42-2 and 29.42-3 of Internal Revenue Regulations 111, income credited to a taxpayer is considered "received" by him, within the meaning of section 42, when it is available to him for withdrawal

without any substantial conditions. Constructive receipt by a taxpayer of income also occurs when it becomes available for application to his liability. See *Acer Realty Co.* v. *Commissioner*, C. C. A.–8, 132 F. (2d) 512, affirming 45 B. T. A. 333. So too when an income credit is transferable. See I. T. 3425, C. B. 1940–2, 39. In *Commissioner* v. *Security Flour Mills Co.*, 321 U. S. 281, Ct. D. 1603, C. B. 1944, 526, at 528, the Court stated that under the accrual method income is not properly returnable for a year other than the year in which the right to receive has become final and definite in amount.

The Federal Deposit Insurance Corporation has informed the Bureau that it considers amounts "credited" to insured banks, under section 7(d), *supra*, "as of December 31, 1950, and as of December 31, of each calendar year thereafter" to be applicable thereunder and available to them only toward payment of the next semiannual deposit-insurance assessment or assessments becoming due after June 30 of each following year, until exhausted, and not to be refundable or withdrawable, in whole or in part, under section 7(e), *supra*, or otherwise, except that, upon termination of a bank's insured status, any balance of such a credit or credits to it remaining after payment of all assessments due or to become due from it is refundable to it or assignable by it to another insured bank which has assumed its deposit liability. Accordingly, an amount "credited," under section 7(d), *supra*, "as of December 31, 1950," to a particular insured bank was applicable, without limit (until exhausted), toward payment of—(1) its deposit-insurance assessment for the 6-month period beginning July 1 and ending December 31, 1951, which was payable (when it was required to file its certified assessment-base statement for that period) on or before July 15, 1951, but after June 30, 1951; (2) its deposit-insurance assessment for the 6-month period beginning January 1 and ending June 30, 1952, which was payable (similarly) on or before January 15, 1952, but after December 31, 1951; and (3) its deposit-insurance assessment for the 6-month period beginning July 1 and ending December 31, 1952, which was payable (similarly) on or before July 15, 1952, but after June 30, 1952; etc. The Corporation also has informed the Bureau that it did not definitely advise the insured banks of the amounts "credited" to them under section 7(d), *supra*, "as of December 31, 1950," until June 1951, namely, by "Credit Memorandum" reading as follows:

> The Federal Deposit Insurance Act provides that each insured bank shall be credited annually with its pro-rata share of sixty percent of the Corporation's net assessment income for the preceding calendar year. The credit due your institution thereunder is shown below. This amount has been credited to your account and is to be inserted as item K–1 on your certified statement to be submitted on or before July 15 and deducted from the assessment then due. If the assessment due that date exceeds the credit below, remit the balance with your certified statement. If the credit exceeds the assessment due, the excess will be deductible from the assessment due on or before the following January 15.

It is to be noted that in such credit notice it is stated "The * * * *Act provides* that each insured bank shall be credited annually with its pro rata share of 60 percent of *the Corporation's* net assessment income for the *preceding* calendar year". (Italics supplied.) In other words, the amounts to be "credited" thereunder to insured banks "as of December 31, 1950, and as of December 31, of each calendar year thereafter" are not to be actually and definitely credited to them

until each following year; and the Corporation's "net assessment income" for each calendar year preceding that in which 60 percent thereof "shall be credited pro rata to insured banks" is simply a base for measuring such credits. Such view is consistent with the following statement in Senate Report No. 2679, Eighty-first Congress, second session, C. B. 1951–1, 240, at 251, in connection with section 433(b)(13) of the Internal Revenue Code, added by the Excess Profits Tax Act of 1950:

> Public Law 797 of the Eighty-first Congress, second session, * * * made provision for a credit which would be counted against the gross assessments due in later years. This credit is computed by reference to the operating experience of the FDIC in the preceding year.

It is also noteworthy that section 7(d), *supra*, specifically provides that the amounts to be "credited" thereunder to insured banks "as of December 31, 1950, and as of December 31, of each calendar year thereafter" are first applicable toward payment of the second semiannual deposit-insurance assessment becoming due in each following calendar year, namely, after June 30 thereof (payable, under the Corporation's Regulations, on or before July 15) rather than to the first semiannual deposit-insurance assessment becoming due in such year (payable on or before January 15). Such provision plainly indicates that Congress deemed it impracticable for the Corporation, even after December 31 of each calendar year, to definitely determine the amounts of the current annual credits and, thereupon, inform each insured bank of the credit in time to permit application thereof toward payment of the first semiannual deposit-insurance assessment becoming due in the following calendar year. Furthermore, it is manifest, from the base provisions of section 7(d), *supra*, that the amounts to be "credited" thereunder to insured banks "as of December 31, 1950," were not determinable by them with a close degree of accuracy until after that date nor until the Corporation, in the following year, had definitely determined "its net assessment income" for the calendar year 1950 and, thereupon, advised each bank of the amount of its credit. Under such provisions, the calendar year "net assessment income," 60 percent of which is to be credited pro rata to insured banks, is *that of the said Corporation after it* has determined appropriate additions to its reserves for insurance losses, with certain adjustments, as well as its operating costs and expenses and insurance losses for the calendar year. As aforeindicated, Congress did not expect that the Corporation should hastily make such determination but provided a period therefor of nearly 6 months after the date "as of" which the credits are based. The situation is distinguishable from that where the amount of an item of gross income or deduction is based on the taxpayer's own net income, such as a State income tax, or a munitions tax based on certain net income of the taxpayer, as in *United States* v. *P. Chauncey Anderson et al.*, 269 U. S. 422, T. D. 3839, C. B. V–1, 179 (1926).

In view of the foregoing, for Federal income tax purposes, an amount "credited," under section 7(d), *supra*, to an insured bank "as of December 31, 1950," was in effect or constructively received as income when and to the extent it was applicable toward payment of a deposit-insurance assessment or assessments, or was refundable or assignable. Accordingly, a bank which keeps its accounts and files

its returns on the cash receipts and disbursements method must take the amount of such credit into gross income at the time and to the extent the credit is applicable toward the payment of a deposit-insurance assessment, or when it is assignable or refundable.

An amount "credited," under section 7(d), *supra*, to an insured bank "as of December 31, 1950," although ultimately realizable by it in full in money or the equivalent thereof, was not to be actually and definitely then credited to it and was not determinable by it with a close degree of accuracy until after that date, nor until the Federal Deposit Insurance Corporation, in the following year, had definitely determined "its net assessment income" for the calendar year 1950 and, thereupon, advised the bank of the amount of its credit. Accordingly, the entire amount of the credit is includible in the income of a bank which keeps its accounts and files its returns on the accrual method of accounting in the taxable year in which it is definitely advised by the Corporation of the amount thereof. Such conclusion is not inconsistent with that reached in I. T. 3770, *supra*, with respect to an accrual basis taxpayer. That ruling was premised on the fact that the credit, to which the employer-taxpayer there involved was entitled under New York State unemployment insurance law, was applicable thereunder only "against contributions which are payable on wages paid in four consecutive calendar quarters beginning on the effective date"; and the ruling held, accordingly, that the credit was accruable, as income, only to the extent, and for the taxable year wherein, the credit was so applicable.

SECTION 29.42-1: When included in gross income. (Also Section 29.42-6; Section 22(b), Section 29.22(b)(4)-4.) Rev. Rul. 105

INTERNAL REVENUE CODE

Proper treatment, for Federal income tax purposes, where matured or maturing United States savings bonds of Series F or G are redeemed by the issuance and acceptance of new, fully marketable, 3¼ percent Treasury bonds of 1978–83 under a special Treasury offer.

Advice is requested relative to the proper treatment, for Federal income tax purposes, where new, fully marketable, 3¼ percent Treasury bonds of 1978–83 were received on May 1, 1953, in redemption of matured or maturing United States savings bonds of Series F or G under a special Treasury offer.

The Series F savings bonds do not bear interest, as such, but were issued on a discount basis of 74 percent, and increase in "redemption values" at the end of the first year from their issue date and at the end of each successive half-year period thereafter until their maturity date (when their maturity "redemption values," face amount, becomes payable). They yield about 2.53 percent per annum compounded semiannually if held to maturity, but less if redeemed before then because their early six-month increments in value are smaller than their later ones. Section 22(d) of the Second Liberty Bond Act, as amended by the Public Debt Act of 1941 (C. B. 1941–1, 546, 547), provides, in part, that "For the purposes of taxation any increment in value represented by the difference between the price paid and the redemption value received (whether at or before maturity) for savings

bonds * * * shall be considered as interest." Accordingly, and since such bonds are never redeemable at less than their purchase price, no gain or loss, either ordinary or capital, is ever realized or sustained, for Federal income tax purposes, upon their redemption, whether at or before maturity. For rulings relative to when the interest (increment in value) on United States savings bonds issued at a discount, and non-interest-bearing, is returnable for Federal income tax purposes, see G. C. M. 15875 (C. B. XIV–2, 100 (1935)); I. T. 2958 (C. B. XV–1, 120 (1936)); and Mimeograph 6327 (C. B. 1948–2, 12).

The Series G savings bonds were issued at par (face amount) and bear interest at the rate of 2½ percent per annum, payable by check semiannually, from their issue date. They are redeemable at par (purchase price, face amount) but if redeemed before their maturity (except in certain cases upon death) the owner is required under their terms to refund a certain portion of the interest already paid to him thereon and will receive only the net proceeds (i. e., the amount by which their face amount exceeds such interest adjustment), termed their "redemption value" at the time redeemed. Thus, a purchaser thereof actually recovers upon their redemption, whether at or before their maturity, exactly their cost (purchase price, face amount). See I. T. 3504 (C. B. 1941–2, 93).

The 3¼ percent Treasury bonds of 1978–83 are dated May 1, 1953, and were offered in Department Circular No. 921, dated April 13, 1953, for cash subscription at par and accrued interest, and also in redemption of United States savings bonds of Series F and G maturing in the months of May through December, 1953, at par with interest adjustments if the savings bonds had not matured on May 1, 1953, and plus cash payment for any denomination difference. Such interest adjustments consisted, in the case of the Series F savings bonds, of the bondholder being charged an amount equivalent to interest at 2.53 percent per annum on their maturity "redemption values" from May 1, 1953, to their maturity dates; and, in the case of the Series G savings bonds, of the bondholder being paid interest at 2½ percent per annum on their face amount (purchase price) from their last interest-payment date to May 1, 1953. Since the Series F and G savings bonds were nonmarketable (nonnegotiable and nontransferable) and recovery of investment therein could be obtained only by Treasury redemption, it is manifest that the new, fully marketable, Treasury bonds of 1978–83 were offered and issued in redemption of such savings bonds and that the transactions did not constitute exchanges for Federal income tax purposes.

1. Where Series F savings bonds which matured on May 1, 1953, were redeemed on that date by the issuance and acceptance of new, fully marketable, Treasury bonds of 1978–83 of principal amounts equal to the maturity "redemption values" (face amounts) of the savings bonds and dated May 1, 1953, and bearing 3¼ percent interest therefrom, without any adjustment on account of either interest (increment in value) on the savings bonds redeemed or interest on the new Treasury bonds received in redemption thereof, the new bonds are regarded as having been purchased by the investor at par (face amounts) by the surrender of the savings bonds for such redemption. Accordingly, such amounts are the subsequent gain or loss bases of the

new Treasury bonds, and all interest (increment in value) on the savings bonds as well as interest on the new Treasury bonds is taxable income at the same time as if the savings bonds had been redeemed in cash and the new bonds had been purchased for cash. Consistently, the investor is regarded as having received in redemption of his savings bonds the amounts of their maturity "redemption values" (face amounts) and, thus having recovered exactly their cost (purchase price), besides full interest (increment in value) thereon, he had no gain or loss on their disposition.

2. Similarly, where Series G savings bonds which matured on May 1, 1953, were redeemed on that date by the issuance and acceptance of new, fully marketable, Treasury bonds of 1978–83 of principal amounts equal to the maturity "redemption values" (purchase price, face amounts) of the savings bonds and dated on May 1, 1953, and bearing 3¼ percent interest therefrom, without any adjustment on account of interest on either the savings bonds redeemed or the new Treasury bonds received in redemption thereof, it is considered that the investor recovered exactly the cost (purchase price) of his savings bonds and purchased the new bonds at par (face amounts), and all interest realized by him on the savings bonds and on the new Treasury bonds is taxable income when received or accrued (depending on his method of accounting).

3. Where Series F savings bonds maturing after May 1, 1953, were redeemed on May 1, 1953, by the issuance and acceptance of new, fully marketable, Treasury bonds of 1978–83 of principal amounts equal to the maturity "redemption values" (face amounts) of the savings bonds and dated May 1, 1953, and bearing 3¼ percent interest from that date, with the investor being required to pay to the Treasury in cash an amount equivalent to interest at 2.53 percent per annum on the maturity "redemption values" (face amounts) of the savings bonds from May 1, 1953, to their maturity dates, the investor is considered to have recovered exactly the cost (purchase price) of his savings bonds, besides interest (increment in value) thereon to the date of their redemption, and to have purchased the new bonds at par (face amounts) namely, by (*a*) surrender of the savings bonds at their net redemption values as fixed by the special Treasury offer and (*b*) payment of the cash differential required under the terms of such offer, or an aggregate equal to the face amounts of the new bonds. The net interest (increment in value) realized on the savings bonds and also the interest on the new Treasury bonds is taxable income when received or accrued (depending upon the taxpayer's method of accounting).

4. Where Series G savings bonds maturing after May 1, 1953, were redeemed on May 1, 1953, by the issuance and acceptance of new, fully marketable, Treasury bonds of 1978–83 of principal amounts equal to the maturity "redemption values" (purchase price, face amounts) of the savings bonds and dated May 1, 1953, and bearing 3¼ percent interest therefrom, with the Treasury paying to the investor interest at 2½ percent per annum on the face amount of the savings bonds from their last preceding interest-payment date to May 1, 1953, as the final interest payment thereon, it is considered that the investor recovered exactly the cost (purchase price) of his savings bonds, besides 2½ percent interest thereon from the last previous interest-payment date to the date of their redemption, and that he purchased the new

bonds at par (face amount). All interest realized by him on the savings bonds and on the new Treasury bonds is taxable income when received or accrued (depending upon his method of accounting).

SECTION 29.42-1: When included in gross income.

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Regulations 111 amended. (See T. D. 5971, page 303.)

SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN

SECTION 29.43-2: When charges deductible. Rev. Rul. 39
(Also Section 23(c), Section 29.23(c)-1.

INTERNAL REVENUE CODE

The accrual date for Federal income tax purposes of Michigan State real and tangible personal property taxes, commencing with such taxes assessed on the basis of ownership of property on January 1, 1950, is January 1 of each year.

I. T. 2995 (C. B. XV-2, 137 (1936)) is inapplicable to such taxes assessed upon the basis of ownership of property on January 1, 1950, and thereafter.

Advice is requested with respect to the proper accrual date, for Federal income tax purposes, of real property and personal property taxes levied by the State of Michigan.

I. T. 2995 (C. B. XV-2, 137 (1936)) holds, in general, that taxpayers in Michigan who keep their books of account on the accrual basis should accrue both personal and real property taxes as of the second Monday in April for Federal income tax purposes, and that taxpayers in cities which operate under special charters should accrue their property taxes as of the assessment day prescribed by such charters.

The pertinent provisions of the Michigan State laws as amended and now in effect are contained in 1950 revised volume 6 of the Michigan Statutes Annotated, and provide, in part, as follows:

SECTION 7.2. REAL PROPERTY; DEFINITION; DATE OF DETERMINATION OF TAXABLE STATUS, TAX DAY; SURVEY, EXAMINATION OR REVIEW OF PROPERTIES.

* * * * * * *

The taxable status of persons and real property shall be determined as of the first day of January, which shall be deemed the tax day. In the year 1950 and thereafter the first day of January shall be the tax day in all assessing districts including cities and villages, any provisions in the charter of any city or village to the contrary notwithstanding: *Provided*, That no assessing officer shall be restricted to any particular period in the preparation of the assessment roll but may survey, examine or review properties at any time prior to or after said tax day.

SEC. 7.3. SAME; PARTIES ASSESSABLE; PERSONS TREATED AS OWNER; PROPERTY OF DECEASED PERSONS.—SEC. 3. Real property shall be assessed in the township or place where situated, to the owner if known, and also to the occupant, if any; if the owner be not known, and there be an occupant, then to such occupant, and either or both shall be liable for the taxes on said property, and if there be no owner or occupant known, then as unknown. * * *

* * * * * * *

SEC. 7.10. ANNUAL ASSESSMENT.—An assessment of all the property in the State, liable to taxation, shall be made annually in the several townships, villages and cities thereof by the supervisors of the several townships and wards, or in villages and cities where provision is made in the acts of incorporation or charter for some other assessing officer, then by such assessing officer, as hereinafter provided.

* * * * * * *

SEC. 7.13. TAXABLE SITUS OF PERSONAL PROPERTY; DATE OF DETERMINATION OF TAXABLE STATUS, TAX DAY; * * * SEC. 13. All personal property, except as hereinafter provided, shall be assessed in the township in which the owner resides on the first day of January, of the year for which the assessment is made. The taxable status of persons and personal property shall be determined as of the first day of January, which shall be deemed the tax day. In the year 1950 and thereafter the first day of January shall be the tax day in all assessing districts including cities and villages, any provisions in the charter of any city or village to the contrary notwithstanding; * * *.

The statutes provide further in sections 7.28 and 7.29 that there shall be boards of review to which the assessment rolls are to be presented on the Tuesday next following the first Monday in March: that such boards are to examine and review the assessment rolls. However, it is specifically provided in section 7.29 of the statutes that the rolls shall be reviewed according to the facts existing on the tax day (January 1), and that the boards shall not add to the rolls any property not subject to taxation on the tax day nor shall it remove from the rolls any property subject to taxation on said day regardless of any change in the taxable status of such property since such day.

The general rule of the Bureau, based on *United States* v. *P. Chauncey Anderson et al.* (269 U. S. 422, T. D. 3839, C. B. V-1, 179 (1926)), has been that the event which determines the liability for property taxes is the ownership of the property on the day as of which the assessment is made under the State law.

The effect of the above-quoted Michigan statute is to provide that, beginning with January 1, 1950, real and tangible personal property taxes are assessed as of January 1 each year.

In view of the foregoing, it is held that the accrual date for Federal income tax purposes of Michigan State real and tangible personal property taxes, commencing with such taxes assessed on the basis of ownership of property on January 1, 1950, is January 1 of each year. I. T. 2995, *supra*, is inapplicable to such taxes assessed upon the basis of ownership of property on January 1, 1950, and thereafter.

SECTION 29.43-2: When charges deductible. . Rev. Rul. 43

INTERNAL REVENUE CODE

In those cases where an employer was ready and willing to pay retroactive wage increases and salary adjustments and had an application for approval of such increases and adjustments pending before a wage and salary control agency at the time of suspension of wage and salary controls, payments of the increased wages and salary adjustments made subsequent to the suspension of such controls are deductible for the year in which the application for approval was filed with the agency, to the extent that such payments relate to services rendered in the year of the application or years prior thereto.

Advice is requested relative to the treatment by employers of deductions, for Federal income and excess profits tax purposes, or payments of retroactive wage increases and salary adjustments made by

employers to employees, subsequent to the suspension of wage and salary controls, in those cases where an application for approval of such increases and adjustments was pending before wage and salary control agencies at the time of the suspension of wage and salary controls.

By Executive Order 10434, 18 F. R. 809, all regulations and orders issued pursuant to the Defense Production Act of 1950, 64 Stat. 798, as amended, stabilizing wages, salaries, and other compensation, were suspended. Such Executive order specifically provided that wage, salary, and other compensation adjustments proposed in petitions pending before wage and salary control agencies may be placed in effect without the approval of such agencies, and to the extent that agreements involved in such petitions were conditioned upon approval under title IV of the Defense Production Act of 1950, said Executive order shall be deemed such approval.

I. T. 3716, C. B. 1945, 140, holds that in a case in which an employer was ready and willing to pay retroactive wage increases requiring the approval of the National War Labor Board, the amounts of such increased wages awarded by the Board are deductible for the year in which the employer filed an application for such approval with the Board, to the extent that such payments relate to services rendered in the year of the application or years prior thereto. I. T. 3716 also holds that in a case in which the employer contests the wage increases or allowances and retroactive pay increases are ordered by the National War Labor Board, the deduction therefor is allowable only for the year in which the controversy is settled. I. T. 3716 states that this principle is equally applicable to wage and salary adjustments under Public Law 729, 56 Stat. 765, approved October 2, 1942, as amended, which adjustments are subject to the approval of the National War Labor Board, the Commissioner of Internal Revenue, or the War Food Administrator.

I. T. 4079, C. B. 1952–1, 40, holds that the principles declared in I. T. 3716, *supra*, are applicable to retroactive wage increases and salary adjustments awarded by the Salary Stabilization Board under the provisions of the Defense Production Act of 1950, *supra*, and Executive Order 10161, 15 F. R. 6105.

Accordingly, it is held that in those cases where an employer was ready and willing to pay retroactive wage increases and salary adjustments and had an application for approval of such increases and adjustments pending before a wage and salary control agency at the time of the issuance of Executive Order 10434, *supra*, payments of such increased wages and salary adjustments made subsequent to the issuance of such Executive order are deductible for the year in which the employer filed the application for approval with such wage and salary control agency, to the extent that the payments relate to services rendered in the year of the application or years prior thereto.

SECTION 29.43-2: When charges deductible. Rev. Rul. 74
(Also Section 23(c), Section 29.23(c)-1.)

INTERNAL REVENUE CODE

The annual tax imposed by section 52A of chapter 63 of the General Laws of Massachusetts on the corporate franchise of every utility

corporation doing business in the Commonwealth of Massachusetts, which tax is due and payable on or after June 30 of each year, depending upon the time of issuance of the notice of assessment, constitutes an accrued liability, for Federal income tax purposes, on December 31 of the preceding year where the corporation files its Federal income tax return on the calendar year basis, and on the last day of the preceding fiscal year for which the Federal income tax return was due prior to April 1 of the year in which the tax is to be assessed, where the corporation files its Federal income tax return on the fiscal year basis.

SECTION 29.43-2: When charges deductible.

INTERNAL REVENUE CODE

Loss of embezzled funds. (See Ct. D. 1754, page 39.)

SECTION 29.43-2: When charges deductible.

INTERNAL REVENUE CODE

Repayment of income previously reported deductible in year repaid. (See Ct. D. 1756, page 68.)

SECTION 29.43-2: When charges deductible.

INTERNAL REVENUE CODE

Tax on bank shares imposed by the Commonwealth of Pennsylvania in the case of an accrual basis taxpayer. (See Rev. Rul. 92, page 39.)

SECTION 29.43-2: When charges deductible.

INTERNAL REVENUE CODE

Determination of surplus and earnings available for dividends. (See Rev. Rul. 107, page 178.)

SECTION 44.—INSTALLMENT BASIS

SECTION 29.44-2: Sale of real property involving deferred payments. Rev. Rul. 93

INTERNAL REVENUE CODE

An election to report a sale of property on the installment basis, under section 44 of the Internal Revenue Code, must be exercised in a timely filed Federal income tax return for the taxable year in which such sale was made, otherwise the right of such an election is forfeited. (See *Sarah Briarly et al.* v. *Commissioner*, 29 B. T. A. 256.)

SECTION 29.44-3: Sale of real property on installment plan. (Also Section 112(n), Section 29.112(n)-1.) Rev. Rul. 75

INTERNAL REVENUE CODE

The gain recognized under section 112(n) of the Internal Revenue Code from the sale by a taxpayer of his principal residence may be reported on the installment basis, provided such sale otherwise qualifies as an installment sale under section 44 of the Code.

Advice is requested whether the gain recognized under the provisions of section 112(n) of the Internal Revenue Code from the sale of a taxpayer's principal residence may be reported on the installment basis, for Federal income tax purposes.

Under the provisions of section 112(n) of the Code if property used by the taxpayer as his principal residence, hereinafter referred to as old residence, is sold by him and, within a period beginning 1 year prior to the date of such sale and ending 1 year after such date, property is purchased and used by the taxpayer as his principal residence, the gain, if any, from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

It is held that if the sale by a taxpayer of his principal residence qualifies as an installment sale under section 44 of the Code the gain recognized under section 112(n) from such sale may be apportioned over the period of the installment transaction for Federal income tax purposes. The amount of the recognized gain to be included in gross income in each taxable year in which an installment payment is received is that proportion of the installment payments actually received in that year which the total gain to be recognized under section 112(n) bears to the total contract price.

SECTION 45.—ALLOCATION OF INCOME AND DEDUCTIONS

SECTION 29.45-1: Determination of the taxable net income of a controlled taxpayer.

INTERNAL REVENUE CODE

Determination of income as between a parent company and a subsidiary which qualifies as a Western Hemisphere trade corporation. (See Rev. Rul. 15, page 141.)

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

SECTION 29.47-1: Returns for periods of less than 12 months.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5969, page 122.)

SECTION 29.47-2: Returns for a period of less than 12 months on account of a change in accounting period. Rev. Rul. 94
(Also Section 481, Section 29.481-2.)

INTERNAL REVENUE CODE

Where a Federal income tax return has been filed for a period of less than 12 months because of a change in accounting period, section 47(c) of the Internal Revenue Code specifically provides for the placing of the net income on an annual basis and the computation of the tax on the annualized income. However, the provisions of that section have no application for purposes of computing the self-employment tax. The self-employment tax should be computed on the actual self-employment income for the short period and should not be prorated for a fractional part of a 12-month period.

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 51.—INDIVIDUAL RETURNS

SECTION 29.51-1: Individual returns.

INTERNAL REVENUE CODE

Marital status in a case where a divorcee remarries prior to the expiration of the waiting period stipulated in the divorce decree. (See Rev. Rul. 29, page 67.)

SECTION 29.51-2: Form of return.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5993, page 9.)

SECTION 52.—CORPORATION RETURNS

SECTION 29.52-1: Corporation returns.

INTERNAL REVENUE CODE

Schedule PS (Form 1120) prepared for use by taxpayers in 1951 will be utilized in the preparation of returns for calendar year 1952 and fiscal years ending in 1953. (See Rev. Rul. 64, page 356.)

SECTION 53.—TIME AND PLACE FOR FILING RETURNS

SECTION 29.53-2: Extensions of time for filing returns. Rev. Rul. 22*

INTERNAL REVENUE CODE

Extension of time for filing corporation income tax returns

1. The following instructions are issued (*a*) in order to permit persons enrolled to practice before the Treasury Department to request

*Originally issued as IR-Mimeograph 128, dated February 9, 1953.

extensions of time for filing income tax returns of corporations represented by them without the necessity of obtaining and filing formal powers of attorney, and (*b*) in order to permit such persons or authorized officers of the corporation to sign and file statements in lieu of tentative returns.

2. Directors of internal revenue are hereby authorized to grant extensions of time for filing corporate income tax returns pursuant to requests for such extensions which are made by persons other than the taxpayer, whether or not such persons have filed powers of attorney, provided that each such request contains representations that the person making the request (*a*) is acting with the knowledge and consent of the taxpayer, and (*b*) is currently enrolled to practice before the Treasury Department. The requests for several corporations may be included in one letter.

3. Any such person may file a Form 7004, "Statement in Lieu of Tentative Return of U. S. Corporation Income Tax," in place of the tentative return otherwise required to be filed by the taxpayer corporation on or before the statutory filing date. Officers of the taxpayer corporation who are authorized to sign the corporation income tax return may also file such statement in place of the tentative return otherwise required. In such case, the phrase in the declaration on the statement that the person signing the statement is duly enrolled to practice before the Treasury Department may be stricken from the declaration. If the extension of time is granted, the taxpayer's completed return must be filed on or before the due date, as extended, and there should be attached to the completed return a copy of the statement and a copy of the approved request for the extension of time.

4. It is expected that a limited supply of the statements, Form 7004, will be available in the offices of directors of internal revenue. Any person requiring a substantial number of these statements should supply his own. Reproductions of the statements should be similar to the Form 7004 in size and color, and on paper of substantial weight and good quality. Typewritten reproductions are permissible.

5. This ruling supersedes all prior instructions to the extent that it relieves enrolled persons from the necessity of filing powers of attorney with requests for extensions of time for filing income tax returns in behalf of corporations and also to the extent that it permits any such person or corporate officers to file a "Statement in Lieu of Tentative Return of U. S. Corporation Income Tax" in place of the tentative return otherwise required. It does not modify any other requirements of existing regulations or instructions, nor is it intended to change or restrict the grounds upon which an extension will be granted.

SECTION 29.53-2: Extensions of time for filing returns. Rev. Rul. 27*

(Also Section 101, Section 29.101(12)-1; Section 56, Section 29.56-2.)

INTERNAL REVENUE CODE

Time extended for filing Exempt Cooperative Association income tax return, Form 990-C (for farmers' cooperative marketing and purchasing association under section 101(12), Internal Revenue Code).

*Originally issued as IR-Mimeograph 135, dated February 12, 1953.

1. Pursuant to the authority contained in section 53(a)(2) of the Internal Revenue Code, the time for filing the Exempt Cooperative Association Income Tax Return, Form 990-C, for a taxable year beginning in 1952 by a farmers' cooperative marketing and purchasing association under section 101(12) of the Internal Revenue Code is hereby extended to and including the 15th day of the sixth month following the close of such taxable year.

2. Pursuant to the authority contained in section 56(c)(1), the time for payment of any tax due from a farmers' marketing and purchasing association subject to tax under section 101(12)(B) for a taxable year beginning in 1952 is hereby extended to and including the 15th day of the sixth month following the close of such taxable year.

3. For the purpose of the computation of interest with respect to the payment of any tax due from farmers' marketing and purchasing associations filing Form 990-C pursuant to the extension granted under paragraphs 1 and 2, such extension shall be deemed to have been granted for such period only as may be necessary to make and file the required return. Any association desiring to avoid the accumulation of interest charges on the amount of income taxes due on returns to be filed under the extension granted may make an advance payment to the director of internal revenue for the district in which such return will be filed, clearly identifying such payment in order to aid the director of internal revenue in the proper application of such payment and in computing interest on deferred payments. Interest on the difference between the amount of tax shown to be due on the return so made and filed and the amount of any advance payment will be computed at the rate of 6 percent only from the original due date of such return to the date of payment.

4. Correspondence regarding this Revenue Ruling should refer to its number and the symbols O:C:A.

SECTION 29.53-2: Extensions of time for filing returns. Rev. Rul. 102*

(Also Section 101, Section 29.101(12)-1; Section 56, Section 29.56-2.)

INTERNAL REVENUE CODE

Time further extended for filing Exempt Cooperative Association Income Tax Return, Form 990-C (for farmers' cooperative marketing and purchasing association under section 101(12) of the Internal Revenue Code).

1. Revenue Ruling 27, page 85, this Bulletin, provides for the extension of time for filing the Exempt Cooperative Association Income Tax Return, Form 990-C, and the extension of time for payment of the income tax due for a taxable year beginning in 1952 by a farmers' cooperative marketing and purchasing association under section 101(12) of the Internal Revenue Code to and including the 15th day of the sixth month following the close of such taxable year.

2. Pursuant to authority contained in sections 53(a)(2) and 56(c)(1) of the Internal Revenue Code, the time for filing the Exempt Cooperative Association Income Tax Return, Form 990-C, and the

*Originally issued as IR-Mimeograph 135, Amendment 1, dated May 22, 1953.

time for payment of the income tax due for a taxable year beginning in 1952 by a farmers' cooperative marketing and purchasing association under section 101(12) of the Internal Revenue Code is hereby further extended to and including the 15th day of the ninth month following the close of such taxable year.

3. Interest will be assessed and collected on the amount determined as the tax, or any installment thereof, from the original due date of the return, the 15th day of the third month following the close of the taxable year, until the date it is paid. The payment of the tax, or any installment thereof, made in advance of the filing of the return will stay the accumulation of interest on the amount of such payment from the time it is paid. Accordingly, any association desiring to minimize the accumulation of interest on the amount of income taxes due on returns to be filed under the extension granted may make such an advance payment to the director of internal revenue for the district in which such return will be filed, clearly identifying such payment in order to aid the director of internal revenue in the proper application of such payment and in computing interest on deferred payments.

4. Correspondence regarding this Revenue Ruling should refer to its number and the symbols O:C:A.

SECTION 54.—RECORDS AND SPECIAL RETURNS

SECTION 29.54–1: Records and income tax forms. Rev. Rul. 5

INTERNAL REVENUE CODE

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

Advice is requested whether the Bureau will accept reproductions of the applicable Federal income tax return forms and schedules, for filing purposes, in lieu of the following official forms and schedules printed by the Government Printing Office:

U. S. Individual Income Tax Return, Form 1040.

U. S. Individual Income Tax Return, Form 1040A.

Profit (or Loss) from Business or Profession, Schedule C (Form 1040).

Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1040).

Schedule of Farm Income and Expenses, Form 1040F.

Declaration of Estimated Tax, Form 1040-ES.

U. S. Fiduciary Income Tax Return, Form 1041.

U. S. Partnership Return of Income, Form 1065.

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

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

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

Subject to the conditions and requirements set forth below, the Bureau will accept, for filing purposes, reproductions of any of the foregoing official forms and schedules, with the exception of Schedule

C (Form 1040). Reproductions of that schedule would be unsuitable for certain processing operations to which it is subjected.

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

1. Reproductions must be facsimiles of the complete official form, produced by photo-offset, photoengraving, or other similar photographic process. Reproductions by other than photographic process are not acceptable.

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

3. Official forms which are printed in black ink must be reproduced in black ink, of substantially the same quality. Reproductions of official forms printed in other than black ink must be printed in ink of substantially the same color and quality as that used on the official forms.

4. Reproductions must be of the same size as that of the official form, both as to the over-all dimensions of the paper and the image reproduced thereon. The Bureau does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms satisfy the stated conditions. It should be noted, however, that photostats generally do not meet all of the above conditions.

While it is preferred that reproduced forms be printed on both sides of the paper, resulting in the same page arrangement as that of the official form, the Bureau will not object if only one side of the paper contains printed matter. Reproductions of forms may be made after insertion of the tax computations and other required information. However, all signatures on forms to be filed with the director of internal revenue must be original signatures, affixed subsequent to the reproduction process.

SECTION 55.—PUBLICITY OF RETURNS

T. D. 5955

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

Treasury Decision 5878 [C. B. 1952–1, 47] amended

TREASURY DEPARTMENT,
Washington 25, D. C.

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

PARAGRAPH 1. Pursuant to the provisions of sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171, 54 Stat. 989, 1008, 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204) and of the Executive order of this date issued thereunder, Treasury Decision 5878 [C. B. 1952–1, 47], approved on January 24, 1952 [26 CFR 458.310] is hereby amended by striking out "1950" and inserting in lieu thereof "1951".

PAR. 2. Because of the necessity of the immediate application of the afore-mentioned amendment, it is found that it is impracticable and

contrary to the public interest 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.

PAR. 3. This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

JOHN W. SNYDER,
Secretary of the Treasury.

Approved December 6, 1952.

HARRY S. TRUMAN,
The White House.

(Filed with the Division of the Federal Register December 8, 1952, 12:55 p. m.)

EXECUTIVE ORDER 10321 AMENDED

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171, 54 Stat. 989, 1008, 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), Executive Order 10321 [C. B. 1952-1, 48], dated January 24, 1952, is hereby amended by striking out "1950" and inserting in lieu thereof "1951".

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

HARRY S. TRUMAN.

THE WHITE HOUSE,
December 6, 1952.

(E. O. 10418)

(Filed with the Division of the Federal Register December 8, 1952, 12:55 p. m.)

T. D. 5981

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

Inspection of income, excess-profits, declared value excess-profits, capital stock, estate, and gift tax returns by the Senate Committee on Government Operations.

TREASURY DEPARTMENT,
Washington 25, D. C.

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

SEC. 458.316. INSPECTION OF RETURNS BY SENATE COMMITTEE ON GOVERNMENT OPERATIONS DURING EIGHTY-THIRD CONGRESS.—(*a*) Pursuant to the provisions of sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and of the Executive order issued thereunder, any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for the years 1945 to 1952, inclusive, shall, during the Eighty-third Congress, be open to inspection by the Senate Committee on Government Operations or the duly authorized subcommittee thereof, in

connection with its studies of the operation of Government activities at all levels with a view to determining its economy and efficiency.

The inspection of returns herein authorized may be made by the committee or such duly authorized subcommittee thereof, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as the committee or the subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of the committee or of the authorized subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary and any officer or employee of the Treasury Department shall furnish such committee or subcommittee with any data relating to or contained in any such return, or shall make such return available for inspection by the committee or the subcommittee or by such examiners or agents as the committee or the subcommittee may designate or appoint, in the office of the Commissioner of Internal Revenue. Any information thus obtained by the Committee or the subcommittee thereof shall be held confidential: *Provided, however*, That any portion or portions thereof relevant or pertinent to the purpose of the investigation may be submitted by the committee to the United States Senate.

(*b*) Because of the immediate need of the said committee to inspect the tax returns herein mentioned, it is found that it is impracticable and contrary to the public interest to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

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

G. M. HUMPHREY,
Secretary of the Treasury.

Approved February 6, 1953.

DWIGHT D. EISENHOWER,
The White House.

(Filed with the Division of the Federal Register February 6, 1953, 5:09 p. m.)

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

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), it is hereby ordered that any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for the years 1945 to 1952, inclusive, shall during the Eighty-third Congress, be open to inspection by the Senate Committe on Government Operations or the duly authorized subcommittee thereof in connection with its studies of the operation of Government activities at all levels with a view to determining its economy and efficiency, subject to the conditions stated in the Treasury Decision relating to the inspection of such returns by that committee, approved by me this date.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
February 6, 1953.

(E. O. 10435)

(Filed with the Division of the Federal Register February 6, 1953, 5:09 p. m.)

T. D. 6001

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

Inspection of income, excess-profits, declared value excess-profits, capital stock, estate, and gift tax returns by the Senate Committee on Interstate and Foreign Commerce.

TREASURY DEPARTMENT,
Washington 25, D. C.

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

SEC. 458.317. INSPECTION OF RETURNS BY SENATE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE DURING EIGHTY-THIRD CONGRESS.—(*a*) Pursuant to the provisions of sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and of the Executive order issued thereunder, any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for any period to and including 1952 shall, during the Eighty-third Congress, be open to inspection by the Senate Committee on Interstate and Foreign Commerce, or the duly authorized subcommittee thereof, for the purpose of carrying out the provisions of Senate Resolution 41 (83d Cong., 1st sess.), agreed to January 30, 1953.

The inspection of returns herein authorized may be made by the committee, or the duly authorized subcommittee thereof, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as the committee or the subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of the committee or of the authorized subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary and any officer or employee of the Treasury Department shall furnish such committee or subcommittee with any data relating to or contained in any such return, or shall make such return available for inspection by the committee or the subcommittee or by such examiners or agents as the committee or the subcommittee may designate or appoint, in the office of the Commissioner of Internal Revenue. Any information thus obtained by the committee or the subcommittee thereof shall be held confidential: *Provided, however*, That any portion or portions thereof relevant or pertinent to the purpose of the investigation may be submitted by the committee to the United States Senate.

(*b*) Because of the immediate need of the said committee to inspect the tax returns herein mentioned, it is found that it is impracticable and contrary to the public interest to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

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

G. M. HUMPHREY,
Secretary of the Treasury.

Approved March 31, 1953.

DWIGHT D. EISENHOWER,
The White House.

(Filed with the Division of the Federal Register April 1, 1953, 11:35 a. m.)

EXECUTIVE ORDER 10442

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

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 506, 603, 729(a), and 1204), it is hereby ordered that any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for any period to and including 1952 shall, during the Eighty-third Congress, be open to inspection by the Senate Committee on Interstate and Foreign Commerce, or the duly authorized subcommittee thereof, for the purpose of carrying out the provisions of Senate Resolution 41 (83d Cong., 1st sess.), agreed to January 30, 1953, subject to the conditions stated in the Treasury Decision relating to the inspection of such returns by that committee, approved by me this date.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
March 31, 1953.

(Filed with the Division of the Federal Register April 1, 1953, 11:35 a. m.)

T. D. 6008

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

Inspection of returns by Senate Committee on the Judiciary

TREASURY DEPARTMENT,
Washington 25, D. C.

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

SEC. 458.318. INSPECTION OF RETURNS BY SENATE JUDICIARY COMMITTEE RELATING TO EXAMINATION OF ADMINISTRATION OF TRADING WITH THE ENEMY ACT.—(*a*) Pursuant to the provisions of sections

55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171, 54 Stat. 989, 1008, 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204) and of the Executive order issued thereunder, any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for the years 1941 to 1952, inclusive, shall be open to inspection by the Senate Committee on the Judiciary or any duly authorized subcommittee thereof for the purpose of carrying out the provisions of Senate Resolution 245 (82d Cong. 2d sess.), agreed to March 24, 1952, as extended by Senate Resolution 47 (83d Cong., 1st sess.), relating to an examination and review of the administration of the Trading with the Enemy Act.

The inspection of returns herein authorized may be made by the committee or a duly authorized subcommittee thereof, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as the committee or subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of the committee or of the authorized subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary of the Treasury and any officer or employee of the Treasury Department, with the approval of the Secretary of the Treasury, may furnish such committee or subcommittee with any data relating to or contained in any such return, or may make such return available for inspection by the committee or subcommittee or by such examiners or agents as the committee or subcommittee may designate or appoint, in the office of the Commissioner of Internal Revenue. Any information thus obtained by the committee or subcommittee thereof shall be held confidential: *Provided, however*, That any portion thereof relevant or pertinent to the purpose of the investigation may be submitted by the committee to the United States Senate.

(*b*) Because of the immediate need of the said Senate Committee on the Judiciary to inspect the returns herein mentioned, it is hereby found that it is impracticable and contrary to the public interest 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.

G. M. HUMPHREY,
Secretary of the Treasury.

Approved April 22, 1953.

DWIGHT D. EISENHOWER,
The White House.

(Filed with the Division of the Federal Register April 22, 1953, 3:39 p. m.)

EXECUTIVE ORDER 10447

INSPECTION OF RETURNS BY SENATE COMMITTEE ON THE JUDICIARY

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171, 54 Stat. 989, 1008, 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a),

and 1204), it is hereby ordered that any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for the years 1941 to 1952, inclusive, shall be open to inspection by the Senate Committee on the Judiciary or any duly authorized subcommittee thereof for the purpose of carrying out the provisions of Senate Resolution 245 (82d Cong., 2d sess.), agreed to March 24, 1952, as extended by Senate Resolution 47 (83d Cong., 1st sess.), agreed to January 30, 1953, relating to an examination and review of the administration of the Trading with the Enemy Act, subject to the conditions stated in the Treasury Decision relating to the inspection of such returns by that committee, approved by me this date.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
April 22, 1953.

(Filed with the Division of the Federal Register April 22, 1953, 3:39 p. m.)

T. D. 6009

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

Inspection of certain returns by the Committee on the Judiciary, House of Representatives.

TREASURY DEPARTMENT,
Washington 25, D. C.

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

SEC. 458.319. INSPECTION OF CERTAIN RETURNS BY THE COMMITTEE ON THE JUDICIARY, HOUSE OF REPRESENTATIVES.—(*a*) Pursuant to the provisions of sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171, 54 Stat. 989, 1008, 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204) and of the Executive order issued thereunder, any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for any period to and including 1952 shall be open to inspection by the Committee on the Judiciary, House of Representatives, or any duly authorized subcommittee thereof, in connection with the inquiry authorized by the resolution of the committee adopted January 27, 1953, with reference to the administration of the Department of Justice and the office of the Attorney General of the United States.

(*b*) The inspection of returns herein authorized may be made by the committee or a duly authorized subcommittee thereof, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as the committee or subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of the committee or of the authorized subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary and any officer or employee of the Treasury Department shall furnish such committee or subcommittee with any data relating to or contained in any such return

or shall make such return available for inspection by the committee or subcommittee or by such examiners or agents as the committee or subcommittee may designate or appoint, in the office of the Commissioner of Internal Revenue. Any information thus obtained by the committee or subcommittee thereof shall be held confidential: *Provided, however*, That any portion thereof relevant or pertinent to the purpose of the investigation may be submitted by the committee to the House of Representatives.

(*c*) Because of the immediate need of the Committee on the Judiciary, House of Representatives, to inspect the returns herein mentioned, it is hereby found that it is impracticable and contrary to the public interest 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.

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

Approved April 28, 1953.

Dwight D. Eisenhower,
The White House.

(Filed with the Division of the Federal Register April 30, 1953, 10:04 a. m.)

Executive Order 10451

INSPECTION OF CERTAIN RETURNS BY THE COMMITTEE ON THE JUDICIARY, HOUSE OF REPRESENTATIVES

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171, 54 Stat. 989, 1008, 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), it is hereby ordered that any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for any period to and including 1952 shall be open to inspection by the Committee on the Judiciary, House of Representatives, or any duly authorized subcommittee thereof, in connection with the inquiry authorized by the resolution of the committee adopted January 27, 1953, with reference to the administration of the Department of Justice and the office of the Attorney General of the United States, subject to the conditions stated in the Treasury Decision relating to the inspection of such returns by that committee, approved by me this date.

Dwight D. Eisenhower.

The White House,
April 28, 1953.

(Filed with the Division of the Federal Register April 30, 1953, 10:04 a. m.)

T. D. 6012

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

Inspection of income, excess-profits, declared value excess-profits, capital stock, estate, and gift tax returns by the Committee on Government Operations, House of Representatives.

TREASURY DEPARTMENT,
Washington 25, D. C.

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

SEC. 458.320. INSPECTION OF RETURNS BY THE COMMITTEE ON GOVERNMENT OPERATIONS, HOUSE OF REPRESENTATIVES, DURING EIGHTY-THIRD CONGRESS.—(*a*) Pursuant to the provisions of sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and of the Executive order issued thereunder, any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for any period to and including 1952, shall, during the Eighty-third Congress, be open to inspection by the Committee on Government Operations, House of Representatives, or any duly authorized subcommittee thereof, in connection with its studies of the operation of Government activities at all levels with a view to determining its economy and efficiency.

The inspection of returns authorized in this section may be made by the committee or such duly authorized subcommittee thereof, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as the committee or the subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of the committee or of the authorized subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary and any officer or employee of the Treasury Department shall furnish such committee or subcommittee with any data relating to or contained in any such return, or shall make such return available for inspection by the committee or the subcommittee or by such examiners or agents as the committee or the subcommittee may designate or appoint, in the office of the Commissioner of Internal Revenue. Any information thus obtained by the committee or the subcommittee thereof shall be held confidential: *Provided, however*, That any portion or portions thereof relevant or pertinent to the purpose of the investigation may be submitted by the committee to the House of Representatives.

(*b*) Because of the immediate need of the said committee to inspect the tax returns herein mentioned, it is found that it is impracticable and contrary to the public interest to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

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

G. M. HUMPHREY,
Secretary of the Treasury.

Approved May 22, 1953.

DWIGHT D. EISENHOWER,
The White House.

(Filed with the Division of the Federal Register May 25, 1953, 9:57 a. m.)

EXECUTIVE ORDER 10455

INSPECTION OF INCOME, EXCESS-PROFITS, DECLARED VALUE EXCESS-PROFITS, CAPITAL STOCK, ESTATE, AND GIFT TAX RETURNS BY THE COMMITTEE ON GOVERNMENT OPERATIONS, HOUSE OF REPRESENTATIVES

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), it is hereby ordered that any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for any period to and including 1952, shall, during the Eighty-third Congress, be open to inspection by the Committee on Government Operations, House of Representatives, or any duly authorized subcommittee thereof in connection with its studies of the operation of Government activities at all levels with a view to determining its economy and efficiency, subject to the conditions stated in the Treasury Decision relating to the inspection of such returns by that committee, approved by me this date.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
May 22, 1953.

(Filed with the Division of the Federal Register May 25, 1953, 9:57 a. m.)

SECTION 56.—PAYMENT OF TAX

SECTION 29.56-2: Extension of time for payment of the tax or installment thereof.

INTERNAL REVENUE CODE

Time extended for filing exempt cooperative association income tax return, Form 990-C. (See Rev. Rul. 27, page 85.)

SECTION 29.56-2: Extension of time for payment of the tax or installment thereof.

INTERNAL REVENUE CODE

Further extension of time for filing exempt cooperative association income tax return, Form 990-C. (See Rev. Rul. 102, page 86.)

SECTION 58.—DECLARATION OF ESTIMATED TAX BY INDIVIDUALS

SECTION 29.58-2: Declarations of estimated tax. Rev. Rul. 118*

INTERNAL REVENUE CODE

Extension of time for filing of declaration of estimated tax in cases of certain alien residents of the United States.

1. Any alien resident of the United States required under the provisions of section 58 of the Internal Revenue Code to file during

*Originally issued as IR-Mimeograph 209, dated June 12, 1953.

the year 1953 a declaration of estimated tax or to amend such a declaration is hereby granted an extension of time for the filing or amendment of such declaration provided that such declaration or amendment thereto is required solely by reason of the operation of section 247 of the Immigration and Nationality Act, Public Law 414, Eighty-second Congress, dealing with the status of certain alien residents of the United States. The extension of time herein granted shall be for a period of 6 months but in no event shall such extension operate to extend the date for such filing or amendment beyond September 15, 1953, or beyond the date prescribed by law for filing the income tax return for the taxable year. For the purpose of this Revenue Ruling the date prescribed by law for the filing of the income tax return for the taxable year shall be determined without regard to any extension of time granted the taxpayer.

2. Correspondence regarding this Revenue Ruling should refer to its number and the symbols T:R.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—RATES OF TAX

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS

SECTION 29.101(2)-1: Mutual savings banks. T. D. 5954

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29 AND PART 40

Taxation of mutual savings banks, building and loan associations, and cooperative banks for taxable years beginning after December 31, 1951.

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

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

On July 1, 1952, notice of proposed rule making was published in the Federal Register (17 F. R. 5909) conforming Regulations 111 [26 CFR, part 29] to sections 313 and 346 of the Revenue Act of 1951, approved October 20, 1951, and conforming Regulations 130 [26 CFR, part 40] to section 313 of the Revenue Act of 1951. After consideration of all such relevant matter as was presented by interested persons relating to the rules proposed, the amendments to Regulations 111 and 130, set forth below, are hereby adopted.

REGULATIONS 111 [26 CFR, PART 29]

PARAGRAPH 1. There is inserted immediately preceding section 29.101(2)-1 the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) MUTUAL SAVINGS BANKS.—Section 101(2) (relating to exemption from tax of mutual savings banks) is hereby repealed.

* * * * * * * *

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

PAR. 2. Section 29.101(2)-1 is amended as follows:

(A) By changing the heading thereof to read as follows: "MUTUAL SAVINGS BANKS—TAXABLE YEARS BEGINNING PRIOR TO JANUARY 1, 1952."

(B) By inserting immediately preceding the first sentence thereof the following new sentence:

The provisions of this section shall be applicable only to taxable years beginning prior to January 1, 1952. For taxable years beginning after December 31, 1951, see section 29.101(2)-2.

PAR. 3. There is inserted immediately preceding section 29.101 (3)-1 the following new section:

SEC. 29.101(2)-2. MUTUAL SAVINGS BANKS—TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951.—For taxable years beginning after December 31, 1951, a mutual savings bank not having capital stock represented by shares is subject to both normal tax and surtax as in the case of other corporations. Such a bank is, however, not subject to excess profits tax. For special rules governing the taxation of a mutual savings bank conducting a life insurance business, see section 110 and the regulations prescribed thereunder.

While the general principles for determining the net income of a corporation are applicable to a mutual savings bank not having capital stock represented by shares, there are certain exceptions and special rules governing the computation in the case of such a bank. See section 29.23(k)-5 for special rules concerning additions to reserves for bad debts. See also section 29.23(r)-1, relating to dividends paid by banking corporations, for special rules concerning deductions for amounts paid to, or credited to the accounts of, depositors as dividends. Furthermore, in determining the normal tax net income of such a mutual savings bank, the credit for dividends received provided in section 26(b) shall not be applicable to dividends which were deductible in computing the net income of the distributing corporation under section 23(r).

The taxable year (fiscal year or calendar year, as the case may be) of a mutual savings bank not having capital stock represented by shares shall be determined without regard to the fact that the taxpayer may have been exempt from tax during any prior period. See sections 41 and 48 and the regulations thereunder. Similarly, in computing net income, the determination of the taxable year for which an item of income or expense is taken into account shall be made under the provisions of sections 41, 42, and 43, and the regulations thereunder, whether or not the item arose during a taxable year beginning before, on, or after December 31, 1951. For the purpose of determining the method of accounting of the mutual savings bank under section 41, a method of accounting recognized under section 41 and under the regulations prescribed thereunder, and utilized in the return of such a bank filed for the first taxable year beginning after December 31, 1951, shall be deemed to constitute the method of accounting regularly employed by the mutual savings bank. The method selected shall be subject to the approval of the Commissioner upon the examination of the return. Any change in the method so selected and so approved may be made only if permission is obtained from the Commissioner under section 29.41-2 to change to another recognized method. For the purpose of computing, under section 122, the net operating loss deduction provided in section 23(s), the terms "preceding taxable year" and "preceding taxable years", as used in section 122, shall not include any taxable year for which the mutual savings bank was exempt from tax. Thus, if the mutual savings bank was exempt from tax for the immediately preceding taxable year, the net operating loss is not a carry-back to any preceding taxable year, and the net operating loss carry-over to succeeding taxable years is not reduced by the net income for any preceding taxable year. No net operating loss carry-back or carry-over shall be allowed from a taxable year beginning prior to January 1, 1952.

PAR. 4. There is inserted immediately preceding section 29.101(4)-1 the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) BUILDING AND LOAN ASSOCIATIONS AND COOPERATIVE BANKS.—Section 101(4) (relating to exemption from tax of building and loan associations and cooperative banks) is hereby amended to read as follows:

"(4) Credit unions without capital stock organized and operated for mutual purposes and without profit; and corporations or associations without capital stock organized prior to September 1, 1951, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of, shares or deposits in—

"(A) domestic building and loan associations,

"(B) cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

"(C) mutual savings banks not having capital stock represented by shares;".

* * * * * * *

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

PAR. 5. Section 29.101(4)-1 is amended as follows:

(A) By changing the heading thereof to read as follows: "BUILDING AND LOAN ASSOCIATIONS AND COOPERATIVE BANKS—TAXABLE YEARS BEGINNING PRIOR TO JANUARY 1, 1952."

(B) By inserting immediately preceding the first sentence thereof the following:

The provisions of this section shall be applicable only to taxable years beginning prior to January 1, 1952. For taxable years beginning after December 31, 1951, see section 29.101(4)-2.

PAR. 6. There is inserted immediately preceding section 29.101(5)-1 the following:

SEC. 29.101(4)-2. BUILDING AND LOAN ASSOCIATIONS AND COOPERATIVE BANKS—TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951.—For taxable years beginning after December 31, 1951, a building and loan association and a cooperative bank not having capital stock represented by shares are subject to both normal tax and surtax as in the case of other corporations. Such institutions are, however, not subject to excess profits tax.

While the general principles for determining the net income of a corporation are applicable to a building and loan association and a cooperative bank not having capital stock represented by shares, there are certain exceptions and special rules governing the computation in the case of such institutions. See section 29.23(k)-5 for special rules concerning additions to reserves for bad debts. See also section 29.23(r)-1, relating to dividends paid by banking corporations, for special rules concerning deductions for amounts paid to, or credited to the accounts of, holders of withdrawable accounts as dividends. Furthermore, in determining the normal tax net income of a building and loan association and a cooperative bank, the credit for dividends received provided in section 26(b) shall not be applicable to dividends which were deductible in computing the net income of the distributing corporations under section 23(r).

The taxable year (fiscal year or calendar year, as the case may be) of a building and loan association and a cooperative bank not having capital stock represented by shares shall be determined without regard to the fact that the taxpayer may have been exempt from tax during any prior period. See sections 41 and 48 and the regulations thereunder. Similarly, in computing net income, the determination of the taxable year for which an item of income or expense is taken

into account shall be made under the provisions of section 41, 42, and 43, and the regulations thereunder, whether or not the item arose during a taxable year beginning before, on, or after December 31, 1951. For the purpose of determining the method of accounting of the building and loan association or cooperative bank under section 41, a method of accounting recognized under section 41 and under the regulations prescribed thereunder and utilized in the return of such institution filed for the first taxable year beginning after December 31, 1951, shall be deemed to constitute the method of accounting regularly employed by the institution. The method selected shall be subject to the approval of the Commissioner upon the examination of the return. Any change of the method so selected and so approved may be made only if permission is obtained from the Commissioner to change to another recognized basis in accordance with section 29.41-2. For the purpose of computing, under section 122, the net operating loss deduction provided in section 23(s), the terms "preceding taxable year" and "preceding taxable years", as used in section 122, shall not include any taxable year for which the building and loan association and cooperative bank were exempt from tax. Thus, if the building and loan association and cooperative bank were exempt from tax for the immediately preceding taxable year, the net operating loss is not a carry-back to any preceding taxable year, and the net operating loss carry-over to succeeding taxable years is not reduced by the net income for any preceding taxable year. No net operating loss carry-back or carry-over shall be allowed from a taxable year beginning prior to January 1, 1952.

SEC. 29.101(4)-3. CREDIT UNIONS AND MUTUAL INSURANCE FUNDS.—Credit unions (other than Federal credit unions which are exempt under section 101(15)) without capital stock organized and operated for mutual purposes and without profit are exempt from tax under section 101(4). Corporations or associations without capital stock organized prior to September 1, 1951, and operated for mutual purposes and without profit for the purpose of providing reserve funds for and insurance of shares or deposits in—

(*a*) Domestic building and loan associations as defined in section 3797(a)(19),

(*b*) Cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

(*c*) Mutual savings banks not having capital stock represented by shares,

are exempt from tax under section 101(4).

PAR. 7. There is inserted immediately preceding section 29.23(k)-1, the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(e) BAD DEBT RESERVES.—Section 23(k)(1) (relating to deduction from gross income of bad debts) is hereby amended by adding at the end thereof the following: "In the case of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit, the reasonable addition to a reserve for bad debts shall be determined with due regard to the amount of the taxpayer's surplus or bad debt reserves existing at the close of December 31, 1951. In the case of a taxpayer described in the preceding sentence, the reasonable addition to a reserve for bad debts for any taxable year shall in no case be less than the amount determined by the taxpayer as the reasonable addition for such year; except that the amount determined by the taxpayer under this sentence shall not be greater than the lesser of (A) the amount of its net income for the taxable year, computed without regard to this subsection, or (B) the amount by which 12 per centum of the total deposits or withdrawable accounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year."

* * * * * * *

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

PAR. 8. Section 29.23(k)-5 is amended as follows:

(A) By changing the heading thereof to read as follows: "RESERVE FOR BAD DEBTS.—(*a*) *Taxpayers other than mutual savings banks, building and loan associations, and cooperative banks.*—"

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

(*b*) *Mutual savings banks, building and loan associations, and cooperative banks.*—(1) *In general.*—For taxable years beginning after December 31, 1951, a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit may, as an alternative to a deduction from gross income for specific debts which become worthless in whole or in part, deduct amounts credited to a reserve for bad debts in the manner and under the circumstances prescribed in this section. In the case of such an institution the selection of either of the alternative methods for treating bad debts may be made by the taxpayer in the return for its first taxable year beginning after December 31, 1951. The method selected shall be subject to the approval of the Commissioner upon examination of the return. Any change in the method so selected and approved may be made only if permission is granted as provided in section 29.23(k)-1(*a*).

(2) *Definitions.*—When used in this paragraph—

(i) The term "institution" means either a mutual savings bank not having capital stock represented by shares, a domestic building and loan association as defined in section 3797(a)(19), or a cooperative bank without capital stock organized and operated for mutual purposes and without profit.

(ii) "Surplus, undivided profits, and reserves" means the amount by which the total assets of an institution exceed the amount of the total liabilities of such an institution. For this purpose the term "total assets" means the sum of money, plus the aggregate of the adjusted basis of the property other than money held by an institution. Such adjusted basis for any asset is its adjusted basis for determining gain upon sale or exchange for Federal income tax purposes. (See, in general, section 113 and the regulations prescribed thereunder. For special rules with respect to adjustments to basis for prior taxable years during which the institution was exempt from tax, see section 29.113(b)(1)-4.) The determination of the total assets of any taxpayer shall conform to the method of accounting employed by such taxpayer in determining net income and to the rules applicable in determining its earnings and profits. The term "total liabilities" means all liabilities of the taxpayer, which are fixed and determined, absolute and not contingent, and includes those items which constitute liabilities in the sense of debts or obligations. The total deposits or withdrawable accounts, as defined in subdivision (iv) below, shall be considered a liability. In the case of a building and loan association having permanent nonwithdrawable capital stock represented by shares, the paid-in amount of such stock shall also be considered a liability. Reserves for contingencies and other reserves, however, which are mere appropriations of surplus are not liabilities.

(iii) The term "surplus or bad debt reserves existing at the close of December 31, 1951", means the amount of surplus, undivided profits, and reserves accumulated by the institution prior to January 1, 1952, and in existence at the close of December 31, 1951.

(iv) The term "total deposits or withdrawable accounts" means the aggregate of (A) amounts placed with an institution for deposit or investment and (B) earnings outstanding on the books of account of the institution at the close of the taxable year which have been credited as dividends upon such accounts prior to the close of the taxable year, except that in the case of a building and loan association, such term does not include permanent nonwithdrawable capital stock represented by shares, or earnings credited thereon.

(3) *Institutions with surplus, reserves, and undivided profits in an amount less than 12 percent of total deposits or withdrawable accounts.*—Where 12 percent of the total deposits or withdrawable accounts of an institution at the close of the taxable year exceeds the sum of its surplus, undivided profits, and reserves

at the beginning of the taxable year, there is allowable as a deduction from gross income as an addition to a reserve for bad debts any amount determined by the taxpayer not exceeding the lesser of:

(i) The amount of the net income of such institution for the taxable year computed without regard to section 23(k)(1) or,

(ii) The amount by which 12 percent of the total deposits or withdrawable accounts at the close of the taxable year exceeds the sum of the institution's surplus, undivided profits, and reserves at the beginning of the taxable year.

Bad debt losses sustained during the taxable year shall be charged against the bad debt reserve. Recoveries of debts charged against the bad debt reserve during a prior taxable year in which the institution was subject to tax under this chapter shall be credited to the bad debt reserve. The establishment of such reserve and all adjustments made thereto must be reflected on the regular books of account of the institution at the close of the taxable year, or as soon as practicable thereafter. For the purpose of this paragraph minimum amounts credited in compliance with Federal or State statutes, regulations, or supervisory orders, to reserve or similar accounts, or additional amounts credited to such reserve or similar accounts and permissive under such statutes, regulations, or orders, against which charges may be made for the purpose of absorbing losses sustained by an institution will be deemed to have been credited to the bad debt reserve authorized under this paragraph.

Example (1). On January 1, 1952, and on December 31, 1952, Institution A, which keeps its books on the basis of the calendar year, has total deposits or withdrawable accounts of $10,000,000, all of which amount is insured by an agency of the Federal government. The surplus, reserves, and undivided profits of Institution A at the opening of business on January 1, 1952, total $800,000. A regulation of a Federal agency requires that at the close of the taxable year an amount equal to 0.3 percent of the value of the insured accounts at the beginning of the year be credited by Institution A to a Federal insurance reserve for the sole purpose of absorbing losses. A statute of the State having jurisdiction over Institution A requires that not less than 5 percent of the net profits of Institution A, computed before provisions for dividends, be credited at the close of the year to a "reserve fund" for the purpose of absorbing losses. The credit to such reserve fund of additional amounts in excess of 5 percent of net profits is permissive under such statute, provided that the total amounts credited do not exceed 25 percent of net profits. It is assumed for the purpose of determining the amount to be credited to the State reserve fund that "not less than 5 percent of the net profits" of Institution A, computed under State law before provisions for dividends for the taxable year 1952 amounts to $17,500.

Prior to the taxable year Institution A did not maintain a reserve for bad debts. During 1952 Institution A sustained bad debt losses of $5,000. The net income of Institution A for the taxable year 1952, computed under chapter 1 after taking into account all applicable deductions (including the deduction for dividends provided in section 23(r)(1)) except the deduction provided in section 23(k)(1) is $200,000.

The books of account of Institution A show credits for the taxable year 1952 to the following reserves:

Federal insurance reserve	$30,000
State reserve fund	25,000
Bad debt reserve	45,000
Miscellaneous reserves	15,000

There is allowable as a deduction under section 23(k)(1) $100,000 ($45,000 credited to the bad debt reserve, $30,000 credited to the Federal insurance reserve, and $25,000 representing a permissive amount less than 25 percent of net profits under the State statute, credited to the State reserve fund).

Assuming that Federal income taxes for 1952 amount to $46,500 on the net income of $100,000, the amount credited to the surplus account for 1952 will be $38,500, that is, $53,500 ($100,000 minus $46,500) less the $15,000 credited to miscellaneous reserves for which no bad debt deduction is allowable. Consequently, the surplus, undivided profits, and reserves of Institution A, amounting to $800,000 at the close of December 31, 1951, as increased by amounts credited to these accounts for 1952 will total $948,500 at the close of December 31, 1952, computed as follows:

Surplus, reserves, and undivided profits at close of December 31, 1951	$800,000
Amount credited to miscellaneous reserve accounts for 1952	15,000
Amount credited to State reserve fund for 1952	25,000
Amount credited to Federal insurance reserve for 1952	30,000
Amount credited to surplus for 1952	38,500
Bad debt reserve at close of December 31, 1951	0
Amount credited to reserve for bad debts for 1952 $45,000	
Less: Bad debt losses sustained during 1952 5,000	
Bad debt reserve at close of December 31, 1952	40,000
Surplus, undivided profits and reserves existing at close of December 31, 1952	948,500

Example (2). The net income of Institution B for the taxable year 1952, computed under chapter 1 after all deductions including the deduction for dividends, but before the deduction provided in section 23(k)(1), is determined to be $250,000. Such $250,000 is credited by Institution B to the bad debt reserve as provided in section 23(k)(1) and section 29.23(k)-5(b)(3). The amount by which 12 percent of the total deposits or withdrawable accounts of Institution B at the close of the taxable year exceeds the sum of such institution's surplus, undivided profits and reserves at the beginning of the taxable year is $500,000.

During 1954, upon examination of the return of income filed by Institution B for 1952, it is determined that the net income of such institution, properly computed, without regard to section 23(k)(1) is $275,000. Assuming that Institution B credits the additional $25,000 to its bad debt reserve, there is allowable as a deduction from gross income for such institution for the taxable year 1952, $275,000.

(4) *Institutions with surplus, reserves, and undivided profits equal to or in excess of 12 percent of deposits or withdrawable accounts.*—Where 12 percent of the total deposits or withdrawable accounts of an institution at the close of the taxable year is equal to or less than the sum of such institution's surplus, undivided profits and reserves at the beginning of the taxable year, there may be allowable as a deduction from gross income a reasonable addition to the reserve for bad debts determined under the general provisions of (*a*) of this section. In making such determination there will be taken into account (i) surplus, or bad debt reserves existing at the close of December 31, 1951, and (ii) changes in the surplus, undivided profits, and reserves of the institution from December 31, 1951, until the beginning of the taxable year. Deductions for additions to the reserve for bad debts, in addition to the deductions allowed, if any, under (3), above, will be authorized in those cases where the institution proves to the satisfaction of the Commissioner that the bad debt experience of the institution warrants the maintenance of a bad debt reserve in excess of that provided in (3), above.

PAR. 9. There is inserted immediately after section 29.113(b)(1)-3 the following:

SEC. 29.113(b)(1)-4. ADJUSTED BASIS: MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, AND COOPERATIVE BANKS.—The adjustments to the cost or other basis of property provided in section 113(b) and section 29.113(b)(1)-1 to section 29.113(b)(1)-3, inclusive, are applicable in the case of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit, although such institutions were exempt from tax for taxable years beginning prior to January 1, 1952. Proper adjustment must be made under section 113(b) for the entire period since the acquisition of property. Thus, adjustment to basis must be made for depreciation allowable for all prior taxable years although such institution may have been exempt from tax during such period. Similarly, in the case of tax exempt and partially taxable bonds purchased at a premium and subject to amortization under section 125, proper adjustment to basis must be made to reflect amortization with respect to such premium from the date of acquisition of the bond.

Example: On January 1, 1952, Z, a mutual savings bank, which keeps its books on a calendar year basis, owns a tax-exempt $1,000 noncallable bond maturing on January 1, 1962. Such bond was acquired by Z on January 1, 1932, for

$1,300. It was sold by Z on December 31, 1952, for $1,250. The yearly rate of amortization of the premium, determined by dividing the total premium of $300 by the life of the bond (30 years) is $10. Z realizes a gain of $60 from such sale computed as follows:

(1) Cost of bond		$1,300
(2) Amount of bond premium attributable to years 1942 through 1951, during which Z was exempt from tax ($10 times 10 years)	$100	
(3) Amount of bond premium amortized from January 1, 1952, through December 31, 1952 ($10 times 1 year)	10	
(4) Total amount of adjustments to basis (aggregate of (2) and (3))		110
(5) Adjusted basis of bond at close of 1952 ((1) reduced by (4))		1,190
(6) Gain realized upon sale. Excess of sale price over adjusted basis ($1,250 minus $1,190)		60

The basis of a fully taxable bond purchased at a premium shall be adjusted from the date of the election to amortize such premium in accordance with the provisions of section 125, except that no adjustment shall be allowable for such portion of the premium, attributable to the period prior to the election.

In the case of a mortgage purchased, acquired, or originated at a premium, where the principal of such mortgage is payable in installments, adjustments to the basis of the premium must be made for all taxable years (whether or not the institution was exempt from tax during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period of payments of the mortgage loans of such institution. For the purpose of this adjustment, the term "premium" includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage is the cost including buying commissions, attorneys' fees or brokerage fees, but such value does not include amounts paid for accrued interest.

PAR. 10. There is inserted immediately after section 29.23(q)-1 as amended by Treasury Decision 5924 [C. B. 1952-2, 100], approved August 4, 1952, the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(f) DIVIDENDS PAID TO DEPOSITORS.—Section 23(r) (relating to the deduction from gross income of certain dividends paid by banking corporations) is hereby amended to read as follows:

"(r) DIVIDENDS PAID BY BANKING CORPORATIONS.—

"(1) In the case of mutual savings banks, cooperative banks, and domestic building and loan associations, amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends on their deposits or withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw.

"(2) For deduction of dividends paid by certain other banking corporations, see section 121."

* * * * * * *

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

SEC. 29.23(r)-1. DIVIDENDS PAID BY MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, AND COOPERATIVE BANKS.—(*a*) *In general.*—A mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit may deduct from gross income amounts which during the taxable year are paid to or credited to the accounts of depositors or holders of accounts, as dividends on their deposits or

withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw.

The deduction provided in section 23(r)(1) is applicable to the taxable year in which amounts credited as dividends become withdrawable by the depositor or holder of account subject only to customary notice of intention to withdraw. Thus, amounts credited as dividends as of the last day of the taxable year which are not withdrawable by depositors or holders of accounts until the business day next succeeding are deductible under this section in the year subsequent to the taxable year in which they were credited. A deduction under this section will not be denied by reason of the fact that amounts credited as dividends, otherwise deductible under this section, are subject to the terms of a pledge agreement between the institution and the depositor or holder of account. In the case of a building and loan association having nonwithdrawable capital stock represented by shares, no deduction is allowable under this section for amounts paid or credited as dividends on such shares.

(*b*) *Serial associations, bonus plans, etc.*—In the case of a building and loan association which operates in whole or in part as a serial association, which maintains a bonus plan, or which issues shares subject to fines, penalties, forfeitures, or other withdrawal fees, there is deductible under section 23 (r) (1) the total amount credited as dividends upon such shares, credited to a bonus account for such shares, or allocated to a series of shares for the taxable year, notwithstanding that as a customary condition of withdrawal—

(1) Amounts invested in, and earnings credited to, series shares must be withdrawn in multiples of even shares, or

(2) Such association has the right, pursuant to by-law, contract, or otherwise, to retain or recover a portion of the total amount invested in, or credited as earnings upon, such shares, such bonus account or series of shares, as a fine, penalty, forfeiture, or other withdrawal fee.

In any taxable year in which the right referred to in subparagraph (2) above is exercised, there is includible in the gross income of such association for such taxable year, amounts retained or recovered by the association pursuant to the exercises of such right.

SEC. 29.23(r)-2. DIVIDENDS PAID BY CERTAIN BANKING CORPORATIONS OTHER THAN MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, AND COOPERATIVE BANKS.—For deduction of dividends paid by certain banking corporations other than mutual savings banks, building and loan associations, and cooperative banks, see section 121.

PAR. 11. There is inserted immediately after section 29.23(bb)-1, as added by Treasury Decision 5873 [C. B. 1952-1, 23], approved December 7, 1951, the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(g) DEDUCTION FOR REPAYMENT OF CERTAIN LOANS.—Section 23 (relating to deductions from gross income) is hereby amended by adding at the end thereof the following:

"(dd) REPAYMENT BY MUTUAL SAVINGS BANKS, ETC., OF CERTAIN LOANS.—In the case of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank without capital stock organized and operated for mutual purposes and without profit, amounts paid by the taxpayer during the taxable year in repayment of loans made prior to September 1, 1951, by (1) the United States or any agency or instrumentality thereof which is wholly owned by the United States, or (2) any mutual fund established under the authority of the laws of any state."

* * * * * * *

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

SEC. 29.23(dd)-1. REPAYMENT OF CERTAIN LOANS BY MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, AND COOPERATIVE BANKS.—For taxable years beginning after December 31, 1951, there shall be deductible under section

23(dd) from the gross income of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank without capital stock organized and operated for mutual purposes and without profit, amounts paid by such institutions during the taxable year in repayment of loans made prior to September 1, 1951, by the United States or any agency or instrumentality thereof which is wholly owned by the United States, and amounts paid to a mutual fund established under the authority of the laws of any State. For example, amounts paid by such institution in repayment of loans made by the Reconstruction Finance Corporation prior to September 1, 1951, are deductible under this section. Section 23(dd) is not applicable, however, in the case of amounts paid to an agency or instrumentality not wholly owned by the United States.

PAR. 12. There is inserted immediately preceding section 29.104-1 the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(h) DEFINITION OF BANK.—Section 104(a) (relating to definition of bank) is hereby amended by inserting at the end thereof the following: "Such term also means a domestic building and loan association."

* * * * * * *

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

PAR. 13. There is inserted immediately preceding section 29.3797-1 the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(i) DEFINITION OF DOMESTIC BUILDING AND LOAN ASSOCIATION.—Section 3797(a) (relating to definitions for the purpose of the Internal Revenue Code) is hereby amended by adding at the end thereof the following new paragraph:

"(19) DOMESTIC BUILDING AND LOAN ASSOCIATION.—The term 'domestic building and loan association' means a domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association, substantially all the business of which is confined to making loans to members."

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

PAR. 14. There is inserted immediately preceding section 111 the following:

SEC. 346. LIFE INSURANCE DEPARTMENTS OF MUTUAL SAVINGS BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) COMPUTATION OF TAX.—Supplement A of chapter 1 is hereby amended by adding at the end thereof the following new section.

"SEC. 110. MUTUAL SAVINGS BANKS CONDUCTING LIFE INSURANCE BUSINESS.

"(a) ALTERNATIVE TAX.—In the case of a mutual savings bank not having capital stock represented by shares, authorized under State law to engage in the business of issuing life insurance contracts, and which conducts a life insurance business in a separate department the accounts of which are maintained separately from the other accounts of the

mutual savings bank, there shall be levied, collected, and paid, in lieu of the taxes imposed by sections 13 and 15, or section 117(c)(1), a tax consisting of the sum of the partial taxes determined under paragraphs (1) and (2):

"(1) A partial tax computed upon the net income determined without regard to any items of gross income or deductions properly allocable to the business of the life insurance department, at the rates and in the manner as if this section has not been enacted; and

"(2) a partial tax computed upon the net income (as defined in section 201(c)(7)) of the life insurance department determined without regard to any items of gross income or deductions not properly allocable to such department, at the rates and in the manner provided in Supplement G with respect to life insurance companies.

"(b) LIMITATIONS OF SECTION.—The provisions of subsection (a) shall be applicable only if the life insurance department would, if it were treated as a separate corporation, qualify as a life insurance company under section 201(b)."

* * * * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

SEC. 29.110-1. MUTUAL SAVINGS BANKS CONDUCTING LIFE INSURANCE BUSINESS.—(*a*) *Scope of application.*—Section 110 is applicable in the case of a mutual savings bank not having capital stock represented by shares which conducts a life insurance business, if

(1) The conduct of such business is authorized under State law,

(2) The life insurance business is carried on in a separate department of the bank,

(3) The books of account of the life insurance business are maintained separately from other departments of the bank, and

(4) The life insurance department of the bank, were it separately incorporated, would qualify as a life insurance company under section 201(b).

(*b*) *Computation of tax.*—In the case of a mutual savings bank conducting a life insurance business to which section 110 is applicable, the tax upon such bank consists of the sum of the following:

(1) A partial tax computed under sections 13 and 15 upon the net income of the bank determined without regard to any items of income or deduction properly allocable to the life insurance department.

(2) A partial tax upon the net income of the life insurance department determined without regard to any items of income or deduction not properly allocable to such department at the rates and in the manner provided in Supplement G with respect to life insurance companies.

PAR. 15. There is inserted immediately preceding section 29.13-1, the following:

SEC. 346. LIFE INSURANCE DEPARTMENTS OF MUTUAL SAVINGS BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—Section 13 (relating to normal tax on corporations) is hereby amended by adding at the end thereof the following new subsection:

"(f) MUTUAL SAVINGS BANKS CONDUCTING LIFE INSURANCE BUSINESS.—For special tax, in lieu of the taxes imposed by this section see section 15, in the case of a mutual savings bank conducting a life insurance business, see section 110."

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

PAR. 16. Section 29.22(b)(4)-2(*a*) is hereby amended as follows:

(A) By inserting immediately following the second sentence thereof which sentence begins with "Section 7 of the Federal Reserve Act" the following:

Section 13 of the Federal Home Loan Bank Act (47 Stat. 725, 12 U. S. C. 1946 ed., 1433) provides that the Federal Home Loan Bank including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation except taxes upon real estate.

(B) By inserting in the fourth sentence thereof, after "Federal land banks, national farm-loan associations" the following: "Federal home loan banks",

REGULATIONS 130 [26 CFR, PART 40]

PAR. 17. There is inserted immediately preceding section 40.454-1 the following:

SEC. 313. MUTUAL SAVINGS BANKS, BUILDING AND LOAN ASSOCIATIONS, COOPERATIVE BANKS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(c) EXEMPTIONS FROM EXCESS PROFITS TAX.—Section 454 (corporations exempted from the excess profits tax) is hereby amended by adding at the end thereof the following:

"(h) Any mutual savings bank not having capital stock represented by shares, any domestic building and loan association (as defined in section 3797(a)(19)), and any cooperative bank without capital stock organized and operated for mutual purposes and without profit."

* * * * * * *

(j) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1951.

PAR. 18. Section 40.454-1 is amended by striking from the first sentence of subsection (e) thereof the words "or (g)" and by inserting in lieu thereof the words "(g), or (h)."

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

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 8, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 10, 1952, 8:53 a. m.)

SECTION 29.101(9)-1: Social clubs. Rev. Rul. 44

INTERNAL REVENUE CODE

A social club, otherwise entitled to exemption from taxation under section 101(9) of the Internal Revenue Code, should not be denied such exemption because it derives its principal income from the operation of a bar or restaurant, provided, among other things, that only members and their guests are permitted the use of the club's facilities.

Advice is requested whether a social club, otherwise entitled to exemption under section 101(9) of the Internal Revenue Code, will be precluded from qualifying for such exemption because it operates a bar or restaurant from which it derives its principal income.

Section 101(9) of the Code exempts from income tax "Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder." Section 29.101(9)-1 of Regulations 111 provides in part, that, "The exemption granted by section 101(9) applies to practically all social and recreation clubs which are supported by membership fees, dues and assessments." It is the position of the Bureau that this sentence is merely descriptive of the type of club usually coming within this section, and does not, standing alone, exclude all other clubs from the scope of this section. It is apparent, therefore, that a club, otherwise entitled to exemption under section 101(9) of the Code, should not be denied such exemption merely because it adopts a method of raising revenue from members other than by fees, dues and assessments. Exemption has been granted by the Bureau to many clubs where considerable revenue was derived from the sale of merchandise and services to members, but such exemption has been denied where substantial revenue was derived from dealings with nonmembers.

Accordingly, it is held that a social club, otherwise entitled to exemption from taxation under section 101(9) of the Internal Revenue Code, should not be denied such exemption because its principal income is derived from the operation of a bar or restaurant, provided, among other things, that only members and their guests are permitted the use of the club's facilities.

SECTION 29.101(12)-1: Farmers' cooperative marketing and purchasing associations: Requirements for exemption under section 101(12)(A). T. D. 6014

(Also Sections 29.101(12)-2, 29.101(12)-3, 29.101(12)-4; Section 22(a), Section 29.22(a)-23; Section 148, Section 29.148-4.)

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

Income tax treatment of exempt cooperatives for taxable years beginning after December 31, 1951.

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

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

On November 8, 1952, notice of proposed rulemaking was published in the Federal Register (17 F. R. 10145) conforming Regulations 111 [26 CFR, part 29] to section 314 (a), (b), and (d) of the Revenue Act of 1951, approved October 20, 1951. After consideration of all such relevant matter as was presented by interested persons relating to the rules proposed, the amendments to Regulations 111 set forth below, are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.101(12)-1 [26 CFR 29.101(12)-1] the following:

SEC. 314. INCOME TAX TREATMENT OF EXEMPT COOPERATIVES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 101(12).—Section 101(12) is hereby amended as follows:

(1) By inserting after "(12)" the following: "(A)".

(2) By inserting after such paragraph the following:

"(B) An organization exempt from taxation under the provisions of subparagraph (A) shall be subject to the taxes imposed by sections 13 and 15, or section 117(c)(1), except that in computing the net income of such an organization there shall be allowed as deductions from gross income (in addition to other deductions allowable under section 23)—

"(i) amounts paid as dividends during the taxable year upon its capital stock, and

"(ii) amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. Allocations made after the close of the taxable year and on or before the fifteenth day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the allocations are attributable to income derived before the close of such year.

Patronage dividends, refunds, and rebates to patrons with respect to their patronage in the same or preceding years (whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount of such dividend, refund, or rebate) shall be taken into account in computing net income in the same manner as in the case of a cooperative organization not exempt under subparagraph (A). Such dividends, refunds, and rebates made after the close of the taxable year and on or before the 15th day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the dividends, refunds, or rebates, are attributable to patronage occurring before the close of such year."

(b) TECHNICAL AMENDMENTS.—

(1) Section 101 is hereby amended by striking out "Except as provided in supplement U" and inserting in lieu thereof the following: "Except as provided in paragraph (12)(B) and in supplement U".

(2) The last sentence of section 101 is hereby amended by striking out "Notwithstanding supplement U" and inserting in lieu thereof "Notwithstanding paragraph (12)(B) and supplement U".

* * * * * * *

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) of this section shall be applicable only with respect to taxable years beginning after December 31, 1951 * * *

PAR. 2. Section 29.101(12)-1, as amended by Treasury Decision 5458 [C. B. 1945, 45], approved June 15, 1945, is amended by changing the heading thereof to read as follows:

FARMERS' COOPERATIVE MARKETING AND PURCHASING ASSOCIATIONS: REQUIREMENTS FOR EXEMPTION UNDER SECTION 101(12)(A)

PAR. 3. There is inserted immediately following section 29.101(12)-1 the following new section:

SEC. 29.101(12)-2. TAX TREATMENT OF FARMERS' COOPERATIVE MARKETING AND PURCHASING ASSOCIATIONS EXEMPT UNDER SECTION 101(12)(A) FOR TAXABLE

YEARS BEGINNING AFTER DECEMBER 31, 1951.—(*a*) *In general.*—For taxable years beginning after December 31, 1951, section 101(12)(B) is applicable to farmers', fruit growers', or like associations organized and operated on a cooperative basis in the manner prescribed in section 101(12)(A). Although such an association is subject to both normal tax and surtax, as in the case of corporations generally, certain special rules for the computation of net income are provided in section 101(12)(B) and section 29.101(12)–3. For the purpose of any law which refers to organizations exempt from income taxes such an association shall, however, be considered as an organization exempt under section 101. Thus, under section 454(a) such an association is not subject to the excess-profits tax. Similarly, the provisions of section 26(b), providing a credit for dividends received from a domestic corporation subject to taxation, are not applicable to dividends received from a cooperative association subject to 101(12)(B). The provisions of section 141, relating to consolidated returns, are likewise not applicable.

Rules governing the manner in which amounts allocated as patronage dividends, refunds, or rebates are to be taken into account in computing the net income of such an association are set forth in section 29.101(12)–4. For the tax treatment, as to patrons, of amounts received during the taxable year as patronage dividends, rebates, or refunds see section 29.22(a)–23.

(*b*) *Meaning of terms.*—For purposes of sections 29.101(12)–2 to 29.101(12)–4, inclusive, section 29.148–4(f), and section 29.22(a)–23, the following terms shall have the meaning ascribed below:

(1) *Cooperative association.*—The term "cooperative association" includes any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons, except that the term does not include any cooperative or nonprofit corporation (including any cooperative or nonprofit corporation engaged in rural electrification) exempt from taxation under section 101 (10) or (11) or any corporation subject to a tax imposed by supplement G (relating to insurance companies).

(2) *Patron.*—The term "patron" includes any person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or a nonmember of the cooperative association, and whether an individual, a trust, estate, partnership, company, corporation, or cooperative association.

(3) *Allocation.*—The term "allocation" includes distributions made by a cooperative association to a patron in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, similar documents, or in any other manner whereby there is disclosed to a patron the dollar amount apportioned on the books of the association for the account of such patron. Thus, a mere credit to the account of a patron on the books of the cooperative associations, without disclosure to the patron, is not an allocation.

(4) *Patronage dividends, rebates, and refunds.*—The term "patronage dividend, rebate, or refund" includes any amount allocated by a cooperative association, to the account of a patron on the basis of the business done with or for such patron. The following are not patronage dividends, rebates, or refunds:

(i) Amounts distributed in redemption of capital stock, or in redemption or satisfaction of certificates of indebtedness, revolving fund certificates, retain certificates, letters of advice, or other similar documents;

(ii) Amounts allocated (whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, refund, or rebate) by the association for products of members or other patrons to the extent such amounts are fixed without reference to the earnings of the cooperative association. For this purpose, the term "earnings" includes the excess of amounts retained (or assessed) by the association to cover expenses or other items over the amount of such expenses or other items.

(*c*) *Examples.*—The application of (*b*) above may be illustrated by the following examples:

Example 1. Cooperative A, a marketing association operating on a pooling basis, receives the products of patron W on January 5, 1952. On the same day Cooperative A advances to W 45 cents per unit for the products so delivered and allocates to him a "retain certificate" having a face value calculated at the rate of 5 cents per unit. During the operation of the pool, and before substantially all the products in the pool are disposed of, Cooperative A advances to W an additional 40 cents per unit, the amount being determined by reference to the market price of the products sold and the anticipated price of the unsold products. At the close of the pool on November 10, 1952, Cooperative A determines the excess of its receipts over the sum of its expenses and its previous advances to patrons, and allocates to W an additional 3 cents per unit and shares of the capital stock of A having an aggregate of face value calculated at the rate of 2 cents per unit.

The amount of patronage dividends, rebates, or refunds allocated to W during 1952 amount to 5 cents per unit, consisting of the aggregate of the following per-unit allocations: the amount of cash distribution (3 cents), and the face value of the capital stock of A (2 cents), which are fixed with reference to the earnings of A. The amount of the two distributions in cash (85 cents) and the face amount of the "retain certificate" (5 cents), which are fixed without reference to the earnings of A, do not constitute patronage dividends, rebates, or refunds.

Example 2. Cooperative B, a marketing association operating on a pooling basis, receives the products of patron X on March 5, 1952. On the same day Cooperative B pays to X $1 per unit for such products, this amount being determined by reference to the market price of the product when received, and issues to him a "participation certificate" having no face value but which entitles X on the close of the pool to the proceeds derived from the sale of his products less the previous payment of $1 and the expenses and other charges attributable to such products. On March 5, 1955, Cooperative B, having sold the products in the pool, having deducted the previous payments for such products, and having determined the expenses and other charges of the pool, redeems the participation certificate of X in cash for 10 cents per unit. The allocation made to X during 1955, amounting to 10 cents per unit, is a patronage dividend, rebate, or refund. Neither the payment to X in 1952 of $1 nor the issuance to him of the participation certificate in that year constitutes a patronage dividend, rebate, or refund within the meaning of this section.

Example 3. Cooperative C, a purchasing association, obtains supplies for patron Y on May 1, 1952, and receives in return therefore $100. On February 1, 1953, Cooperative C, having determined the excess of its receipts over its cost and expenses, allocates to Y a cash distribution of $1 and a revolving fund certificate of a face amount of $1. The amount of patronage dividends, rebates, or refunds allocated to Y for 1953 is $2, the aggregate of the cash distribution of $1, and the face amount, $1, of the revolving fund certificate.

Example 4. Cooperative D, a service association, sells the products of members on a fee basis. It receives the products of patron Z under an agreement not to pool his products with those of other members, to sell his products, and to deliver to him the proceeds of the sale. Patron Z makes payments to Cooperative D during 1952 aggregating $75 for service rendered him by Cooperative D during that year. On May 15, 1953, Cooperative D, having determined the excess of its receipts over its costs and expenses, allocates to Z a cash distribution of $2. Such amount is a patronage dividend, rebate, or refund allocated by Cooperative D during 1953.

SEC. 29.101(12)-3. MANNER OF TAXATION OF COOPERATIVE ASSOCIATIONS SUBJECT TO 101(12).—(*a*) *In general.*—For taxable years beginning after December 31, 1951, farmers', fruit growers', or like associations, organized and operated in compliance with the requirements of section 101(12)(A) and section 29.101(12)-1 shall be subject to the taxes imposed by sections 13 and 15 or section 117(c)(1), except that there shall be allowed as deductions from gross income, in addition to the other deductions allowable under section 23, certain special deductions provided in section 101(12)(B)(i) and (*c*) of this section, and section 101(12)(B)(ii) and (*d*) of this section. Amounts allocated as patronage dividends, refunds, or rebates, whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated, with respect to patronage for the taxable year or for preceding taxable years, shall be taken into account in the manner provided in section 101(12)(B) and in section 29.101(12)-4.

(b) *Cooperative associations exempt from tax before January 1, 1952.*—In the case of a cooperative association exempt from tax for taxable years beginning prior to January 1, 1952, the taxable year (fiscal year or calendar year, as the case may be) shall be determined without regard to the fact that such association may have been exempt from tax and not subject to the provisions of section 101(12)(B) during any prior period. See sections 41 and 48 and the regulations thereunder. Similarly in computing net income, the determination of the taxable year for which an item of income or expense is taken into account shall be made under the provisions of sections 41, 42, and 43 and the regulations prescribed thereunder, whether or not the item arose during a taxable year beginning before, on, or after December 31, 1951. For the purpose of determining the method of accounting of the cooperative association under section 41, a method of accounting recognized under section 41 and under the regulations prescribed thereunder and utilized in the return of such association filed for the first taxable year beginning after December 31, 1951, shall be deemed to constitute the method of accounting regularly employed by the cooperative association. The method selected shall be subject to the approval of the Commissioner upon the examination of the return. Any change of the method so selected and so approved may be made only if permission is obtained from the Commissioner to change to another recognized basis in accordance with section 29.41-2.

In any case where inventories are an income-producing factor see section 22 (c) and (d) and the regulations prescribed thereunder. The elective method of inventorying goods provided in section 22(d) may be adopted by the cooperative association for any taxable year beginning after December 31, 1951, in accordance with the requirements of section 22(d) and the regulations issued under that section. In order to use such method for such a taxable year, the cooperative association must exercise the election provided in sections 22(d)(2) and 29.22(d)-3 even though it may have utilized such method for accounting purposes for taxable years beginning prior to January 1, 1952.

The following rules shall be applicable in computing, under section 122, the net operating loss deduction provided in section 23(s): No net operating loss carryback or carryover shall be allowed from a taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt from tax under section 101(12). In the case of a taxable year beginning prior to January 1, 1952, for which the association was not exempt under section 101(12), and of a taxable year beginning after December 31, 1951, the amount of the net operating loss carryback or carryover from such year shall not be reduced by reference to the income of any taxable year beginning prior to January 1, 1952, for which the association was exempt from tax under section 101(12). However, in determining preceding taxable years and succeeding taxable years under section 122(b), a taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt from tax under section 101(12) shall be taken into account and shall be considered to be a "preceding taxable year" or a "succeeding taxable year," as the case may be.

The adjustments to the cost or other basis provided in section 113(b) and section 29.113(b)(1)-1 to section 29.113(b)(1)-3, inclusive, are applicable for the entire period since the acquisition of the property. Thus, proper adjustment to basis must be made under section 113(b) for depreciation, obsolescence, amortization, and depletion for all taxable years beginning prior to January 1, 1952, although the cooperative association was exempt from tax under section 101(12) for such years. However, the provisions of section 114(b) (relating to percentage and discovery depletion) are applicable only for such years during which the association was not exempt from tax under section 101(12). The amendment to section 113(b)(1)(B) (limiting the adjustment to basis for excessive depreciation, etc., which did not result in a reduction of taxes) made by Public Law 539, Eighty-second Congress, is also applicable for such years where the association has made a proper election in accordance with section 113(d) and the regulations prescribed thereunder. Similarly, in the case of tax-exempt and partially taxable bonds purchased at a premium and subject to amortization under section 125, proper adjustment to basis must be made to reflect amortization with respect to such premium from the date of acquisition of the bond. (For principles governing the method of computation, see the example in section 29.113(b)-1(4) relating to mutual savings banks, building and loan associations, and cooperative banks.) The basis of a fully taxable bond purchased at a premium shall be adjusted from the date of the election to amortize such premium in accordance with the provisions of section 125 except

that no adjustment shall be allowable for such portion of the premium attributable to the period prior to the election.

In the case of a mortgage acquired at a premium where the principal of such mortgage is payable in installments, adjustments to the basis of the premium must be made for all taxable years (whether or not the association was exempt from tax under section 101(12) during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period of payments of the mortgage loans of such association. For the purpose of this adjustment, the term "premium" includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage is the cost including buying commissions, attorneys' fees, or brokerage fees, but such value does not include amounts paid for accrued interest.

The cooperative association may select either of the alternative methods for treating bad debts provided in section 29.23(k)-1(*a*) in the return for its first taxable year beginning after December 31, 1951. The method selected shall be subject to the approval of the Commissioner upon examination of the return. Any change in the method so selected and approved may be made only if permission is granted as provided in section 29.23(k)-1(*a*).

(*c*) *Deduction for dividends paid.*—There is allowable as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 101(12) (A) and section 29.101(12)-1, amounts paid as dividends during the taxable year upon the capital stock of the cooperative association. For the purpose of the preceding sentence, the term "capital stock" includes common stock (whether voting or nonvoting), preferred stock, or any other form of capital represented by capital retain certificates, revolving fund certificates, letters of advice, or other evidence of a proprietary interest in a cooperative association. Such deduction is applicable only to the taxable year in which the dividends are actually or constructively paid to the holder of capital stock or other proprietary interest of the cooperative association. If a dividend is paid by check and the check bearing a date within the taxable year is deposited in the mail, in a cover properly stamped and addressed to the shareholder at his last known address, at such time that in the ordinary handling of the mails the check would be received by such holder within the taxable year, a presumption arises that the dividend was paid to such holder in such year. The determination of whether a dividend has been paid to such holder by the corporation during its taxable year is in no way dependent upon the method of accounting regularly employed by the corporation in keeping its books, or upon the method of accounting upon the basis of which the net income of the corporation is computed. For further rules as to the determination of the right to a deduction for dividends paid, under certain specific circumstances, see section 29.27(b)-2.

(*d*) *Deduction for amounts allocated from income not derived from patronage.*—There is allowable as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 101(12) (A) and section 29.101(12)-1 amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether such amounts are paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. For this purpose, allocations made after the close of the taxable year and on or before the 15th day of the ninth month following the close of the taxable year shall be considered as made on the last day of such taxable year to the extent that such allocations are attributable to income derived during the taxable year or during years prior to the taxable year. As used in this paragraph, the term "income not derived from patronage" means incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment in securities, from the sale or exchange of capital assets, constitutes income not derived from patronage. Business done with the United States shall constitute income not derived from patronage. In order that the deduction for income not derived from patronage may be applicable, it is necessary that the amount sought to be deducted be allocated on a patronage basis in proportion, insofar as is practicable, to the amount of business done by or for patrons during the period to which such income is attributable. Thus,

if capital gains are realized from the sale or exchange of capital assets acquired and disposed of during the taxable year, income realized from such gains must be allocated to patrons of such year in proportion to the amount of business done by such patrons during the taxable year. Similarly, if capital gains are realized by the association from the sale or exchange of capital assets held for a period of more than one taxable year income realized from such gains must be allocated, in proportion insofar as is practicable, to the patrons of the taxable years during which the asset was owned by the association, and to the amount of business done by such patrons during such taxable years.

SEC. 29.101(12)-4. PATRONAGE DIVIDENDS, REBATES, OR REFUNDS: TREATMENT AS TO COOPERATIVE ASSOCIATIONS ENTITLED TO TAX TREATMENT UNDER SECTION 101(12)(B).—(*a*) *General rule.*—For taxable years beginning after December 31, 1951, patronage dividends, refunds, or rebates, allocated by a cooperative association entitled to tax treatment under section 101(12)(B) to a patron shall be taken into account in computing the gross income of such association for the taxable year, as an increase in its other cost of goods sold in the case of an association marketing products for patrons, or as a reduction in its gross receipts, in the case of an association purchasing supplies and equipment or performing services for patrons, as the case may be, if—

(i) The allocation is made in fulfillment and satisfaction of a valid obligation of such association to the patron, which obligation was in existence prior to the receipt by the cooperative association of the amount allocated, and

(ii) The allocation is made on or before the 15th day of the ninth month following the close of the taxable year in which the amounts allocated were received by the cooperative association.

For the purpose of (i) above, amounts allocated by a cooperative association entitled to tax treatment under section 101(12)(B) will be deemed allocated in fulfillment and satisfaction of a valid enforceable obligation, if made pursuant to provisions of the bylaws, articles of incorporation, or other contract, whereby the association is obligated to make such allocation after the retention of "reasonable reserves" and after payment of dividends on capital stock or other proprietary capital interests. Notwithstanding the provisions of (i) and (ii) above, amounts allocated as patronage dividends, refunds, or rebates during the taxable year, or on or before the 15th day of the ninth month following the close of such year, with respect to patronage for years preceding the taxable year, shall be taken into account as an increase in its other cost of goods sold, or as a reduction in gross receipts, for the taxable year, as the case may be, where retention as "reasonable reserves" of the amounts so allocated beyond the year in which earned was proper in accordance with the provisions of section 101(12)(A) and where the allocation is made to the patron on a patronage basis in proportion insofar as is practicable, to the amount of business done by such patrons during the taxable year or years in which the retained amounts were received by the cooperative association.

(*b*) *Illustrations:*

Example 1. E, a cooperative association entitled to tax treatment under section 101(12)(B), organized without capital stock, is engaged in the business of marketing products for its patrons on a nonpool basis. The bylaws of Cooperative E provide that there shall be allocated to patrons as patronage dividends within a reasonable time following the close of the year all of the gross returns from sales, less expenses of operation for the year and amounts retained as "reasonable reserves" necessary to the operation of Cooperative E. At the close of the taxable year, 1952, it is determined that from the gross returns from sales less operating expenses and all taxes for such year, $5,000 is to be retained as "reasonable reserves" for various necessary purposes of Cooperative E. It is assumed that the retention of such amount is proper in accordance with the provisions of section 101(12)(A). Such $5,000 is apportioned on the books of Cooperative E to patrons of 1952 on a patronage basis, or permanent records are kept from which an apportionment to such patrons can be made. On March 1, 1953, pursuant to the terms of the bylaws $200,000, the balance of the gross returns for the taxable year is allocated to patrons of 1952 on the basis of patronage. $100,000 of such $200,000 is allocated in cash. The remaining $100,000 is allocated in "retain certificates", bearing no interest and redeemable in the discretion of the Board of Directors of Cooperative E.

There may be added to the cost of goods sold by Cooperative E for 1952, $200,000 ($100,000 in cash, $100,000 in retain certificates), the total amount allocated as patronage dividends, rebates, or refunds in fulfillment and satisfaction of the obligation of the bylaws, on March 1, 1953, before the 15th day of the ninth month following the close of 1952. There may not be added to the cost of goods sold by Cooperative E for 1952, $5,000, the amount retained as reserves apportioned on the books, but not allocated as patronage dividends, rebates, or refunds.

Example 2. The facts are the same as Example 1, it additionally appearing that at the close of 1953 it is determined by Cooperative E to allocate as cash patronage dividends, rebates, or refunds to patrons of 1952, $5,000, the amount retained as "reasonable reserves" for 1952 in accordance with the provisions of section 101(12)(A). On March 1, 1954, such amount is allocated.

There may be added to the cost of goods sold by Cooperative E for 1953, $5,000, the amount allocated with respect to patronage of a preceding year, 1952, properly maintained as a reserve under section 101(12)(A).

PAR. 4. There is inserted immediately after section 29.22(a)-22 the following:

SEC. 29.22(a)-23. ALLOCATIONS BY COOPERATIVE ASSOCIATIONS; TAX TREATMENT AS TO PATRONS.—(*a*) *In general.*—Amounts allocated on the basis of the business done with or for a patron by a cooperative association, whether or not entitled to tax treatment under section 101(12)(B), in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner disclosing to the patron the dollar amount allocated shall be included in the computation of the gross income of such patron for the taxable year in which received to the extent prescribed in (*b*) of this section, regardless of whether the amount allocated is deemed, for the purpose of section 101(12)(B), to be made at the close of a preceding taxable year of the cooperative association. The determination of the extent of taxability of such amounts is in no way dependent upon the method of accounting employed by the patron or upon the basis, cash, accrual, or otherwise, upon which the net income of such patron is computed.

(*b*) *Extent of taxability.*—(1) Amounts allocated to a patron on a patronage basis by a cooperative association with respect to products marketed for such patron, or with respect to supplies, equipment, or services the cost of which was deductible by the patron under section 23, shall be included in the computation of the gross income of such patron to the following extent:

(i) If the allocation is in cash, in the amount of cash received.

(ii) If the allocation is in merchandise, to the extent of the fair market value of such merchandise at the time of receipt by the patron.

(iii) If the allocation is in the form of capital stock, revolving fund certificates, certificates of indebtedness, letters of advice, retain certificates, or similar documents—

(A) To the extent of the face amount of such documents, if the allocation was made in fulfillment and satisfaction of a valid obligation of such association to the patron, which obligation was in existence prior to the receipt by the cooperative association of the amount allocated. For this purpose, it is immaterial whether such allocation was made within the time required by section 29.101(12)-4(*a*)(ii).

(B) To the extent of the face amount of such documents, if the allocation was made with respect to patronage of a year preceding the taxable year from amounts retained as "reasonable reserves" under section 29.101-4(*a*).

(C) To the extent of the cash or merchandise received in redemption or satisfaction of such documents (except those which are negotiable instruments) at the time of receipt of such cash or merchandise by the patron, where such allocation was not made in pursuance of the valid obligation referred to in (A), above, or from amounts retained as "reasonable reserves" under section 29.101(12)-4(*a*), referred to in (B), above. Where, in such case, the documents allocated are negotiable instruments, such documents shall be includible in the income of the patron to the extent of their fair market value at the time of their receipt.

(2) Amounts which are allocated on a patronage basis by a cooperative association with respect to supplies, equipment, or services the cost of which was not deductible by the patron under section 23, are not includible in the computation of the gross income of such patron; however, in the case of such amounts which are allocated with respect to capital assets (as defined in section 117(a)(1)) or property used in the trade or business within the meaning of section 117(j), shall, to the extent set forth in subdivisions (i), (ii), and (iii) of paragraph (1) of this subsection, be taken into account in determining under section 113 the cost or other basis of the assets or property purchased for the patron.

PAR. 5. Section 29.148–4, as added by Treasury Decision 5907 [C. B. 1952–1, 107], approved May 29, 1952, is amended as follows:

(A) By changing the heading of subsection (*d*) thereof to read as follows: "*Definitions applicable to distributions for the calendar years 1951 and 1952.*—" and by adding immediately after such heading the following: "In the case of distributions for the calendar years 1951 and 1952, the following terms shall, for the purpose of this section, have the meaning ascribed below:"

(B) By striking the words "of this section" in the sentence immediately following the heading of subsection (*e*) thereof, which sentence begins with the words "The application of" and inserting in lieu thereof the following: "of subsection (*d*) above, applicable to distributions for the calendar years 1951 and 1952,"

(C) By inserting immediately after subsection (*e*) thereof the following new subsection:

(*f*) *Definitions applicable to distributions for the calendar year 1953 and subsequent calendar years.*—In the case of distributions for the calendar year 1953, and subsequent calendar years the terms "Cooperative association," "Patron," "Patronage dividends, rebates, and refunds," and "Allocation" are defined for the purpose of this section, in section 29.101(12)-2(*b*).

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

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved May 29, 1953.

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

(Filed with the Division of the Federal Register June 2, 1953, 8:53 a. m.)

SECTION 29.101(12)-1: Farmers' cooperative marketing and purchasing associations.

INTERNAL REVENUE CODE

Time extended for filing exempt cooperative association income tax return, Form 990–C. (See Rev. Rul. 27, page 85.)

SECTION 29.101(12)-1: Farmers' cooperative marketing and purchasing associations.

INTERNAL REVENUE CODE

Further extension of time for filing exempt cooperative association income tax return, Form 990–C. (See Rev. Rul. 102, page 86.)

SECTION 102.—SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

SECTION 29.102–4: Computation of undistributed section 102 net income. T. D. 5989

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 section 315 of the Revenue Act of 1951.

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

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

On December 4, 1952, notice of proposed rule making conforming Regulations 111 [26 CFR, part 29] to section 315 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 10971). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments to Regulations 111, set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.102–1 the following:

SEC. 315. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) LONG-TERM CAPITAL GAINS.—Section 102(d)(1) (relating to definition of section 102 net income) is hereby amended by adding at the end thereof the following new subparagraph:

"(D) Long-Term Capital Gains.—The excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by this chapter attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between (i) the taxes imposed by this chapter (except the tax imposed by this section) for such year and (ii) such taxes computed for such year without including such excess in net income."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall be applicable only with respect to taxable years beginning after December 31, 1950.

PAR. 2. Section 29.102–4, as amended by Treasury Decision 5796 [C. B. 1950–2, 24], approved July 19, 1950, is further amended as follows:

(A) By changing the period at the end of the second sentence to a semicolon and by adding at the end thereof the following:

(*e*) for taxable years beginning after December 31, 1950, the amount remaining after deducting from the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year (computed without regard to any capital loss carryover) the taxes attributable to such excess. For purposes of (*e*) above, the taxes attributable to such excess shall be the amount remaining after deducting from the taxes imposed by chapter 1 for such year (determined without regard to the taxes imposed by section 102) the taxes similarly imposed and determined for such year without including the excess of net long-term capital gain over the net short-term capital loss for such year in

net income. For example, if the taxpayer pays the alternative tax as computed under section 117(c) the tax attributable to the excess of the net long-term capital gain over the net short-term capital loss shall be the amount computed under section 117(c)(1)(B).

(B) By changing the period at the end of the fifth sentence to a comma and by adding at the end thereof the following:

and, in addition, for taxable years beginning after December 31, 1950, the deduction enumerated in (*e*), above.

(C) By striking the period at the end of the sixth sentence and adding at the end thereof the following:

(including, for taxable years beginning after December 31, 1950, the deduction enumerated in (*e*), above).

(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).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved February 16, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 19, 1953, 8:52 a. m.)

SECTION 29.102–4: Computation of undistributed section 102 net income. Rev. Rul. 6

INTERNAL REVENUE CODE

In determining the "section 102 net income" of a corporation which keeps accounts and files returns on the accrual basis, an adjustment in Federal income tax liability for the taxable year 1950 resulting from a net operating loss carry-back from the taxable year 1951 should not be reflected in the tax deduction provided by section 102(d)(1)(A) of the Internal Revenue Code.

Advice is requested whether, in determining the net income under section 102 of the Internal Revenue Code (relating to surtax on corporations improperly accumulating surplus) of a corporation which keeps accounts and files returns on the accrual basis, an adjustment in Federal income tax liability for the taxable year 1950 resulting from a net operating loss carry-back from the taxable year 1951 should be reflected in the tax deduction provided by section 102(d)(1)(A) of the Code.

Section 102(d)(1)(A) of the Internal Revenue Code provides in part as follows:

(d) DEFINITIONS.—As used in this chapter—

(1) SECTION 102 NET INCOME.—The term "section 102 net income" means the net income * * * computed without the net operating loss deduction provided in section 23(s), minus the sum of—

(A) TAXES.—Federal income, war-profits, and excess-profits taxes * * * paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

It is the position of the Bureau that the term "paid or accrued," as used in section 102(d)(1)(A) of the Code, *supra*, must be construed

according to the method of accounting used in computing the net income of the taxpayer. Therefore, a taxpayer which keeps its accounts and files its returns on the accrual basis must accrue its Federal income, war-profits, and excess-profits taxes for the purpose of determining its deduction for taxes provided by section 102(d)(1)(A) of the Code in computing its "section 102 net income." (See section 29.43-1 of Regulations 111.)

The Federal income tax liability for the taxable year 1950 accrued at the close of such taxable year. The taxpayer was required to compute its Federal income tax and file its return for such year without regard to any net operating loss carry-back. (See S. Rept. 1631, 77th Cong., 2d sess., C. B. 1942-2, 504, 597.) The amount of the tax so computed constituted a deduction for taxes under section 102(d)(1)(A) of the Code, *supra*.

In Mimeograph 6444 (C. B. 1949-2, 11), relating to the treatment for Federal income tax purposes of refunds of taxes, the deduction of which in prior years resulted in tax benefits, it is stated: "Since the decision in *Burnet* v. *Sanford & Brooks Co.* (282 U. S. 359, Ct. D. 277, C. B. X-1, 363 (1931)), emphasis has been given to the point that income taxation is on an annual basis. So long as an item of income or expense was properly accounted for in one period, no change is justified under this doctrine merely because events in a subsequent period might materially change the treatment of the original item." It is concluded in Mimeograph 6444, from an analysis of the opinion of the Supreme Court of the United States in *Security Flour Mills Co.* v. *Commissioner* (321 U. S. 281, Ct. D. 1603, C. B. 1944, 526), in conjunction with earlier cases including *United States* v. *Anderson* (269 U. S. 422, T. D. 3839, C. B. V-1, 179 (1926)), *Dixie Pine Products Co.* v. *Commissioner* (320 U. S. 516, Ct. D. 1598, C. B. 1944, 509), and *Fawcus Machine Co.* v. *United States* (282 U. S. 375, Ct. D. 278, C. B. X-1, 424 (1931)), that each taxable year is to be treated as a separate unit.

In the instant case, it is evident that the event which fixed the right of the taxpayer to a reduction in income tax liability and a refund of a portion of the income tax accrued and paid for the taxable year 1950 did not occur until the close of the year 1951, when the amount of the net operating loss for such year (1951) became definite and certain. Since the taxpayer could not reasonably have anticipated a net operating loss for the taxable year 1951 which would later be available to reduce the amount of income tax liability for 1950, it could not, at the close of the taxable year 1950, have determined the amount of dividends to be distributed in order to obviate the application of section 102 of the Code to its income for 1950.

Accordingly, it is held that in determining the "section 102 net income" of a corporation which keeps accounts and files returns on the accrual basis, an adjustment in Federal income tax liability for the taxable year 1950 resulting from a net operating loss carry-back from the taxable year 1951 should not be reflected in the tax deduction provided by section 102(d)(1)(A) of the Internal Revenue Code.

SECTION 108.—FISCAL YEAR TAXPAYERS

SECTION 29.108-4: Computation of tax of individuals for taxable years beginning before October 1, 1950, and ending after September 30, 1950 (other than the calendar year 1950). (Also Sections 29.108-5, 29.108-6, 29.108-7, 29.108-8, 29.108-9; Section 47, Section 29.47-1; Section 430, Section 40.430-2, Regulations 130.) T. D. 5969

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29 AND PART 40

Regulations 111 amended to conform to section 131 of the Revenue Act of 1950, section 203 of the Excess Profits Tax Act of 1950, and section 131 (a) and (c) of the Revenue Act of 1951; and Regulations 130 amended to conform to section 131(b) of the Revenue Act of 1951.

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

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

On October 18, 1952, notice of proposed rule making, regarding amendments to conform Regulations 111 [26 CFR, part 29] to section 131 of the Revenue Act of 1950, approved September 23, 1950, section 203 of the Excess Profits Tax Act of 1950, approved January 3, 1951, and section 131 (a) and (c) of the Revenue Act of 1951, approved October 20, 1951, and to conform Regulations 130 [26 CFR, part 40] to section 131(b) of the Revenue Act of 1951, was published in the Federal Register (17 F. R. 9251). No objection to the rules proposed having been received, the amendments to Regulations 111 and 130 set forth below are hereby adopted.

REGULATIONS 111 [26 CFR, PART 29]

PARAGRAPH 1. Section 29.47-1, as amended by Treasury Decision 5517 [C. B. 1946-2, 6], approved June 12, 1946 [26 CFR 29.47-1], is further amended by adding at the end of the section the following:

Any reference in the regulations in this part to a taxable year which is the calendar year (see, for example, the regulations under sections 11-15, inclusive, and 108) means a taxable year of 12 months beginning on January 1 and ending on December 31. The term does not include a taxable year of less than 12 months, even though the taxpayer may have customarily made his returns on the basis of a calendar year.

PAR. 2. There is inserted immediately preceding section 29.108-1 [26 CFR 29.108-1] the following:

SEC. 131. FISCAL YEAR TAXPAYERS [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

(a) AMENDMENT OF SECTION 108.—Section 108 is hereby amended by striking out subsection (e) and inserting in lieu thereof the following new subsections:

"(e) CERTAIN TAXABLE YEARS OF INDIVIDUALS BEGINNING BEFORE OCTOBER 1, 1950, AND ENDING AFTER SEPTEMBER 30, 1950.—In the case of a taxable year (other than one beginning on January 1, 1950, and ending

on December 31, 1950) of a taxpayer other than a corporation beginning before October 1, 1950, and ending after September 30, 1950, the tax imposed by sections 11, 12, and 400 shall be an amount equal to the sum of—

"(1) that portion of a tentative tax, computed under the provisions of sections 11(b), 12(b)(2), 12(c)(2), and 12(d), or table III of section 400, applicable to such taxable year, which the number of calendar months in such taxable year prior to October 1, 1950, bears to the total number of calendar months in such taxable year, plus

"(2) that portion of a tentative tax, computed under the provisions of sections 11(a), 12(b)(1), 12(d), and 12(f), or Table I of section 400, as if such provisions were applicable to such taxable year, which the number of calendar months in such taxable year after September 30, 1950, bears to the total number of calendar months in such taxable year.

For the purposes of this subsection, a calendar month only part of which falls within the taxable year (A) shall be disregarded if less than 15 days of such month are included in such taxable year, and (B) shall be included as a calendar month within the taxable year if more than 14 days of such month fall within the taxable year.

"(f) CERTAIN TAXABLE YEARS OF CORPORATIONS BEGINNING BEFORE JULY 1, 1950, AND ENDING AFTER JUNE 30, 1950.—In the case of a taxable year (other than one beginning on January 1, 1950, and ending on December 31, 1950) of a corporation beginning before July 1, 1950, and ending after June 30, 1950, the tax imposed by sections 13, 14, and 15 shall be an amount equal to the sum of—

"(1) that portion of a tentative tax, computed under the provisions of sections 13(b)(3), 14, and 15(b)(3), applicable to such taxable year, which the number of days in such taxable year prior to July 1, 1950, bears to the total number of days in such taxable year, plus

"(2) that portion of a tentative tax, computed under the provisions of sections 13(b)(1) and 15(b)(1), as if such provisions (and the provisions of sections 26(b)(2)(A), 26(h)(1)(B), and 26(i)(1)) were applicable to such taxable year, which the number of days in such taxable year after June 30, 1950, bears to the total number of days in such taxable year.

"(g) SPECIAL CLASSES OF TAXPAYERS.—This section shall not apply to an insurance company subject to Supplement G or an investment company subject to Supplement Q."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) in striking out subsection (e) of section 108 of the Internal Revenue Code shall not apply in the case of any taxable year described in subsections (a), (b), or (c) of such section.

SEC. 203. FISCAL YEAR TAXPAYERS [EXCESS PROFITS TAX ACT OF 1950, APPROVED JANUARY 3, 1951].

Section 108(f)(2) of the Internal Revenue Code (relating to computation of tax of a fiscal year beginning before July 1, 1950, and ending after June 30, 1950) is hereby amended by adding at the end thereof the following new sentence: "For the purposes of this paragraph, the provisions of sections 15(b)(1), 26(h)(1), and 26(i)(1) shall be applied without regard to the amendments made to such provisions by Title II [secs. 201, 202, and 203] of the Excess Profits Tax Act of 1950."

SEC. 131. FISCAL YEAR TAXPAYERS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 108.—Section 108 is hereby amended by striking out paragraph (2) of subsection (f) and inserting in lieu thereof the following:

"(2) that portion of a tentative tax consisting of—

"(A) A tentative normal tax of 25 per centum of the normal-tax net income, plus

"(B) a tentative surtax of 20 per centum of the surtax net income in excess of $25,000,

which the number of days in such taxable year after June 30, 1950, and before April 1, 1951, bears to the total number of days in such taxable year, plus (if the taxable year ends after March 31, 1951)

"(3) that portion of a tentative tax consisting of—

"(A) a tentative normal tax of 30 per centum of the normal-tax net income plus,

"(B) a tentative surtax of 20 per centum of the surtax net income in excess of $25,000,

which the number of days in such taxable year after March 31, 1951, bears to the total number of days in such taxable year.

In computing for the purposes of paragraph (2) the normal-tax net income and the corporation surtax net income, the credits provided in section 26 applicable to taxable years beginning on July 1, 1950, shall be allowed in the manner and to the extent provided in sections 13 and 15 applicable to years beginning on such date, except that such credits shall be applied without regard to the amendments made to section 26 by title II [inc. sec. 202] of the Excess Profits Tax Act of 1950. In computing for the purposes of paragraph (3) the normal-tax net income and the corporation surtax net income, the credits provided in section 26 applicable to taxable years beginning on April 1, 1951, shall be allowed in the manner and to the extent provided in sections 13 and 15 applicable to years beginning on such date.

"(g) CERTAIN TAXABLE YEARS OF CORPORATIONS BEGINNING AFTER JUNE 30, 1950, AND BEFORE APRIL 1, 1951.—In the case of a taxable year (other than one beginning on January 1, 1951, and ending on December 31, 1951) of a corporation beginning after June 30, 1950, and before April 1, 1951, and ending after March 31, 1951, the tax imposed by sections 13 and 15 shall be an amount equal to the sum of—

"(1) that portion of a tentative tax, computed under the provisions of sections 13 and 15 applicable to such taxable year, which the number of days in such taxable year prior to April 1, 1951, bears to the total number of days in such taxable year, plus

"(2) that portion of a tentative tax, computed under the provisions of sections 13 and 15 applicable to years beginning on April 1, 1951, as if such provisions were applicable to such taxable year, which the number of days in such taxable year after March 31, 1951, bears to the total number of days in such taxable year.

"(h) CERTAIN TAXABLE YEARS OF INDIVIDUALS BEGINNING BEFORE NOVEMBER 1, 1951, AND ENDING AFTER OCTOBER 31, 1951.—In the case of a taxable year (other than one beginning on January 1, 1951, and ending on December 31, 1951) of a taxpayer, other than a corporation, beginning before November 1, 1951, and ending after October 31, 1951, the tax imposed by sections 11 and 12, section 400, or section 421(a)(2), shall be an amount equal to the sum of—

"(1) that portion of a tentative tax, computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), applicable to such year, which the number of calendar months in such taxable year prior to November 1, 1951, bears to the total number of calendar months in such taxable year, plus

"(2) that portion of a tentative tax, computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), applicable to years beginning on November 1, 1951, as if such provisions (other than the provisions relating to head of household) were applicable to such taxable year, which the number of calendar months in such taxable year after October 31, 1951, bears to the total number of calendar months in such taxable year.

This subsection shall not apply in the case of a trust described in section 421(b)(2) if the taxable year of such trust began before January 1, 1951.

"(i) DEFINITION OF CALENDAR MONTH.—For the purposes of this section, a calendar month only part of which falls within a taxable year (1) shall be disregarded if less than 15 days of such month are included in such taxable year, and (2) shall be included as a calendar month within the taxable year if more than 14 days of such month fall within the taxable year.

"(j) TAXABLE YEARS OF INDIVIDUALS BEGINNING IN 1953 AND ENDING IN 1954.—In the case of a taxable year of a taxpayer, other than a corporation, beginning before January 1, 1954, and ending after December 31, 1953, the tax imposed by sections 11 and 12, section 400, or section 421 (a) (2), shall be an amount equal to the sum of—

"(1) that portion of a tentative tax, computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), applicable to years beginning on January 1, 1953, which the number of calendar months in such taxable year prior to January 1, 1954, bears to the total number of calendar months in such taxable year, plus

"(2) that portion of a tentative tax, computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), applicable to years beginning on January 1, 1954, as if such provisions were applicable to such taxable year, which the number of calendar months in such taxable year after December 31, 1953, bears to the total number of calendar months in such taxable year.

"(k) TAXABLE YEARS OF CORPORATIONS BEGINNING BEFORE APRIL 1, 1954, AND ENDING AFTER MARCH 31, 1954.—In the case of a taxable year of a corporation beginning before April 1, 1954, and ending after March 31, 1954, the tax imposed by sections 13 and 15, or section 421(a)(1), shall be an amount equal to the sum of—

"(1) that portion of a tentative tax, computed under the provisions of sections 13 and 15, or section 421(a)(1), applicable to years beginning on January 1, 1953, which the number of days in such taxable year prior to April 1, 1954, bears to the total number of days in such taxable year, plus

"(2) that portion of a tentative tax, computed under the provisions of sections 13 and 15, or section 421(a)(1), applicable to years beginning on April 1, 1954, as if such provisions were applicable to such taxable year, which the number of days in such taxable year after March 31, 1954, bears to the total number of days in such taxable year."

* * * * * * *

(c) TECHNICAL AMENDMENTS.—

(1) Section 108(e)(2) is hereby amended by inserting after "section 400." the following: "applicable to years beginning on October 1, 1950.".

(2) Section 108(g) is hereby amended by striking out "(g)" and inserting in lieu thereof "(1)".

PAR. 3. There is inserted immediately after section 29.108-3, as added by Treasury Decision 5687 [C. B. 1949-1, 9], approved February 16, 1949 [26 CFR 29.108-3], the following new sections:

SEC. 29.108-4. COMPUTATION OF TAX OF INDIVIDUALS FOR TAXABLE YEARS BEGINNING BEFORE OCTOBER 1, 1950, AND ENDING AFTER SEPTEMBER 30, 1950 (OTHER THAN THE CALENDAR YEAR 1950).—(*a*) *General rule.*—For a taxable year beginning before October 1, 1950, and ending after September 30, 1950 (other than the calendar year 1950), 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(e), as amended by the Revenue Acts of 1950 and 1951. The tax shall be an amount equal to the sum of—

(1) That portion of a tentative tax under section 108(e)(1), computed under the provisions of sections 11(b), 12(b)(2), 12(c)(2), and 12(d), or table III of section 400, applicable to taxable years beginning on September 1, 1950, which the number of calendar months prior to October 1, 1950, in the taxable year of the taxpayer bears to the total number of calendar months in such taxable year, and

(2) That portion of a tentative tax under section 108(e)(2), computed under the provisions of sections 11(a), 12(b)(1), 12(d), and 12(f), or table I of section 400, applicable to taxable years beginning on October 1, 1950, which the number of calendar months after September 30, 1950, in the taxable year of the taxpayer bears to the total number of calendar months in such taxable year.

For the purpose of section 108(e) and this section, a calendar month only part of which falls within the taxable year (i) shall be disregarded if less than 15 days of such month are included in such taxable year, and (ii) shall be included as a calendar month within the taxable year if more than 14 days of such month fall within the taxable year.

(*b*) *Estates, trusts, and nonresident alien individuals.*—The provisions of section 108(e) apply to estates, trusts, and nonresident alien individuals subject to tax under sections 11 and 12.

(*c*) *Short taxable years.*—The provisions of section 108(e) apply to a taxable year beginning before October 1, 1950, and ending after September 30, 1950 (other than the calendar year 1950), 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(e) 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(e), 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(e). However, in the case of a taxpayer who is subject to the provisions of section 108(e) 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).

(*d*) *Alternative tax under section 117(c).*—In any case in which a taxpayer subject to the provisions of section 108(e) 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(e), 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).

(*e*) *Certain joint returns.*—If a joint return of a husband and wife is filed under the provisions of section 51(b)(3), if the husband and wife have different taxable years solely because of the death of either spouse, and if the taxable year of the surviving spouse covered by such joint return is a period which began before October 1, 1950, and ended after September 30, 1950 (other than the calendar year 1950), the number of calendar months to be taken into account for the purpose of computing the portions of the tentative tax under section 108(e)(1) and (2) shall be the number of calendar months prior to October 1, 1950, in the taxable year of the surviving spouse, the number of calendar months after September 30, 1950, in the taxable year of the surviving spouse, and the total number of calendar months in the taxable year of the surviving spouse.

(*f*) *Credits against tax.*—In the case of a taxpayer subject to the provisions of section 108(e), any credit against the tax otherwise imposed by sections 11, 12, and 400, such as the credit for taxes paid to a foreign country or possession of the United States under section 131, shall be deducted from, and any limitation in such credit shall be based upon, the tax computed under section 108(e). However, in those instances in which an individual taxpayer computes a tentative tax under section 108(e) by taking into account the optional standard deduction under section 23(aa), the following credits shall not be allowed: all credits under section 131 with respect to taxes of foreign countries and possessions, and all credits with respect to taxes withheld at the source under section 143(a), relating to interest on tax-free covenant bonds.

SEC. 29.108-5. COMPUTATION OF TAX OF CORPORATIONS FOR TAXABLE YEARS BEGINNING BEFORE JULY 1, 1950, AND ENDING AFTER JUNE 30, 1950 (OTHER THAN THE CALENDAR YEAR 1950).—(*a*) *In general.*—For a taxable year beginning before July 1, 1950, and ending after June 30, 1950 (other than the calendar year 1950), the normal tax and surtax imposed by sections 13, 14, and 15 upon corporations shall be computed under section 108(f), as added by the Revenue Act of 1950 and as amended by the Excess Profits Tax Act of 1950 and the Revenue Act of 1951.

(*b*) *Taxable years beginning before July 1, 1950, and ending after June 30, 1950, and before April 1, 1951.*—For a taxable year beginning before July 1, 1950, and ending after June 30, 1950, and before April 1, 1951 (other than the calen-

dar year 1950), the normal tax and surtax of a corporation shall be an amount equal to the sum of—

(1) That portion of a tentative tax under section 108(f)(1), computed under the provisions of sections 13(b)(3), 14, and 15(b)(3), applicable to taxable years begining on June 1, 1950, (for applicable rates, see (*d*) of this section), which the number of days prior to July 1, 1950, in the taxable year of the taxpayer bears to the total number of days in such taxable year, and

(2) That portion of a tentative tax under section 108(f)(2) consisting of—

(i) a tentative normal tax of 25 percent of the normal-tax net income, plus

(ii) a tentative surtax of 20 percent of the surtax net income in excess of $25,000,

which the number of days after June 30, 1950, in the taxable year of the taxpayer bears to the total number of days in such taxable year.

(*c*) *Taxable years beginning before July 1, 1950, and ending after March 31, 1951.*—For a taxable year beginning before July 1, 1950, and ending after March 31, 1951, the normal tax and surtax of a corporation shall be an amount equal to the sum of—

(1) That portion of a tentative tax under section 108(f)(1), computed under the provisions of sections 13(b)(3), 14, and 15(b)(3), applicable to taxable years beginning on June 1, 1950 (for applicable rates, see (d) of this section), which the number of days prior to July 1, 1950, in the taxable year of the taxpayer bears to the total number of days in such taxable year, and

(2) That portion of a tentative tax under section 108(f)(2) consisting of—

(i) a tentative normal tax of 25 percent of the normal-tax net income, plus

(ii) a tentative surtax of 20 percent of the surtax net income in excess of $25,000,

which the number of days after June 30, 1950, and before April 1, 1951, in the taxable year of the taxpayer bears to the total number of days in such taxable year, and

(3) That portion of a tentative tax under section 108(f)(3) consisting of—

(i) a tentative normal tax of 30 percent of the normal-tax net income, plus

(ii) a tentative surtax of 20 percent of the surtax net income in excess of $25,000,

which the number of days after March 31, 1951, in the taxable year of the taxpayer bears to the total number of days in such taxable year.

(*d*) *Rates applicable under section 108(f)(1).*—(1) *Normal tax.*—The tentative normal tax under section 108(f)(1) of a corporation, other than a foreign corporation, is computed upon its normal-tax net income at the rates prescribed by section 13 or 14, which are as follows:

(i) if the normal-tax net income is not in excess of $5,000, 15 percent of the amount thereof;

(ii) if the normal-tax net income is in excess of $5,000 but not in excess of $20,000, $750 plus 17 percent of the amount of such income in excess of $5,000;

(iii) if the normal-tax net income is in excess of $20,000 but not in excess of $25,000, $3,300 plus 19 percent of such income in excess of $20,000;

(iv) if the normal-tax net income is in excess of $25,000 but not in excess of $50,000, $4,250 plus 31 percent of such income in excess of $25,000; or

(v) if the normal-tax net income is in excess of $50,000, 24 percent of the entire amount thereof.

The tentative normal tax under section 108(f)(1) of a foreign corporation engaged in trade or business within the United States is computed upon its normal-tax net income at the rate of 24 percent as prescribed by section 14.

(2) *Surtax.*—The tentative surtax under section 108(f)(1) of a corporation, other than a foreign corporation, not engaged in trade or business within the United States, is computed upon its corporation surtax net income at the rates prescribed by section 15, which are as follows:

(i) if the corporation surtax net income is not in excess of $25,000, 6 percent of the amount thereof;

(ii) if the corporation surtax net income is in excess of $25,000 but not in excess of $50,000, $1,500 plus 22 percent of the amount of such income in excess of $25,000; or

(iii) if the corporation surtax net income is in excess of $50,000, 14 percent of the entire amount thereof.

(e) *Computation of normal-tax net income and corporation surtax net income in special cases.*—(1) *In general.*—In computing the tentative taxes under section 108(f) (1), (2), and (3), the amount of the net income and the amount of the adjusted net income of the corporation are not recomputed and remain unchanged. However, the credits provided in section 26 (b), (h), and (i) may differ in computing the several tentative taxes. Thus, in the case of a Western Hemisphere trade corporation, or a public utility corporation which has paid dividends on its preferred stock with respect to which the credit for dividends paid provided in section 26(h) is allowable, or any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26(h) is allowable to the distributing corporation, the amount of the normal-tax net income and the amount of the corporation surtax net income for one tentative tax computation differ from such amounts for any other tentative tax computation. Moreover, in the case of any corporation which has a taxable year ending after March 31, 1951, and which has received dividends on the stock of a foreign corporation with respect to which the credit provided in section 26(b)(3) is allowable, the amount of the normal-tax net income and the amount of the corporation surtax net income for the third tentative tax computation differ from such amounts for the first and second tentative tax computations. See (2), (3), (4), and (5), below.

(2) *Western Hemisphere trade corporations.*—In the case of a Western Hemisphere trade corporation, its tentative tax under section 108(f)(1) is computed only on its normal-tax net income, since a Western Hemisphere trade corporation is not subject to surtax under the law applicable (without regard to section 108) to a taxable year beginning on June 1, 1950, and the credit provided in section 26(i) is not applicable in determining its normal-tax net income for the purpose of the computation of the first tentative tax. The normal-tax net income and corporation surtax net income of a Western Hemisphere trade corporation are determined for the purpose of the tentative tax computation under section 108(f)(2), with the allowance of the 31 percent credit provided in section 26(i) applicable to a taxable year beginning on July 1, 1950, without regard to the amendment of section 26(i) made by the Excess Profits Tax Act of 1950, and, for the purpose of the tentative tax computation under section 108(f)(3), with the allowance of the 27 percent credit provided in section 26(i) applicable to a taxable year beginning on April 1, 1951.

(3) *Public utilities paying dividends on preferred stock.*—In the case of a public utility corporation which has paid dividends on its preferred stock with respects to which the credit for dividends paid provided in section 26(h) is allowable, its normal-tax net income is determined, for the purpose of the tentative tax computation under section 108(f)(1), without regard to the credit provided in section 26(h), and its corporation surtax net income is determined, for such purpose, with the allowance of the credit provided in section 26(h) applicable to a taxable year beginning on June 1, 1950. The normal-tax net income and corporation surtax net income of such a public utility corporation are determined, for the purpose of the tentative tax computation under section 108(f)(2), with the allowance of the 31 percent credit provided in section 26(h) applicable to a taxable year beginning on July 1, 1950, without regard to the amendment of section 26(h) made by the Excess Profits Tax Act of 1950, and, for the purpose of the tentative tax computation under section 108(f)(3), with the allowance of the 27 percent credit provided in section 26(h) applicable to a taxable year beginning on April 1, 1951.

(4) *Corporations receiving dividends on preferred stock of public utility.*—In the case of any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26(h) is allowable to the distributing corporation, its normal-tax net income is determined, for the purpose of the tentative tax computation under section 108(f)(1), with the allowance of the 85 percent credit provided in section 26(b) with respect to such dividends received, and its corporation surtax net income is determined, for such purpose, without regard

to any credit provided in section 26(b) with respect to such dividends received. The normal-tax net income and corporation surtax net income of such a corporation are determined for the purpose of the tentative tax computation under section 108(f)(2), with the allowance of the 59 percent credit provided in section 26(b)(2) with respect to such dividends received, and, for the purpose of the tentative tax computation under section 108(f)(3), with the allowance of the 62 percent credit provided in section 26(b)(2) with respect to such dividends received.

(5) *Corporations receiving dividends from foreign corporation.*—In the case of any corporation which has a taxable year ending after March 31, 1951, and which has received dividends on the stock of a foreign corporation with respect to which the credit provided in section 26(b)(3) is allowable, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computations under section 108(f) (1) and (2), without regard to the credit provided in section 26(b)(3), and, for the purpose of the tentative tax computation under section 108(f)(3), with the allowance of the credit provided in section 26(b)(3).

(*f*) *Classes of corporations excluded from operation of section 108(f).*—The provisions of section 108(f) do not apply to an insurance company subject to supplement G, a regulated investment company subject to supplement Q, or a foreign corporation not engaged in trade or business within the United States.

(*g*) *Short taxable years.*—The provisions of section 108(f) apply to a taxable year beginning before July 1, 1950, and ending after June 30, 1950 (other than the calendar year 1950), whether or not such taxable year is one of less than 12 months. In the case of a taxpayer which is subject to the provisions of section 108(f) and which 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 each tentative tax computation under section 108(f), or shall be computed under the exception in section 47(c)(2) for the purpose of each such tentative tax computation. 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(f). However, in the case of a taxpayer which is subject to the provisions of section 108(f) and which because of any reason other than a change in accounting period has a taxable year of less than 12 months, the net income for the purpose of section 108(f) 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).

(*h*) *Alternative tax under section 117(c).*—In any case in which a taxpayer subject to the provisions of section 108(f) 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(f), by computing each such tentative tax pursuant to the alternative tax computation provided in section 117(c), regardless of whether any tentative tax so computed on the alternative basis is larger or smaller than the tentative tax computed without regard to section 117(c).

(*i*) *Credits against tax.*—In the case of a taxpayer subject to the provisions of section 108(f), any credit against the tax otherwise imposed by sections 13, 14, and 15, such as the credit for taxes paid to a foreign country or possession of the United States under section 131, shall be deducted from, and any limitation in such credit shall be based upon, the tax computed under section 108(f).

(*j*) *Examples.*—This section may be illustrated by the following examples:

Example (1). The A Corporation, a domestic corporation (which is neither a public utility referred to in section 26(h) nor a Western Hemisphere trade corporation referred to in section 26(i)), makes its income tax returns on the basis of a fiscal year ending May 31. For the fiscal year which began June 1, 1950, and ended May 31, 1951, the A Corporation had net income of $100,000, which did not include any interest on United States obligations or dividends on stock of foreign corporations. The net income includes cash dividends received from a domestic corporation other than a public utility (allowable as a credit under section 26(b)(1)) in the amount of $10,000, and cash dividends received from a domestic public utility corporation on its preferred stock (with respect to

which a credit is allowable to the public utility under section 26(h)) in the amount of $5,000. The normal tax and surtax of the A Corporation for its fiscal year ended May 31, 1951, are $22,771.50 and $12,713.21, respectively, computed as follows:

(i) *Computation of tentative taxes provided in section 108(f)(1).*

NORMAL TAX

1. Net income		$100,000.00
2. Less credit under section 26(b)(1) for dividends received from domestic corporations (85 percent of $15,000)		12,750.00
3. Normal-tax net income		87,250.00
4. Normal tax (24 percent of item 3)		20,940.00

SURTAX

5. Net income		$100,000.00
6. Less credit under section 26(b)(1) for dividends received from domestic corporation other than dividends with respect to which credit is allowable under section 26(h) (85 percent of $10,000)		8,500.00
7. Corporation surtax net income		91,500.00
8. Surtax (14 percent of item 7)		12,810.00

(ii) *Computation of tentative taxes provided in section 108(f)(2).*

NORMAL TAX AND SURTAX

9. Net income		$100,000.00
10. Less credit under section 26(b)(1) for dividends received from domestic corporation other than dividends with respect to which credit is allowable under section 26(h) (85 percent of $10,000)	$8,500.00	
11. Less credit under section 26(b)(2) for dividends received with respect to which credit is allowable under section 26(h) (59 percent of $5,000)	2,950.00	
		11,450.00
12. Normal-tax net income and corporation surtax net income		88,550.00
13. Normal tax (25 percent of item 12)		22,137.50
14. Surtax (20 percent of $63,550, the excess of $88,550 over $25,000)		12,710.00

(iii) *Computation of tentative taxes provided in section 180(f)(3).*

NORMAL TAX AND SURTAX

15. Net income		$100,000.00
16. Less credit under section 26(b)(1) (85 percent of $10,000)	$8,500.00	
17. Less credit under section 26(b)(2) (62 percent of $5,000)	3,100.00	
		11,600.00
18. Normal-tax net income and corporation surtax net income		88,400.00
19. Normal tax (30 percent of item 18)		26,520.00
20. Surtax (20 percent of $63,400, the excess of $88,400 over $25,000)		12,680.00

(iv) *Computation of normal tax and surtax for fiscal year ended May 31, 1951.*

21. Number of days in taxable year prior to July 1, 1950	30
22. Number of days in taxable year after June 30, 1950, and before April 1, 1951	274
23. Number of days in taxable year after March 31, 1951	61
24. Total number of days in taxable year	365

NORMAL TAX

25. Tentative normal tax computed in (i)	$20,940.00	
26. 30/365ths of $20,940		$1,721.10
27. Tentative normal tax computed in (ii)	$22,137.50	
28. 274/365th of $22,137.50		16,618.29
29. Tentative normal tax computed in (iii)	$26,520.00	
30. 61/365ths of $26,520		4,432.11
31. Total normal tax		22,771.50

SURTAX

32. Tentative surtax computed in (i)	$12,810.00	
33. 30/365ths of $12,810		$1,052.88
34. Tentative surtax computed in (ii)	$12,710.00	
35. 274/365ths of $12,710		9,541.21
36. Tentative surtax computed in (iii)	$12,680.00	
37. 61/365ths of $12,680		2,119.12
38. Total surtax		12,713.21

Example (2). The facts are the same as in example (1), above, except that the taxable year is the fiscal year which began April 1, 1950, and ended March 31, 1951. The normal tax and surtax of the A Corporation for such fiscal year are computed only under paragraphs (1) and (2) of section 108(f), since paragraph (3) of such section is not applicable to a taxable year which ended before April 1, 1951. Its normal tax and surtax for the fiscal year ended March 31, 1951, are $21,838.95 and $12,734.94, respectively. The tentative normal tax and tentative surtax under section 108(f) (1) and (2) are computed as set forth in (i) and (ii) of example (1). The normal tax and surtax of the A Corporation are further computed as follows:

1. Number of days in taxable year prior to July 1, 1950	91
2. Number of days in taxable year after June 30, 1950	274
3. Total number of days in taxable year	365

NORMAL TAX

4. Tentative normal tax as computed in (i) of example (1)	$20,940.00	
5. 91/365ths of $20,940		$5,220.66
6. Tentative normal tax as computed in (ii) of example (1)	$22,137.50	
7. 274/365ths of $22,137.50		16,618.29
8. Total normal tax		21,838.95

SURTAX

9. Tentative surtax as computed in (i) of example (1)	$12,810.00	
10. 91/365ths of $12,810		$3,193.73
11. Tentative surtax as computed in (ii) of example (1)	$12,710.00	
12. 274/365ths of $12,710		9,541.21
13. Total surtax		12,734.94

SEC. 29.108-6. COMPUTATION OF TAX OF CORPORATIONS FOR TAXABLE YEARS BEGINNING AFTER JUNE 30, 1950, AND BEFORE APRIL 1, 1951, AND ENDING AFTER MARCH 31, 1951 (OTHER THAN THE CALENDAR YEAR 1951).—(*a*) *General rule.*—For a taxable year beginning after June 30, 1950, and before April 1, 1951, and ending after March 31, 1951 (other than the calendar year 1951), the normal tax and surtax imposed by sections 13 and 15 upon corporations shall be computed under section 108(*g*), as added by the Revenue Act of 1950 and as amended by the Revenue Act of 1951. The tax shall be an amount equal to the sum of—

(1) That portion of a tentative tax under section 108(g)(1), computed under the provisions of sections 13(b)(1) and 15(b)(1), applicable to taxable years beginning on July 1, 1950, which the number of days prior to April 1, 1951, in the taxable year of the taxpayer bears to the total number of days in such taxable year, and

(2) That portion of a tentative tax under section 108(g)(2), computed under the provisions of sections 13(b) (2) and 15, applicable to taxable years beginning on April 1, 1951, which the number of days after March 31, 1951, in the taxable year of the taxpayer bears to the total number of days in such taxable year.

The tentative normal taxes under section 108(g)(1) and (2) of a corporation are computed upon its normal-tax net income at the rates of 25 percent and 30 percent, respectively. The tentative surtaxes under section 108(g) (1) and (2) of a corporation are computed upon its corporation surtax net income in excess of $25,000 at the rate of 22 percent. See, however, section 15(c) and section 29.15-2 as to the circumstances under which the $25,000 exemption from surtax may be disallowed, in whole or in part, in the computation of the tentative surtax under section 108(g)(2).

(*b*) *Computation of normal-tax net income and corporation surtax net income in special cases.*—(1) *In general.*—In computing the tentative taxes under section 108(g) (1) and (2), the amount of the net income and the amount of the adjusted net income of the corporation are not recomputed and remain unchanged. However, the credits provided in section 26 (b), (h), and (i) may differ in computing the several tentative taxes. Thus, in the case of a Western Hemisphere trade corporation, or a public utility corporation which has paid dividends on its preferred stock with respect to which the credit for dividends paid provided in section 26(h) is allowable, or any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26(h) is allowable to the distributing corporation, or any corporation which has received dividends on the stock of a foreign corporation with respect to which the credit provided in section 26(b)(3) is allowable, the amount of the normal-tax net income and the amount of the corporation surtax net income for the first tentative tax computation differ from such amounts for the second tentative tax computation. See (2), (3), (4), and (5), below.

(2) *Western Hemisphere trade corporations.*—In the case of a Western Hemisphere trade corporation, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108(g)(1), with the allowance of the 30 percent credit provided in section 26(i) applicable to a taxable year beginning on July 1, 1950, and, for the purpose of the tentative tax computation under section 108(g)(2), with the allowance of the 27 percent credit provided in section 26(i) applicable to a taxable year beginning on April 1, 1951.

(3) *Public utilities paying dividends on preferred stock.*—In the case of a public utility corporation which has paid dividends on its preferred stock with respect to which the credit for dividends paid provided in section 26(h) is allowable, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108(g)(1), with the allowance of the 30 percent credit provided in section 26(h) applicable to a taxable year beginning on July 1, 1950, and, for the purpose of the tentative tax computation under section 108(g)(2), with the allowance of the 27 percent credit provided in section 26(h) applicable to a taxable year beginning on April 1, 1951.

(4) *Corporations receiving dividends on preferred stock of public utility.*—In the case of any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26(h) is allowable to the distributing corporation, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108(g)(1), with the allowance of the 59 percent credit provided in section 26(b)(2) with respect to such dividends received, and, for the purpose of the tentative tax computation under section 108(g)(2), with the allowance of the 62 percent credit provided in section 26(b)(2) with respect to such dividends received.

(5) *Corporations receiving dividends from foreign corporation.*—In the case of any corporation which has received dividends on the stock of a foreign corporation with respect to which the credit provided in section 26(b)(3) is allowable, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108(g)(1), without regard to the credit provided in section 26(b)(3), and, for the purpose of the tentative tax computation under section 108(g)(2), with the allowance of the credit provided in section 26(b)(3).

(c) *Classes of corporations excluded from operation of section 108(g).*—The provisions of section 108(g) do not apply to an insurance company subject to Supplement G, a regulated investment company subject to Supplement Q, or a foreign corporation not engaged in trade or business within the United States.

(d) *Short taxable years.*—The provisions of section 108(g) apply to a taxable year beginning after June 30, 1950, and before April 1, 1951, and ending after March 31, 1951 (other than the calendar year 1951), whether or not such taxable year is one of less than 12 months. In the case of a taxpayer which is subject to the provisions of section 108(g) and which 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(g), 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(g). However, in the case of a taxpayer which is subject to the provisions of section 108(g) and which because of any reason other than a change in accounting period has a taxable year of less than 12 months, the net income for the purpose of section 108(g) 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).

(e) *Alternative tax under section 117(c).*—In any case in which a taxpayer subject to the provisions of section 108(g) 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(g), 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).

(f) *Credits against tax.*—In the case of a taxpayer subject to the provisions of section 108 (g), any credit against the tax otherwise imposed by sections 13 and 15, such as the credit for taxes paid to a foreign country or possession of the United States under section 131, shall be deducted from, and any limitation in such credit shall be based upon, the tax computed under section 108(g).

(g) *Example.* This section may be illustrated by the following example:

Example. The A Corporation, a domestic corporation (which is neither a public utility referred to in section 26(h) nor a Western Hemisphere trade corporation referred to in section 26(i)), makes its income tax returns on the basis of a fiscal year ending June 30. For the fiscal year which began July 1, 1950, and ended June 30, 1951, the A Corporation had net income of $100,000, which did not include any interest on United States obligations or dividends on stock of foreign corporations. The net income includes cash dividends received from a domestic corporation other than a public utility (allowable as a credit under section 26(b)(1)) in the amount of $10,000, and cash dividends received from a domestic public utility corporation on its preferred stock (with respect to which a credit is allowable to the public utility under section 26(h)) in the amount of $5,000. The normal tax and surtax of the A Corporation for its fiscal year ended June 30, 1951, are $23,230.13 and $13,972.78, respectively, computed as follows:

(i) *Computation of tentative taxes provided in section 108(g)(1).*

NORMAL TAX AND SURTAX

1. Net income		$100,000.00
2. Less credit under section 26(b)(1) for dividends received from domestic corporation other than dividends with respect to which credit is allowable under section 26(h) (85 percent of $10,000)	$8,500.00	
3. Less credit under section 26(b)(2) for dividends received with respect to which credit is allowable under section 26(h) (59 percent of $5,000)	2,950.00	11,450.00
4. Normal-tax net income and corporation surtax net income		88,550.00
5. Normal tax (25 percent of item 4)		22,137.50
6. Surtax (22 percent of $63,550, the excess of $88,550 over $25,000)		13,981.00

(ii) *Computation of tentative taxes provided in section 108(g)(2).*

NORMAL TAX AND SURTAX

7. Net income		$100,000.00
8. Less credit under section 26(b)(1) (85 percent of $10,000)	$8,500.00	
9. Less credit under section 26(b)(2) (62 percent of $5,000)	3,100.00	11,600.00
10. Normal-tax net income and corporation surtax net income		88,400.00
11. Normal tax (30 percent of item 10)		26,520.00
12. Surtax (22 percent of $63,400, the excess of $88,400 over $25,000)		13,948.00

(iii) *Computation of normal tax and surtax for fiscal year ended June 30, 1951.*

13. Number of days in taxable year prior to April 1, 1951		274
14. Number of days in taxable year after March 31, 1951		91
15. Total number of days in taxable year		365

NORMAL TAX

16. Tentative normal tax computed in (i)	$22,137.50	
17. 274/365ths of $22,137.50		$16,618.29
18. Tentative normal tax computed in (ii)	$26,520.00	
19. 91/365ths of $26,520		6,611.84
20. Total normal tax		23,230.13

SURTAX

21. Tentative surtax computed in (i)	$13,981.00	
22. 274/365ths of $13,981		$10,495.33
23. Tentative surtax computed in (ii)	$13,948.00	
24. 91/365ths of $13,948		3,477.45
25. Total surtax		13,972.78

SEC. 29.108-7. COMPUTATION OF TAX OF INDIVIDUALS FOR TAXABLE YEARS BEGINNING BEFORE NOVEMBER 1, 1951, AND ENDING AFTER OCTOBER 31, 1951 (OTHER THAN THE CALENDAR YEAR 1951).—(*a*) *General rule.*—For a taxable year beginning before November 1, 1951, and ending after October 31, 1951 (other than the calendar year 1951), the normal tax, surtax, optional tax, and Supplement U normal tax and surtax imposed by sections 11, 12, 400, and 421(a)(2) upon taxpayers other than corporations shall be computed under section 108(h), as added by the Revenue Act of 1951. The tax shall be an amount equal to the sum of—

(1) That portion of a tentative tax under section 108(h)(1), computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), applicable to taxable years beginning on October 1, 1951, which the number of calendar months prior to November 1, 1951, in the taxable year of the taxpayer bears to the total number of calendar months in such taxable year, and

(2) That portion of a tentative tax under section 108(h)(2), computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), other than the provisions of such sections relating to a head of a household, applicable to taxable years beginning on November 1, 1951, which the number of calendar months after October 31, 1951, in the taxable year of the taxpayer bears to the total number of calendar months in such taxable year.

For the purpose of section 108(h) and this section, a calendar month only part of which falls within the taxable year (i) shall be disregarded if less than 15 days of such month are included in such taxable year, and (ii) shall be included as a calendar month within the taxable year if more than 14 days of such month fall within the taxable year.

(*b*) *Estates, trusts, and nonresident alien individuals.*—The provisions of section 108(h) apply to estates, trusts, and nonresident alien individuals subject to tax under sections 11 and 12 and to trusts described in section 421(b)(2) which are subject to tax under section 421(a)(2). However, the provisions of section 108(h) do not apply to a trust described in section 421(b)(2) in the case of a taxable year of such trust which began before January 1, 1951.

(*c*) *Short taxable years.*—The provisions of section 108(h) apply to a taxable year beginning before November 1, 1951, and ending after October 31, 1951 (other than the calendar year 1951), 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(h) 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(h), 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(h). However, in the case of a taxpayer who is subject to the provisions of section 108(h) 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).

(*d*) *Alternative tax under section 117(c).*—In any case in which a taxpayer subject to the provisions of section 108(h) 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(h), 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).

(*e*) *Certain joint returns.*—If a joint return of a husband and wife is filed under the provisions of section 51(b)(3), if the husband and wife have different taxable years solely because of the death of either spouse, and if the taxable year of the surviving spouse covered by such joint return is a period which began before November 1, 1951, and ended after October 31, 1951 (other than the calendar year 1951), the number of calendar months to be taken into account for the purpose of computing the portions of the tentative tax under section 108(h) (1) and (2) shall be the number of calendar months prior to November 1, 1951, in the taxable year of the surviving spouse, the number of calendar months after October 31, 1951, in the taxable year of the surviving spouse, and the total number of calendar months in the taxable year of the surviving spouse.

(*f*) *Credits against tax.*—In the case of a taxpayer subject to the provisions of section 108(h), any credit against the tax otherwise imposed by sections 11, 12, 400, and 421(a)(2), such as the credit for taxes paid to a foreign country or possession of the United States under section 131, shall be deducted from, and any limitation in such credit shall be based upon, the tax computed under section 108(h). However, in those instances in which an individual taxpayer computes a tentative tax under section 108(h) by taking into account the optional standard deduction under section 23(aa), the following credits shall not be allowed: all credits under section 131 with respect to taxes of foreign countries and possessions, and all credits with respect to taxes withheld at the source under section 143(a), relating to interest on tax-free covenant bonds.

SEC. 29.108-8. COMPUTATION OF TAX OF INDIVIDUALS FOR TAXABLE YEARS BEGINNING IN 1953 AND ENDING IN 1954.—(*a*) *General rule.*—For a taxable year beginning in 1953 and ending in 1954, the normal tax, surtax, optional tax, and supplement U normal tax and surtax, imposed by sections 11, 12, 400, and 421(a)(2) upon taxpayers other than corporations, shall be computed under section 108(j), as added by the Revenue Act of 1951. The tax shall be an amount equal to the sum of—

(1) That portion of a tentative tax under section 108(j)(1), computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), applicable to taxable years beginning on January 1, 1953, which the number of calendar months prior to January 1, 1954, in the taxable year of

the taxpayer bears to the total number of calendar months in such taxable year, and

(2) That portion of a tentative tax under section 108(j)(2), computed under the provisions of sections 11 and 12, section 400, or section 421(a)(2), applicable to taxable years beginning on January 1, 1954, which the number of calendar months after December 31, 1953, in the taxable year of the taxpayer bears to the total number of calendar months in such taxable year.

For the purpose of section 108(j) and this section, a calendar month only part of which falls within the taxable year (i) shall be disregarded if less than 15 days of such month are included in such taxable year, and (ii) shall be included as a calendar month within the taxable year if more than 14 days of such month fall within the taxable year.

(*b*) *Estates, trusts, and nonresident alien individuals.*—The provisions of section 108(j) apply to estates, trusts, and nonresident alien individuals subject to tax under sections 11 and 12 and to trusts described in section 421(b)(2) which are subject to tax under section 421(a)(2).

(*c*) *Short taxable years.*—The provisions of section 108(j) apply to a taxable year beginning in 1953 and ending in 1954, 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(j) 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(j), 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(j). However, in the case of a taxpayer who is subject to the provisions of section 108(j) 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).

(*d*) *Alternative tax under section 117(c).*—In any case in which a taxpayer subject to the provisions of section 108(j) 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(j), 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).

(*e*) *Certain joint returns.*—If a joint return of a husband and wife is filed under the provisions of section 51(b)(3), if the husband and wife have different taxable years solely because of the death of either spouse, and if the taxable year of the surviving spouse covered by such joint return is a period which begins in 1953 and ends in 1954, the number of calendar months to be taken into account for the purpose of computing the portions of the tentative tax under section 108(j)(1) and (2) shall be the number of calendar months prior to January 1, 1954, in the taxable year of the surviving spouse, the number of calendar months after December 31, 1953, in the taxable year of the surviving spouse, and the total number of calendar months in the taxable year of the surviving spouse.

(*f*) *Credits against tax.*—In the case of a taxpayer subject to the provisions of section 108(j), any credit against the tax otherwise imposed by sections 11, 12, 400, and 421(a)(2), such as the credit for taxes paid to a foreign country or possession of the United States under section 131, shall be deducted from, and any limitation in such credit shall be based upon, the tax computed under section 108(j). However, in those instances in which an individual taxpayer computes a tentative tax under section 108(j) by taking into account the optional standard deduction under section 23(aa), the following credits shall not be allowed: all credits under section 131 with respect to taxes of foreign countries and possessions, and all credits with respect to taxes withheld at the source under section 143(a), relating to interest on tax-free covenant bonds.

SEC. 29.108-9. COMPUTATION OF TAX OF CORPORATIONS FOR TAXABLE YEARS BEGINNING BEFORE APRIL 1, 1954, AND ENDING AFTER MARCH 31, 1954.—(*a*) ***General***

rule.—For a taxable year beginning before April 1, 1954, and ending after March 31, 1954 (including the calendar year 1954), the normal tax, surtax, and supplement U normal tax and surtax imposed by sections 13, 15, and 421(a)(1) upon corporations shall be computed under section 108(k), as added by the Revenue Act of 1951. The tax shall be an amount equal to the sum of—

(1) That portion of a tentative tax under section 108(k)(1), computed under the provisions of section 13(b) (2) and 15, or section 1421(a)(1), applicable to taxable years beginning on January 1, 1953, which the number of days prior to April 1, 1954, in the taxable year of the taxpayer bears to the total number of days in such taxable year, and

(2) That portion of a tentative tax under section 108(k)(2), computed under the provisions of sections 13(b)(3) and 15(b), or section 421(a)(1), applicable to taxable years beginning on April 1, 1954, which the number of days after March 31, 1954, in the taxable year of the taxpayer bears to the total number of days in such taxable year.

The tentative normal taxes under section 108(k)(1) and (2) of a corporation are computed at the rates of 30 percent and 25 percent, respectively, upon its normal-tax net income or upon its supplement U net income, in the case of a corporation subject to tax under supplement U. The tentative surtaxes under section 108(k) (1) and (2) of a corporation are computed upon its corporation surtax-net income or supplement U net income, as the case may be, in excess of $25,000 at the rate of 22 percent. See, however, section 15(c) and section 29.15-2 as to the circumstances under which the $25,000 exemption from surtax may be disallowed, in whole or in part, in the computation under section 108(k)(1) of the tentative surtax under section 15 for a taxable year beginning before July 1, 1953.

(*b*) COMPUTATION OF NORMAL-TAX NET INCOME AND CORPORATION SURTAX NET INCOME IN SPECIAL CASES.—(1) *In general.*—In computing the tentative taxes under section 108(k) (1) and (2), the amount of the net income and the amount of the adjusted net income of the corporation are not recomputed and remain unchanged. However, the credits provided in section 26 (b), (h), and (i) may differ in computing the several tentative taxes. Thus, in the case of a Western Hemisphere trade corporation, or a public utility corporation which has paid dividends on its preferred stock with respect to which the credit for dividends paid provided in section 26(h) is allowable, or any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26(h) is allowable to the distributing corporation, the amount of the normal-tax net income and the amount of the corporation surtax net income for the first tentative tax computation differ from such amounts for the second tentative tax computation. See (2), (3), and (4), below.

(2) *Western Hemisphere trade corporations.*—In the case of a Western Hemisphere trade corporation, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108(k)(1), with the allowance of the 27 percent credit provided in section 26(i) applicable to a taxable year beginning on January 1, 1953, and, for the purpose of the tentative tax computation under section 108(k)(2), with the allowance of the 30 percent credit provided in section 26(i) applicable to a taxable year beginning on April 1, 1954.

(3) *Public utilities paying dividends on preferred stock.*—In the case of a public utility corporation which has paid dividends on its preferred stock with respect to which the credit for dividends paid provided in section 26(h) is allowable, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108(k)(1), with the allowance of the 27 percent credit provided in section 26(h) applicable to a taxable year beginning on January 1, 1953, and, for the purpose of the tentative tax computation under section 108(k)(2), with the allowance of the 30 percent credit provided in section 26(h) applicable to a taxable year beginning on April 1, 1954.

(4) *Corporations receiving dividends on preferred stock of public utility.*—In the case of any corporation which has received dividends on the preferred stock of a domestic public utility corporation with respect to which the credit provided in section 26(h) is allowable to the distributing corporation, its normal-tax net income and corporation surtax net income are determined, for the purpose of the tentative tax computation under section 108(k)(1), with the allowance of the 62 percent credit provided in section 26(b)(2) with respect

to such dividends received, and, for the purpose of the tentative tax computation under section 108(k)(2), with the allowance of the 59 percent credit provided in section 26 (b)(2) with respect to such dividends received.

(c) *Classes of corporations excluded from operation of section 108(k).*—The provisions of section 108(k) do not apply to an insurance company subject to supplement G, a regulated investment company subject to supplement Q, or a foreign corporation not engaged in trade or business within the United States other than such a corporation subject to supplement U.

(d) *Short taxable years.*—The provisions of section 108(k) apply to a taxable year beginning before April 1, 1954, and ending after March 31, 1954, whether or not such taxable year is one of less than 12 months. In the case of a taxpayer which is subject to the provisions of section 108(k) and which 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(k), 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(k). However, in the case of a taxpayer which is subject to the provisions of section 108(k) and which because of any reason other than a change in accounting period has a taxable year of less than 12 months, the net income for the purpose of section 108(k) 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).

(e) *Alternative tax under section 117(c).*—In any case in which a taxpayer subject to the provisions of section 108(k) 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(k), 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).

(f) *Credits against tax.*—In the case of a taxpayer subject to the provisions of section 108(k), any credit against the tax otherwise imposed by sections 13, 15, and 421(a)(1), such as the credit for taxes paid to a foreign country or possession of the United States under section 131, shall be deducted from, and any limitation in such credit shall be based upon, the tax computed under section 108(k).

(g) *Example.*—This section may be illustrated by the following example:

Example. The A Corporation, a domestic corporation (which is neither a public utility referred to in section 26(h) nor a Western Hemisphere trade corporation referred to in section 26(i), and which is not subject to tax under supplement U), makes its income tax returns on the basis of the calendar year. For the calendar year 1954, the A Corporation has net income of $100,000, which does not include any interest on United States obligations or dividends on stock of foreign corporations. The net income includes cash dividends received from a domestic corporation other than a public utility (allowable as a credit under section 26(b)(1)) in the amount of $10,000, and cash dividends received from a domestic public utility corporation on its preferred stock (with respect to which a credit is allowable to the public utility under section 26(h)) in the amount $5,000. The normal tax and surtax of the A Corporation for the calendar year 1954 are $23,218.12 and $13,972.86, respectively, computed as follows:

(i) *Computation of tentative taxes provided in section 108(k)(1).*

	Normal Tax and Surtax	
1. Net income		$100,000
2. Less credit under section 26(b)(1) for dividends received from domestic corporation other than dividends with respect to which credit is allowable under section 26(h) (85 percent of $10,000)	$8,500	
3. Less credit under section 26(b)(2) for dividends received with respect to which credit is allowable under section 26(h) (62 percent of $5,000)	3,100	11,600

4. Normal-tax net income and corporation surtax net income		$88,400.00
5. Normal tax (30 percent of item 4)		26,520.00
6. Surtax (22 percent of $63,400, the excess of $88,400 over $25,000)		13,948.00

(ii) *Computation of tentative taxes provided in section 108(k)(2).*

NORMAL TAX AND SURTAX

7. Net income		$109,000.00
8. Less credit under section 26(b)(1) (85 percent of $10,000)	$8,500.00	
9. Less credit under section 26(b)(2) (59 percent of $5,000)	2,950.00	11,450.00
10. Normal-tax net income and corporation surtax net income		88,550.00
11. Normal tax (25 percent of item 10)		22,137.50
12. Surtax (22 percent of $63,550, the excess of $88,550 over $25,000)		13,981.00

(iii) *Computation of normal tax and surtax for calendar year 1954.*

13. Number of days in taxable year prior to April 1, 1954		90
14. Number of days in taxable year after March 31, 1954		275
15. Total number of days in taxable year		365

NORMAL TAX

16. Tentative normal tax computed in (i)	$26,520.00	
17. 90/365ths of $26,520		$6,539.18
18. Tentative normal tax computed in (ii)	$22,137.50	
19. 275/365ths of $22,137.50		16,678.94
20. Total normal tax		23,218.12

SURTAX

21. Tentative surtax computed in (i)	$13,948.00	
22. 90/365ths of $13,948		$3,439.23
23. Tentative surtax computed in (ii)	$13,981.00	
24. 275/365ths of $13,981		10,533.63
25. Total surtax		13,972.86

REGULATIONS 130 [26 CFR, PART 40]

PAR. 4. There is inserted immediately preceding section 40.430-1 [26 CFR 40.430-1] the following:

SEC. 131. FISCAL YEAR TAXPAYERS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) COMPUTATION OF EXCESS PROFITS TAX.—Subsection (b) of section 430 (relating to computation of excess profits tax in the case of certain taxable years) is hereby amended to read as follows:

"(b) CERTAIN TAXABLE YEARS BEGINNING BEFORE 1951.—

"(1) Taxable years ending before April 1, 1951.—In the case of a taxable year beginning before July 1, 1950, and ending after June 30, 1950, and before April 1, 1951, the tax imposed by subsection (a) shall be an amount equal to that portion of a tentative tax, computed under the provisions of subsection (a) applicable to taxable years ending on December 31, 1950, which the number of days in such taxable year after June 30, 1950, bears to the total number of days in such taxable year.

"(2) Taxable years ending after March 31, 1951.—In the case of a taxable year (other than a taxable year beginning on January 1,

1951, and ending on December 31, 1951) beginning before April 1, 1951, and ending after March 31, 1951, the tax imposed by subsection (a) shall be an amount equal to the sum of—

"(A) that portion of a tentative tax, computed under the provisions of subsection (a) applicable to taxable years ending on December 31, 1950, which the number of days in such taxable year after June 30, 1950, and before April 1, 1951, bears to the total number of days in such taxable year, plus

"(B) that portion of a tentative tax, computed under the provisions of subsection (a) applicable to taxable years beginning on April 1, 1951, which the number of days in such taxable year after March 31, 1951, bears to the total number of days in such taxable year."

* * * * * * *

PAR. 5. Section 40.430-2(b) [26 CFR 40.430-2(b)] is amended to read as follows:

(*b*) *Taxable years beginning before April 1, 1951 (other than the calendar year 1951).*—(1) *Taxable years beginning before July 1, 1950, and ending after June 30, 1950, and before April 1, 1951.*—In the case of any taxable year which begins before July 1, 1950, and ends after June 30, 1950, and before April 1, 1951 (including the calendar year 1950), the excess profits tax will be an amount which is proportionate to the part of the year falling after June 30, 1950. The tax will be an amount equal to that portion of a tentative tax, computed under the provisions of section 430(a) and (*a*) of this section applicable to the taxable year, which the number of days in the taxable year after June 30, 1950, bears to the total number of days in such year. Thus, in the case of the calendar year 1950, the tax will be 184/365ths of the tentative tax computed under (a)(1) (i) and (ii) and (a)(2) of this section. In computing the tentative tax under section 430(b)(1) and this paragraph for a taxable year other than the calendar year 1950, the tax which would be imposed under sections 13, 14, and 15 shall, for purposes of section 430(a)(2)(A) and of (a)(1)(ii) of this section, be determined subject to the provisions of section 108(f) (1) and (2), relating to fiscal year taxpayers, and subject to the provisions of section 141(c), relating to consolidated returns, if applicable.

(2) *Taxable years beginning before April 1, 1951, and ending after March 31, 1951 (other than the calendar year 1951).*—In the case of any taxable year which begins before April 1, 1951, and ends after March 31, 1951 (other than the calendar year 1951), the excess profits tax will be an amount equal to the sum of—

(i) that portion of a tentative tax, computed under the provisions of section 430(a) and (*a*) of this section applicable to taxable years ending before April 1, 1951, which the number of days in the taxable year after June 30, 1950, and before April 1, 1951, bears to the total number of days in such year, and

(ii) that portion of a tentative tax, computed under the provisions of section 430(a) and (*a*) of this section applicable to taxable years beginning on April 1, 1951, which the number of days in the taxable year after March 31, 1951, bears to the total number of days in such year.

In computing the tentative tax under section 430(b)(2)(A) and clause (i) of this paragraph, the tax which would be imposed under sections 13, 14, and 15 shall, for purposes of section 430(a)(2)(A) and of (a)(1)(ii) of this section, be determined subject to the provisions of section 108 (f) or (g), whichever is applicable to the taxable year, and subject to the provisions of section 141(c), relating to consolidated returns, if applicable.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 29, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 5, 1953, 8:45 a. m.)

SECTION 109.—WESTERN HEMISPHERE TRADE CORPORATIONS

SECTION 29.109–1: Western Hemisphere trade corporations. Rev. Rul. 15
(Also Section 45, Section 29.45–1.)

INTERNAL REVENUE CODE

Where a subsidiary company is organized for the purpose of securing the benefits derived from qualification as a Western Hemisphere trade corporation under section 109 of the Internal Revenue Code, all transactions between the parent company and the subsidiary should be on an "arm's length" basis, since section 45 of the Code (pertaining to allocation of income and deductions) may be applied in such cases where necessary to prevent evasion of taxes or clearly to reflect the income of either of the separate companies.

In determining whether the transactions in a particular case are at "arm's length," consideration will be given to all the facts and circumstances involved.

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 112(a).—RECOGNITION OF GAIN OR LOSS: GENERAL RULE

SECTION 29.112(a)–1: Sales or exchanges.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5990, page 142.)

SECTION 29.112(a)–1: Sales or exchanges.

INTERNAL REVENUE CODE

Presentment of certain Japanese prewar dollar bonds to the Japanese Government for the purpose of overprinting an extended maturity date thereon. (See Rev. Rul. 54, page 204.)

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

SECTION 29.112(b)(7)–1: Corporate liquidations in calendar month in 1944, 1951, or 1952.

INTERNAL REVENUE CODE

Treatment of basis of mortgaged property received in complete liquidation. (See Rev. Rul. 95, page 162.)

263354°—53——10

SECTION 29.112(b)(11)-1: Certain distributions of stock on reorganization. T. D. 5990
(Also Section 29.112(b)(11)-2; Section 112(a), Section 29.112(a)-1; Section 112(g), Sections 29.112(g)-1, 29.112(g)-2, 29.112(g)-5; Section 113(a), Sections 29.113(a)-2, 29.113(a)-(23)-1.)

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 section 317 of the Revenue Act of 1951, relating to certain distributions of stock on reorganization.

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

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

On November 22, 1952, notice of proposed rule making with respect to regulations under sections 112(b)(11) and 113(a)(23) of the Internal Revenue Code, as added by section 317 of the Revenue Act of 1951, approved October 20, 1951, relating to certain distributions of stock on reorganization, was published in the Federal Register (17 F. R. 10647). After consideration of all relevant matter presented by interested persons regarding the rules proposed, the amendments to Regulations 111 [26 CFR, part 29], set forth below are hereby adopted.

PARAGRAPH 1. Section 29.112(a)-1, as amended by Treasury Decision 5402 [C. B. 1944, 229], approved September 5, 1944 [26 CFR 29.112(a)-1], is further amended by adding at the end thereof the following:

See section 112(b)(11), with respect to nonrecognition of gain upon the distribution of stock (other than preferred) in a corporation a party to a reorganization under certain circumstances without the surrender of stock.

PAR. 2. There is inserted immediately following section 29.112(b)(10)-2 [26 CFR 29.112(b)(10)-2] the following:

SEC. 317. CERTAIN DISTRIBUTIONS OF STOCK ON REORGANIZATION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) DISTRIBUTIONS NOT IN LIQUIDATION.—Section 112(b) (relating to nonrecognition of gain or loss in the case of certain exchanges) is hereby amended by adding at the end thereof the following new paragraph:

"(11) DISTRIBUTION OF STOCK NOT IN LIQUIDATION.—If there is distributed, in pursuance of a plan of reorganization, to a shareholder of a corporation which is a party to the reorganization, stock (other than preferred stock) in another corporation which is a party to the reorganization, without the surrender by such shareholder of stock, no gain to the distributee from the receipt of such stock shall be recognized unless it appears that (A) any corporation which is a party to such reorganization was not intended to continue the active conduct of a trade or business after such reorganization, or (B) the corporation whose stock is distributed was used principally as a device for the distribution of earnings and profits to the shareholders of any corporation a party to the reorganization."

* * * * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable with respect to taxable years ending after the date of the enactment of this Act, but shall apply only with respect to distributions of stock made after such date.

SEC. 29.112(b)(11)-1. CERTAIN DISTRIBUTIONS OF STOCK ON REORGANIZATION.—If there is distributed after October 20, 1951, in pursuance of a plan of reorganization, to a shareholder of a corporation which is a party to the reorganization, stock (other than preferred stock) in another corporation which is a party to the reorganization, without the surrender by such shareholder of stock, no gain to such shareholder from the receipt of such stock shall be recognized, unless it appears that—

(1) any corporation which is a party to such reorganization was not intended to continue the active conduct of a trade or business after such reorganization, or

(2) the corporation whose stock is distributed was used principally as a device for the distribution of earnings and profits to the shareholders of any corporation a party to the reorganization.

For section 112(b)(11) to be applicable, there must be a reorganization as defined in section 112(g)(1) and a distribution to shareholders in pursuance of the plan of reorganization. Accordingly, for the purpose of section 112(b)(11), there must be compliance with the rules prescribed in sections 29.112(a)-1, 29.112(g)-1, and 29.112(g)-2, relating to reorganizations and to exchanges and distributions. The distributions under section 112(b)(11) must be of stock in a corporation which is a party to the reorganization, which stock was received in the reorganization.

Section 112(b)(11) involves cases in which one corporation, in a reorganization as defined in section 112(g)(1)(D), transfers a part of its assets to another corporation in exchange for stock, and, in pursuance of the plan of reorganization, distributes or causes to be distributed on its behalf to its shareholders, without the surrender by them of stock in the transferor corporation, stock (other than preferred stock) received in the reorganization. For limitations specially applicable under section 112(b)(11), see section 29.112(b)(11)-2. The distribution of preferred stock or other property received in the reorganization, or of other property of the transferor corporation, is not within the provisions of section 112(b)(11).

SEC. 29.112(b)(11)-2. LIMITATIONS UPON THE APPLICATION OF SECTION 112(b)(11).—The benefits of section 112(b)(11) are limited to a reorganization in which all of the corporations, parties to the reorganization, are intended to continue the active conduct of a trade or business after the reorganization, and in which the corporation whose stock is distributed is not used principally as a device for the distribution of earnings and profits to shareholders of any corporation a party to the reorganization. The underlying assumption of section 112(b)(11) and of the rules applicable to reorganizations is that the reorganization and distribution of stock must result in a continuation of the old business activities and in a continuation of the interests of the shareholders therein.

A corporation shall be considered for the purpose of section 112(b)(11) to be engaged in the active conduct of a trade or business after the reorganization only if it directly conducts such business or indirectly conducts the business through ownership of stock in another corporation actively conducting the business, which other corporation is a subsidiary (whether or not majority-owned) of the corporation, a party to the reorganization. For the purpose of the preceding sentence, a corporation is considered a subsidiary of another corporation if a majority of its voting stock is owned by the other corporation or if a part of its stock (whether or not a majority of its voting stock) is owned by the other corporation under such circumstances that the policies of the first corporation are directed by the second corporation. The assets, if any, of a corporation used directly in the conduct of a business and stock, if any, held by a corporation in a subsidiary actively conducting a business must constitute a substantial part of all of the assets of the corporation.

Ordinarily, the business reasons (as distinguished from any desire to make a distribution of earnings and profits to the shareholders) which support the reorganization and the distribution of the stock will require the distribution of all of the stock received by the transferor corporation in the reorganization.

Example 1. Corporation A owns and operates several mines and in addition owns 45 percent of the stock of Corporation X, 40 percent of the stock of

Corporation Y, and 35 percent of the stock of Corporation Z. Corporation A is the largest single shareholder in each of these corporations, and directs their policies in such manner that these corporations are operated as subsidiaries of Corporation A. Corporations X, Y, and Z are each directly engaged in the active conduct of a trade or business. Corporation A transfers all its stock in Corporations X, Y, and Z to newly organized Corporation B in exchange for all of Corporation B's stock, which stock is distributed *pro rata* among the shareholders of Corporation A. Corporation B then directs the policies of these corporations in such manner that they are operated as subsidiaries of Corporation B. There are no other relevant facts. The distribution of the stock (other than preferred stock) in Corporation B to the shareholders of Corporation A is within the terms of section 112(b)(11).

Example 2. Corporation C owns and operates a department store. It decides to provide parking facilities for the customers of the store. In order to provide such facilities, Corporation C enters into a contract to purchase land adjacent to its premises. The purchase price of the land is $100,000 and it is estimated that the cost of developing the parking lot will be $50,000. In order to separate the operations of the parking lot from those of the department store, Corporation C transfers to a newly formed Corporation D $90,000 in cash and $90,000 in bonds, together with the contract for the purchase of the land, in exchange for all the stock of Corporation D, which stock is distributed *pro rata* among the shareholders of Corporation C. The purchase of the land is completed on the date fixed in the contract, and the parking facilities are developed and operated by Corporation D. There are no other relevant facts. The transfer of the cash, bonds, and contract to Corporation D in exchange for its stock is a reorganization under section 112(g)(1) and the distribution of stock (other than preferred stock) in Corporation D to the shareholders of Corporation C is within the terms of section 112(b)(11).

Example 3. Corporation E is engaged in a manufacturing business. The assets of Corporation E include $300,000 in cash and $600,000 in bonds in addition to $450,000 in other assets used in the manufacturing business. Corporation E forms a new corporation, F, to which Corporation E transfers $200,000 in cash and the $600,000 in bonds in exchange for all the stock of Corporation F, which stock is distributed among the shareholders of Corporation E *pro rata*. At the time of the transaction there is no clear and definite plan for the acquisition by Corporation F of specific business assets. There are no other relevant facts. The transfer of cash and bonds to Corporation F is not a reorganization under section 112(g)(1) of the Code; therefore, the distribution of the stock of Corporation F is taxable as a dividend to the extent provided in section 115(a).

PAR. 3. Section 29.112(g)-1, as amended by Treasury Decision 5402 [26 CFR 29.112(g)-1], is further amended by inserting immediately preceding the last sentence of the third paragraph thereof the following:

The nonrecognition of gain or loss is also prescribed with respect to the distribution occurring after October 20, 1951, in pursuance of a plan of reorganization, to a shareholder of a corporation which is a party to the reorganization, of stock (other than preferred stock) in another corporation which is a party to the reorganization, where such shareholder does not surrender any stock. (See section 112(b)(11) and the regulations thereunder.)

PAR. 4. Sec. 29.112(g)-2 [26 CFR 29.112(g)-2] is amended by striking from the second paragraph from the end (which paragraph begins with the words "The term 'plan of reorganization' ") the word "exchanges" wherever it appears and inserting in each instance in lieu thereof the words "exchanges or distributions".

PAR. 5. Section 29.112(g)-5 [26 CFR 29.112(g)-5] is amended by adding at the end thereof the following:

See section 29.112(b)(11)-1 with respect to the distribution occurring after October 20, 1951, to a shareholder, in pursuance of a plan of reorganization of stock (other than preferred stock) in another corporation which is a party to the reorganization, without the surrender by such shareholder of stock.

PAR. 6. Section 29.113(a)-2, as amended by Treasury Decision 5402 [26 CFR 29.113(a)-2], is further amended by striking from the second sentence thereof the expression "113(a)(22)" and by inserting in lieu thereof the expression "113(a)(23)".

PAR. 7. There is inserted immediately after section 29.113(a)(22)-1 [26 CFR 29.113(a)(22)-1] the following:

SEC. 317. CERTAIN DISTRIBUTIONS OF STOCK ON REORGANIZATION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) BASIS OF STOCK.—Section 113(a) (relating to unadjusted basis for determining gain or loss) is hereby amended by adding at the end thereof the following new paragraph:

"(23) TAX-FREE DISTRIBUTIONS.—If the property consists of stock distributed after the date of the enactment of the Revenue Act of 1951 to a taxpayer in connection with a transaction described in section 112(b)(11) (hereinafter in this paragraph called 'new stock'), or consists of stock in respect of which such distribution was made (hereinafter in this paragraph called 'old stock'), then the basis of the new stock and of the old stock, respectively, shall, in the shareholder's hands, be determined by allocating between the old stock and the new stock the adjusted basis of the old stock; such allocation to be made under regulations prescribed by the Secretary."

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable with respect to taxable years ending after the date of the enactment of this Act, but shall apply only with respect to distributions of stock made after such date.

SEC. 29.113(a)(23)-1. BASIS OF STOCK ON CERTAIN DISTRIBUTIONS ON REORGANIZATION.—The distribution, in pursuance of a plan of reorganization, to a shareholder of a corporation (a party to the reorganization) of stock in another corporation (also a party to the reorganization) may be within the provisions of section 112(g) of the Revenue Act of 1932, or the corresponding provisions of prior revenue laws, if made before January 1, 1934, or may be within the provisions of section 112(b)(11) if made after October 20, 1951, and if the distribution consists of stock other than preferred stock. Section 112(g) of the Revenue Act of 1932 and section 112(b)(11) provide that no gain shall be recognized to the shareholder in the case of such distribution. The basis of the stock in respect of which the distribution was made and of the stock distributed to the shareholder is ascertained in accordance with the principles set forth in section 29.113(a)(12)-1 in the case of such a distribution made before January 1, 1934. The same principles of section 29.113(a)(12)-1 shall apply to the determination of the basis of such stock in the case of a distribution after October 20, 1951, to which section 112(b)(11) is applicable.

PAR. 8. Section 29.115-11 as amended by Treasury Decision 5402 [26 CFR 29.115-11], is further amended by striking subparagraph (1) of the third undesignated paragraph thereof [26 CFR 29.115-11(c)(1)] and inserting in lieu thereof the following:

(1) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, to its shareholders—

(A) of stock or securities in such corporation or in another corporation a party to the reorganization in any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112(g) of the Revenue Act of 1932); or

(B) of stock (other than preferred stock) in another corporation which is a party to the reorganization without the surrender by the distributees of stock in the distributing corporation if the distribution occurs after October 20, 1951 (see section 112(b)(11)); or

(C) of stock or securities in such corporation or in another corporation a party to the reorganization in any taxable year (beginning before January 1, 1939, or on or after such date) in exchange for its stock or securities (see section 112(b)(3))

if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(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).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved February 17, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 19, 1953, 8:52 a. m.)

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

SECTION 29.112(f)-1: Involuntary conversion where disposition of the converted property occurred prior to January 1, 1951. T. D. 5991

(Also Sections 29.112(f)-2, 29.112(f)-3; Section 112(n), Section 29.112(n)-1; Section 113(a), Section 29.113(a)(9)-1; Section 113(b), Section 29.113(b)(1)-1; Section 117, Section 29.117-4; Section 275, Section 29.275-1.)

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 section 318 of the Revenue Act of 1951, to Public Law 251 (82d Cong.) [C. B. 1951-2, 353], and to Public Law 567 (82d Cong.) [C. B. 1952-2, 360].

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

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

On December 20, 1952, notice of proposed rule making, regarding amendments to the income tax regulations made necessary by section 318 of the Revenue Act of 1951, approved October 20, 1951, by Public Law 251 (82d Cong.) [C. B. 1951-2, 353] approved October 31, 1951, and by Public Law 567 (82d Cong.) [C. B. 1952-2, 360], approved July 16, 1952, was published in the Federal Register (17 F. R. 11657). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed the amendments set forth below are hereby adopted. Such amendments are necessary in order to conform Regulations 111 [26 CFR, part 29] to section 318 of the Revenue Act of 1951, to Public Law 251 (82d Cong.), and to Public Law 567 (82d Cong.).

PARAGRAPH 1. There is inserted immediately preceding section 29.112(f)-1 [26 CFR 29.112(f)-1] the following:

SEC. 318. GAIN FROM SALE OR EXCHANGE OF TAXPAYER'S RESIDENCE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

(1) Section 112(f) (relating to involuntary conversions) is hereby amended by adding at the end thereof the following: "This subsection shall not apply, in the case of property used by the taxpayer as his principal residence, if the destruction, theft, seizure, requisition, or condemnation of the residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950."

* * * * * * *

PUBLIC LAW 251, EIGHTY-SECOND CONGRESS APPROVED OCTOBER 31, 1951

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 112(f) of the Internal Revenue Code (relating to involuntary conversions) is hereby amended to read as follows:

"(f) INVOLUNTARY CONVERSION.—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

"(1) CONVERSION INTO SIMILAR PROPERTY.—Into property similar or related in service or use to the property so converted, no gain shall be recognized.

"(2) CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED PRIOR TO 1951.—Into money, and the disposition of the converted property occurred before January 1, 1951, no gain shall be recognized if such money is forthwith in good faith, under regulations prescribed by the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund. If any part of the money is not so expended, the gain shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain). For the purposes of this paragraph and paragraph (3), the term 'disposition of the converted property' means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

"(3) CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED AFTER 1950.—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

"(A) Nonrecognition of Gain.—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph—

"(i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

"(ii) The taxpayer shall be considered to have purchased property or stock only if, but for the provisions

of section 113(a)(9), the unadjusted basis of such property or stock would be its cost within the meaning of section 113(a).

"(B) Period Within Which Property Must Be Replaced.—The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

"(i) one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

"(ii) subject to such terms and conditions as may be specified by the Secretary, at the close of such later date as the Secretary may designate upon application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary may by regulations prescribe.

"(C) Time for Assessment of Deficiency Attributable to Gain Upon Conversion.—If a taxpayer has made the election provided in subparagraph (A), then (i) the statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain upon such conversion is realized, attributable to such gain shall not expire prior to the expiration of three years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of the replacement of the converted property or of an intention not to replace, and (ii) such deficiency may be assessed prior to the expiration of such three-year period notwithstanding the provisions of section 272(f) or the provisions of any other law or rule of law which would otherwise prevent such assessment.

"(D) Time for Assessment of Other Deficiencies Attributable to Election.—If the election provided in subparagraph (A) is made by the taxpayer and such other property or such stock was purchased prior to the beginning of the last taxable year in which any part of the gain upon such conversion is realized, any deficiency, to the extent resulting from such election, for any taxable year ending before such last taxable year may be assessed (notwithstanding the provisions of section 272(f) or 275 or the provisions of any other law or rule of law which would otherwise prevent such assessment) at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed.

This subsection shall not apply, in the case of property used by the taxpayer as his principal residence, if the destruction, theft, seizure, requisition, or condemnation of residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950."

* * * * * * *

SEC. 3. The amendments made by the first two sections of this Act shall be applicable only with respect to taxable years ending after December 31, 1950, except that the provisions of section 112(f)(3), and the provisions of section 113(a)(9), of the Internal Revenue Code as amended by this Act shall also be applicable to any taxable year ending prior to January 1, 1951, in which (a) any gain was realized upon the conversion of property and the disposition of such converted property occurred (within the meaning of such section 112(f)(3)) after December 31, 1950, or (b) the basis of property is affected by an election made under the provisions of section 112(f)(3) of such Code.

* * * * * * *

PAR. 2. Section 29.112(f)-1 [26 CFR 29.112(f)-1] is hereby amended as follows:

(A) By changing the heading thereof to read as follows: "INVOLUNTARY CONVERSION WHERE DISPOSITION OF THE CONVERTED PROPERTY OCCURRED PRIOR TO JANUARY 1, 1951."

(B) By inserting immediately preceding the first paragraph thereof the following:

This section applies only with respect to involuntary conversions where the disposition of the converted property occurred prior to January 1, 1951. The term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation. See section 29.112(f)-3 if the disposition of the converted property occurred after December 31, 1950.

PAR. 3. Section 29.112(f)-2 [26 CFR 29.112(f)-2] is hereby amended as follows:

(A) By changing the heading thereof to read as follows: "REPLACEMENT FUNDS WHERE DISPOSITION OF THE CONVERTED PROPERTY OCCURRED PRIOR TO JANUARY 1, 1951."

(B) By inserting immediately preceding the first paragraph thereof the following:

This section applies only with respect to involuntary conversions where the disposition of the converted property (as defined in section 29.112(f)-1) occurred prior to January 1, 1951. See section 29.112(f)-3 if the disposition of the converted property occurred after December 31, 1950.

PAR. 4. There is inserted immediately after section 29.112(f)-2 [26 CFR 29.112(f)-2] the following:

SEC. 29.112(f)-3. INVOLUNTARY CONVERSION WHERE DISPOSITION OF THE CONVERTED PROPERTY OCCURRED AFTER DECEMBER 31, 1950.—(*a*) *In general.*—This section applies only with respect to involuntary conversions where the disposition of the converted property (as defined in section 29.112(f)-1) occurred after December 31, 1950. See section 29.112(f)-1 and -2 if the disposition of the converted property occurred prior to January 1, 1951. This section also applies only with respect to gains; losses from involuntary conversions are recognized or not recognized without regard to this section. This section shall not apply in the case of an involuntary conversion of property used by the taxpayer as his principal residence; see section 29.112(n)-1. In the case of property used by the taxpayer partially as a principal residence and partially for other purposes, proper allocation shall be made and this section shall apply only with respect to the involuntary conversion of the portion used for other purposes.

(*b*) *Conversion into similar property.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted only into property similar or related in service or use to the property so converted, no gain shall be recognized. Such nonrecognition of gain is mandatory. If the conversion is, in whole or in part, into money or property not similar or related in service or use to the property so converted, see (*c*) below.

(*c*) *Conversion into money or into dissimilar property.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such conversion exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted, or the cost of stock of a corporation owning such other property which is purchased by the taxpayer in the acquisition of control of such corporation, if the taxpayer purchased such other property, or such stock, for the purpose of replacing the property so converted and during the period specified below.

All of the details in connection with an involuntary conversion of property at a gain (including those relating to the replacement of the converted property, or a decision not to replace, or the expiration of the period for replacement)

shall be reported in the return for the taxable year or years in which any of such gain is realized. An election to have such gain recognized only to the extent provided in the preceding paragraph shall be made by including such gain in gross income for such year or years only to such extent. If, at the time of filing such a return, the period within which the converted property must be replaced has expired, or if such an election is not desired, the gain should be included in gross income for such year or years in the regular manner. A failure to so include such gain in gross income in the regular manner shall be deemed to be an election by the taxpayer to have such gain recognized only to the extent provided in the preceding paragraph even though the details in connection with the conversion are not reported in such return. If, after having made an election under section 112(f)(3), the converted property is not replaced within the required period of time, or replacement is made at a cost lower than was anticipated at the time of the election, or a decision is made not to replace, the tax liability for the year or years for which the election was made shall be recomputed. Such recomputation should be in the form of an "amended return". If a decision is made to make an election under section 112(f)(3) after the filing of the return and the payment of the tax for the year or years in which any of the gain on an involuntary conversion is realized and before the expiration of the period within which the converted property must be replaced, a claim for credit or refund for such year or years should be filed. If the replacement of the converted property occurs in a year or years in which none of the gain on the conversion is realized, all of the details in connection with such replacement shall be reported in the return for such year or years.

The period referred to above is the period of time commencing with the date of the disposition of the converted property, or the date of the beginning of the threat or imminence of requisition or condemnation of the converted property, whichever is earlier, and ending 1 year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or at the close of such later date as may be designated pursuant to an application of the taxpayer. Such application shall be made prior to the expiration of the 1 year after the close of the first taxable year in which any part of the gain upon the conversion is realized. Such application shall be made to the Commissioner, or to such person as he may designate, and shall contain all of the details in connection with the involuntary conversion. No extension of time shall be granted pursuant to such an application unless the taxpayer executes a bond, with such surety as the Commissioner may require, in an amount not in excess of twice the estimated additional income taxes (including interest, penalties, and additions to the tax) which would be payable if an election were not made under this section, and conditioned upon the replacement of the converted property within the extended period of time (including any subsequent extensions granted by the Commissioner or such person as he may designate), or the payment of the additional tax attributable to the gain on the conversion (including interest, penalties, and additions to the tax). Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. See section 29.112(f)-2 with respect to the depositing of bonds or notes of the United States in lieu of sureties.

Property or stock purchased before the disposition of the converted property shall be considered to have been purchased for the purpose of replacing the converted property only if such property or stock is held by the taxpayer on the date of the disposition of the converted property. Property or stock shall be considered to have been purchased only if, but for the provisions of section 113(a)(9), the unadjusted basis of such property or stock would be its cost to the taxpayer within the meaning of section 113(a). If the taxpayer's unadjusted basis of the replacement property would be determined, in the absence of section 113(a)(9), under any of the other numbered paragraphs of section 113(a), the unadjusted basis of the property would not be its cost within the meaning of section 113(a). For example, if property similar or related in service or use to the converted property is acquired by gift and its basis is determined under section 113(a)(2), such property will not qualify as a replacement for the converted property.

If a taxpayer makes an election under section 112(f)(3), any deficiency, for any taxable year in which any part of the gain upon the conversion is realized, which is attributable to such gain may be assessed at any time prior to the expiration of 3 years from the date the officer with whom the return for such year has been filed is notified by the taxpayer of the replacement of the con-

verted property or of an intention not to replace, or of a failure to replace, within the required period, notwithstanding the provisions of section 272(f) or the provisions of any other law or rule of law which would otherwise prevent such assessment. If replacement has been made, such notification shall contain all of the details in connection with such replacement. Such notification should be made in the return for the taxable year or years in which the replacement occurs, or the intention not to replace is formed, or the period for replacement expires, if this return is filed with such officer. If this return is not filed with such officer, then such notification shall be made to such officer at the time of filing this return. If the taxpayer so desires, he may, in either event, also notify such officer prior to the filing of such return.

If a taxpayer makes an election under section 112(f)(3) and the replacement property or stock was purchased prior to the beginning of the last taxable year in which any part of the gain upon the conversion is realized, any deficiency, for any taxable year ending before such last taxable year, which is attributable to such election may be assessed at any time prior to the expiration of the period within which a deficiency for such last taxable year may be assessed, notwithstanding the provisions of section 272(f) or 275 or the provisions of any law or rule of law which would otherwise prevent such assessment.

If the taxpayer makes an election under section 112(f)(3), the gain upon the conversion shall be recognized to the extent that the amount realized upon such conversion exceeds the cost of the replacement property or stock, regardless of whether such amount is realized in one or more taxable years.

See section 29.112(f)-1 as to when property is similar or related in service or use to other property, and as to the treatment of proceeds of a use and occupancy insurance contract and of special assessments.

PAR. 5. There is inserted immediately after section 29.112(m)-4, as added by Treasury Decision 5374 [C. B. 1944, 243], approved May 25, 1944 [26 CFR 29.112(m)-4], the following:

SEC. 318. GAIN FROM SALE OR EXCHANGE OF TAXPAYER'S RESIDENCE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) NONRECOGNITION OF GAIN IN CERTAIN CASES.—Section 112 (relating to recognition of gain or loss) is hereby amended by adding at the end thereof the following new subsection:

"(n) GAIN FROM SALE OR EXCHANGE OF RESIDENCE.—

"(1) NONRECOGNITION OF GAIN.—If property (hereinafter in this subsection called 'old residence') used by the taxpayer as his principal residence is sold by him and, within a period beginning one year prior to the date of such sale and ending one year after such date, property (hereinafter in this subsection called 'new residence') is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

"(2) RULES FOR APPLICATION OF SUBSECTION.—For the purposes of this subsection:

"(A) An exchange by the taxpayer of his residence for other property shall be considered as a sale of such residence, and the acquisition of a residence upon the exchange of property shall be considered as a purchase of such residence.

"(B) If the taxpayer's residence (as a result of its destruction in whole or in part, theft, or seizure) is compulsorily or involuntarily converted into property or into money, such destruction, theft, or seizure shall be considered as a sale of the residence; and if the residence is so converted into property which is used by the taxpayer as his residence, such conversion shall be considered as a purchase of such property by the taxpayer.

"(C) In the case of an exchange or conversion described in subparagraph (A) or (B), in determining the extent to which the selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence, the amount realized by the

taxpayer upon such exchange or conversion shall be considered the selling price of the old residence.

"(D) A residence any part of which was constructed or reconstructed by the taxpayer shall be considered as purchased by the taxpayer. In determining the taxpayer's cost of purchasing a residence, there shall be included only so much of his cost as is attributable to the acquisition, construction, reconstruction, and improvements made which are properly chargeable to capital account, during the period specified in paragraph (1).

"(E) If a residence is purchased by the taxpayer prior to the date of his sale of the old residence, the purchased residence shall not be treated as his new residence if sold or otherwise disposed of by him prior to the date of the sale of the old residence.

"(F) If the taxpayer, during the period described in paragraph (1) purchases more than one residence which is used by him as his principal residence at some time within one year after the date of the sale of the old residence, only the last of such residences so used by him after the date of such sale shall constitute the new residence. If within the one year referred to in the preceding sentence property used by the taxpayer as his principal residence is destroyed, stolen, seized, requisitioned, or condemned, or is sold or exchanged under threat or imminence thereof, then for the purposes of the preceding sentence such one year shall be considered as ending with the date of such destruction, theft, seizure, requisition, condemnation, sale, or exchange.

"(G) In the case of a new residence the construction of which was commenced by the taxpayer prior to the expiration of one year after the date of the sale of the old residence, the period specified in paragraph (1), and the one year referred to in subparagraph (F) of this paragraph, shall be considered as including a period of 18 months beginning with the date of the sale of the old residence.

"(3) LIMITATION.—The provisions of paragraph (1) shall not be applicable with respect to the sale of the taxpayer's residence if within one year prior to the date of such sale the taxpayer sold at a gain other property used by him as his principal residence, and any part of such gain was not recognized by reason of the provisions of paragraph (1). For the purposes of this paragraph, the destruction, theft, seizure, requisition, or condemnation of property or the sale or exchange of property under threat or imminence thereof, shall not be considered as a sale of such property.

"(4) BASIS OF NEW RESIDENCE.—Where the purchase of a new residence results, under paragraph (1), in the nonrecognition of gain upon the sale of an old residence, in determining the adjusted basis of the new residence as of any time following the sale of the old residence, the adjustments to basis shall include a reduction by an amount equal to the amount of the gain not so recognized upon the sale of the old residence. For this purpose, the amount of the gain not so recognized upon the sale of the old residence includes only so much of such gain as is not recognized by reason of the cost, up to such time, of purchasing the new residence.

"(5) TENANT-STOCKHOLDERS IN A COOPERATIVE APARTMENT CORPORATION.—For the purposes of this subsection, section 113(b)(1)(K), and section 117(h)(7), references to proeperty used by the taxpayer as his principal residence, and references to the residence of a taxpayer, shall include stock held by a tenant-stockholder (as defined in section 23(z)(2)) in a cooperative apartment (as defined in such section) if—

"(A) in the case of stock sold, the apartment which the taxpayer was entitled to occupy as such stockholder was used by him as his principal residence, and

"(B) in the case of stock purchased, the taxpayer used as his principal residence the apartment which he was entitled to occupy as such stockholder.

"(6) HUSBAND AND WIFE.—If the taxpayer and his spouse, in accordance with regulations which shall be prescribed by the Secretary pursuant to this paragraph, consent to the application of subparagraph (B) of this paragraph, then—

"(A) for the purposes of this subsection, the words 'taxpayer's selling price of the old residence' shall mean the selling price (of the taxpayer, or of the taxpayer and his spouse) of the old residence, and the words 'taxpayer's cost of purchasing the new residence' shall mean the cost (to the taxpayer, his spouse, or both) of purchasing the new residence (whether held by the taxpayer, his spouse, or the taxpayer and his spouse); and

"(B) so much of the gain upon the sale of the old residence as is not recognized solely by reason of this paragraph, and so much of the adjustment under paragraph (4) to the basis of the new residence as results solely from this paragraph, shall be allocated between the taxpayer and his spouse as provided in such regulations.

This paragraph shall apply only if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence. In case the taxpayer and his spouse do not consent to the application of subparagraph (B) of this paragraph, then the recognition of gain upon the sale of the old residence shall be determined under this subsection without regard to the rules provided in this paragraph.

"(7) STATUTE OF LIMITATIONS.—If the taxpayer during a taxable year sells at a gain property used by him as his principal residence, then—

"(A) the statutory period for the assessment of any deficiency attributable to any part of such gain shall not expire prior to the expiration of three years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of—

"(i) the taxpayer's cost of purchasing the new residence which the taxpayer claims results in nonrecognition of any part of such gain,

"(ii) the taxpayer's intention not to purchase a new residence within the period specified in paragraph (1), or

"(iii) a failure to make such purchase within such period; and

"(B) such deficiency may be assessed prior to the expiration of such three-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment."

* * * * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable to taxable years ending after December 31, 1950, but the provisions of section 112(n) (1) and (6) of the Internal Revenue Code shall apply only with respect to residences sold (within the meaning of such section) after such date.

PUBLIC LAW 567, EIGHTY-SECOND CONGRESS
APPROVED JULY 16, 1952

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 112(n) of the Internal Revenue Code (relating to nonrecognition of gain from sale or exchange of residence) is hereby amended by adding at the end thereof the following new paragraph:

"(8) MEMBERS OF ARMED FORCES.—The running of any period of time specified in paragraph (1) or (2) (other than the one year referred to in paragraph (2)(F)) of this subsection shall be suspended during any time that the taxpayer (or his spouse if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) serves on extended active duty with the Armed Forces of the United States after the date of the sale

of the old residence and before January 1, 1954, except that any such period as so suspended shall not extend beyond the date four years after the date of the sale of the old residence. For the purpose of this paragraph, the term 'extended active duty' means any period of active duty pursuant to a call or order to such duty for a period in excess of ninety days or for an indefinite period."

SEC. 2. The amendment made by the first section of this Act shall be applicable to taxable years ending after December 31, 1950, with respect to residences sold (within the meaning of section 112(n) of the Internal Revenue Code) after such date.

* * * * * * *

SEC. 29.112(n)-1. GAIN FROM SALE OR EXCHANGE OF RESIDENCE.—(*a*) *In general.*—Gain from a sale after December 31, 1950, of property used by the taxpayer as his principal residence (referred to hereinafter as the "old residence") will not be recognized if the taxpayer within a period beginning 1 year prior to the date of such sale and ending 1 year after such date purchases property and uses it as his principal residence (referred to hereinafter as the "new residence") except to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence. In the case of a new residence the construction of which was commenced by the taxpayer at any time prior to the expiration of 1 year after the date of the sale of the old residence, the 1 year after the sale of the old residence referred to in the preceding sentence shall be considered as including a period of 18 months beginning with the date of the sale of the old residence. Such nonrecognition of gain is mandatory. This section applies only with respect to gains; losses from sales of property used by the taxpayer as his principal residence are recognized or not recognized without regard to this section.

(*b*) *Rules for application of section.*—(1) *Property used by the taxpayer as his principal residence.*—Whether or not property is used by the taxpayer as his residence, and whether or not property is used by the taxpayer as his principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all of the facts and circumstances in each individual case, including the bona fides of the taxpayer. The mere fact that property is, or has been, rented is not determinative that such property is not used by the taxpayer as his principal residence. For example, if the taxpayer purchases his new residence before he sells his old residence, the fact that he temporarily rents out the new residence during the period before he vacates the old residence may not, in the light of all the facts and circumstances in the case, prevent the new residence from being considered as property used by the taxpayer as his principal residence. Property used by the taxpayer as his principal residence may include a houseboat, a house trailer, or stock held by a tenant-stockholder in a cooperative apartment corporation (as those terms are defined in section 23(z)(2)), if the apartment which the taxpayer is entitled to occupy as such stockholder is used by him as his principal residence. Property used by the taxpayer as his principal residence does not include personal property such as a piece of furniture, a radio, etc., which, in accordance with the applicable local law is not a fixture.

Where part of a property is used by the taxpayer as his principal residence and part is used for other purposes, an allocation must be made to determine the application of this section. If the old residence is used only partially for residential purposes, only that part of the gain allocable to the residential portion may be not recognized under this section and only an amount allocable to the selling price of such portion need be reinvested in the new residence in order to have the gain allocable to such portion not recognized under this section. If the new residence is used only partially for residential purposes, only so much of its cost as is allocable to the residential portion may be counted as the cost of purchasing the new residence.

(2) *Sale of residence.*—For the purpose of this section, an exchange by the taxpayer of his residence for other property shall be considered as a sale of such residence. Also, if the taxpayer's residence (as a result of its destruction in whole or in part, theft, seizure, requisition or condemnation) is compulsorily or involuntarily converted into money or property, the destruction, theft, seizure, requisition or condemnation shall be considered as a sale of such residence.

(3) *Purchase of residence.*—For the purpose of this section, the acquisition of a residence upon the exchange of property shall be considered as a purchase of such residence. Also, the acquisition of a residence upon the compulsory or

involuntary conversion of the taxpayer's residence as the result of its destruction in whole or in part, theft, seizure, requisition or condemnation shall be considered to be a purchase of the residence. A residence any part of which was constructed or reconstructed by the taxpayer shall be considered as purchased by the taxpayer, but the mere improvement of a residence, not amounting to reconstruction, does not constitute a purchase of a residence.

(4) *Selling price of old residence.*—The taxpayer's selling price of the old residence includes the amount of any mortgage, trust deed, or other indebtedness to which such property is subject in the hands of the purchaser whether or not the purchaser assumed such indebtedness. Such selling price also includes the face amount of any liabilities of the purchaser which are part of the consideration for the sale. Commissions and other selling expenses paid or incurred by the taxpayer on the sale of the old residence are not to be deducted or taken into account in determining such selling price. In the case of an exchange or conversion which is considered as a sale under this section, the amount realized by the taxpayer upon such exchange or conversion shall be considered to be the taxpayer's selling price of the old residence. As to what constitutes the amount realized, see section 29.111-1.

(5) *Cost of purchasing new residence.*—The taxpayer's cost of purchasing the new residence also includes such indebtedness to which the property purchased is subject at the time of purchase whether or not assumed by the taxpayer (including purchase-money mortgages, etc.) and the face amount of any liabilities of the taxpayer which are part of the consideration for the purchase. Commissions and other purchasing expenses paid or incurred by the taxpayer on the purchase of the new residence are to be included in determining such cost. In the case of an acquisition of a residence upon an exchange or conversion which is considered as a purchase under this section, the fair market value of the new residence shall be considered as the taxpayer's cost of purchasing the new residence. The taxpayer's cost of purchasing the new residence includes only so much of such cost as is attributable to acquisition, construction, reconstruction, or improvements made within the 2-year or 30 months' period of time, as the case may be, in which the purchase and use of the new residence must be made in order to have gain on the sale of the old residence not recognized under this section. Such cost also includes only such amounts as are properly chargeable to capital account rather than to the current expense. As to what constitutes capital expenditures, see section 29.24-2. Where any part of the new residence is acquired by the taxpayer other than by purchase, the value of such part is not to be included in determining the taxpayer's cost of the new residence. For example, if the taxpayer acquires a residence by gift or inheritance, and spends $20,000 in reconstructing such residence, only such $20,000 may be treated as his cost of purchasing the new residence.

(6) *Selling price and cost of residence in the case of husband and wife.*—If the taxpayer and his spouse file the consent referred to below, then the "taxpayer's selling price of the old residence" shall mean the taxpayer's or the taxpayer and his spouse's selling price of the old residence, and the "taxpayer's cost of purchasing the new residence" shall mean the cost to the taxpayer, or to his spouse, or to both of them, of purchasing the new residence, whether such new residence is held by the taxpayer, or his spouse, or both. Such consent may be filed only if the old residence and the new residence are each used by the taxpayer and his same spouse as their principal residence. If the taxpayer and his spouse do not file such a consent, the recognition of gain upon sale of the old residence shall be determined under this section without regard to the foregoing.

The consent referred to above is a consent by the taxpayer and his spouse to have the basis of the interest of either of them in the new residence reduced from what it would have been but for the filing of such consent by an amount by which the gain of either of them on the sale of his interest in the old residence is not recognized solely by reason of the filing of such consent. Such reduction in basis is applicable to the basis of the new residence, whether such basis is that of the husband, of the wife, or divided between them. If the basis is divided between the husband and wife, the reduction in basis shall be divided between them in the same proportion as the basis (determined without regard to such reduction) is divided between them. Such consent shall be filed with the officer with whom the return for the taxable year or years in which the gain from the sale of the old residence is realized has been filed. The following examples will illustrate the application of this rule:

Example (1). A taxpayer, in 1951, sells for $10,000 the principal residence of himself and his wife, which he owns individually and which has an adjusted basis to him of $5,000. Within a year after such sale he and his wife contribute $5,000 each from their separate funds for the purchase of their new principal residence which they hold as tenants in common, each owning an undivided one-half interest therein. If the taxpayer and his wife file the required consent, the gain of $5,000 upon the sale of the old residence will not be recognized to the taxpayer, and the adjusted basis of the taxpayer's interest in the new residence will be $2,500 and the adjusted basis of the taxpayer's wife's interest in such property will be $2,500.

Example (2). A taxpayer and his wife, in 1951, sell for $10,000 their principal residence, which they own as joint tenants and which has an adjusted basis of $2,500 to each of them ($5,000 together). Within a year after such sale, the wife spends $10,000 of her own funds in the purchase of a principal residence for herself and the taxpayer and takes title in her name only. If the taxpayer and his wife file the required consent, the adjusted basis to the wife of the new residence shall be $5,000, and the gain of the taxpayer of $2,500 upon the sale of the old residence will not be recognized. The wife, as a taxpayer herself, will have her gain of $2,500 on the sale of the old residence not recognized under the general rule.

(*c*) *Basis of new residence.*—Where the purchase of a new residence results, under this section, in the nonrecognition of any part of the gain realized upon the sale of an old residence, then, in determining the adjusted basis of the new residence as of any time following the sale of the old residence, the adjustments to basis shall include a reduction by an amount equal to the amount of the gain which was not recognized upon the sale of the old residence. Such a reduction is not to be made for the purpose of determining the adjusted basis of the new residence as of any time preceding the sale of the old residence. For the purpose of this determination, the amount of the gain not recognized under this section upon the sale of the old residence includes only so much of the gain as is not recognized because of the taxpayer's cost, up to the date of the determination of the adjusted basis, of purchasing the new residence. The following example will illustrate this rule:

Example (3). On January 1, 1951, the taxpayer buys a new residence for $10,000. On March 1, 1951, he sells for $15,000 his old residence which has an adjusted basis to him of $5,000. During April a wing is constructed on the new house at a cost of $5,000 and in May he builds a garage at a cost of $2,000. The adjusted basis of the new residence is $10,000 during January and February, $5,000 during March and April, and $7,000 following the completion of the construction in May.

(*d*) *Limitations on application of section.*—If a residence is purchased by the taxpayer prior to the date of the sale of the old residence, the purchased residence shall, in no event, be treated as a new residence if such purchased residence is sold or otherwise disposed of by him prior to the date of the sale of the old residence. And, if the taxpayer, during the period within which the purchase and use of the new residence must be made in order to have any gain on the sale of the old residence not recognized under this section, purchases more than one property which is used by him as his principal residence during the 1 year (or 18 months in the case of the construction of the new residence) succeeding the date of the sale of the old residence, only the last of such properties shall be considered a new residence. However, if the taxpayer's new residence is destroyed, stolen, seized, requisitioned, condemned, or sold or exchanged under the threat or imminence of requisition or condemnation within such year (or 18 months) succeeding the sale of the old residence, then, for the purpose of the preceding sentence, such year (or 18 months) is deemed to end on the date of the destruction, theft, seizure, requisition, condemnation, sale, or exchange. If within 1 year prior to the date of the sale of the old residence, the taxpayer sold other property used by him as his principal residence at a gain, and any part of such gain was not recognized under this section, this section shall not apply with respect to the sale of the old residence. For the purpose of the preceding sentence, however, the destruction, theft, seizure, requisition, condemnation, or sale or exchange under threat or imminence of requisition or condemnation shall not be considered as a sale. The following example will illustrate these rules:

Example (4). A taxpayer sells his old residence on January 15, 1951, and purchases a new residence on February 15, 1951. On March 15, 1951, he sells

the new residence and purchases a second new residence on April 15, 1951. The gain on the sale of the old residence on January 15, 1951, will not be recognized except to the extent to which the taxpayer's selling price of the old residence exceeds the cost of purchasing the second new residence purchased on April 15, 1951. Gain on the sale of the first new residence on March 15, 1951, will be recognized. If, instead of selling the first new residence on March 15, 1951, such residence had been destroyed by fire on that date and insurance proceeds in cash had been received as a result thereof, the gain on the sale of the old residence on January 15, 1951, will not be recognized except to the extent to which the taxpayer's selling price of the old residence exceeds his cost of purchasing the new residence purchased on February 15, 1951. And, the gain on the involuntary conversion by fire of the first new residence on March 15, 1951, will not be recognized except to the extent to which the amount realized from such conversion exceeds the taxpayer's cost of purchasing the second new residence purchased on April 15, 1951.

(*e*) *Statute of limitations.*—Whenever a taxpayer sells property used as his principal residence at a gain, the statutory period prescribed in section 275 for the assessment of any deficiency attributable to any part of such gain will not expire prior to the expiration of 3 years from the date of the officer, with whom the return for the taxable year or years in which the gain from the sale of the old residence is realized has been filed, is notified by the taxpayer (1) of the cost of purchasing the new residence which the taxpayer claims results in the nonrecognition of any part of such gain, or (2) of the taxpayer's intention not to, or failure to, purchase a new residence within the period when such a purchase will result in the nonrecognition of any part of such gain. Such a deficiency may be assessed prior to the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which might otherwise bar such assessment.

Such notification shall be made in the return for the taxable year or years in which the purchase of the new residence occurs, or the intention not to make such a purchase is formed, or the period for the replacement expires if this return is filed with such officer. If this return is not filed with such officer, then such notification shall be made to such officer at the time of filing this return. If the taxpayer so desires, he may, in either event, also notify such officer prior to the filing of this return. Such notification shall contain all of the details in connection with the sale of the residence and, if applicable, the purchase of the new residence. If an intention not to replace is formed, or if the period for replacement expires, or if the cost of purchasing the new residence is less than the selling price of the old residence, the recognizable gain shall be included in the gross income for the taxable year or years in which such gain was realized; a recomputation in the form of an "amended return" should be made for this purpose if necessary.

(*f*) *Members of Armed Forces.*—The running of the 1-year (or 18 months in the case of the construction of the new residence) period, specified in (*a*) hereof, after the sale of the old residence within which the purchase and use of a new residence may result in the nonrecognition of gain on such sale shall be suspended during any time that the taxpayer serves on extended active duty in the Armed Forces of the United States after the date of the sale of the old residence and before January 1, 1954. Any such period as so suspended, however, shall not extend beyond the date 4 years after the date of the sale of the old residence. For example, if the taxpayer is on extended active duty with the army from January 1, 1951, to December 31, 1953, and if he sold his old residence on January 1, 1951, the latest date on which the taxpayer may use a new residence constructed by him and have any part of the gain on the sale of the old residence not recognized under this section is January 1, 1955, the date 4 years after the date of the sale of the old residence.

This suspension covers not only the Armed Forces service of the taxpayer but if the taxpayer and his same spouse used both the old and the new residences as their principal residence, then the extension applies in like manner to the time the taxpayer's spouse is on extended active duty with the Armed Forces of the United States.

The time during which the running of the period is suspended is part of such period. Thus, construction costs during such time are includible in the cost of purchasing the new residence under (b) (5) hereof.

The running of the 1-year (or 18 month) periods referred to in (*d*) hereof is not suspended, nor is the running of the 1-year period prior to the date of the

sale of the old residence within which the new residence may be purchased in order to have gain on the sale of the old residence not recognized under this section.

The term "extended active duty" means any period of active duty which is served pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period. If the call or order is for a period of more than 90 days, it is immaterial that the time served pursuant to such call or order is less than 90 days, if the reason for such shorter period of service occurs after the beginning of such duty. As to what constitutes active service as a member of the Armed Forces of the United States, see section 29.22(b)(13)-2. As to who are members of the Armed Forces, of the United States, see section 29.3797-11.

PAR. 6. There is inserted immediately preceding section 29.113(a)(9)-1 [26 CFR 29.113(a)(9)-1] the following:

SEC. 318. GAIN FROM SALE OR EXCHANGE OF TAXPAYER'S RESIDENCE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(2) Section 113(a)(9) (relating to basis of property acquired as a result of involuntary conversions) is hereby amended by adding at the end thereof the following: "This paragraph shall not apply in respect of property acquired as a result of a compulsory or involuntary conversion of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, or condemnation of such residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950."

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PUBLIC LAW 251, EIGHTY-SECOND CONGRESS
APPROVED OCTOBER 31, 1951

* * * * * * *

SEC. 2. Paragraph (9) of section 113(a) of the Internal Revenue Code (relating to unadjusted basis of property acquired as the result of an involuntary conversion) is hereby amended by striking out "section 112(f)" and inserting in lieu thereof "section 112(f)(1) or (2)", and by adding at the end of such paragraph the following new sentence: "In the case of property purchased by the taxpayer which resulted, under the provisions of section 112(f)(3), in the nonrecognition of any part of the gain realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of such property decreased in the amount of the gain not so recognized; and if the property purchased consists of more than one piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs."

SEC. 3. The amendments made by the first two sections of this Act shall be applicable only with respect to taxable years ending after December 31, 1950, except that the provisions of section 112(f)(3), and the provisions of section 113(a)(9), of the Internal Revenue Code as amended by this Act shall also be applicable to any taxable year ending prior to January 1, 1951, in which (a) any gain was realized upon the conversion of property and the disposition of such converted property occurred (within the meaning of such section 112(f)(3)) after December 31, 1950, or (b) the basis of property is affected by an election made under the provisions of section 112(f)(3) of such Code.

* * * * * * *

PAR. 7. Section 29.113(a)(9)-1 [26 CFR 29.113(a)(9)-1] is hereby amended as follows:

(A) By inserting immediately after the words "The provisions of" therein the following "the first sentence of", and by inserting after the word "*Example*" therein the following "*(1)*".

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

The provisions of the last sentence of section 113(a)(9) may be illustrated by the following example:

Example (2). A taxpayer realizes $22,000 from the involuntary conversion of his barn; the adjusted basis of the barn to him was $10,000, and he spent $20,000 for a new barn which resulted in the nonrecognition of $10,000 of the $12,000 gain on the conversion. The unadjusted basis of the new barn to the taxpayer would be $10,000—the cost of the new barn ($20,000) less the amount of the gain not recognized on the conversion ($10,000). The unadjusted basis of the new barn would not be a substituted basis in the hands of the taxpayer within the meaning of sections 113(b)(2)(B) and 29.113(b)(2)-1. If the replacement of the converted barn had been made by the purchase of two smaller barns which, together, were similar or related in service or use to the converted barn and which cost $8,000 and $12,000, respectively, then the basis of the two barns would be $4,000 and $6,000, respectively, the cost of each barn ($8,000 and $12,000) less in each case the proportion of the gain not recognized on the conversion ($10,000) that the cost of each barn bears to the cost of both barns $\frac{(8{,}000 \text{ and } 12{,}000)}{(20{,}000 \quad 20{,}000)}$.

PAR. 8. There is inserted immediately preceding section 29.113(b)(1)-1 [26 CFR 29.113(b)(1)-1] the following:

SEC. 318. GAIN FROM SALE OR EXCHANGE OF TAXPAYER'S RESIDENCE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(3) Section 113(b)(1) (relating to adjusted basis of property) is hereby amended by adding at the end thereof the following new subparagraph:

"(K) in the case of a residence the acquisition of which resulted, under the provisions of section 112(n), in the nonrecognition of any part of the gain realized upon the sale, exchange, or involuntary conversion of another residence, to the extent provided in section 112(n)(4)."

* * * * * * *

PAR. 9. Section 29.113(b)(1)-1, as amended by Treasury Decision 5980 [page 65, this Bulletin], approved February 3, 1953 [26 CFR 29.113(b)(1)-1], is hereby amended by adding at the end thereof the following:

For the adjustments to basis of a residence because its acquisition resulted, under the provisions of section 112(n), in the nonrecognition of any part of the gain realized upon the sale, exchange, or involuntary conversion of another residence, see section 29.112(n)-1.

PAR. 10. There is inserted immediately preceding section 29.117-1 [26 CFR 29.117-1] the following:

SEC. 318. GAIN FROM SALE OR EXCHANGE OF TAXPAYER'S RESIDENCE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(4) Section 117(h) (relating to determination of holding period) is hereby amended by adding at the end thereof the following new paragraph:

"(7) In determining the period for which the taxpayer has held a residence, the acquisition of which resulted under section 112(n) in the nonrecognition of any part of the gain realized on the sale, exchange, or involuntary conversion of another residence, there

shall be included the period for which such other residence had been held as of the date of such sale, exchange, or involuntary conversion."

* * * * * * *

PAR. 11. Section 29.117-4 [26 CFR 29.117-4] is hereby amended by adding at the end thereof the following:

The period for which the taxpayer has held a residence, the acquisition of which resulted, under the provisions of section 112(n), in the nonrecognition of any part of the gain realized on the sale, exchange, or involuntary conversion of another residence, shall include the period for which such other residence had been held as of the date of such sale, exchange, or involuntary conversion. See section 29.112(n)-1.

PAR. 12. There is inserted immediately preceding section 29.275-1 the following:

SEC. 318. GAIN FROM SALE OR EXCHANGE OF TAXPAYER'S RESIDENCE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(5) Section 276 (relating to period of limitation upon assessment and collection) is hereby amended by adding at the end thereof the following:

"(e) GAIN UPON SALE OR EXCHANGE OF RESIDENCE.—In the case of a deficiency described in section 112(n)(7), such deficiency may be assessed at any time prior to the expiration of the time therein provided."

* * * * * * *

PUBLIC LAW 251, EIGHTY-SECOND CONGRESS APPROVED OCTOBER 31, 1951

* * * * * * *

(b) Section 276 of the Internal Revenue Code (relating to period of limitation upon assessment and collection) is hereby amended by adding at the end thereof the following:

"(f) INVOLUNTARY CONVERSION.—In the case of a deficiency described in section 112(f)(3) (C) or (D), such deficiency may be assessed at any time prior to the expiration of the time therein provided."

* * * * * * * *

PAR. 13. Section 29.275-1, as amended by Treasury Decision 5971 [page 303, this Bulletin], approved January 8, 1953 [26 CFR 29.275-1], is hereby amended by inserting immediately preceding the last paragraph thereof the following:

(14) In the case of a deficiency described in section 112(n)(7), such deficiency may be assessed at any time prior to the expiration of the time therein provided. See section 29.112(n)-1.

(15) In the case of a deficiency described in section 112(f)(3) (C) or (D), such deficiency may be assessed at any time prior to the expiration of the time therein provided. See section 29.112(f)-3.

(This Treasury Decision is issued under the authority contained in sections 62, 112(f), 112(n), and 3791 of the Internal Revenue Code (53 Stat. 32, 65 Stat. 494, 733, and 53 Stat. 467; 26 U. S. C. 62, 112(f), 112(n), and 3791).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 17, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 20, 1953, 8:50 a. m.)

SECTION 29.112(f)-1: Involuntary conversion where disposition of the converted property occurred prior to January 1, 1951.

INTERNAL REVENUE CODE

Amounts received for the use of property acquired by the United States Government through condemnation proceedings constitute rental income where the interest acquired by the Government is no more than a leasehold interest. (See Rev. Rul. 38, page 16.)

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

SECTION 29.112(g)-1: Purpose and scope of exception of reorganization exchanges.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5990, page 142.)

SECTION 112(n).—RECOGNITION OF GAIN OR LOSS: GAIN FROM SALE OR EXCHANGE OF RESIDENCE

SECTION 29.112(n)-1: Gain from sale or exchange of residence.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5991, page 146.)

SECTION 29.112(n)-1: Gain from sale or exchange of residence.

INTERNAL REVENUE CODE

Gain from sale of old residence in excess of purchase price of new residence. (See Rev. Rul. 75, page 83.)

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

SECTION 29.113(a)-2: General rule.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5990, page 142.)

SECTION 29.113(a)(9)-1: Property acquired as a result of an involuntary conversion.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5991, page 146.)

SECTION 29.113(a)(13)-1: Property contributed in kind by a partner to a partnership.

INTERNAL REVENUE CODE

Life insurance policies contributed to a partnership. (See Rev. Rul. 72, page 23.)

SECTION 29.113(a)(18)-1: Basis of property received in certain corporate liquidations. (Also Section 112(b), Section 29.112(b)(7)-1.) Rev. Rul. 95

INTERNAL REVENUE CODE

The basis for depreciation and gain or loss upon the sale or other disposition of mortgaged property received by stockholders in a complete corporate liquidation, pursuant to the provisions of section 112(b)(7) of the Internal Revenue Code, should be determined by adding the amount of the mortgage indebtedness to the basis prescribed by section 113(a)(18) of the Code. This result follows whether the mortgage indebtedness is assumed by the stockholders or whether the property is taken subject to the mortgage debt.

Advice is requested whether the basis of assets distributed to stockholders in a complete corporate liquidation, with respect to which the provisions of section 112(b)(7) of the Internal Revenue Code are applicable, should be determined by adding the principal amount of mortgage indebtedness outstanding on such assets to the basis of the stock canceled or redeemed in the liquidation.

Section 112(b)(7) of the Code provides in effect that shareholders in certain liquidating corporations may postpone the recognition of that portion of the gain on the liquidation which would otherwise be recognized and which is attributable to appreciation in value of certain corporate assets unrealized by the corporation at the time such assets are distributed in complete liquidation.

Section 113(a)(18) of the Code provides for the basis of property received in such liquidations and reads in part as follows:

(a) BASIS (UNADJUSTED) OF PROPERTY.—The basis of property shall be the cost of such property; except that—

(18) PROPERTY RECEIVED IN CERTAIN CORPORATE LIQUIDATIONS.—If the property was acquired by a shareholder in the liquidation of a corporation in cancellation or redemption of stock with respect to which gain was realized, but with respect to which, as the result of an election made by him under paragraph (7) of section 112(b) of this chapter [chapter 1] * * *, the extent to which gain was recognized was determined under such paragraph, then the basis shall be the same as the basis of such stock canceled or redeemed in the liquidation, decreased in the amount of any money received by him, and increased in the amount of gain recognized to him.

The above statute substitutes the shareholder's stock basis, subject to specified adjustments, for the assets or property received. In some cases, however, the outstanding stock held by a shareholder may constitute only a part of the consideration given by him in exchange for the property received. In such cases, to limit the basis of the property received for purposes of depreciation, or gain or loss upon subsequent disposition, solely to the stock basis prescribed in section 113(a)(18) would result in a basis which includes only a portion of the consideration given by the shareholder to obtain the property.

It is the opinion of this office that section 113(a)(18) of the Code, *supra*, excludes from the shareholder's property basis only the amount

of gain realized but not recognized under the provisions of section 112(b)(7); it does not exclude from the property basis of shareholders in such cases the additional consideration of the mortgage indebtedness to which the property might be subject. Accordingly, such amount should be added to the stock basis prescribed under section 113(a)(18) of the Code as an additional cost incurred by the shareholders within the meaning of section 113(a) of the Code. Whether the mortgage indebtedness is assumed by the shareholders or the property is taken subject to the mortgage is immaterial. In either case, for purposes of depreciation and gain or loss upon sale or other disposition of the property, the mortgage indebtedness is treated in the same manner as cash paid. (See *Beulah B. Crane* v. *Commissioner*, 331 U. S. 1, Ct. D. 1684, C. B. 1947-1, 97.)

In view of the foregoing, it is held that, provided the requirements of section 112(b)(7) of the Internal Revenue Code are complied with, the basis of assets (other than money) acquired by the stockholders of the company shall be the same as the basis of the shares of stock redeemed and canceled, decreased in the amount of any money received and increased in the amount of gain recognized, in accordance with section 113(a)(18) of the Code, to which amount should be added the amount of the unsecured liabilities assumed by the stockholders. The amount thus arrived at should be allocated to the various assets received on the basis of their net fair market values (the net fair market value of an asset is its fair market value less any specific mortgage or pledge to which it is subject). To that portion of the basis thus determined for each property against which there is a lien should be added the amount of such lien. Where more than one property is covered by the same lien, the amount of the lien should be divided among the properties, allocating to each that proportion of the lien that the fair market value of such property bears to the total market value of the properties covered by the same lien.

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS

SECTION 29.113(b)(1)-1: Adjusted basis: General rule. T. D. 5967

(Also Section 29.113(d)-1.)

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 Public Law 539 (82d Cong.) [C. B. 1952-2, 358], which amends section 113(b)(1)(B) of the Internal Revenue Code, relating to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion.

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

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

On November 26, 1952, notice of proposed rule making was published in the Federal Register (17 F. R. 10740) conforming Regula-

tions 111 [26 CFR, part 29] to Public Law 539 (82d Cong.) [C. B. 1952-2, 358], approved July 14, 1952, which amends section 113(b)(1)(B) of the Internal Revenue Code, relating to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion. After consideration of all such relevant matter as was presented by interested persons relating to the rules proposed, the amendments to Regulations 111, set forth below, are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.113(b)(1)-1 the following:

PUBLIC LAW 539 (82d CONG.) [APPROVED JULY 14, 1952]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That so much of section 113(b)(1)(B) of the Internal Revenue Code (relating to adjustments to basis of property for depreciation, etc.) as precedes the word "Where" is hereby amended to read as follows:

"(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount—

"(i) allowed as deductions in computing net income under this chapter or prior income tax laws, and

"(ii) resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under this chapter (other than subchapter E), subchapter E of chapter 2, or prior income, war-profits, or excess-profits tax laws,

but not less than the amount allowable under this chapter or prior income tax laws. Clause (ii) of this subparagraph shall not apply in respect of any period since February 28, 1913, and before January 1, 1952, unless an election has been made under subsection (d)."

* * * * * * *

SEC. 3. The amendments made by this Act shall apply in respect of taxable years beginning after December 31, 1938. Provisions having the effect of such amendments shall be deemed to have been included in the revenue laws respectively applicable to taxable years ending after December 31, 1931, and beginning before January 1, 1939.

PAR. 2. Section 29.113(b)(1)-1 as amended by Treasury Decision 5873 [C. B. 1952-1, 23], approved December 7, 1951, is amended as follows:

(A) By inserting immediately preceding the second paragraph thereof the following:

(a) Items properly chargeable to capital account.

(B) By striking the sixth paragraph of such section, which paragraph begins with the words "The cost or other basis * * *", and the seventh paragraph thereof, which paragraph begins with the words "The depreciation allowed * * *", and inserting in lieu thereof the following:

(b) Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.—(1) *In General.*—The cost or other basis must also be decreased, to the extent provided in paragraphs (2), (3), and (4), below, by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion. The adjustment required for any taxable year or period is the amount allowed (or the portion thereof referred to in paragraph (2)(i) or paragraph (4)(i), as the case may be) or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a

later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. The determination of the amount properly allowable shall, however, be made on the basis of facts reasonably known to exist at the end of such year or period. The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted.

The deductions by which the cost or other basis is to be decreased shall include deductions allowed under section 114(b) (2), (3), and (4) of the Revenue Act of 1932, the Revenue Act of 1934, the Revenue Act of 1936, the Revenue Act of 1938, and the Internal Revenue Code, for the taxable year 1932 and subsequent taxable years, but the amount of the diminution in respect of depletion for taxable years prior to 1932 shall not exceed a depletion deduction computed without reference to discovery value in the case of mines, or without reference to discovery value or a percentage of income in the case of oil and gas wells.

(2) *Adjustment for periods beginning on or after January 1, 1952.*—The decrease required by paragraph (1), above, for deductions in respect of any period beginning on or after January 1, 1952, shall be whichever is the greater of the following amounts:

(i) The amount allowed as deductions in computing net income under chapter 1 and resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under chapter 1 (other than subchapter E, relating to the tax on self-employment income);

(ii) The amount properly allowable as deductions in computing net income under chapter 1 (whether or not the amount properly allowable would have caused a reduction for any taxable year of the taxpayer's taxes).

(3) *Adjustment for periods since February 28, 1913, and before January 1, 1952, where no election made.*—Except where an election has been properly made under section 113(d) (see paragraph (4), below), the decrease required by paragraph (1) for deductions in respect of any period since February 28, 1913, and before January 1, 1952, shall be whichever of the following amounts is the greater:

(i) The amount allowed as deductions in computing net income under chapter 1 or prior income tax laws;

(ii) The amount properly allowable in computing net income under chapter 1 or prior income tax laws.

For the purpose of determining the decrease required by this paragraph it is immaterial whether or not the amount under (i), above, or the amount under (ii), above, would have resulted in a reduction for any taxable year of the taxpayer's taxes.

(4) *Adjustment for period since February 28, 1913, and before January 1, 1952, where election made under section 113(d).*—If an election has been properly made under section 113(d) (see section 29.113(d)-1), the decrease required by paragraph (1) for deductions in respect of any period since February 28, 1913, and before January 1, 1952, shall be whichever is the greater of the following amounts:

(i) The amount allowed as deductions in computing net income under chapter 1 or prior income tax laws and resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under chapter 1 (other than subchapter E, relating to the tax on self-employment income), subchapter E of chapter 2, or prior income, war-profits, or excess-profits tax laws;

(ii) The amount properly allowable as deductions in computing net income under chapter 1 or prior income tax laws (whether or not the amount properly allowable would have caused a reduction for any taxable year of the taxpayer's taxes).

(5) *Determination of amount allowed which reduced taxpayer's taxes.*—For the purpose of determining whether the amount allowed which resulted in a reduction for any taxable year of the taxpayer's taxes under chapter 1 of the Internal Revenue Code (other than subchapter E), subchapter E of chapter 2, or prior income, war-profits, or excess-profits tax laws, which amount is hereinafter referred to as the "tax-benefit amount allowed", exceeded the amount allowable, a determination must be made of that portion of the excess of the amount allowed over the amount allowable which, if disallowed, would not have resulted in an increase in any such tax previously determined. If the entire

excess of the amount allowed over the amount allowable could be disallowed without any such increase in tax, the tax-benefit amount allowed shall not be considered to have exceeded the amount allowable. If only part of such excess could be disallowed without any such increase in tax, the tax-benefit amount allowed shall be considered to exceed the amount allowable to the extent of the remainder of such excess.

For this purpose, the tax previously determined shall be determined under the principles of section 3801(d), and the only adjustments to be made in determining whether there would be an increase in tax shall be those resulting from the disallowance of the amount allowed. The taxable years for which the determination is made shall be the taxable year for which the deduction was allowed and any other taxable year which would be affected by the disallowance of such deduction. Examples of such other taxable years are taxable years to which there was a carry-over or carry-back of a net operating loss or an unused excess-profits credit from the taxable year for which the deduction for depreciation, etc., was allowed, and taxable years for which a computation under section 22(b)(12) or section 127 was made by reference to the taxable year for which the deduction was allowed. In determining whether the disallowance of any part of the deduction for depreciation, etc., would not have resulted in an increase in any tax previously determined, proper adjustment must be made for previous determinations under sections 452, 734, or 3801, and for any previous application of section 113(b)(1)(B)(ii).

If a determination under section 113(b)(1)(B)(ii) must be made with respect to several properties for each of which the amount allowed for the taxable year exceeded the amount allowable, the tax-benefit amount allowed with respect to each of such properties shall be an allocated portion of the tax-benefit amount allowed determined by reference to the sum of the amounts allowed and the sum of the amounts allowable with respect to such several properties.

In the case of property held by a partnership or trust, the computation of the tax-benefit amount allowed shall take into account the tax benefit of the partners or beneficiaries, as the case may be, from the deduction by the partnership or trust of the amount allowed to the partnership or the trust. For this purpose, the determination of the amount allowed which resulted in a tax benefit to the partners or beneficiaries shall be made in the same manner as that provided above with respect to the taxes of the person holding the property.

A taxpayer seeking to limit the adjustment to basis to the tax-benefit amount allowed for any period, in lieu of the amount allowed, must establish the tax-benefit amount allowed. A failure of adequate proof as to the tax-benefit amount allowed with respect to one period does not preclude the taxpayer from limiting the adjustment to basis to the tax-benefit amount allowed with respect to another period for which adequate proof is available. For example, a corporate transferee may have available adequate records with respect to the tax effect of the deduction for the taxable years 1946 and 1947 of erroneous depreciation, but may not have available adequate records with respect to the deduction of excessive depreciation for a prior period during which the property was held by its transferor. In such case, assuming a proper election is made under section 113(d), the corporate transferee shall not be denied the right to apply this section with respect to the erroneous depreciation for the period for which adequate proof is available.

(6) *Determination of amount allowable in prior taxable years.*—Under section 113(b)(1)(B), one of the factors involved in determining the adjustment to basis as of any date is the amount allowable for periods prior to such date. The amount allowable for such prior periods is determined under the law applicable to such prior periods; all adjustments required by the law applicable to such periods are made in determining the adjusted basis of the property for the purpose of determining the amount allowable. Since provisions corresponding to the amendment to section 113(b)(1)(B) made by Public Law 539 (82d Cong.) are deemed included in all revenue laws applicable to taxable years ending after December 31, 1931, the amount allowable for any such taxable year must be computed with the application of such provisions. For example, if the adjusted basis of property is determined as of January 1, 1952, if an election was properly made under section 113(d), and if the property was held since January 1, 1930, then the amount allowable which is taken into account in computing the adjusted basis as of January 1, 1952, shall be determined for all taxable years ending after December 31, 1931, with the application

to each such taxable year of the provisions of section 113(b)(1)(B) as amended by Public Law 539. Public Law 539 made no change in the law applicable in determining the amount allowable for taxable years ending before January 1, 1932. In any case in which, prior to the enactment of Public Law 539 (July 14, 1952) there was a final decision of a court determining the amount allowable for a particular taxable year, such determination (but only for the purpose of determining the adjustment under section 113(b)(1)(B) by reference to such allowable amount) must be adjusted to the extent necessary to reflect the amendment made by Public Law 539 to the law applicable to the taxable year for which the amount was allowable.

Although Public Law 539 amends the law applicable to all taxable years ending after December 31, 1931, the amendment does not open for refund, credit, or assessment of a deficiency any taxable year for which such refund, credit, or assessment is barred by any law or rule of law.

(7) *Property with transferred basis.*—The following rules apply in the determination of the adjustments to basis of property in the hands of a transferee, donee, or grantee which are required by section 113(b)(2) with respect to the period the property was held by the transferor, donor, or grantor:

(i) An election under section 113(d) by a transferor, donor, or grantor made after the date of the transfer, gift, or grant of the property shall not affect the basis of such property in the hands of the transferee, donee, or grantee. Such an election made before the date of the transfer must be taken into account in determining under section 113(b)(2) the adjustments to basis as of the date of the transfer, gift, or grant, whether or not an election under section 113(d) was made by the transferee, donee, or grantee.

(ii) An election by the transferee, donee, or grantee shall be applicable in determining the adjustments to basis for the period during which the property was held by the transferor, donor, or grantor, whether or not the transferor, donor, or grantor had made an election, provided that the property was held by the transferee, donee, or grantee at any time on or before the date on which his election was made.

(8) *Example (1).* The case of Corporation A discloses the following facts:

(1) Year	(2) Amount allowed	(3) Amount allowed which reduced taxpayer's taxes	(4) Amount allowable	(5) Amount allowable but not less than amount allowed	(6) Amount allowable but not less than amount allowed which reduced taxpayer's taxes
1949	$6,000	$5,500	$5,000	$6,000	$5,500
1950	7,000	7,000	6,500	7,000	7,000
1951	5,000	4,000	6,500	6,500	6,500
Total 1949-1951				19,500	19,000
1952	6,500	6,500	6,000		6,500
1953	5,000	4,000	4,000		4,000
1954	4,500	4,500	6,000		6,000
Total 1952-1954					16,500

The cost or other basis is to be adjusted by $16,500 with respect to the years 1952–1954, that is, by the amount allowable but not less than the amount allowed which reduced the taxpayer's taxes. An adjustment must also be made with respect to the years 1949–1951, the amount of such adjustment depending upon whether an election was properly made under section 113(d). If no such election was made, the amount of the adjustment with respect to the years 1949–1951 is $19,500, that is, the amount allowed but not less than the amount allowable. If an election was properly made, the amount of the adjustment with respect to the years 1949–1951 is $19,000, that is, the amount allowable but not less than the amount allowed which reduced the taxpayer's taxes.

Example (2). Corporation A purchased a building on January 1, 1950, at a cost of $100,000. On the basis of the facts reasonably known to exist at the end

of 1950, a period of 50 years should have been used as the correct useful life of the building; nevertheless, depreciation was computed by Corporation A on the basis of a useful life of 25 years, and was allowed for 1950 through 1953 as a deduction in an annual amount of $4,000. The building was sold on January 1, 1954. Corporation A did not make an election under section 113(d). No part of the amount allowed Corporation A for any of the years 1950 through 1953 resulted in a reduction of Corporation A's taxes. The adjusted basis of the building as of January 1, 1954, is $88,166, computed as follows:

Year	Adjustments to basis as of beginning of taxable year	Adjusted basis	Remaining life	Depreciation allowable	Depreciation allowed
1950	0	$100,000	50	$2,000	$4,000
1951	$4,000	96,000	49	1,959	4,000
1952	8,000	92,000	48	1,917	4,000
1953	9,917	90,083	47	1,917	4,000
1954	11,834	88,166			

Example (3). The facts are the same as in Example (2), except that Corporation A made a proper election under section 113(d). In such case, the adjusted basis of the building as of January 1, 1954, is $92,000, computed as follows:

Year	Adjustments to basis as of beginning of taxable year	Adjusted basis	Remaining life	Depreciation allowable	Depreciation allowed
1950	0	$100,000	50	$2,000	$4,000
1951	$2,000	98,000	49	2,000	4,000
1952	4,000	96,000	48	2,000	4,000
1953	6,000	94,000	47	2,000	4,000
1954	8,000	92,000			

Example (4). If it is assumed that in Example (2), or in Example (3), all of the deduction allowed Corporation A for 1953 had resulted in a reduction of A's taxes, the adjustment to the basis of the building for depreciation for 1953 would reflect the entire $4,000 deduction. In such case, the adjusted basis of the building as of January 1, 1954, would be $86,083 in Example (2), and $90,000 in Example (3).

Example (5). The facts are the same as in Example (2) except that for the year 1950 all of the $4,000 amount allowed Corporation A as a deduction for depreciation for that year resulted in a reduction of A's taxes. In such case, the adjustments to the basis of the building remain the same as those set forth in Example (2).

Example (6). The facts are the same as in Example (3) except that for the year 1950 all of the $4,000 amount allowed Corporation A as a deduction for depreciation resulted in a reduction of A's taxes. In such case, the adjusted basis of the building as of January 1, 1954, is $90,123, computed as follows:

Year	Adjustments to basis as of beginning of taxable year	Adjusted basis	Remaining life	Depreciation allowable	Depreciation allowed
1950	0	$100,000	50	$2,000	$4,000
1951	$4,000	96,000	49	1,959	4,000
1952	5,959	94,041	48	1,959	4,000
1953	7,918	92,082	47	1,959	4,000
1954	9,877	90,123			

(C) By inserting before the eighth paragraph thereof beginning with the words "The cost or other basis shall also be decreased * * *" the following: "(*c*) *Exhaustion, wear and tear,*

obsolescence, amortization, and depletion—periods prior to March 1, 1913."

(D) By inserting immediately prior to the ninth paragraph thereof, which paragraph begins with the words "In the case of stock, * * *" the following: "(*d*) *Certain stock distributions.*"

(E) By inserting immediately prior to the eleventh paragraph thereof, which paragraph begins with the words "In the case of stock of United States shareholders * * *", the following: "(*e*) *Stock of United Statese shareholders of a foreign personal holding company.*"

(F) By inserting immediately prior to the twelfth paragraph thereof, which paragraph begins with the words "Adjustments must always be made * * *", the following: "(*f*) *Other applicable rules.*".

PAR. 3. There is inserted immediately after section 29.113(c)-1 the following:

PUBLIC LAW 539 (82d CONG.) [APPROVED JULY 14, 1952]

* * * * * * *

SEC. 2. Section 113 of the Internal Revenue Code (relating to basis of property) is hereby amended by adding at the end thereof the following new subsection:

"(d) ELECTION IN RESPECT OF DEPRECIATION, ETC., ALLOWED BEFORE 1952.—Any person may elect to have clause (ii) of subsection (b)(1)(B) apply in respect of periods since February 28, 1913, and before January 1, 1952. Such an election shall be made in such manner as the Secretary may by regulations prescribe, shall be irrevocable, and shall apply in respect of all property held by the person making the election at any time on or before the date on which the election was made and in respect of all periods since February 28, 1913, and before January 1, 1952, during which such person held such property or for which adjustments must be made under subsection (b)(2). An election by a transferor, donor, or grantor made after the date of the transfer, gift, or grant of property shall not affect the basis of such property in the hands of the transferee, donee, or grantee. No such election may be made after December 31, 1952."

"SEC. 3. The amendments made by this Act shall apply in respect of taxable years beginning after December 31, 1938. Provisions having the effect of such amendments shall be deemed to have been included in the revenue laws respectively applicable to taxable years ending after December 31, 1931, and beginning before January 1, 1939.

SEC. 29.113(d)-1. ELECTION AS TO AMOUNTS ALLOWED IN RESPECT OF DEPRECIATION, ETC., BEFORE 1952.—(*a*) *In general.*—Any person may elect to have the adjustments to the cost or other basis of property under section 113(b)(1)(B) determined in accordance with clause (ii) of such section, by filing with the director or collector of internal revenue, on or before December 31, 1952, the written statement of election provided in (b), below. The statement must be filed with the collector or director with whom the return must be filed (determined under section 53(b) as of December 31, 1952). Such election shall be irrevocable after December 31, 1952, and shall apply with respect to all periods since February 28, 1913, and before January 1, 1952. The election shall apply to all properties held by the person making the election at any time on or before the date of such election.

A taxpayer may include in an election filed before December 31, 1952, a statement that the election shall take effect when filed, and in such case the election shall be irrevocable on the date filed, and shall not apply to any property acquired by the taxpayer after such date. If an election is made before December 31, 1952, and does not contain such statement, the election may be revoked by filing on or before December 31, 1952, in the same office in which the election was filed, a statement of revocation executed in the same manner as the election. Such an election made before December 31, 1952, and not revoked on or before that date, shall be deemed made on December 31, 1952, and shall apply to all property held by the taxpayer at any time on or before such date.

A copy of the written statement of election must be filed with the first income tax return, amended return, or claim for refund filed on or after the date on which the election is made.

An election by a partner is not an election by the partnership of which he is a member, but a separate election must be made by the partnership. Similarly, an election by the partnership applies only with respect to the partnership, and is not applicable to the separate property of the partners. A similar rule applies with respect to elections by trusts and beneficiaries of such trusts.

An election which conforms in substance to the provisions of this section shall not be deemed invalid solely because it was filed prior to the date on which the regulations in this section were promulgated.

(*b*) *Rules applicable to making of election.*—The following rules are applicable to the making of an election under section 113(d):

(1) *Form of election.*—The election shall be in the form of a statement in writing addressed to the collector or director of internal revenue with whom filed, shall state the name and address of the taxpayer making the election, and shall contain a statement that such taxpayer elects to have the provisions of section 113(b)(1)(B)(ii) apply in respect of all periods since February 28, 1913, and before January 1, 1952.

(2) *Signature.*—The statement shall be signed by the taxpayer making the election, if an individual, or, if the taxpayer making the election is not an individual, the statement shall be executed in the same manner as is required in the case of the income tax return of such taxpayer.

(3) *Filing.*—The written statement must be filed in the office of the collector or director of internal revenue on or before December 31, 1952. An election shall be considered as timely filed if it is placed in the mail on or before midnight of December 31, 1952, as shown by the postmark on the envelope containing the written statement of election or as shown by other available evidence of the mailing date.

The amendments to section 29.113(b)(1)-1 of Regulations 111, covering taxable years beginning after December 31, 1941, set forth in this Treasury Decision, are hereby made applicable to taxable years beginning after December 31, 1931, and before January 1, 1942 (such years being covered by Regulations 77, 86, 94, 101, and 103).

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 29, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 30, 1952, 11:32 a. m.)

SECTION 29.113(b)(1)-1: Adjusted basis: General rule.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5980, page 65.)

SECTION 29.113(b)(1)-1: Adjusted basis: General rule.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5991, page 146.)

SECTION 29.113(b)(1)-1: Adjusted basis: General rule.

INTERNAL REVENUE CODE

Elections filed by taxpayers under section 113(d) in respect of depreciation, etc., allowed before 1952. (See Rev. Rul. 30, below.)

SECTION 29.113(b)(3)-1: Adjusted basis: Discharge of corporate indebtedness: General rule.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 6003, page 24.)

SECTION 113(d).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ELECTION IN RESPECT OF DEPRECIATION, ETC., ALLOWED BEFORE 1952

SECTION 29.113(d)-1: Election as to amounts allowed in respect of depreciation, etc., before 1952. Rev. Rul. 30*
(Also Section 113(b), Section 29.113(b)(1)-1.)

INTERNAL REVENUE CODE

Procedures relating to the processing and examination of elections, in respect of depreciation, etc., allowed for any period before January 1, 1952, filed by taxpayers pursuant to section 113(d) of the Internal Revenue Code, as added by Public Law 539 (82d Cong.), C. B. 1952-2, 358.

1. Public Law 539 (82d Cong.), C. B. 1952-2, 358, amended section 113(b)(1)(B) of the Internal Revenue Code (relating to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion) and added section 113(d) thereto. In accordance with section 113(d), any person may elect to have clause (ii) of section 113(b)(1)(B) apply and such election shall apply with respect to all periods after February 28, 1913, and before January 1, 1952, during which such person held the property and the period, if any, for which adjustments must be made as provided in section 113(b)(2) of the Code, relating to substituted basis.

2. Treasury Decision 5967, page 163, this Bulletin, approved December 30, 1952, sets forth the amendments to Regulations 111 by virtue of Public Law 539. Section 29.113(d)-1 of such regulations, as amended, prescribes the manner in which the taxpayer may make an election as to amounts allowed in respect of depreciation, etc., for any period before January 1, 1952. Among other things, the prescribed form of election is required to be filed with the appropriate collector or director of internal revenue on or before December 31, 1952, and is irrevocable after December 31, 1952.

3. All elections will be retained in the audit divisions of the directors' offices for permanent, alphabetical filing. An examination of the

*Originally issued as IR-Mimeograph 129, dated February 5, 1953.

elections will be made to determine whether or not they have been timely filed and otherwise meet the requirements of the regulations. Many of the elections will have been filed prior to publication of the regulations, and it is probable that there will be a number which, although clear as to intent, do not conform precisely to the requirements. In view thereof, timely filed statements which reasonably satisfy the requirements of the regulations and clearly signify an intention on the part of the taxpayer to make an election, will be treated as such by directors even though, in minor respects, they may not conform precisely to the stated requirements.

4. All timely filed elections found to be acceptable will be acknowledged by the director's office by letter which, in addition to an acknowledgment of receipt of the election, will contain the following statements:

Your attention is called to Treasury Decision 5967, page 163, this Bulletin, amending Regulations 111, which provides in section 29.113(d)-1(*a*) that a copy of the written statement of election must be filed with the first income tax return, amended return, or claim for refund filed on or after the date on which election is made; and which provides in section 29.113(b)(1)-1(*b*)(6) that although Public Law 539 amends the law applicable to all taxable years ending after December 31, 1931, the amendment does not open for refund, credit, or assessment of a deficiency any taxable year for which such refund, credit, or assessment is barred by law or any rule of law.

The law itself, or the filing of an election thereunder, neither provides a basis for automatic adjustment of any reported tax liability nor extends the statutory period of limitation for adjustment. Accordingly, it will be necessary for you to file a claim for refund or an amended return for any taxable year for which the tax liability is to be adjusted by reason of adjustment to the basis of property attributable to the election and for which the statutory period of limitation has not expired.

5. Any election not timely filed will be made the subject of a letter to the taxpayer stating briefly that, since the election was not filed on or before December 31, 1952, in accordance with the provision of the law and regulations, such election is not valid and, therefore, the provisions of clause (ii) of section 113(b)(1)(B) of the Internal Revenue Code do not apply in respect of any period prior to January 1, 1952.

6. A valid election will not of itself require an examination of the returns of the taxpayer involved. Claims for refund or amended returns filed by taxpayers as a result of making an election will be examined in accordance with established procedures. Other returns involving the provisions of section 113(b)(1)(B)(ii) of the Code, whether because of an election or otherwise, will be considered for examination under regular classification and selection procedures. However, the foregoing is not intended to preclude a director's office from making an examination of a taxpayer's return on the basis of the application of section 113(b)(1)(B)(ii), otherwise than as hereinbefore indicated, if the circumstances of the case warrant.

SECTION 29.113(d)-1: Election as to amounts allowed in respect of depreciation, etc., before 1952.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5967, page 163.)

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

SECTION 29.114–1: Basis for allowance of depreciation and depletion. Rev. Rul. 16
(Also Section 23(m), Section 29.23(m)-1.)

INTERNAL REVENUE CODE

Where ad valorem property taxes are imposed on mineral-bearing lands and the lessee pays the lessor's share of such taxes pursuant to the mineral lease on the land, such payments shall be treated as additional royalties which are excludable from the lessee's gross income and includible in the lessor's depletable gross income to the extent that there is sufficient gross income from mineral production to cover the tax. If there is insufficient gross income from production to cover the tax, such payments shall be treated as delay rental, a deductible expense of the lessee and nondepletable income to the lessor.

Advice is requested whether ad valorem property taxes on mineral-bearing lands are excludable from depletable gross income of the lessee, under section 114(b) of the Internal Revenue Code, where, pursuant to the terms of the mineral lease, the lessee pays all such taxes which are imposed on the leased lands.

The typical lease in question provides that the lessee shall pay to the lessor royalty payments based on the amount of ore mined during the year, subject to minimum annual payments; and that such minimum payments, to the extent that they exceed the royalties due within the year, shall be credited against royalties due in any future year. It further provides that the lessee shall pay all ad valorem property taxes accruing on the property during the period the lease remains in force.

In the instant case, the tax bill was addressed to the lessee and the assessment was for State, county, town and school taxes, which were based upon the assessed valuation of the property, including the value of any mineral rights contained in the land. The liability for such taxes is not confined to years in which mining operations are conducted, but may apply to years prior to the opening of a mine or to years during which operations are suspended. Under State law, such taxes are levied against the property itself, enforceable only by an *in rem* proceeding in which no personal liability is created, although the lessee's interest in the property, together with all improvements placed thereon by the lessee would be subject to seizure to satisfy any such tax against the property.

In G. C. M. 26526 (C. B. 1950-2, 40), it was, in effect, concluded that payments made, pursuant to lease terms, by a lessee of oil and gas properties of ad valorem taxes assessed against a lessor's interest in such properties were in the nature of delay rentals in years prior to production, but were "rent or royalty" payments, under section 114(b)(3) of the Internal Revenue Code, in years of production to the extent that such payments of tax liability did not exceed the gross income from production from the properties for the year. As both the lessor and the lessee in that case undoubtedly possessed depletable economic interests in the leased property, the only questions therein presented were the extent to which the payment by the lessee of the

lessor's ad valorem taxes represented depletable income, and whether the agreement by the lessee to make such payment was a part of the sharing arrangement between the parties to be taken into account in equitably apportioning allowable depletion between them.

It seems clear that royalty payments may be measured in various ways. For example, had the lease provided for royalty payments measured by a specified share of the year's production proceeds, plus the lessor's share of the ad valorem taxes for the year, the total not to exceed the income from production for that year, there would seem to be no question that production income to that extent would have been the lessor's share of the income produced—i. e., a royalty payment excluded from gross income of the lessee within the ambit of the express language of section 114(b)(4)(A) of the Internal Revenue Code, excluding from lessee's "gross income an amount equal to any rents or royalties paid or incurred * * * in respect of the property."

It seems equally clear that delay rental payments may likewise be measured in various ways. Had the lease involved in the cited opinion provided for delay rental payments measured by x dollars per acre per year for years prior to development, plus lessor's share of the ad valorem tax for such years, it would seem plain that such delay rentals would have represented neither depletable income to the lessor nor payments excludable from lessee's income under the above-cited statutory provision. Such payments are nondepletable items of income to the lessor, since the requisite diminution in the value of his capital interest in the leased property, resulting from a conversion of capital into income to give the depletion provisions operative effect, did not occur upon such payments. Certainly, there was no diminution in value attributable to the extraction and sale of the natural resource content of the land as occurs in the case of ordinary production royalty payment. Nor can such payments qualify as advance royalty payments to establish the requisite diminution in value in the lessor's interest resulting from such payments as in the case of either (1) a bonus payment upon the execution of a lease (which presumptively reduces future production royalty payments to the lessor), or (2) royalty payments in advance of production, such as minimum royalty payments which may be credited as royalty payments on production in future years.

Nor are such delay rental payments given implicit depletion significance by being "rents or royalties" excludable from gross income of the lessee under the above-quoted provision of section 114(b)(4)(A) of the Code. That provision, first appearing in the Revenue Act of 1932, merely (1) codified the then existing rule that provisions for royalty payments in mineral leases effected a sharing arrangement between the parties, each such party being required to include in his gross income only his agreed share, thereby excluding the gross income attributable to other shares, and (2) extended such exclusion rule to "rents". (See *Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312, Ct. D. 905, C. B. XIV-1, 253 (1935); G. C. M. 22730, C. B. 1941-1, 214 and cases cited therein.) The concept of excluding the income share of others from the income of one nominally in the position of the payor necessarily assumes that there is production income to

divide. Payments made in other circumstances are essentially either capital expenditures, as in the case of advance royalty payments, or deductible expenses as in the case of delay rental payments, and, therefore, without the quoted exclusion provision. Such payments are depletable income to the payee only if they are advance royalties attended by diminution in the value of the payee's capital interest. Payments of the lessor's share of ad valorem taxes, being payable throughout the production life of the mineral property, are not advance payments in any sense; nor do they cause diminution in the payee's capital interest, except to the extent payable out of income from the extraction and sale of the mineral content of the land.

Thus, viewed realistically, the lessee's payments of the lessor's share of ad valorem taxes is nondepletable income to the lessor (and deductible rather than excludable rental payments by the lessee) except to the extent payable out of production income. This result flows from the application to this issue of the basic reasoning of the controlling cases. The codifying statute confirms this view, as the statute seems inept except to the extent there is sufficient production income to meet the payment, in which event the plain language of the statute requires it to be treated as a "rent or royalty" exclusion from lessee income for the reason that it represents gross income of the lessor, and, consequently, depletable gross income to him.

Attempts to distinguish the instant case from the case presented in G. C. M. 26526, *supra*, are not persuasive. As the instant payments were to, or for the benefit of, the lessor pursuant to the lease contract, they seem to qualify as rent or royalties as much in the one case as in the other. As additional royalties they are distinguishable from other business expenses of the lessee incurred by him in transactions with third parties in the pursuit of his business of exploiting the mineral resources of the land.

The entire ad valorem tax cannot be said to be the tax liability of the lessee merely because his entire lessee interest and his other properties thereon could be seized to satisfy the tax claim. The lessor could say the same with equal force for the same reason. Had the parties not contracted as they did, the ad valorem tax would doubtless have been shared between them—presumptively in proportion to the value of their respective interests—as the assessment is based on the total value of the property in which their interests inhere. If, as indicated, the fact that the lessee paid the entire tax leads only to the conclusion that payment of the lessor's share thereof was essentially additional rental payment for the account of the lessor, it would seem to follow that the lease provisions giving the lessor a lien to assure such payment would not change the character of the payment made under the Internal Revenue Code.

If, as noted, the lease agreement between the lessee and lessor had not provided for the payment of ad valorem taxes on the leased property by the lessee, such taxes would doubtless have been shared by them. Therefore, in order to determine the amount of such taxes paid by the lessee for the account of the lessor it is necessary to ascertain the proportionate values of their respective interests in the property and to use such values as a basis for determining a ratio which is to be used to allocate the taxes between the parties. Only relative

values are required. Therefore, it will not be necessary to reduce total profits to their present worth. Results of operations in a current taxable year should never be used as the sole criterion for determining a ratio. The ratio may be determined by the Bureau, in case no agreement can be reached between the parties, or, if an agreement thereon is reached between the parties which is considered reasonable by the Bureau, such ratio will be accepted. The ratio, once established, must remain undisturbed in future years as long as there is no material change in the bases upon which it was originally established.

Accordingly, it is held that where ad valorem property taxes are imposed on mineral-bearing lands and the lessee pays the lessor's share of such taxes pursuant to the mineral lease on the land, such payments shall be treated as additional royalties which are excludable from the lessee's gross income and includible in the lessor's depletable gross income to the extent that there is sufficient gross income from mineral production to cover the tax. If there is insufficient gross income from production to cover the tax, such payments shall be treated as delay rental, a deductible expense of the lessee and nondepletable income to the lessor.

SECTION 29.114-1: Basis for allowance of depreciation and depletion. Rev. Rul. 76
(Also Section 23(m); Section 29.23(m)-1.)

INTERNAL REVENUE CODE

Computation of percentage depletion in the case of pyrites and similar ores containing two or more minerals which are granted different percentages of gross income under section 114(b)(4)(A) of the Internal Revenue Code.

Advice is requested as to the proper method of computing percentage depletion in those cases where ores containing two or more minerals, such as pyrites, subject to differing rates of percentage depletion, are produced.

In the illustrative case of pyrite, an iron sulfide, the ore may be sold, (*a*) for its sulfur content (rate 23 percent), or (*b*) for its iron content (rate 15 percent), or both.

It is the position of the Bureau that pyrite is an ore of sulfur *and* iron, which products are entitled to different rates of percentage depletion. In the case of pyrite, 23 percent of gross income from sulfur plus 15 percent of gross income from iron would be the maximum allowable percentage depletion under section 114(b)(4)(B), but the deduction would be subject to the limitation provided for in that section, i. e., 50 percent of "net income from the property," the "property" being the taxpayer's interest in the mineral deposit, and the "net income" being the *overall* net income resulting from the sale of all included commercial minerals.

The same problem extends to cases where the property contains one or more minerals entitled to percentage depletion and one or more additional minerals which are entitled to cost depletion only. In such cases, depletion allowance is determined exactly as above and illustrated as follows.

Assume the addition of a third mineral, A, in the pyrite ore, which is entitled to cost depletion only. Maximum allowable percentage depletion would be 23 percent of gross income from sulfur, plus 15 percent of gross income from iron, plus zero percent of gross income from A. The limitation would be 50 percent of net income resulting from the sale of all three minerals. Cost depletion, which is the minimum depletion allowable, would be computed on the adjusted basis of the entire property.

When all minerals in an ore are entitled to depletion at the same rate, the sum of the receipts becomes the basis for computing statutory "gross income from the property" for the single computation necessary. When the minerals involved are entitled to different rates, the amount received in payment for each necessarily becomes a fact question. Normally this fact question can be resolved by an examination of the sales contracts.

SECTION 29.114–1: Basis for allowance of depreciation and depletion. (Also Section 23(cc); Section 23(ff).) Rev. Rul. 106

INTERNAL REVENUE CODE

Percentage depletion allowable to producers of uranium minerals, such deposits being classified as "metal mines." Sections 23(ff) and 23(cc) of the Internal Revenue Code apply to all types of mining operations including uranium mines.

Advice is requested as to the classification for percentage depletion purposes of a deposit of minerals or ores used as a source of uranium; also as to the applicability of sections 23 (ff) and (cc) to uranium mines.

As uranium is a metal, any deposit of minerals or ores used as a source thereof is classified as a "metal mine" for percentage depletion purposes under section 114(b)(4) of the Internal Revenue Code.

It follows that, for years ending after December 31, 1950, sections 23 (ff) and (cc) of the Code, both applicable to "metal mines," apply to exploration and development expenditures.

SECTION 29.114–1: Basis for allowance of depreciation and depletion.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 6004, page 45.)

SECTION 29.114–1: Basis for allowance of depreciation and depletion.

INTERNAL REVENUE CODE

Basis of determining depletion allowances with respect to income received from the sale of top soil. (See Rev. Rul. 78, page 18.)

SECTION 115.—DISTRIBUTIONS BY CORPORATIONS

SECTION 29.115-1: Dividends. Rev. Rul. 45
(Also Section 22(a), Section 29.22(a)-1.)

INTERNAL REVENUE CODE

A majority stockholder waived all right, title, and interest in future undeclared dividends for a certain period of time in order to increase the surplus of the corporation to enable it to meet certain legal requirements regarding contemplated business. There was no family, or direct business relationship, between the majority and minority stockholders. The declaration and payment of any dividend to the minority stockholders would not increase the interest of the waiving stockholder in the remaining or future surplus of the corporation. The arrangement was entered into for bona fide business reasons. *Held*, any dividend payments to minority stockholders will not result in income to the waiving stockholder and the corporation will not realize income on account of the waiver.

SECTION 29.115-3: Earnings or profits. Rev. Rul. 107
(Also Section 43, Section 29.43-2.)

INTERNAL REVENUE CODE

Fraud penalties recommended against a taxpayer should not be accrued as liabilities for the purpose of determining the amount of surplus and earnings available for dividends, until the liability therefor has become final and definite in amount, either by agreement or otherwise.

SECTION 29.115-7: Stock dividends.

INTERNAL REVENUE CODE

Distribution of principal cash to an income life beneficiary of a trust in lieu of a nontaxable stock dividend which was not permitted to be distributed under State law. (See Rev. Rul. 24, page 263.)

SECTION 116.—EXCLUSIONS FROM GROSS INCOME

SECTION 29.116-1: Earned income from sources without the United States.

INTERNAL REVENUE CODE

Income of United States citizens for services performed on Guam. (See Rev. Rul. 8, page 300.)

SECTION 117.—CAPITAL GAINS AND LOSSES

SECTION 29.117-4: Determination of period for which capital assets are held.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5991, page 146.)

SECTION 29.117-7: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business. Ct. D. 1760

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS INCOME—ORDINARY INCOME v. CAPITAL GAIN—SALE OF ORANGE GROVE, INCLUDING UNMATURED CROP.

Where taxpayer, engaged in the business of growing and selling oranges, in August 1944, sold her interest in the orange grove, including land, trees, unmatured crop, improvements, etc., that portion of the proceeds from the sale which is attributable to the unmatured crop should be treated as ordinary income rather than as capital gain.

2. DECISION AFFIRMED.

Decision of the United States Court of Appeals, Ninth Circuit, 197 F. (2) 56 (1952), affirming decision of the Tax Court of the United States, 15 T. C. 800 (1950), affirmed.

SUPREME COURT OF THE UNITED STATES

Ernest A. Watson and M. Gladys Watson, petitioners, v. *Commissioner of Internal Revenue*

On writ of certiorari to the United States Court of Appeals for the Ninth Circuit

[May 18, 1953]

OPINION

Mr. Justice BURTON delivered the opinion of the Court.

This case relates to a taxpayer who, for several years, held an undivided interest in an orange grove and engaged in the business of growing and selling the oranges it produced. In the midst of the 1944 growing season, she sold her interest in the grove, including an unmatured crop then on the trees. The question before us is whether, for Federal income tax purposes, she must treat that part of her profit from the sale which is attributable to the unmatured crop as ordinary income or as a capital gain. For the reasons hereafter stated, she must treat it as ordinary income.

In 1944, Mrs. M. Gladys Watson, one of the petitioners here, and her two brothers, each owned an undivided one-third interest in a 110-acre navel orange grove near Exeter, Tulare County, Calif. Its management had been supervised by her brothers since 1912 and, since 1942, she and her brothers had operated it as a partnership. It was the oldest and one of the best groves in the locality. Its production per acre was about twice the average of such production in the county. In each of the last 5 years the value of its crop had increased over that of the year before. In 1943 it produced 79,851 loose boxes of oranges, yielding a gross income of $136,808.71. After deducting all expenses of cultivation, operation, picking and hauling, a net income of $92,153.05 was left.[1] An-

[1] In 1942 it yielded 54,939 boxes with a gross income of $82,521.17 and a net of $49,790.10. Its average annual yield from 1934 to 1943 was 55,097 boxes with a gross income of $46,512.68 and a net of $22,141.42.

ticipating a heavy frost after November 1944, one of the brothers advocated selling the grove before then. Accordingly, in May or June, it was offered for $197,100, complete, including land, trees, unmatured crop, improvements, equipment and a 5-acre peach orchard. At about that time the 1944 orange crop was in bloom.

By July the smaller fruit had dropped from the trees and the crop was "set," but not assured. A purchaser became interested but delayed his decision so as to determine more accurately the probable crop and to cause the sellers to bear more of the expense of its care. He examined past production records and, by early August, received estimates that the 1944 crop might be from 70,000 to 80,000 boxes, which, at current prices, would bring him $120,000 for the crop above expenses. One of Mrs. Watson's brothers also estimated the 1944 crop at 70,000 boxes if it matured. August 10, the sales price of $197,100 was agreed upon, payable $10,000 in cash and the balance September 1. No allocation of the price between the crop and the rest of the property was specified but the seller bore the expense of caring for the crop up to September 1, amounting to $16,020.54. The sale was carried through and there was no serious frost. The crop filled 74,268 boxes. The purchaser sold them for $146,000, yielding him a net return of $126,000.

Mrs. Watson filed a joint return with her husband, taking full deductions for her one-third share of all of the business expenses incurred in the cultivation of the crop, but treating her gain from the sale of the grove, including the unmatured crop, as a long-term capital gain. On that basis, her net gain from the sale of the grove was shown as $48,819.32, but, treating it as a long-term capital gain, only 50 percent of it, or $24,409.91, was included in her taxable income.[2]

The Commissioner of Internal Revenue assessed a deficiency against petitioners, largely based on his claim that whatever part of Mrs. Watson's income was attributable to the unmatured crop should be treated as ordinary income. He allocated $122,500, out of the $197,100 received for the grove, as attributable to the unmatured crop. On that premise, he assessed a deficiency of $24,101.35 against petitioners on their joint return. On review, the Tax Court, with two judges dissenting, sustained the Commissioner in principle but reduced to $40,000 the portion of the proceeds attributable to the crop. 15 T. C. 800. With other adjustments, not material here, the Tax Court reduced the deficiency to $6,920.35. The court of appeals affirmed. 197 F. 2d 56. In the meantime, the Tax Court made comparable decisions in *McCoy* v. *Commissioner*, 15 T. C. 828, and *Owen* v. *Commissioner*, 19 P-H 1950 Fed. Tax Serv. paragraph 50,300, each of which was reversed on appeal, 192 F. 2d 486 (C. A. 10th Cir.), and 192 F. 2d 1006 (C. A. 5th Cir.). Shortly before the latter decisions, the Revenue Act of 1951 amended the statute in relation to taxable years beginning after December 31, 1950, to permit proceeds from certain sales of unharvested crops to be treated as capital gains.[3] We granted certiorari in the instant case to resolve the above-indicated conflict of statutory construction still affecting many sales made before 1951. 344 U. S. 895.

The issue before us turns upon the Acts of Congress. In 1951, Congress, for the first time, dealt expressly and specifically with this subject.[4] While that action was prospective only, its terms throw light on the problems of prior years.[5] The

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[2] Sec. 117 (b) and (c)(2), I. R. C., as amended by sec. 150(c) of the Revenue Act of 1942, c. 619, 56 Stat. 843-844, 26 U. S. C. (1940 ed., Supp. V) sec. 117 (b) and (c)(2).

[3] 65 Stat. 500-501, 26 U. S. C. (Supp. V) secs. 117(j), 24(f), 113(b)(1).

[4] The Revenue Act of 1951 added to sec. 117(j) of the Internal Revenue Code:

"(3) SALE OF LAND WITH UNHARVESTED CROP.—In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted as described in paragraph (2)) at the same time and to the same person, the crop shall be considered as 'property used in the trade or business.'" 65 Stat. 500, 26 U. S. C. (Supp. V) sec. 117(j)(3).

And, equally important, it added to sec. 24 of the Internal Revenue Code:

"(f) SALE OF LAND WITH UNHARVESTED CROP.—Where an unharvested crop sold by the taxpayer is considered under the provisions of section 117(j)(3) as 'property used in the trade or business,' in computing net income no deduction (whether or not for the taxable year of the sale and whether for expenses, depreciation, or otherwise) attributable to the production of such crop shall be allowed." *Id.*, at 501, 26 U. S. C. (Supp. V) sec. 24(f).

[5] The purpose of Congress to make this amendment prospective, rather than retroactive, is emphasized in the very next section of the 1951 Act. That section made retroactive to 1942 another amendment to sec. 117(j). It redefined capital gains so as to include the proceeds of certain sales of livestock, provided such stock be held for draft, breeding or dairy purposes. Stock so held is comparable to the orange trees rather than to the orange crop in the instant case.

adoption of that amendment emphasized the point that the question was one of Federal law. Its adoption also recognized that, in order for such income to be a capital gain, an affirmative statement by Congress was needed. Finally, it not only permitted proceeds of unharvested crops to be treated as capital gains under certain circumstances, but it provided that, under those circumstances, the taxpayer could not deduct from his taxable income the expenses attributable to the production of the unharvested crop. Those expenses thereafter must be treated as capital investments added to the basis of the property to which they relate. This emphasizes the impropriety of the interpretation advocated by Mrs. Watson in the instant case. She seeks to deduct her share of the crop cultivation expenses at 100 percent up to the date of the sale. At the same time, she claims a right to report only 50 percent of her gain on the sale of those crops to which the cultivation expenses relate.[6]

In the instant case, we are dependent upon sec. 117(j) of the Internal Revenue Code, as in effect in 1944.[7] The controlling language in that subsection then required that, in order for gains from the sale of property to be treated as capital gains, the property sold must be "used in the trade or business" of the taxpayer, "held for more than 6 months," and *not* "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." In the instant case, the Commissioner contends that, while the land and trees met these and all other tests of the subsection, the unmatured, unharvested crop of oranges met none of the above three.

Each day brought the annual crop closer to its availability for sale in the ordinary course of that business. While the uncertainty of its condition at maturity discounted its current value, nevertheless, its presence contributed substantially to the value of the grove. The Commissioner allocated to the unmatured crop, as of September 1, a value of $122,500 out of the $197,100. The Tax Court reduced this to $40,000. We accept the latter amount now confirmed by the court of appeals. It is obvious that the parties to this sale did in fact attribute substantial value to the unmatured crop. If, at any moment, the crop had been stripped from the trees or destroyed by frost, there would have resulted at once a substantial reduction in the sales value of the grove.

Assuming $40,000 to be the value fairly attributable to the presence of the crop in August and September 1944, it remains for the taxpayer to demonstrate that sec. 117(j) has authorized that value, in addition to the value of the land, trees, improvements and equipment, to be treated as a capital gain.

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[6] In this connection, the Senate Committee on Finance, when reporting the proposed amendment in 1951, said:

"Your committee believes that sales of land together with growing crops or fruit are not such transactions as occur in the ordinary course of business and should thus result in capital gains rather than in ordinary income. Sec. 323 of the bill so provides.

"Your committee recognizes, however, that when the taxpayer keeps his accounts and makes his returns on the cash receipts and disbursements basis, the expenses of growing the unharvested crop or the unripe fruit will be deducted in full from ordinary income, while the entire proceeds from the sale of the crop, as such, will be viewed as a capital gain. Actually, of course, the true gain in such cases is the difference between that part of the selling price attributable to the crop or fruit and the expenses attributable to its production. Therefore, your committee's bill provides that no deduction shall be allowed which is attributable to the production of such crops or fruit, but that the deductions so disallowed shall be included in the basis of the property for the purpose of computing the capital gain.

"The provisions of this section are applicable to sales or other dispositions occurring in taxable years beginning after December 31, 1950.

"The revenue loss under this provision is expected to be about $3 million annually." S. Rept. No. 781, 82d Cong., 1st sess. 47-48.

[7] Internal Revenue Code, as amended, 56 Stat. 846:

"SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * * * *

"(j) GAINS AND LOSSES * * * FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.—

"(1) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.—*"For the purposes of this subsection, the term 'property used in the trade or business' means property* used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, *which is not* (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) *property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.*

"(2) GENERAL RULE.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business * * * exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets * * *." (Italics supplied.) See 26 U. S. C. sec. 117(j).

Mrs. Watson and the Courts of Appeals for the Fifth and Tenth Circuits have placed emphasis upon a claim that, under the law of the state where the land is situated, an unmatured, unharvested crop, for many purposes, is treated as real property. We regard that as immaterial. Whether or not the crop be real property, the Federal income tax upon the gain resulting from its sale is, in its nature, a subject of Federal law.

The Commissioner urges two grounds in support of his position that sec. 117(j) does not authorize the taxpayer's treatment of the proceeds of the unmatured crop as a capital gain. The first is that the proceeds fairly attributable to the crop are derived from property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. We agree with that contention. Although the property was not severable at the date of its sale, there is nothing in the Act requiring it to be severable. While, in previous years, like crops were held for a sale that occurred after maturity, in 1944 the date of that sale came September 1. There is nothing in the Act that distinguishes between the taxable character of a gain derived from a present sale discounting the hazards of the future, and one derived from a later sale when the hazards are past. After the transfer of title to the grove, the crop on the trees retained its character and continued to be held for sale to customers of the grove owner in the ordinary course of the owner's trade or business.

The Commissioner's treatment of the proceeds of sales of unmatured crops as ordinary income in the absence of a statutory requirement to the contrary is consistent with the policy evidenced in *Williams* v. *McGowan*, 152 F. 2d 570, 572, which established in the Second Circuit, in 1945, the doctrine that "upon the sale of a going business it [the sales price] is to be comminuted into its fragments, and these are to be separately matched against the definition in sec. 117(a)(1) * * *." It is consistent also with the policy of the Bureau of Internal Revenue and the Tax Court, dating, at least, from the statement made by the Bureau in 1946, that, under circumstances comparable to those before us, "regardless of their stage of development, any gain realized from the sale of growing crops is ordinary income." [8]

We do not have here the situation which arises from the sale of land, including coal or other mineral wealth not separated from its natural state and not in the course of annual growth leading to a seasonal separation. See *Butler Consolidated Coal Co.* v. *Commissioner*, 6 T. C. 183. The instant case also is distinguishable from that of growing timber which is not in itself an annual or short-term product. See *Carroll* v. *Commissioner*, 70 F. 2d 806; *Camp Manufacturing Co* v *Commissioner*, 3 T. C. 467.

Having reached this conclusion, we find it unnecessary to pass upon the Commissioner's second contention that, because the crop did not come into existence before it was "set" in July, or at least before it was in bloom in May or June, it had not been held by Mrs. Watson for more than 6 months at the time of its sale.

Accordingly, the judgment of the court of appeals is

Affirmed.

Dissenting opinion by Mr. Justice MINTON, with whom Mr. Justice REED and Mr. Justice DOUGLAS join.

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[8] "The production of fruit from orchards or groves constitutes a business, and section 117(j) of the Code, *supra*, is applicable to the sale of an orchard or grove. The crops are produced with the primary purpose of selling the fruit to customers in the ordinary course of the business. Therefore regardless of their stage of development, any gain realized from the sale of growing crops is ordinary income.

"In view of the foregoing, it is held that, for Federal income tax purposes, where citrus groves are sold with fruit on the trees, a portion of the selling price must be allocated to the fruit and the balance to the land and trees. Gain from the sale of the fruit will constitute ordinary income. Gain from the sale of the land and trees may be treated as capital gain under section 117(j) of the Internal Revenue Code, provided the recognized gains from all transactions coming within the purview of that section exceed the recognized losses thereunder." C. B. 1946-2, 31.

SECTION 29.117-7: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business. T. D. 5970

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 section 324 of the Revenue Act of 1951, relating to sales of livestock.

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

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

On May 16, 1952, notice of proposed rule making, regarding section 324 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 4494). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments set forth below are hereby adopted. Such amendments are necessary in order to conform Regulations 111 [26 CFR, part 29] to section 324 of the Revenue Act of 1951.

PARAGRAPH 1. There is inserted immediately preceding section 29.117-1 [26 CFR 29.117-1] the following:

SEC. 324. SALES OF LIVESTOCK [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 117(j)(1) is hereby amended by adding at the end thereof the following new sentences: "Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry." The first sentence added to section 117(j)(1) by the amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from 6 to 12 months shall be applicable only with respect to taxable years beginning after December 31, 1950. The second sentence added to section 117(j)(1) by the amendment made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950.

PAR. 2. Section 29.117-7, as amended by Treasury Decision 5951 [C. B. 1952-2, 81], approved December 2, 1952, [26 CFR 29.117-7], is further amended as follows:

(A) By changing the first paragraph thereof to read as follows:

(*a*) *In general.*—(1) Section 117(j) provides that the recognized gains and losses described below shall be treated as gains and losses from the sale or exchange of capital assets held for more than 6 months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. The gains and losses referred to above are the following:

(i) Gains and losses from the sale, exchange, or involuntary conversion of "section 117(j) property", as defined below, held for more than 6 months.

(ii) Gains and losses from the involuntary conversion of capital assets held for more than 6 months.

(iii) Gains and losses upon cutting or disposal of timber to the extent provided in section 29.117-8.

(iv) Gains and losses from the sale, exchange, or involuntary conversion of livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for more than 6 months from the date of acquisition (12 months or more from the date of acquisition in the case of a taxable year beginning after December 31, 1950). (See (c) below.)

(2) For the purpose of this section, the "involuntary conversion" of property is the conversion of such property into money or other property as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof. Losses upon the destruction in whole or in part, theft or seizure, requisition or condemnation of property are treated as losses upon an involuntary conversion whether or not there was a conversion of the property into money or other property. For example, if a capital asset held for more than 6 months, with an adjusted basis of $400, is stolen, and the loss from this theft is not compensated for by insurance or otherwise, the $400 loss is included in the computations under section 117(j).

(3) For the purpose of this section, the term "section 117(j) property" means property used in the trade or business of the taxpayer at the time of its sale, exchange, or involuntary conversion, which is of a character subject to the allowance for depreciation provided in section 23(l) or which is real property, except any such property which is within one of the following categories:

(i) Property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or which is held by the taxpayer primarily for sale to customers in the ordinary course of trade or business.

(ii) In the case of taxable years beginning after September 23, 1950, a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in section 117(a)(1)(C).

(iii) Livestock held for draft, breeding, or dairy purposes. (See, however, (1)(iv) above.)

(iv) In the case of a taxable year beginning after December 31, 1950, poultry.

(B) By striking the first two sentences of the second paragraph thereof and by changing the third sentence of the second paragraph thereof to read as follows:

(*b*) *Application of section.*—In determining whether the gains described in (*a*)(1) of this section exceed the losses described therein, such gains and losses are taken into account in full, that is, 100 percent of such gains and losses is taken into account.

(C) By striking out the fourth paragraph thereof.

(D) By adding at the end thereof the following:

(*c*) *Livestock held for draft, breeding, or dairy purposes.*—For the purpose of this section, the term "livestock" shall be given a broad, rather than a narrow, interpretation and includes cattle, hogs, horses, mules, donkeys, sheep, goats, fur-bearing animals, and other mammals. It does not include chickens, turkeys, pigeons, geese, other birds, fish, frogs, reptiles, etc.

The determination whether or not livestock is held by the taxpayer for a draft, breeding, or dairy purpose depends upon all of the facts and circumstances in each particular case. The purpose for which the animal is held is ordinarily shown by the taxpayer's actual use of the animal. However, a draft, breeding, or dairy purpose may be present in a case where the animal is disposed of within a reasonable time after its intended use for such purpose is prevented by accident, disease, or other circumstance. An animal held for ultimate sale to customers in the ordinary course of the taxpayer's trade or business may, depending upon the circumstances, be considered held for a draft, breeding, or dairy purpose. An animal is not held by the taxpayer for a draft, breeding, or dairy purpose merely because it is suitable for such purpose or because it is held by the taxpayer for sale to other persons for use by them for such purpose. Furthermore, an animal held by the taxpayer for other purposes is not con-

sidered to be held for a draft, breeding, or dairy purpose merely because of a negligible use of the animal for such purpose or because of the use of the animal for such purpose as an ordinary or necessary incident to the purpose for which the animal is held.

These principles may be illustrated by the following examples:

Example 1. An animal intended by the taxpayer for use by him for breeding purposes is discovered to be sterile, and is disposed of within a reasonable time thereafter. This animal was held for breeding purposes.

Example 2. The taxpayer retires from the breeding or dairy business and sells his entire herd, including young animals which would have been used by him for breeding or dairy purposes if he had remained in business. These young animals were held for breeding or dairy purposes.

Example 3. A taxpayer in the business of raising hogs for slaughter customarily breeds sows to obtain a single litter to be raised by him for sale, and sells these brood sows after obtaining the litter. Even though these brood sows are held for ultimate sale to customers in the ordinary course of the taxpayer's trade or business, they are considered to be held for breeding purposes.

Example 4. A taxpayer in the business of raising horses for sale to others for use by them as draft horses uses such horses for draft purposes on his own farm in order to train them. This use is an ordinary or necessary incident to the purpose of selling such animals, and, accordingly, these horses are not held for draft purposes.

Example 5. The taxpayer is in the business of raising registered cattle for sale to others for use by them as breeding cattle. It is the business practice for the cattle to be bred, prior to sale, in order to establish their fitness for sale as registered breeding cattle. In such case, those cattle used by the taxpayer to produce calves which calves are added to the taxpayer's herd (whether or not the breeding herd) are considered to be held for breeding purposes; the breeding of other cattle is an ordinary or necessary incident to the holding of such other cattle for the purpose of selling them as registered breeding cattle, and the breeding of such cattle does not demonstrate that the taxpayer is holding the cattle for breeding purposes.

Example 6. A taxpayer, engaged in the business of buying cattle and fattening them for slaughter, purchased cows with calf. The calves were born while the cows were held by the taxpayer. These cows were not held for breeding purposes.

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

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 6, 1953.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 9, 1953, 8:51 a. m.)

SECTION 29.117-7: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business. Rev. Rul. 108

INTERNAL REVENUE CODE

A taxpayer who customarily buys automobiles at wholesale prices or at fleet discounts and, after leasing them for a period of substantially shorter duration than their normal useful life, sells them at wholesale or retail prices, is in the business of dealing in automobiles, as well as in the business of leasing them. Gains from the sale of automobiles, under such circumstances, do not qualify for treatment under section 117(j) of the Internal Revenue Code as gains from sales of capital assets held for more than 6 months.

Advice is requested whether automobiles purchased at wholesale prices or at fleet discounts and sold after having been leased for periods substantially less than their normal useful life constitute "property used in the trade or business" within the meaning of section 117(j) of the Internal Revenue Code, sales of which may be treated as sales of capital assets held for more than 6 months.

It appears that a number of taxpayers in the business of leasing automobiles buy their automobiles in wholesale quantities either at fleet discounts, at agents' prices as dealers, or through affiliates, and lease them for a period of a year or less, or for a stated number of miles substantially less than the normal mile-life of an automobile. At the expiration of such lease the automobiles are sold, either at wholesale or retail prices, thereby availing the taxpayer of what would normally be considered to be the dealer's profits. In the usual case, the gains from such sales constitute a substantial portion of the taxpayer's income.

Section 117(j) of the Code provides in part that, for the purposes of that section, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, which is not property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

A situation similar to that under consideration here is present in the case of dealers who take cars from their stock for use as "demonstrators" and later sell them at retail. In I. T. 4062, C. B. 1951-2, 61, it is held that "demonstrators" are property held for sale to customers in the ordinary course of business, and any gain on the sale thereof may not be treated as capital gain under section 117(j) of the Code. That ruling was based upon the decision in the case of *W. R. Stephens Co.* v. *Commissioner*, Tax Court memorandum opinion dated August 8, 1951, affirmed 199 Fed. (2d) 665. To the same effect is *Rollingwood Corporation et al.* v. *Commissioner*, 190 Fed. (2d) 263.

It is the opinion of this Bureau that the custom of buying cars at wholesale prices, or at fleet discounts, and leasing them for substantially less than their normal useful life and selling them on the wholesale or retail market, constitutes dealing in automobiles. A taxpayer who customarily engages in such operations is in the business of dealing in automobiles as well as in the business of leasing them. Under such circumstances, the automobiles constitute "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" within the meaning of section 117(j) of the Code, and any gain from the sale of such automobiles may not be treated as a capital gain under section 117(j) of the Code.

It should be noted, with respect to depreciation, that the treatment of "leased automobiles" differs from that of "demonstrators" in that depreciation is allowable on leased cars prior to their conversion to "property held primarily for sale to customers in the ordinary course of business," whereas no depreciation is allowable on "demonstrators."

SECTION 29.117-7: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5980, page 65.)

SECTION 29.117-11: Collapsible corporations. T. D. 5999

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 section 212 of the Revenue Act of 1950 and to section 326 of the Revenue Act of 1951.

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

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

On October 9, 1952, notice of proposed rulemaking, regarding section 212 of the Revenue Act of 1950, approved September 23, 1950, and section 326 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 9014). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments set forth below are hereby adopted. Such amendments are necessary in order to conform Regulations 111 [26 CFR, part 29] to section 212 of the Revenue Act of 1950 and to section 326 of the Revenue Act of 1951.

PARAGRAPH 1. There is inserted immediately after section 29.117-10, as added by Treasury Decision 5881 [C. B. 1952-1, 56], approved February 11, 1952 [26 CFR 29.117-10], the following:

SEC. 212. TREATMENT OF GAIN TO SHAREHOLDERS OF COLLAPSIBLE CORPORATIONS [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

(a) COLLAPSIBLE CORPORATIONS.—Section 117 (relating to capital gains or losses) is hereby amended by adding after subsection (l) (added by section 211(a) of this Act) the following new subsection:

"(m) COLLAPSIELE CORPORATIONS.—

"(1) TREATMENT OF GAIN TO SHAREHOLDERS.—Gain from the sale or exchange (whether in liquidation or otherwise) of stock of a collapsible corporation, to the extent that it would be considered (but for the provisions of this subsection) as gain from the sale or exchange of a capital asset held for more than 6 months, shall, except as provided in paragraph (3), be considered as gain from the sale or exchange of property which is not a capital asset.

"(2) DEFINITIONS.—

"(A) For the purposes of this subsection, the term 'collapsible corporation' means a corporation formed or availed of principally for the manufacture, construction, or production of property, or for the holding of stock in a corporation so formed or availed of, with a view to—

"(i) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation manufacturing, constructing, or producing the property of a substantial part of the net income to be derived from such property, and

"(ii) the realization by such shareholders of gain attributable to such property.

"(B) For the purposes of subparagraph (A), a corporation shall be deemed to have manufactured, constructed, or produced property, if—

"(i) it engaged in the manufacture, construction, or production of such property to any extent,

"(ii) it holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, or produced the property, or

"(iii) it holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, or produced by the corporation.

"(3) LIMITATIONS ON APPLICATION OF SUBSECTION.—In the case of gain realized by a shareholder upon his stock in a collapsible corporation—

"(A) this subsection shall not apply unless, at any time after the commencement of the manufacture, construction, or production of the property, such shareholder (i) owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation, or (ii) owned stock which was considered as owned at such time by another shareholder who then owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation;

"(B) this subsection shall not apply to the gain recognized during a taxable year unless more than 70 per centum of such gain is attributable to the property so manufactured, constructed, or produced; and

"(C) this subsection shall not apply to gain realized after the expiration of three years following the completion of such manufacture, construction, or production.

For purposes of subparagraph (A), the ownership of stock shall be determined in accordance with the rules prescribed by paragraphs (1), (2), (3), (5), and (6) of section 503(a), except that, in addition to the persons prescribed by paragraph (2) of that section, the family of an individual shall include the spouses of that individual's brothers and sisters (whether by the whole or half blood) and the spouses of that individual's lineal descendants."

(b) EFFECTIVE DATE.—The amendment made by this section shall be applicable to taxable years ending after December 31, 1949, but shall apply only with respect to gain realized after such date. The determination of the tax treatment of gains realized prior to January 1, 1950, shall be made as if this section had not been enacted and without inferences drawn from the fact that the amendment made by this section is not expressly made applicable to gains realized prior to such date and without inferences drawn from the limitations contained in section 117(m), added to the Internal Revenue Code by this section.

SEC. 326. COLLAPSIBLE CORPORATIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) DEFINITIONS WITH RESPECT TO COLLAPSIBLE CORPORATIONS.—Section 117(m)(2) (relating to definitions with respect to collapsible corporations) is hereby amended to read as follows:

"(2) DEFINITIONS.—

"(A) For the purposes of this subsection, the term 'collapsible corporation' means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in subsection (a)(1)(A), or for the holding of stock in a corporation so formed or availed of, with a view to—

"(i) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation manufacturing, constructing, producing, or purchasing the

property of a substantial part of the net income to be derived from such property, and

"(ii) the realization by such shareholders of gain attributable to such property.

"(B) For the purposes of subparagraph (A), a corporation shall be deemed to have manufactured, constructed, produced, or purchased property, if—

"(i) it engaged in the manufacture, construction, or production of such property to any extent,

"(ii) it holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or

"(iii) it holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, produced, or purchased by the corporation."

(b) LIMITATIONS ON APPLICATION OF SECTION 117(m).—Subparagraphs (A), (B), and (C) of section 117(m)(3) (relating to the limitations on the application of section 117(m)) are hereby amended to read as follows:

"(A) this subsection shall not apply unless, at any time after the commencement of the manufacture, construction, or production of the property, or at the time of the purchase of the property described in subsection (a)(1)(A) or at any time thereafter, such shareholder (i) owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation, or (ii) owned stock which was considered as owned at such time by another shareholder who then owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation;

"(B) this subsection shall not apply to the gain recognized during a taxable year unless more than 70 per centum of such gain is attributable to the property so manufactured, constructed, produced, or purchased; and

"(C) this subsection shall not apply to gain realized after the expiration of three years following the completion of such manufacture, construction, production, or purchase."

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable to taxable years ending after August 31, 1951, but shall be applicable only with respect to gains realized after such date. The determination of the tax treatment of gains realized prior to September 1, 1951, shall be made as if this section had not been enacted and without inferences drawn from the fact that the amendments to section 117(m) made by this section are not expressly made applicable to gains realized prior to September 1, 1951, and without inferences drawn from the limitations contained in section 117(m), as amended by this section.

SEC. 29.117–11. COLLAPSIBLE CORPORATIONS.—(*a*) *In general.*—With respect to taxable years ending after December 31, 1949, but only with respect to gain realized after such date, and subject to the limitations contained in (*c*) hereof, the entire gain from (1) the actual sale or exchange of stock of a collapsible corporation, (2) amounts distributed in complete or partial liquidation of a collapsible corporation which are treated, under section 115(c), as payment in exchange for stock, and (3) a distribution made by a collapsible corporation which, under section 115(d), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property, shall be considered as gain from the sale or exchange of property which is not a capital asset.

(*b*) *Determination of collapsible corporation.*—With respect to taxable years ending after December 31, 1949, but only with respect to gain realized after such date, a collapsible corporation is defined by section 117(m)(2)(A) to be a corporation formed or availed of principally for the manufacture, construction, or production of property, or for the holding of stock in a corporation so formed or availed of, with a view to (1) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation manufacturing, constructing, or producing

the property of a substantial part of the net income to be derived from such property, and (2) the realization by such shareholders of gain attributable to such property. With respect to taxable years ending after August 31, 1951, but only with respect to gain realized after such date, the definition of a collapsible corporation under section 117(m)(2)(A) is expanded to include a corporation formed or availed of principally for the purchase of property which (in the hands of the corporation) is property described in section 117(a)(1)(A), or for the holding of stock in a corporation so formed or availed of, with a view to (1) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation purchasing the property of a substantial part of the net income to be derived from such property, and (2) the realization by such shareholders of gain attributable to such property.

See (*d*) of this section for a description of the facts which will ordinarily be considered sufficient to establish whether or not a corporation is a collapsible corporation under the rules of this section. See (*e*) of this section for examples of the application of section 117(m).

Under section 117(m)(2)(A), the corporation must be formed or availed of with a view to the action therein described, that is, the sale or exchange of its stock by its shareholders, or a distribution to them, prior to the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the net income to be derived from such property, and the realization by the shareholders of gain attributable to such property. This requirement is satisfied in any case in which such action was contemplated by those persons in a position to determine the policies of the corporation, whether by reason of their owning a majority of the voting stock of the corporation or otherwise. The requirement is satisfied whether such action was contemplated unconditionally, conditionally, or as a recognized possibility. If the corporation was so formed or availed of, it is immaterial that a particular shareholder was not a shareholder at the time of the manufacture, construction, production, or purchase of the property, or if a shareholder at such time, did not share in such view, and any gain of such shareholder on his stock in the corporation shall be treated in the same manner as gain of a shareholder who did share in such view. See, however, the limitation contained in (*c*)(2) hereof. The existence of a bona fide business reason for doing business in the corporate form does not, by itself, negate the fact that the corporation may also have been formed or availed of with a view to the action described in section 117(m)(2)(A).

A corporation is formed or availed of with a view to the action described in section 117(m)(2)(A) if the requisite view existed at any time during the manufacture, production, construction, or purchase referred to in that section. Thus, if the sale, exchange, or distribution is attributable solely to circumstances which arose after the manufacture, construction, production, or purchase (other than circumstances which reasonably could be anticipated at the time of such manufacture, construction, production, or purchase), the corporation shall, in the absence of compelling facts to the contrary, be considered not to have been so formed or availed of. However, if the sale, exchange, or distribution is attributable to circumstances present at the time of the manufacture, construction, production, or purchase, the corporation shall, in the absence of compelling facts to the contrary, be considered to have been so formed or availed of.

The property referred to in section 117(m)(2)(A) is that property or the aggregate of those properties with respect to which the requisite view existed. In order to ascertain the property or properties as to which the requisite view existed, reference shall be made to each property as to which, at the time of the sale, exchange, or distribution referred to in section 117(m)(2)(A), there has not been a realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the net income to be derived from such property. However, where any such property is a unit of an integrated project involving several properties similar in kind, the determination whether the requisite view existed shall be made only if a substantial part of the net income to be derived from the project has not been realized at the time of the sale, exchange, or distribution, and in such case the determination shall be made by reference to the aggregate of the properties constituting the single project.

A corporation shall be deemed to have manufactured, constructed, produced, or purchased property if it (1) engaged in the manufacture, construction, or production of property to any extent, or (2) holds property having a basis deter-

mined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or (3) holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, produced, or purchased by the corporation. Thus, under (1), for example, a corporation need not have originated nor have completed the manufacture, construction, or production of the property. Under (2), for example, if an individual were to transfer property constructed by him to a corporation in exchange for all of the capital stock of such corporation, and such transfer qualifies under section 112(b)(5), then the corporation would be deemed to have constructed the property, since the basis of the property in the hands of the corporation would, under section 113(a)(8), be determined by reference to the basis of the property in the hands of the individual. Under (3), for example, if a corporation were to exchange property constructed by it for property of like kind constructed by another person, and such exchange qualifies under section 112(b)(1), then the corporation would be deemed to have constructed the property received by it in the exchange, since the basis of the property received by it in the exchange would, under section 113(a)(6), be determined by reference to the basis of the property constructed by the corporation.

In determining whether a corporation is a collapsible corporation by reason of the purchase of property, it is immaterial whether the property is purchased from the shareholders of the corporation or from persons other than such shareholders. The property, however, must be property which, in the hands of the corporation, is property of a kind described in section 117(a)(1)(A). Section 117(a)(1)(A) describes the following property: stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. The determination whether property is of a kind described in section 117(a)(1)(A) shall be made without regard to the fact that the corporation is formed or availed of with a view to the action described in section 117(m)(2)(A).

Section 117(m) is applicable whether the shareholder is an individual, a trust, an estate, a partnership, a company, or a corporation.

(c) *Limitations on application of section.*—(1) *General.*—This section shall apply only to the extent that the recognized gain of a shareholder upon his stock in a collapsible corporation would be considered, but for the provisions of this section, as gain from the sale or exchange of a capital asset held for more than 6 months. Thus, if a taxpayer sells at a gain stock of a collapsible corporation which he has held for 6 months or less, this section would not, in any event, apply to such gain. Also, if it is determined, under provisions of law other than section 117(m), that a sale or exchange at a gain of stock of a collapsible corporation which has been held for more than 6 months results in ordinary income rather than long-term capital gain, then this section (including the limitations contained herein) has no application whatsoever to such gain.

(2) *Stock ownership rules.*—This section shall apply in the case of gain realized by a shareholder upon his stock in a collapsible corporation only if the shareholder, at any time after the actual commencement of the manufacture, construction, or production of the property, or at the time of the purchase of the property described in section 117(a)(1)(A) or at any time thereafter, (i) owned, or was considered as owning, more than 10 percent in value of the outstanding stock of the corporation, or (ii) owned stock which was considered as owned at such time by another shareholder who then owned, or was considered as owning, more than 10 percent in value of the outstanding stock of the corporation.

The ownership of stock shall be determined in accordance with the rules prescribed by section 503(a) (1), (2), (3), (5), and (6), except that, in addition to the persons prescribed by section 503(a)(2), the family of an individual shall include the spouses of that individual's brothers and sisters, whether such brothers and sisters are by the whole or the half blood, and the spouses of that individual's lineal descendants.

For the purpose of this limitation, treasury stock shall not be considered as outstanding stock.

It is possible, under this limitation, that a shareholder in a collapsible corporation may have gain upon his stock in that corporation treated differently from the gain of another shareholder in the same collapsible corporation.

(3) *Seventy-percent rule.*—This section shall apply to the gain recognized during a taxable year upon the stock in a collapsible corporation only if more than 70 percent of such gain is attributable to the property referred to in section 117(m)(2)(A). If more than 70 percent of such gain is so attributable, then all of such gain is subject to this section, and, if 70 percent or less of such gain is so attributable, then none of such gain is subject to this section.

For the purpose of this limitation, the gain attributable to the property referred to in section 117(m)(2)(A) is the excess of the recognized gain of the shareholder during the taxable year upon his stock in the collapsible corporation over the recognized gain which the shareholder would have if the property had not been manufactured, constructed, produced, or purchased. In the case of gain on a distribution in partial liquidation or a distribution described in section 115(d), the gain attributable to the property shall not be less than an amount which bears the same ratio to the gain on such distribution as the gain which would be attributable to the property if there had been a complete liquidation at the time of such distribution bears to the total gain which would have resulted from such complete liquidation.

Gain may be attributable to the property referred to in section 117(m)(2)(A) even though such gain is represented by an appreciation in the value of property other than that manufactured, constructed, produced, or purchased. Where, for example, a corporation owns a tract of land and the development of one-half of the tract increases the value of the other half, the gain attributable to the developed half of the tract includes the increase in the value of the other half.

(4) *Three-year rule.*—This section shall not apply to that portion of the gain of a shareholder that is realized more than 3 years after the actual completion of the manufacture, construction, production, or purchase of the property to which such portion is attributable.

(*d*) *Application of section.*—(1) Whether or not a corporation is a collapsible corporation shall be determined under the rules of (*b*) of this section on the basis of all the facts and circumstances in each particular case. The following paragraphs set forth those facts which will ordinarily be considered sufficient to establish that a corporation is or is not a collapsible corporation. The facts set forth in the following paragraphs are not exclusive of other facts which may be controlling in any particular case. For example, if the facts in paragraph (2), but not the facts in paragraph (3), are present, the corporation may nevertheless not be a collapsible corporation if there are other facts which clearly establish that the rules of (*b*) of this section are not satisfied. Similarly, if the facts in paragraph (3) are present, the corporation may nevertheless be a collapsible corporation if there are other facts which clearly establish that the corporation was formed or availed of in the manner described in (*b*) of this section, or if the facts in paragraph (3) are not significant by reason of other facts, such as the fact that the corporation is subject to the control of persons other than those who were in control immediately prior to the manufacture, construction, production, or purchase of the property.

See (*c*) of this section for provisions which make section 117(m) inapplicable to certain shareholders of collapsible corporations.

(2) The following facts will ordinarily be considered sufficient (except as otherwise provided in paragraph (1), above, and paragraph (3), below) to establish that a corporation is a collapsible corporation:

(i) A shareholder of the corporation sells or exchanges his stock, or receives a liquidating distribution, or a distribution described in section 115(d),

(ii) Upon such sale, exchange, or distribution, such shareholder realizes gain attributable to the property described below, and

(iii) At the time of the manufacture, construction, production, or purchase of the property described below, such activity was substantial in relation to the other activities of the corporation which manufactured, constructed, produced, or purchased such property.

The property referred to above is that property or the aggregate of those properties which meet the following two requirements:

(iv) The property is manufactured, constructed, or produced by the corporation or by another corporation stock of which is held by the corporation, or is property purchased by the corporation or by such other corporation which (in the hands of the corporation holding such property) is property described in section 117(a)(1)(A) (relating to stock in trade, inventories, and property held primarily for sale to customers), and

(v) At the time of the sale, exchange, or distribution described in (i) above, the corporation which manufactured, constructed, produced, or pur-

chased such property has not realized a substantial part of the net income to be derived from such property.

In the case of property which is a unit of an integrated project involving several properties similar in kind, the rules of this paragraph shall be applied to the aggregate of the properties constituting the single project rather than separately to such unit. Under the rules of this paragraph, a corporation shall be considered a collapsible corporation by reason of holding stock in other corporations which manufactured, constructed, produced, or purchased the property only if the activity of the corporation in holding stock in such other corporations is substantial in relation to the other activities of the corporation.

(3) The absence of any of the facts set forth in paragraph (2) or the presence of the following facts will ordinarily be considered sufficient (except as otherwise provided in paragraph (1), above) to establish that a corporation is not a collapsible corporation:

(i) In the case of a corporation subject to the rules of paragraph (2) only by reason of the manufacture, construction, production, or purchase (either by the corporation or by another corporation the stock of which is held by the corporation) of property which is property described in section 117(a)(1)(A), the amount (both in quantity and value) of such property is not in excess of the amount which is normal—

(A) For the purpose of the business activities of the corporation which manufactured, constructed, produced, or purchased the property if such corporation has a substantial prior business history involving the use of such property and continues in business, or

(B) For the purpose of an orderly liquidation of the business if the corporation which manufactured, constructed, produced, or purchased such property has a substantial prior business history involving the use of such property and is in the process of liquidation.

(ii) In the case of a corporation subject to the rules of paragraph (2) with respect to the manufacture, construction, or production (either by the corporation or by another corporation the stock of which is held by the corporation) of property, the amount of the unrealized net income from such property is not substantial in relation to the amount of the net income realized (after the completion of a material part of such manufacture, construction, or production, and prior to the sale, exchange, or distribution referred to in paragraph (2) (i)) from such property and from other property manufactured, constructed, or produced by the corporation.

(*e*) *Examples.* The following examples will illustrate the application of this section:

Example (1). On January 2, 1951, A formed the W Corporation and contributed $50,000 cash in exchange for all of the stock thereof. The W Corporation borrowed $900,000 from a bank, the loan being insured by the Federal Housing Authority, and used $800,000 of such sum in the construction of an apartment house on land which it purchased for $50,000. The apartment house was completed on December 31, 1951. On December 31, 1951, the corporation, having determined that the fair market value of the apartment house, separate and apart from the land, was $900,000, made a distribution (permitted under the applicable state law) to A of $100,000. At this time, the fair market value of the land was $50,000. As of December 31, 1951, the corporation has not realized any earnings and profits. In 1952, the corporation began the operation of the apartment house and received rentals therefrom. The corporation has since continued to own and operate the building. The corporation reported on the basis of the calendar year and cash receipts and disbursements.

Since A received a distribution and realized a gain attributable to the building constructed by the corporation, since, at the time of such distribution, the corporation has not realized a substantial part of the net income to be derived from such building, and since the construction of the building was a substantial activity of the corporation, the W Corporation is considered a collapsible corporation under (*d*)(2) of this section. The provisions of section 117 (m)(3) do not prohibit the application of section 117(m) (1) to A. Therefore, the distribution, if and to the extent that it may be considered long-term capital gain rather than ordinary income without regard to section 117(m), will be considered ordinary income under section 117(m)(1).

In the event of the existence of additional facts and circumstances in the above case, the corporation, notwithstanding the above facts, might not be considered a collapsible corporation. See (*b*) and (*d*)(1) of this section.

Example (2). On January 2, 1950, B formed the X Corporation and became the sole shareholder thereof. This corporation completed the construction of an

office building in 1950. Immediately after the completion of the building, the corporation sold this building at a gain of $50,000, included this entire gain in its return for 1950, and distributed this entire gain (less taxes) to B. The corporation completed the construction of a second office building in June 1951. In August 1951, B sold the entire stock of the X Corporation at a gain of $12,000, which gain is attributable to the second building. In view of the fact that B sold stock of the X Corporation and realized a gain attributable to the second office building, that, at the time of such sale, the corporation had not realized a substantial part of the net income to be derived from such building, and that the construction of such building during the time of such construction was a substantial activity of the corporation, the X Corporation is considered a collapsible corporation under (*d*)(2) of this section. Since the provisions of section 117(m)(3) do not prohibit the application of section 117(m)(1) to B, the gain of $12,000 to B is, accordingly, considered ordinary income.

Example (*3*). The facts in this example are the same as in example (2), except that the following facts are shown: B was the president of the X Corporation and active in the conduct of its business. The second building was constructed as the first step in a project of the X Corporation for the development for rental purposes of a large suburban center involving the construction of several buildings by the corporation. The sale of the stock by B was caused by his retiring from all business activity as a result of illness arising after the second building was constructed. Under these additional facts, the corporation is not considered a collapsible corporation. See (*b*) and (*d*)(1) of this section.

Example (*4*). On January 2, 1947, C formed the Y Corporation and became the sole shareholder thereof. The Y Corporation has been engaged solely in the business of producing motion pictures and licensing their exhibition. On January 2, 1952, C sold all of the stock of the Y Corporation at a gain. The Y Corporation has produced one motion picture each year since its organization and prior to January 2, 1952, it has realized a substantial part of the net income to be derived from each of its motion pictures except the last one made in 1951. This last motion picture was completed September 1, 1951. As of January 2, 1952, no license had been made for its exhibition. The fair market value on January 2, 1952, of this last motion picture exceeds the cost of its production by $50,000. A material part of the production of this last picture was completed on January 1, 1951, and between that date and January 2, 1952, the corporation had realized net income of $500,000 from other motion pictures produced by it. The corporation has consistently distributed to its shareholder its net income when received (after adjustment for taxes).

Although the corporation is within (*d*)(2) of this section with respect to the production of property, the amount of the unrealized net income from such property ($50,000) is not substantial in relation to the amount of the net income realized, after the completion of a material part of the production of such property and prior to sale of the stock, from such property and other property produced by the corporation ($500,000). Accordingly, the Y Corporation is within (*d*)(3)(ii) of this section, and is not considered a collapsible corporation.

Example (*5*). The facts are the same as in example (4) except that C sold all of his stock to D on February 1, 1951. On January 2, 1952, D sold all of the Y Corporation stock at a gain, the gain being attributable to the picture completed September 1, 1951, and not released by the corporation for exhibition. In view of the change of control of the corporation, the provisions of (*d*)(3)(ii) are not significant at the time of the sale by D, and the Y Corporation would be considered a collapsible corporation on January 2, 1952. See (*b*) and (*d*)(1) of this section.

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

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved March 26, 1953.

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

(Filed with the Division of the Federal Register April 1, 1953, 8:51 a. m.)

SECTION 29.117-12: Dealers in securities. T. D. 6013
(Also Section 29.117-1.)

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 section 327 of the Revenue Act of 1951.

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

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

On October 22, 1952, there was published in the Federal Register (17 F. R. 9588) a notice of proposed rulemaking to conform Regulations 111 [26 CFR, part 29] to section 327 of the Revenue Act of 1951, relating to capital gains and ordinary losses of dealers in securities, approved October 20, 1951. No objections to the rules proposed having been received, the amendments set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 29.117-1 [26 CFR 29.117-1] the following:

SEC. 327. DEALERS IN SECURITIES—CAPITAL GAINS AND ORDINARY LOSSES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Effective with respect to sales or exchanges made after the expiration of the thirtieth day after the date of the enactment of this act, section 117 is hereby amended by adding at the end thereof the following new subsection:

"(n) DEALERS IN SECURITIES.—

"(1) CAPITAL GAINS.—Gain by a dealer in securities from the sale or exchange of any security shall in no event be considered as gain from the sale or exchange of a capital asset unless—

"(A) the security was, prior to the expiration of the thirtieth day after the date of its acquisition or after the date of the enactment of the Revenue Act of 1951 (whichever is the later), clearly identified in the dealer's records as a security held for investment; and

"(B) the security was not, at any time after the expiration of such thirtieth day, held by such dealer primarily for sale to customers in the ordinary course of his trade or business.

"(2) ORDINARY LOSSES.—Loss by a dealer in securities from the sale or exchange of any security shall, except as otherwise provided in subsection (i) (relating to bond, etc., losses of banks), in no event be considered as loss from the sale or exchange of property which is not a capital asset if at any time after the thirtieth day following the date of the enactment of the Revenue Act of 1951 the security was clearly identified in the dealer's records as a security held for investment.

"(3) DEFINITION OF SECURITY.—For the purposes of this subsection the term 'security' means any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing."

PAR. 2. Section 29.117-1, as amended by Treasury Decision 5951 [C. B. 1952-2, 81], approved December 2, 1952 [26 CFR 29.117-1], is further amended by adding at the end of the next to the last paragraph, which commences with the words "See section 23 (g) and (k)", the following new sentence:

See also section 117(n) and section 29.117-12 for the determination of whether or not gains from the sale or exchange of securities by a dealer in securities shall be treated as capital gains, or whether losses from such sales or exchanges shall be treated as ordinary losses.

PAR. 3. There is inserted immediately after section 29.117-11, as added by Treasury Decision 5999 [page 187, this Bulletin], approved March 26, 1953 [26 CFR 29.117-11], the following new section:

SEC. 29.117-12. DEALERS IN SECURITIES.—(*a*) *Capital gain.*—Effective with respect to sales or exchanges made on or after November 20, 1951, gain by a dealer in securities from the sale or exchange of a security shall in no event be considered to be gain from the sale or exchange of a capital asset unless—

(1) the security is, prior to the expiration of the 30th day after the date of its acquisition or of the 30th day after October 20, 1951, whichever is later, clearly identified in the dealer's records as a security held for investment; and

(2) the security is not, at any time after the expiration of such 30th day, held by the dealer primarily for sale to customers in the ordinary course of his trade or business.

This provision is applicable only in the case where gain from the sale or exchange of a security would, but for such provision, be considered capital gain. Thus, if the sale of a security by a dealer would, but for section 117(n)(1), be considered to constitute the sale of a security held for investment, gain from such sale will in no event be considered to be capital gain unless the security has been properly identified within the 30-day period in the dealer's records as being held for investment and such security is not at any time after the expiration of the 30-day period held by the dealer primarily for sale to customers in the ordinary course of his trade or business. However, the mere fact that a security which is actually held by a dealer for sale to customers in the ordinary course of his trade or business is identified as a security held for investment will not in and of itself cause the gain from the sale of the security to be treated as capital gain whether the security is sold within the 30-day period or after such period.

(*b*) *Ordinary loss.*—Effective with respect to sales or exchanges made on or after November 20, 1951, loss by a dealer in securities from the sale or exchange of a security shall in no event be considered to be loss from the sale or exchange of property which is not a capital asset if at any time after November 19, 1951, the security has been clearly identified in the dealer's records as a security held for investment. Once a security has been identified after November 19, 1951, as being held for investment, a loss on the subsequent disposition of such security shall in no event be considered an ordinary loss but shall be considered as one arising from the sale or exchange of a capital asset.

Nothing in this paragraph shall be taken to restrict or prohibit the application of section 117(i), without regard to the manner in which the securities described therein have been identified in the records, to the net capital losses of a bank from sales or exchanges of bonds and certain other securities.

(*c*) *General.*—For the purpose of this section the term "security" means any share of stock in any corporation, any certificate of stock or interest in any corporation, any note, bond, debenture, or other evidence of indebtedness, or any evidence of an interest in, or right to subscribe to or purchase, any of the foregoing.

A security is clearly identified in the dealer's records as a security held for investment when there is an accounting separation of such security from other securities. Accounting separation will be satisfied by (1) making appropriate entries in the dealer's books of account to distinguish the security from inventories and to carry it as an investment and (2) indicating with such entries, to the extent feasible, the individual serial number of, or other characteristic symbol imprinted upon, the individual security.

In computing the 30-day period within which the security must be clearly identified, and after which such security may not be held primarily for sale to customers in the ordinary course of the trade or business, the first day of such period is the day following the date of acquisition. Thus, in the case of a security acquired on March 18, 1952, the 30-day period expires at midnight on April 17, 1952.

For a definition of a dealer in securities, see section 29.22(c)-5.

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

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved May 25, 1953.

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

(Filed with the Division of the Federal Register May 28, 1953, 8:50 a. m.)

SECTION 122.—NET OPERATING LOSS DEDUCTION

SECTION 29.122-1: Net operating loss deduction. T. D. 5963
(Also Sections 29.122-2, 29.122-3, 29.122-4.)

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 section 215 of the Revenue Act of 1950, section 304(e) of the Excess Profits Tax Act of 1950, and sections 330 and 344 of the Revenue Act of 1951.

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

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

On October 18, 1952, a notice of proposed rule making was published in the Federal Register (17 F. R. 9249) to conform Regulations 111 [26 CFR, part 29] to section 215 of the Revenue Act of 1950, approved September 23, 1950, section 304(e) of the Excess Profits Tax Act of 1950, approved January 3, 1951, and sections 330 and 344 of the Revenue Act of 1951, approved October 20, 1951. No objections to the rules proposed having been received within the 30 days following such publication, the amendments set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 29.122-1 [26 CFR 29.122-1] the following:

SEC. 215. NET OPERATING LOSS DEDUCTIONS [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

(a) ALLOWANCE OF FIVE-YEAR CARRY-OVER.—Section 122(b) (relating to the amount of carry-backs and carry-overs) is hereby amended to read as follows:

"(b) AMOUNT OF CARRY-BACK AND CARRY-OVER.—

"(1) NET OPERATING LOSS CARRY-BACK.—

"(A) Loss for Taxable Year Beginning Before 1950.—If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

"(B) Loss for Taxable Year Beginning After 1949.—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year.

"(2) NET OPERATING LOSS CARRY-OVER.—

"(A) Loss for Taxable Year Beginning Before 1950.—If for any taxable year beginning before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss, without regard to any net operating loss carry-back, and without regard to any reduction specified in subsection (c).

For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

"(iii) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c).

"(B) Loss for Taxable Year Beginning After 1949.—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for each intervening taxable year, without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1949, shall be reduced by the amount, if any, of the net income for the preceding taxable year computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for such preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c)."

(b) EFFECTIVE DATE OF SUBSECTION (a).—The amendment made by subsection (a) shall be applicable in computing the net operating loss deduction for taxable years beginning after December 31, 1947.

SEC. 304. TECHNICAL AMENDMENTS [EXCESS PROFITS TAX ACT OF 1950, APPROVED JANUARY 3, 1951].

* * * * * * *

(e) Section 122(d)(6) of such [Internal Revenue] Code (relating to the computation of the net operating loss deduction) shall not apply with respect to any taxable year ending after June 30, 1950.

* * * * * * *

(g) The amendments made by this section shall be applicable with respect to taxable years ending after June 30, 1950.

SEC. 330. NET OPERATING LOSS CARRY-OVER [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) LOSS FOR TAXABLE YEAR BEGINNING BEFORE 1948.—So much of subparagraph (A) of section 122(b)(2) (relating to the amount of carry-overs) as precedes "the taxpayer" is hereby amended to read as follows:

"(A) Loss for Taxable Year Beginning Before 1948.—Except as provided in subparagraph (D), if for any taxable year beginning before January 1, 1948,".

(b) ALLOWANCE OF THREE-YEAR LOSS CARRY-OVER FROM TAXABLE YEARS 1948–1949.—Section 122(b)(2) (relating to the amount of carry-over) is hereby amended by adding after subparagraph (B) the following new subparagraphs:

"(C) Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.—If for any taxable year begining after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for each intervening taxable year without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1947, and before January 1, 1950, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

"(iii) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c).

"(D) Loss for Taxable Year Beginning After December 31, 1946, and Before January 1, 1948, in the Case of a Corporation Which Commenced Business After December 31, 1945.—If for any taxable year beginning after December 31, 1946, and before January 1, 1948, a corporation which commenced business after December 31, 1945, has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for each intervening taxable year without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1946, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

"(iii) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c)."

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable in computing the net operating loss deduction for taxable years beginning after December 31, 1948.

SEC. 344. NONBUSINESS CASUALTY LOSSES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) REMOVAL OF LIMITATION.—Section 122(d)(5) (relating to net operating loss deduction) is hereby amended by inserting at the end thereof the following new sentence: "This paragraph shall not apply with respect to deductions allowable for losses sustained after December 31, 1950, in respect of property, if the losses arise from fire, storm, shipwreck, or other casualty, or from theft."

(b) EFFECTIVE DATE.—The amendment made by this section shall be applicable in computing the net operating loss deduction for taxable years ending after December 31, 1948.

PAR. 2. Section 29.122-1(a) [26 CFR 29.122-1(a)] is amended as follows:

(A) By striking the second and third sentences of the second paragraph and inserting in lieu thereof the following new sentence:

See section 29.122-4 for the taxable years from which a net operating loss may be carried over or carried back to the current taxable year.

(B) By striking the last two sentences of the second paragraph thereof, which read as follows:

Therefore, the net operating loss carry-overs to a taxable year beginning on or after January 1, 1942, are the net operating loss for the first preceding taxable year and so much of the net operating loss for the second preceding taxable year as has not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year, and the net operating loss carrybacks to such a taxable year are the net operating loss for the second succeeding taxable year and so much of the net operating loss for the first succeeding taxable year as has not been absorbed by the net income (computed under section 122), if any, for the first preceding taxable year. If either of the taxable years preceding the taxable year for which the deduction is allowed began on or after January 1, 1942, the net operating loss for such preceding taxable year is first reduced to the extent it has been absorbed by the net income (computed under section 122), if any, for the taxable years to which such loss has been carried back.

(C) By striking the third paragraph and inserting in lieu thereof the following new paragraph:

A fractional part of a year which is a taxable year under section 48(a) is a preceding or a succeeding taxable year for the purpose of determining under section 122 the first, second, etc., preceding or succeeding taxable year.

PAR. 3. Section 29.122-1(b) [26 CFR 29.122-1(b)] is amended by striking the second sentence and inserting in lieu thereof the following new sentence:

The first step is the computation of the net operating loss, if any, for any preceding or succeeding taxable year from which a net operating loss may be carried forward or carried back to the current taxable year.

PAR. 4. Section 29.122-2 [26 CFR 29.122-2] is amended by inserting at the end of paragraph (5) thereof, which paragraph begins "(5) For taxable years beginning after December 31, 1941", the following new sentence:

This deduction is not allowed for any taxable year ending after June 30, 1950; for example, the deduction is not allowed for any taxable year ending after June 30, 1950, in the case of a taxpayer which makes its return on the basis of cash receipts and disbursements and which pays such excess profits tax during such taxable year.

PAR. 5. Section 29.122-3(a) [26 CFR 29.122-3(a)] is amended by adding at the end of paragraph (7) thereof the following new sentence:

For the purpose of computing the net operating loss deduction for any taxable year ending after December 31, 1948, any deduction allowable for a loss sustained after December 31, 1950, in respect of property, if the loss arises from fire, storm, shipwreck, or other casualty, or from theft, shall not be considered to be an ordinary nonbusiness deduction but shall be treated as a deduction attributable to the operation of a trade or business regularly carried on by the taxpayer.

PAR. 6. Section 29.122-4(a) [26 CFR 29.122-4(a)] is amended to read as follows:

(a) *In general.*—The aggregate of any net operating loss carry-overs and any net operating loss carry-backs to a taxable year shall be the basis of the net operating loss deduction. In order to compute such deduction the taxpayer must first determine the part of any net operating losses for any preceding or succeeding taxable years which are carry-overs or carry-backs to the current taxable year.

The number of taxable years to which a net operating loss may be carried back and carried over are as follows (subject to the two exceptions set forth below):

Net operating loss for a taxable year beginning: After	and Before	May be carried back to the following preceding taxable years	May be carried over to the following succeeding taxable years
Dec. 31, 1938	Jan. 1, 1942	None	2
Dec. 31, 1941	Jan. 1, 1948	2	2
Dec. 31, 1947	Jan. 1, 1950	2	3
Dec. 31, 1949		1	5

The first exception referred to above is that a net operating loss may not be carried back to any taxable year beginning prior to January 1, 1941. The second exception referred to above is that in the case of a corporation which commenced business after December 31, 1945 the net operating loss for any taxable year beginning after December 31, 1946, and before January 1, 1948, may be carried over to the three succeeding taxable years in lieu of the two succeeding taxable years shown above. The date the corporation commenced business shall be determined for the purpose of this exception under the rules provided in the regulations promulgated under section 445, relating to the computation of the average base period net income in the case of new corporations. See section 40.445-1 of Regulations 130.

The amount which is carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the net income for other taxable years, preceding such taxable year, to which it was carried back or carried over. For the purpose of determining the net income for a taxable year which so absorbs the net operating loss that is carried back or carried over, the various net operating loss carry-overs and carry-backs to such taxable year are considered to be applied in reduction of the net income for such taxable year in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year.

PAR. 7. Section 29.122-4(b) [26 CFR 29.122-4(b)] is amended to read as follows:

(*b*) *Portion of net operating loss which is a carry-over or a carry-back to the current taxable year.*—A net operating loss must first be carried to the earliest of the several taxable years to which such loss is allowable as a carry-back or a carry-over, and is then to be carried to the next earliest of such several taxable years, etc. See (*a*) of this section for the taxable years to which a net operating loss incurred in any particular taxable year may be carried back or carried over. The entire net operating loss may be carried to such earliest year. The portion of the loss which may be carried to any taxable year subsequent to such earliest year is the excess of such net operating loss over the aggregate of the net income, if any (computed as provided in (*c*) of this section), for those of such several taxable years which precede the taxable year to which such net operating loss is allowable as a carry-back or a carry-over.

Example. A taxpayer on the calendar year basis has net operating losses for 1940 and 1948. The entire net operating loss for 1940 may be carried over to 1941, and the amount of the carry-over to 1942 is the excess of that loss over the net income (computed as provided in (*c*) of this section) for 1941. Similarly, the entire net operating loss for 1948 may be carried back to 1946, the amount of the carry-back to 1947 is the excess of that loss over the net income (computed as provided in (c) of this section) for 1946, and the amount of the carry-over to 1949, 1950, and 1951, is the excess of that loss over the aggregate of the net income (computed as provided in (*c*) of this section) for 1946 and 1947, for 1946, 1947, and 1949, and for 1946, 1947, 1949, and 1950, respectively.

PAR. 8. Section 29.122-4(c), as amended by Treasury Decision 5600 [C. B. 1948-1, 5], approved February 2, 1948 [26 CFR 29.122-4(c)], is further amended by striking the second, third, and fourth paragraphs and inserting in lieu thereof the following new paragraphs:

(1) The net operating loss deduction for such taxable year is computed (i) by taking into account only such net operating losses otherwise allowable as carry-overs or carry-backs to such taxable year as were sustained in taxable years preceding the taxable year in which the taxpayer sustained the net operating loss from which the net income is to be deducted, and (ii) if the taxable year to which the net operating loss is to be carried begins after December 31, 1947, by disregarding the adjustment provided in section 122(c) and section 29.122-5 (relating to the conversion of the aggregate of the net operating loss carry-overs and carry-backs to the taxable year into the net operating loss deduction).

Example. The taxpayer files its income tax returns on the basis of the calendar year. In computing the net operating loss deduction for 1945, the taxpayer has a carry-over from 1943 of $9,000, a carry-over from 1944 of $6,000, a carry-back from 1946 of $18,000, and a carry-back from 1947 of $14,000, or an aggregate of $47,000 in carry-overs and carry-backs which is the basis for the deduction. The adjustment under section 122(c) for the purpose of computing the net operating loss deduction for 1945 is $2,500. In computing the net income for 1945 which is deducted from the net operating loss for 1946 or 1947, as the case may be, for the purpose of determining the amount of such loss which may be carried back or carried over, the net operating loss deduction for 1945 is computed as follows:

For the purpose of determining the carry-over or carry-back: From—	To—	*The net income for 1946 is computed with the following net operating loss deduction*
1946	1947	$12,500, that is, the aggregate of the $9,000 carry-over from 1943 and the $6,000 carry-over from 1944, less the $2,500 adjustment required by section 122(c).
1946	1948	$15,000, that is, the aggregate of the $9,000 carry over from 1943 and the $6,000 carry-over from 1944. The adjustment required by section 122(c) is disregarded since the taxable year, 1948, to which the net operating loss is to be carried begins after December 31, 1947.
1947	1946	$30,500, that is, the $9,000 carry-over from 1943, the $6,000 carry-over from 1944, and the $18,000 carry-back from 1946, less the $2,500 adjustment required by section 122(c).
1947	1948 or 1949	$33,000, that is, the aggregate of the $9,000 carry-over from 1943, the $6,000 carry-over from 1944, and the $18,000 carry-back from 1946. The adjustment required by section 122(d) is disregarded.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 16, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 19, 1952, 8:57 a. m.)

SECTION 29.122-2: Computation of net operating loss in case of corporation.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5963, page 197.)

SECTION 29.122-3: Computation of net operating loss in case of a taxpayer other than a corporation.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5963, page 197.)

SECTION 29.122-4: Computation of net operating loss carry-overs and net operating loss carry-backs.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5963, page 197.)

SECTION 127(c).—WAR LOSSES: RECOVERIES

SECTION 29.127(c)-1: Recoveries in respect of war losses. (Also Section 112(a), Section 29.112(a)-1.) **Rev. Rul. 54**

INTERNAL REVENUE CODE

Recovery of war losses sustained by holders of certain Japanese prewar dollar bonds, for the purposes of section 127(c) of the Internal Revenue Code, occurred on November 11, 1950, the date the Securities and Exchange Commission removed the restrictions against trading in such bonds.

Presentment of such bonds to the Japanese Government for the purpose of overprinting an extended maturity date thereon does not constitute an exchange of property which results in gain or loss recognizable under section 112 of the Code.

Advice is requested relative to the date on which war losses sustained by holders of certain prewar dollar bonds of the Japanese Government and of Japanese public and private corporate bodies are considered to be recovered for the purposes of section 127(c) of the Internal Revenue Code. Advice is also requested whether presentment of such bonds for the purpose of overprinting the extended maturity date thereon, pursuant to the terms of an offer of settlement by the government of Japan, constitutes an exchange of property which results in gain or loss recognizable under section 112 of the Code.

The bonds here under consideration are as follows:

Imperial Japanese Government External Loan of 1924 Thirty Year Sinking Fund 6½ Percent Gold Bond.

Imperial Japanese Government External Loan of 1930 Thirty-five Year Sinking Fund 5½ Percent Gold Bond.

City of Yokohama External Loan of 1926 Sinking Fund 6 Percent Gold Bond.

City of Tokyo External Loan of 1927 Sinking Fund 5½ Percent Gold Bond.

The Oriental Development Company, Limited (Toyo Takushoku Kabushiki Kaisha) External Loan Thirty Year 6 Percent Gold Debenture Bond.

The Oriental Development Company, Limited (Toyo Takushoku Kabushiki Kaisha) External Loan Thirty Year 5½ Percent Gold Debenture Bond.

Taiwan Electric Power Company, Limited (Taiwan Denryoku Kabushiki Kaisha) Forty Year Sinking Fund 5½ Percent Gold Bonds.

Great Consolidated Electric Power Company, Limited (Daido Denryoku Kabushiki Kaisha) First Mortgage 7 Percent Sinking Fund Gold Bond, Series A.

Toho Electric Power Company, Limited (Toho Denryoku Kabushiki Kaisha) First Mortgage (Kansai Division) Sinking Fund 7 Percent Gold Bond, Series A.

Ujigawa Electric Power Company, Limited (Ujigawa Denki Kabushiki Kaisha) First Mortgage 7 Percent Sinking Fund Gold Bond.

Great Consolidated Electric Power Company, Limited (Daido Denryoku Kabushiki Kaisha) First and General Mortgage 6½ Percent Sinking Fund Gold Bond.

Shinyetsu Electric Power Company, Limited (Shinyetsu Denryoku Kabushiki Kaisha) First Mortgage 6½ Percent Sinking Fund Bond.

Nippon Electric Power Company, Limited (Nippon Denryoku Kabushiki Kaisha) First Mortgage 6½ Percent Gold Bond.

Tokyo Electric Light Company, Limited (Tokyo Dento Kabushiki Kaisha) First Mortgage Gold Bonds, 6 Percent Dollar Series.

Service on the above bond issues was suspended on December 8, 1941. On December 11, 1941, the Securities and Exchange Commission advised stock and bond exchanges and security dealers throughout the United States to cease handling all transactions in Japanese bonds. The restrictions were removed by the Securities and Exchange Commission pursuant to Release No. 4518 dated November 11, 1950. There was no market for the bonds in the United States during the period the restrictions were in effect, and there were no quotations on the bonds during such period.

The liabilities for the Japanese Government and municipal bonds are the direct and sole obligation of the Government, and the obligations of the public and private corporate bodies were assumed by the Japanese Government in 1943 pursuant to Japanese Law No. 60 of 1943, relating to the treatment of foreign currency bonds. The Japanese Government resumed service on December 22, 1952, on those bonds the holders of which accept the offer of settlement.

Under the terms of the offer of settlement the maturity date of the bonds shall be extended for the exact period of 10 years. However, the Japanese Government reserves the right to redeem, at any time prior to the new maturity dates, all or part of any of the bonds in accordance with the provisions in the original contract of, and/or indenture for, the respective bonds. Bonds, the holders of which accept the offer of settlement, will be overprinted with appropriate legends showing the extension of the maturity dates thereof and the acceptance of the offer. The sinking fund operations shall be resumed in the way stipulated in the original contracts and/or indentures as from the year 1953 with certain adjustments to give effect to the reduced amount of outstanding bonds which has been produced by mandatory conversion of dollar bonds into yen obligations.

For the extended periods after original maturity dates, the bonds shall bear interest at the same rate and with the same semiannual payment dates of each extended year as specified in the original contracts and/or indentures. The Japanese Government will endeavor to arrange that, about 1 month prior to the first semiannual interest payment date in the first such extended year, or as soon as possible in the case of bonds already matured, new coupon sheets corresponding to such extended periods shall be attached to the respective bonds. In cases where new coupon sheets are not ready by the date of actual payment, scrip or other certificates may be delivered so as to serve the purpose of the interest payment.

In the case of the Great Consolidated Electric Power Company, Limited, First Mortgage 7 percent Sinking Fund Gold Bond, Series A, and Ujigawa Electric Power Company, Limited, First Mortgage 7 percent Sinking Fund Gold Bond, new printed coupon sheets covering the period from and including 1943 to the extended maturity date of such bonds will be prepared and the engraved coupons already attached to the bonds maturing in or after 1943 will be detached and canceled. In the case of the Great Consolidated Electric Power Company, Limited, First and General Mortgage 6½ percent Sinking Fund Gold Bond, the coupon due January 1, 1953, will be in printed form.

The coupons bearing payment dates prior to December 22, 1942, shall be payable on December 22, 1952. The payment dates of the coupons bearing payment dates on or after December 22, 1942, and

prior to September 26, 1952, shall be extended in each case for the exact period of 10 years, and payment shall be made on the new dates. Coupons overprinted with new payment dates shall be detached from the bonds so that such bonds may be transferred or delivered separate and apart from such coupons, scrip, or other certificates so overprinted with new payment dates. Such coupons, scrip, or other certificates, so overprinted with new payment dates, shall continue to be payable on the new payment dates overprinted thereon, notwithstanding the prior maturity or redemption of the bonds to which they originally appertained, and the accrued interest represented thereby will not be deemed to be "accrued interest" for the purpose of determining the redemption price of bonds or the maximum price at which bonds may be purchased with moneys in a sinking fund therefor.

The terms and conditions under the original contracts and/or indentures for the bonds concerned shall be maintained except those articles, clauses, and phrases which are specifically replaced or eliminated by the terms of the offer, or are inconsistent with the amendments set forth therein. The offer of settlement does not affect the existing rights of holders of bonds or coupons who do not accept the offer. However, no payment on the bonds or coupons concerned will be made except with respect to bonds or coupons the holders of which accept the offer in the prescribed manner.

It is held that recovery of war losses sustained by holders of the foregoing Japanese bonds, for the purposes of section 127(c) of the Internal Revenue Code, occurred on November 11, 1950, the date the Securities and Exchange Commission removed the restrictions against trading in such bonds. It is further held that acceptance of the offer of settlement and presentment of the bonds to the Japanese Government for the purpose of overprinting the extended maturity date thereon, pursuant to the offer of settlement, does not constitute an exchange of property which results in gain or loss recognizable under section 112 of the Code.

SECTION 29.127(c)-1: Recoveries in respect of war losses. T. D. 5968

(Also Section 29.127(d)-1, 29.127(f)-1; Section 131, Section 29.131-1; Section 275, Section 29.275-1; Section 322, Section 29.322-7.)

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 section 341 of the Revenue Act of 1951, relating to war losses.

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

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

On November 22, 1952, notice of proposed rule making with respect to amendments to conform Regulations 111 to section 341 of the Revenue Act of 1951 (P. L. 183, 82d Cong., 1st sess.), approved October 20, 1951, relating to war losses, was published in the Federal Register

(17 F. R. 10649). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, the amendments to Regulations 111 [26 CFR, part 29] set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 29.127(c)-1 [26 CFR 29.127(c)-1] the following:

SEC. 341. WAR LOSSES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) TAX UPON WAR LOSS RECOVERY.—Section 127(c) (relating to recoveries included in gross income) is hereby amended to read as follows:

"(c) RECOVERIES.—

"(1) GENERAL RULE.—Upon the recovery in the taxable year of any money or property in respect of property considered under subsection (a) as destroyed or seized in any prior taxable year, the amount of such recovery shall be included in gross income to the extent provided in paragraph (2), unless the provisions of paragraph (3) are applicable to the taxable year pursuant to an election made by the taxpayer under the provisions of paragraph (5).

"(2) INCLUSION IN GROSS INCOME.—

"(A) Amount of Recovery.—The amount of the recovery of any money or property in respect of property considered under subsection (a) as destroyed or seized in any prior taxable year shall be an amount equal to the aggregate of such money and the fair market value of such property, determined as of the date of the recovery.

"(B) Amount of Gain Includible.—To the extent that the amount of the recovery plus the aggregate of the amounts of previous such recoveries do not exceed that part of the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a) which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall not be includible in gross income and shall not be deemed gain upon the involuntary conversion of property as a result of its destruction or seizure. To the extent that such amount plus the aggregate of the amounts of previous such recoveries exceed that part of the aggregate of such deductions, which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2 and do not exceed that part of the aggregate of such deductions which did result in a reduction of any tax of the taxpayer under this chapter or chapter 2, such amount shall be included in gross income but shall not be deemed a gain upon the involuntary conversion of property as a result of its destruction or seizure. To the extent that such amount plus the aggregate of the amounts of previous such recoveries exceed the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a), such amount shall be considered a gain upon the involuntary conversion of property as a result of its destruction or seizure and shall be recognized or not recognized as provided in section 112(f). If for any previous taxable year the taxpayer chooses under subsection (b) to treat any obligations and liabilities as discharged or satisfied out of the property or interest described in subsection (a), and if such obligations and liabilities were not so discharged or satisfied, the amount of such obligations and liabilities treated as discharged or satisfied under subsection (b) shall be considered for the purposes of this section as a deduction by reason of this section which did not result in a reduction of any tax of the taxpayer under this chapter or chapter 2. For the purposes of this paragraph an allowable deduction for any taxable year on account of the destruction or seizure of

property described in subsection (a) shall, to the extent not allowed in computing the tax of the taxpayer for such taxable year, be considered an allowable deduction which did not result in a reduction of any tax for the taxpayer under this chapter or chapter 2.

"(3) TAX ADJUSTMENT MEASURED BY PRIOR BENEFITS.—If the provisions of this paragraph are applicable to the taxable year pursuant to an election made by the taxpayer under the provisions of paragraph (5)—

"(A) Amount of Recovery.—The amount of the recovery in the taxable year of any money or property in respect of property considered under subsection (a) as destroyed or seized in any prior taxable year shall be an amount equal to the aggregate of such money and the fair market value of such property, determined as of the date of the recovery. For the purpose of this paragraph, in the case of the recovery of the same property or interest considered under subsection (a) as destroyed or seized, the fair market value of such property or interest shall, at the option of the taxpayer, be considered an amount equal to the adjusted basis (for determining loss) of such property or interest in the hands of the taxpayer on the date such property or interest was considered under subsection (a) as destroyed or seized. The amount of the recovery determined under this subparagraph shall be reduced for the purposes of subparagraphs (B) and (C) by the amount of the obligations or liabilities with respect to the property considered under subsection (a) as destroyed or seized in respect of which the recovery was received, if the taxpayer for any previous taxable year chose under subsection (b)(2) to treat such obligations or liabilities as discharged or satisfied out of such property, and such obligations or liabilities were not so discharged or satisfied prior to the date of the recovery.

"(B) Adjustment for Prior Tax Benefits.—That part of the amount of the recovery, in respect of any property considered under subsection (a) as destroyed or seized, which is not in excess of the allowable deductions in prior taxable years on account of such destruction or seizure of the property (the amount of such allowable deductions being first reduced by the aggregate amount of any prior recoveries in respect of the same property) shall be excluded from gross income for the taxable year of the recovery for the purpose of computing the tax under this chapter and chapter 2; but there shall be added to, and assessed and collected as a part of, the tax under this chapter for the taxable year of the recovery the total increase in the tax under this chapter and chapter 2 for all taxable years which would result by decreasing, in an amount equal to such part of the recovery so excluded, such deductions allowable in the prior taxable years with respect to the destruction or seizure of the property. Such increase in the tax for each such year so resulting shall be computed in accordance with regulations prescribed by the Secretary. Such regulations shall give effect to previous recoveries of any kind (including recoveries described in section 22(b)(12)) with respect to any prior year, and shall provide for the case where there was no tax for the prior year, but shall otherwise treat the tax previously determined for any year in accordance with the principles set forth in section 3801(d). All credits allowable against the tax for any year and all carry-overs and carry-backs affected by so decreasing the allowable deductions shall be taken into account in computing the increase in the tax, except that the computation of the excess profits credit under chapter 2E for any taxable year shall not be affected.

"(C) Gain Upon Recovery.—The amount of any recovery or part thereof, in respect of property considered under subsection (a) as destroyed or seized, which is not excluded from gross income under the provisions of subparagraph (B) shall be

considered for the taxable year of the recovery as gain on the involuntary conversion of property as a result of its destruction or seizure and shall be recognized or not recognized as provided in section 112(f).

"(D) Recoveries Treated as Gross Income for Certain Purposes.—For the purposes of sections 51, 52, and 3801(b) the recovery in the taxable year of any money or property in respect of property considered under subsection (a) as destroyed or seized in any prior taxable year shall be deemed to be an item includible in gross income for the taxable year in which the recovery is made.

(4) RESTORATION OF VALUE OF INVESTMENTS REFERABLE TO DESTROYED OR SEIZED PROPERTY.—For the purpose of this subsection the restoration in whole or in part of the value of any interest described in subsection (a)(3) by reason of any recovery of money or property in respect of property to which such interest related and which was considered under subsection (a) (1) or (2) as destroyed or seized shall be deemed a recovery of property in respect of property considered under subsection (a) as destroyed or seized. In applying paragraph (3) of this subsection such restoration shall be treated as the recovery of the same interest considered under subsection (a) as destroyed or seized.

"(5) ELECTION BY TAXPAYER FOR APPLICATION OF PARAGRAPH (3).—If the taxpayer elects to have the provisions of paragraph (3) applicable to any taxable year in which he recovered any money or property in respect of property considered under subsection (a) as destroyed or seized, the provisions of paragraph (3) shall be applicable to all taxable years of the taxpayer beginning after December 31, 1941, and such election, once made, shall be irrevocable. The election shall be made in such manner and at such time as the Secretary may by regulations prescribe, except that no election under this paragraph may be made after December 31, 1952, unless the taxpayer recovers money or property (in respect of property considered under subsection (a) as destroyed or seized) during a taxable year ending after the date of the enactment of the Revenue Act of 1951. If pursuant to such election the provisions of paragraph (3) are applicable to any taxable year—

"(A) the period of limitations provided in sections 275 and 276 on the making of assessments and the beginning of distraint or a proceeding in court for collection shall not, with respect to—

"(i) the amount to be added to the tax for such taxable year under the provisions of paragraph (3), and

"(ii) any deficiency for such taxable year or for any other taxable year, to the extent attributable to the basis of the recovered property being determined under the provisions of subsection (d)(2).

expire prior to the expiration of two years following the date of the making of such election, and such amount and such deficiency may be assessed at any time prior to the expiration of such period notwithstanding any law or rule of law which would otherwise prevent such assessment and collection, and

"(B) in case refund or credit of any overpayment resulting from the application of the provisions of paragraph (3) to such taxable year is prevented on the date of the making of such election, or within one year from such date, by the operation of any law or rule of law (other than section 3761, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within one year from such date.

In the case of any taxable year ending before the date of the making by the taxpayer of an election under this paragraph, no interest shall be paid on any overpayment resulting from the application of the provisions of paragraph (3) to such taxable year, and no interest shall be assessed or collected with respect to any amount or any deficiency specified in clause (A), for any period prior to the

expiration of six months following the date of the making of such election by the taxpayer."

* * * * * * *

(d) EFFECTIVE DATES.—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1941.

PAR. 2. Section 29.127(c)-1, as amended by Treasury Decision 5454 [C. B. 1945, 68], approved May 10, 1945 [26 CFR 29.127(c)-1], is further amended to read as follows:

SEC. 29.127(c)-1. RECOVERIES IN RESPECT OF WAR LOSSES.—(*a*) *General.*—(1) Upon the recovery by the taxpayer in the taxable year of any money or property in respect of property considered under section 127(a) as destroyed or seized in any prior taxable year, the amount of such recovery must be included in gross income to the extent provided in section 127(c)(2), unless pursuant to the taxpayer's election the provisions of section 127(c)(3) are applicable to such recovery. For the treatment of war loss recoveries under such provisions, and the manner of making such election, see paragraphs (*c*) and (*d*) hereof.

(2) Except as provided in section 127(c)(3)(A) and in this paragraph, the amount of the recovery in respect of a war loss in a previous taxable year is determined in the same manner for the purpose of section 127(c) (2) or (3). The amount of the recovery of any money or property in respect of any war loss is the aggregate of the amount of such money and of the fair market value of such property, both determined as of the date of the recovery. If pursuant to the taxpayer's election under section 127(c)(5) the provisions of section 127(c)(3) are applicable to any taxable year in which he recovers the same property or interest considered under section 127(a) as destroyed or seized in a previous taxable year, the fair market value of such property or interest shall, at the option of the taxpayer, be considered an amount equal to the adjusted basis (for determining loss) of such property or interest in the hands of the taxpayer on the date such property or interest was considered as destroyed or seized. This option is exercisable by the taxpayer with respect to each separate property or interest considered under section 127(a) as destroyed or seized in a previous taxable year. Also, if the provisions of section 127(c)(3) are applicable pursuant to the taxpayer's election, the amount of the recovery of any money or property in respect of property considered under section 127(a) as destroyed or seized in any prior taxable year shall be reduced for the purpose of section 127(c)(3) (B) and (C) by the amount of the obligations or liabilities with respect to such property, if the taxpayer for any previous taxable year chose under section 127(b)(2) to treat such obligations or liabilities as discharged or satisfied out of such property, and such obligations or liabilities were not so discharged or satisfied prior to the date of the recovery. See section 29.127(b)-1. The recoveries in respect of any war loss include the recovery of the property or interest treated as destroyed or seized under section 127 and the recovery of any money or property in lieu of such property or interest or on account of the destruction or seizure of such property or interest. For example, there is a recovery upon the return to the taxpayer after the termination of the war of his property which was treated as resulting in a war loss because it was located in a country at war with the United States. An award by a government on account of the seizure of the taxpayer's property by an enemy country is a recovery under section 127(c). The amount obtained upon the sale or other transfer by the taxpayer of his right to any property treated as resulting in a war loss is also a recovery for the purpose of section 127(c). Similarly, if a taxpayer who sustained a war loss under section 127(c) upon the liquidation of a corporation has received the rights to any property of the corporation which was treated as destroyed or seized under section 127(a) (1) or (2), any recovery by the taxpayer with respect to such rights is a recovery by him for the purposes of section 127(c). Furthermore, if any interest of the taxpayer in or with respect to property was determined to be worthless and was treated as a war loss under section 127(a)(3) (see section 29.127(a)-4), or if the taxpayer retained an interest in a corporation with respect to which he sustained a war loss under section 127(e), and if the interest in the hands of the taxpayer is restored in value, in whole or in part, by reason of a recovery with respect to the underlying assets treated as destroyed or seized under section 127, then such restoration in value is a recovery by the taxpayer for the purposes of section

127(c). In the application of section 127(c)(3) such restoration shall be treated as a recovery of the same interest considered as destroyed or seized. Property considered as destroyed or seized under section 127(a) is considered as not being in existence from the date of the loss to the date of its recovery.

(3) For the purpose of section 127(c), the recoveries considered are only those with respect to war losses sustained in prior taxable years. Similarly, the only deductions considered are those allowable for prior taxable years, and any allowable deductions for the year of the recovery are ignored for the purposes of applying such section to the recovery. If property is treated as destroyed or seized under section 127, and if in the same taxable year there is also a recovery with respect to such property, such recovery is not within the provisions of section 127(c) but is taken into account under section 127(b) in determining the amount of the loss, if any, on the destruction or seizure. See section 127(b)-1. An allowable deduction with respect to a war loss is any deduction to which the taxpayer is entitled on account of any property or interest being treated as destroyed or seized under section 127, regardless of whether or not such deduction was claimed by the taxpayer or otherwise allowed in computing his tax. If a deduction was claimed by a taxpayer in computing his tax for any taxable year, and if such deduction was disallowed, such deduction will not be considered an allowable deduction for such taxable year since the previous determination will not be reconsidered.

(*b*) *General rule—Inclusion of recovery in gross income.*—(1) A taxpayer who has sustained a war loss described in section 127 and who has not elected to have the provisions of section 127(c)(3) apply to any taxable year in which he recovered any money or property in respect of a war loss in any previous taxable year must include in his gross income for each taxable year, to the extent provided in section 127(c)(2), the amount of his recoveries of money and property for such taxable year in respect of any war loss in a previous taxable year. Section 127(c)(2) provides that such recoveries for any taxable year are not includible in income until the taxpayer has recovered an amount equal to his allowable deductions in prior taxable years on account of such war losses which did not result in a reduction of any tax under chapter 1 of the Internal Revenue Code, that is, of any income tax of the taxpayer, or chapter 2, including the excess profits tax imposed by subchapter E thereof. War loss recoveries are considered as made first on account of war losses allowable but not actually allowed as a deduction, and second on account of war losses allowed as a deduction but which did not result in a reduction of tax under chapter 1 or chapter 2. If there were deductions allowed on account of war losses for two or more taxable years which did not result in a reduction of any tax under chapter 1 or chapter 2, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed, beginning with the latest. See section 29.127(f)-1 for the determination of the amount of such deductions. Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of the taxpayer's allowable deductions in prior taxable years on account of war losses which did result in a reduction of any such tax under chapter 1 or chapter 2. Any further recoveries in excess of all the taxpayer's allowable deductions in prior taxable years for war losses are treated as gain on an involuntary conversion of property as a result of its destruction or seizure, and such gain is recognized or not recognized under the provisions of section 112(f). See section 29.112(f)-1. Such gain, if recognized, is included in gross income as ordinary income unless section 117(j) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than 6 months. See section 29.117-7.

(2) The determination as to whether and to what extent any recoveries are to be included in gross income is made upon the basis of the amount of all the recoveries for each day upon which there are any such recoveries, as follows:

(i) The amount of the recoveries for any day is not included in gross income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of the allowable deductions in prior taxable years on account of war losses which did not result in a reduction of any tax of the taxpayer under chapter 1 or chapter 2 of the Internal Revenue Code, as determined under section 29.127(f)-1, exceeds the amount of all previous recoveries in the same and prior taxable years.

(ii) The amount of the recoveries for any day which is not excluded from gross income under (i) is included in gross income as ordinary income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of all the allowable deductions in prior taxable years on account of war losses (both those which resulted in a reduction of a tax of the taxpayer and those which did not) exceeds the sum of the amount of all previous recoveries in the same and prior taxable years and of that portion, if any, of the amount of the recoveries for such day which is not included in gross income under (i).

(iii) The amount of the recoveries for any day which is not excluded from gross income under (i) and is not included in gross income as ordinary income under (ii) is considered gain on an involuntary conversion of property as a result of its destruction or seizure. The following provisions then apply to this gain:

(A) Such gain is recognized or not recognized under the provisions of section 112(f), relating to gain upon such conversion of property. For the purpose of applying section 112(f), such gain for any day is deemed to be expended in the manner provided in section 112(f) to the extent the recovery for such day is so expended.

(B) If such gain is recognized it is included in gross income as ordinary income or, if the provisions of section 117(j) apply and require such treatment, as gain on the sale or exchange of a capital asset held for more than 6 months. For the purpose of applying section 117(j), such recognized gain for any day is deemed to be derived from property described in that section to the extent of the recovery for such day with respect to such property, except such portion of such recovery as is attributable to the nonrecognized gain for such day.

(C) Section 127(d) provides that in determining the unadjusted basis of recovered property, the total gain and the recognized gain with respect to such property must be determined. For such purpose, the recognized gain deemed to be derived from properties described in section 117(j) may be allocated among such properties in the proportion of the recoveries with respect to such properties, reduced for each property by the portion of the recovery attributable to the nonrecognized gain for such day, and the recoveries with respect to properties not described in section 117(j) may be similarly allocated. The total gain derived from any recovered property is the sum of the nonrecognized gain attributable to the recovery of such property and of the recognized gain allocable to such property.

(3) The foregoing provisions may be illustrated by the following examples:

Example (1). The taxpayer sustained war losses of $3,000 on account of properties A, B, C, and D. Of this amount, $1,000 did not result in a reduction of any income tax of the taxpayer, as determined under the provisions of section 29.127(f)-1. In a subsequent taxable year, he received an award of $800 from the Government on account of property A. This is not included in income since it is less than the amount by which his allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit, $1,000, exceed $0, the sum of all his previous recoveries. On a later date the taxpayer recovers property B, which is worth $1,500 on the date of recovery. This recovery is not included in gross income to the extent of $200, the amount by which the allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit, of $1,000, exceed the sum of all previous recoveries, or $800. All of the remaining $1,300 of the recovery is included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, since it is less than the amount by which the aggregate of all the allowable deductions in prior taxable years on account of war losses, or $3,000, exceeds $1,000, the sum of the $800 of previous recoveries and of the $200 portion of the recovery with respect to B which is not included in gross income. On a still later date the taxpayer sells for $2,500 his rights to recover C. Since the allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit ($1,000) do not exceed the previous recoveries by the taxpayer ($800 and $1,500, or $2,300), none of the recovery on account of C is excluded from gross income. This recovery is included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, to the extent of $700, the amount

by which the aggregate of all the allowable deductions for prior taxable years on account of war losses ($3,000) exceeds $2,300, the sum of the $2,300 of previous recoveries and of the $0 portion of the recovery on account of C which is not included in gross income. The remaining $1,800 of the recovery is considered gain on an involuntary conversion of property on account of its destruction or seizure, and is not recognized if forthwith expended in the manner provided in section 112(f). Thus, it is not recognized if it is forthwith expended for the acquisition of property relating in service or use to C. On a later date the taxpayer recovers D, which has a fair market value of $400 at the time of the recovery. Since the aggregate of all the allowable deductions for prior taxable years on account of war losses ($3,000) does not exceed the previous recoveries by the taxpayer ($800+$1,500+$2,500, or $4,800), all of the recovery with respect to D is considered gain on an involuntary conversion of property as a result of its destruction or seizure. Under the provisions of section 112(f), this gain is not recognized if D is used for the same purposes for which it was used before it was deemed destroyed or seized under section 127.

Example (2). The taxpayer on one day recovers $3,000 for property A and $7,000 for property B, both of which were treated under section 127 as destroyed or seized in a prior taxable year, and $8,000 of such $10,000 recoveries is considered gain on the involuntary conversion of property as a result of its destruction or seizure. The taxpayer forthwith expends $5,000 in the acquisition of property similar in use to B. Therefore, $5,000 of the $8,000 gain is not recognized under section 112(f), leaving $3,000 of recognized gain. Property B is within the provisions of section 117(j), relating to gains and losses on the involuntary conversion of certain described property, but property A is not. Therefore, the provisions of section 117(j) apply to $2,000 of the $3,000 gain, that is, the amount of the recovery with respect to B which is not attributable to the nonrecognized gain for such day ($7,000 minus $5,000). If the taxpayer forthwith expended $8,000 or more for the acquisition of property similar in use to B, none of the gain would be recognized. If the taxpayer forthwith expended the $5,000 to acquire property related in use to A, the $3,000 recognized gain would be considered derived from B to the extent of the recovery with respect to B ($7,000), not reduced by any nonrecognized gain since none of such recovery is attributable to such nonrecognized gain, and therefore all of the $3,000 recognized gain would be subject to the provisions of section 117(j).

(c) *Elective method—Tax adjustment measured by prior benefits.*—(1) If the taxpayer elects pursuant to section 127(c)(5) and in accordance with the provisions of these regulations to have the provisions of section 127(c)(3) apply to any taxable year in which he recovers any money or property in respect of property considered under section 127(a) as destroyed or seized in any previous taxable year, the amount of the recovery in respect of such property for any taxable year shall not be included in income until the taxpayer has recovered an amount equal to his allowable deductions in prior taxable years on account of the destruction or seizure of such property, whether or not such allowable deductions resulted in a reduction of any tax under chapter 1 or chapter 2 of the Internal Revenue Code. However, for the purposes of section 51, relating to the requirement of individual returns, section 52, relating to the requirement of corporation returns, and section 3801(b), relating to the mitigation of the effect of the statute of limitations, the entire amount of the recovery shall be deemed to be an item includible in gross income for the taxable year in which the recovery is made. In lieu of including such amount in gross income, there shall be added to, and assessed and collected as a part of, the tax imposed under chapter 1 for the taxable year of the recovery an adjustment on account of any tax benefits in all prior taxable years resulting directly or indirectly from the fact that the loss from the destruction or seizure of such property was an allowable deduction. The amount of such adjustment shall be the total increase in the tax under chapter 1 of the Code, that is, any income tax of the taxpayer, and under chapter 2 including the excess profits tax imposed by subchapter E thereof, for all taxable years which would result by decreasing such allowable deductions with respect to the destruction or seizure of such property by an amount equal to that portion of the amount of the recovery which is not included in gross income for the taxable year of the recovery. The portion of the amount of the recovery which is in excess of such allowable deductions is included in gross income for the taxable year of the recovery as gain on the involuntary conversion of property as a result of its destruction or seizure and is recognized or not recognized as provided in section 112(f). See section

29.112(f)-1. Such gain, if recognized, is included in gross income as ordinary income unless section 117(j) applies to cause such gain to be treated as gain on the sale or exchange of capital assets held for more than 6 months. See section 29.117-7.

(2) The determination as to whether and to what extent the amount of the recovery is to be excluded from gross income is to be made upon the basis of the total amount of the recoveries in each taxable year in respect of the same property considered under section 127(a) as destroyed or seized in any previous taxable year, as follows:

(i) The amount of the recovery in any taxable year is excluded from the gross income of such year and is not considered gain on an involuntary conversion to the extent that such amount does not exceed the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of such property (whether or not such deductions resulted in a reduction of a tax of the taxpayer) reduced by the aggregate amount of any recoveries in intervening taxable years in respect of the same property.

(ii) The amount of the recovery in any taxable year which is not excluded from gross income under (i) is included in gross income and is considered gain on an involuntary conversion of property as a result of its destruction or seizure. The following provisions apply to this gain:

(A) Such gain is recognized or not recognized under the provisions of section 112(f) relating to gain upon such conversion of property. For the purpose of applying section 112(f), such gain for any taxable year is deemed to be expended in the manner provided in section 112(f) to the extent the recovery in such taxable year is so expended.

(B) If such gain is recognized it is included in gross income as ordinary income or, if the provisions of section 117(j) apply and require such treatment, as gain on the sale or exchange of a capital asset held for more than 6 months. In the case of the recovery of the same property or interest considered under section 127(a) as destroyed or seized, any gain will not be deemed to be recognized under the provisions of section 112(f) if such property is used for the same purpose for which it was used before it was deemed destroyed or seized under section 127(a).

(3) The determination of the total increase in the tax under chapters 1 and 2 of the Code for all taxable years which would result by decreasing the deductions allowable in any prior taxable years with respect to the destruction or seizure of the property in respect of which the taxpayer has made a recovery by an amount equal to the part of such recovery not included in gross income for the taxable year of such recovery shall be made as provided in this subparagraph. Such total increase shall include the increases described in (i), (ii), (iii), and (iv) of this subparagraph, and shall be added to, and assessed and collected as a part of, the tax under chapter 1 for the taxable year of the recovery. Proper adjustment of such increases shall be made on account of the application of the provisions of this subparagraph to intervening taxable years. Proper adjustment shall also be made in the determination of such increases in the case of a taxpayer who has made a valid election under section 113(d), relating to the adjustment of basis of property for depreciation, obsolescence, amortization, and depletion. The term "tax previously determined" as used in this subparagraph shall have the same meaning as used in section 3801(d) of the Code and shall include any tax under chapter 1 or chapter 2 of the Code. In computing the amount of the increase in the tax previously determined under chapter 1 or chapter 2 for any taxable year, the principles of section 3801(d) shall be applicable. See section 29.3801(d)-1. However, the computation of the excess profits credit under chapter 2E for any taxable year shall not be affected by the adjustment provided in this subparagraph. All credits allowable against the tax for any year shall be taken into account in computing the increase in the tax previously determined. The increases referred to above include the following:

(i) The increase, if any, in the tax previously determined for each prior taxable year in which a deduction was allowable on account of the destruction or seizure of the property in respect of which there is a recovery in the taxable year. After the tax previously determined has been ascertained, such tax shall be recomputed by disregarding such allowable deduction (to the extent that it does not exceed the sum of the amount of such recovery not included in gross income for the taxable year of such recovery, plus the aggregate amount of any recoveries in intervening taxable years in

respect of the same property) and any other deductions allowable on account of other war losses or any other losses, expenditures or accruals in such prior taxable year in respect of which, and to the extent that, recoveries in intervening taxable years have been excluded from gross income under section 127(c)(3), section 22(b)(12), or otherwise. The difference between the tax previously determined and the tax as recomputed will be the increase in the tax previously determined for the taxable year.

(ii) The increase, if any, in the tax previously determined for any taxable year (including the taxable year of the recovery) in which a net operating loss deduction was allowable, if all or a part of such deduction was attributable to the carry-over or carry-back to such taxable year of a net operating loss from another taxable year in which a deduction was allowable on account of the destruction or seizure of the property in respect of which there is a recovery in the taxable year to which such increase is to be added. After the tax previously determined has been ascertained, such tax shall be recomputed by redetermining such net operating loss deduction. In the determination of such net operating loss deduction the net operation loss shall be recomputed by disregarding the deduction allowable on account of the war loss in respect of which there is a recovery in the taxable year to which such increase is to be added (to the extent that such deduction does not exceed the sum of the amount of such recovery not included in gross income for the taxable year of such recovery, plus the aggregate amount of any recoveries in intervening taxable years in respect of the same property) and by disregarding any other deductions allowable on account of other war losses or any other losses, expenditures, or accruals in the taxable year in respect of which, and to the extent that, recoveries in intervening taxable years have been excluded from gross income under section 127(c)(3), section 22(b)(12), or otherwise. The difference between the tax previously determined and the tax as recomputed will be the increase in the tax previously determined for the taxable year.

(iii) The increase, if any, in the tax previously determined for any taxable year (including the taxable year of recovery) in which an unused excess profits credit was availed of in computing the unused excess profits credit adjustment for such taxable year, if all or a part of such adjustment was attributable to the carry-over or carry-back to such taxable year of an unused excess profits credit from another taxable year in which a deduction was allowable on account of the destruction or seizure of the property in respect of which there is a recovery in the taxable year to which such increase is to be added. After the tax previously determined has been ascertained, such tax shall be recomputed by redetermining such unused excess profits credit carry-over or carry-back. In the recomputation such carry-over or carry-back shall be redetermined by disregarding such allowable war loss deduction (to the extent that such deduction does not exceed the sum of the amount of the recovery not included in gross income for the taxable year of such recovery, plus the aggregate amount of any recoveries in intervening taxable years in respect of the same property) and by disregarding any other deductions allowable on account of other war losses or any other losses, expenditures, or accruals in the taxable year in respect of which, and to the extend that, recoveries in intervening taxable years have been excluded from gross income under section 127(c)(3), section 22(b)(12), or otherwise. The difference between the tax previously determined and the tax as recomputed will be the increase in the tax previously determined for the taxable year. In case there is an increase in the excess profits tax under chapter 2E for the taxable year in which an unused excess profits credit was availed of in computing the unused excess profits credit adjustment, and a decrease in the income tax under chapter 1 for such taxable year, the increase in the tax previously determined shall be considered to be an amount equal to the excess of the increase in the excess profits tax over the decrease in the income tax.

(iv) The increase, if any, in the tax previously determined for any taxable year (including the taxable year of the recovery) in which an unused excess profits credit was availed of in computing the unused excess profits credit adjustment for such taxable year, if all or a part of such adjustment was attributable to the carry-over or carry-back to such taxable year of an

unused excess profits credit from another taxable year in which there was allowable a net operating loss deduction attributable to the carry-over or carry-back to such other taxable year of a net operating loss, and such net operating loss resulted in whole or in part from the deduction allowable on account of the destruction or seizure of the property in respect of which there is a recovery in the taxable year to which such increase is to be added. After the tax previously determined has been ascertained, such tax shall be recomputed by redetermining such net operating loss deduction and such unused excess profits credit carry-over or carry-back. In the redetermination of such net operating loss deduction the net operating loss carry-over or carry-back shall be recomputed by disregarding such allowable war loss deduction (to the extent that such deduction does not exceed the sum of the amount of such recovery not included in gross income for the taxable year of such recovery, plus the aggregate amount of any recoveries in intervening taxable years in respect of the same property) and by disregarding any other deductions allowable on account of other war losses or any other losses, expenditures, or accruals in the taxable year in respect of which, and to the extent that, recoveries in intervening taxable years have been excluded from gross income under section 127(c)(3), section 22(b)(12), or otherwise. The unused excess profits credit carry-over or carry-back shall then be recomputed to conform to the redetermination of the net operating loss deduction for the taxable year from which the unused credit is carried over or carried back. The difference between the tax previously determined and the tax as recomputed will be the increase in the tax previously determined for the taxable year. In case there is an increase in the excess profits tax under chapter 2E for the taxable year in which an unused excess profits credit was availed of in computing the unused excess profits credit adjustment, and a decrease in the income tax under chapter 1 for such taxable year, the increase in the tax previously determined shall be considered to be an amount equal to the excess of the increase in the excess profits tax over the decrease in the income tax.

(*d*) *Elective method—Time and manner of making election and effect thereof.*—(1) If the taxpayer elects to have the provisions of section 127(c)(3) applicable to any taxable year in which any money or property is recovered in respect of property considered under section 127(a) as destroyed or seized, section 127(c)(3) will be applicable by virtue of that election to all taxable years of the taxpayer beginning after December 31, 1941. Thus, the taxpayer need not make an election with respect to each separate taxable year in which he had a recovery. An election for any taxable year in which the taxpayer had a recovery in respect of a prior war loss is sufficient to make the provisions of section 127(c)(3) applicable not only to war loss recoveries received by the taxpayer in any past taxable year beginning after December 31, 1941, but to any recoveries which may be received by the taxpayer in any future taxable year. Such election once made shall be irrevocable.

(2) The election of the taxpayer to have the provisions of section 127(c)(3) applicable to any taxable year in which any money or property is recovered in respect of property considered under section 127(a) as destroyed or seized must be made not later than December 31, 1952, unless the taxpayer recovers money or property (in respect of a prior war loss) during a taxable year ending after the date of the enactment of the Revenue Act of 1951 (October 20, 1951). If the taxpayer has a recovery during any taxable year ending after the date of the enactment of the Revenue Act of 1951, unless such taxable year is a taxable year ending on or before March 31, 1953, such election must be made by the taxpayer not later than the expiration of 6 months from the last day prescribed by law for the filing of his income tax return for such taxable year. However, if the taxpayer recovers any money or property (in respect of a prior war loss) during a taxable year ending after the date of the enactment of the Revenue Act of 1951 and on or before March 31, 1953, such election must be made not later than December 31, 1953. In all cases the election shall be made by a written statement that the taxpayer elects to have the provisions of section 127(c)(3) apply to any taxable year in which any money or property is recovered in respect of property considered under section 127(a) as destroyed or seized, which statement shall be made in (or attached to)—

(i) the return or amended return filed for such taxable year;

(ii) a claim for refund or credit filed for such taxable year for an overpayment resulting from the application of such provisions;

(iii) a timely petition or amended petition to The Tax Court of the United States for a redetermination of any deficiency for such taxable year;

(iv) a letter addressed to the director of internal revenue for the district in which the return for such taxable year was required to be filed;

If the written statement of election is made in a letter, it shall be signed by the taxpayer making the election if an individual or, if the taxpayer is not an individual, the letter must be executed in the same manner as required in the case of the income tax return of such taxpayer. The date of the making of the election shall be the date the return, amended return, claim for refund or credit, petition or amended petition, or letter is filed in the office of the director of internal revenue. In case the election is made in a return filed before the last day prescribed by law for the filing thereof (including any extension of time for such filing), such election shall not be considered made until such last day. In case the election is made in a letter addressed to the director of internal revenue, such election will be considered as timely filed if it is placed in the mail on or before midnight of the last day prescribed by this paragraph for the making of the election, as shown by the postmark on the envelope containing the letter or as shown by other available evidence of the mailing date.

(3) If the provisions of section 127(c)(3) are applicable to any taxable year pursuant to an election made by the taxpayer in accordance with the provisions of subparagraph (1), the period of limitations provided in sections 275 and 276 of the Code on the making of assessments and the beginning of distraint or a proceeding in court for collection with respect to (i) the amount to be added to the tax for such taxable year under the provisions of section 127(c)(3) and (ii) any deficiency for such taxable year or for any other taxable year to the extent attributable to the basis of the recovered property being determined under the provisions of section 127(d)(2), shall not expire prior to the expiration of two years following the date of the making of such election. Such amount or such deficiency may be assessed at any time prior to the expiration of such period, notwithstanding any law or rule of law which would otherwise prevent such assessment and collection. No interest shall be assessed or collected with respect to any such amount or any such deficiency for any period prior to the expiration of 6 months following the date of the making of the election by the taxpayer.

(4) If the provisions of section 127(c)(3) are applicable to any taxable year pursuant to an election made by the taxpayer in accordance with the provisions of subparagraph (1), and refund or credit of any overpayment resulting from the application of such provisions to such taxable year is prevented on the date of the making of such election, or within one year from such date, by the operation of any law or rule of law (other than section 3761 relating to compromises), refund or credit of such overpayment may nevertheless be made or allowed, provided claim therefor is filed within one year from such date. Thus, the amount of such overpayment which may be refunded or credited is not subject to the limitations contained in section 322 (b) or (d). No interest shall be paid on any overpayment resulting from the application of the provisions of section 127(c)(3) to any taxable year ending before the date of the making of the election by the taxpayer.

PAR. 3. There is inserted immediately preceding section 29.127(d)-1 [26 CFR 29.127(d)-1] the following:

SEC. 341. WAR LOSSES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) BASIS OF RECOVERED PROPERTY.—Section 127(d) (relating to basis of recovered property) is hereby amended to read as follows:

"(d) BASIS OF RECOVERED PROPERTY.—

"(1) IN GENERAL.—The unadjusted basis of property recovered in respect of property considered as destroyed or seized under subsection (a) shall be determined under this subsection. Such basis shall be an amount equal to the fair market value of such property, determined as of the date of the recovery, reduced by an amount equal to the excess of the aggregate of such fair market value and the amounts of previous recoveries of money or property

in respect of property considered under subsection (a) as destroyed or seized over the aggregate of the allowable deductions in prior taxable years on account of the destruction or seizure of property described in subsection (a), and increased by that portion of the amount of the recovery which under subsection (c) is treated as a recognized gain from the involuntary conversion of property. Upon application of the taxpayer, the aggregate of the bases (determined under the preceding sentence) of any properties recovered in respect of properties considered under subsection (a) as destroyed or seized may be allocated among the properties so recovered in such manner as the Secretary may determine under regulations prescribed by him, and the amounts so allocated to any such property so recovered shall be the unadjusted basis of such property in lieu of the unadjusted basis of such property determined under the preceding sentence.

"(2) PROPERTY RECOVERED IN TAXABLE YEAR TO WHICH SUBSECTION (c)(3) IS APPLICABLE.—In the case of a taxpayer who has made an election under the provisions of subsection (c)(5), the basis of property recovered shall be an amount equal to the value at which such property is included in the amount of the recovery under subsection (c)(3)(A) (determined without regard to the last sentence thereof), reduced by such part of the gain under subsection (c)(3)(C) which is not recognized as provided in section 112(f)."

* * * * * *

(d) EFFECTIVE DATES.—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1941.

PAR. 4. Section 29.127(d)-1 [26 CFR 29.127(d)-1] is amended as follows:

(A) By inserting immediately preceding the first sentence thereof the following: "(*a*) *General rule.*"

(B) By striking "section 127(d)" in each place where such term appears therein and inserting in lieu thereof in each place the following: "section 127(d)(1)".

(C) By striking "section 29.127(c)-1" in each place where such term appears therein and inserting in lieu thereof the following: "section 29.127(c)-1(*b*)".

(D) By adding at the end thereof the following:

(*b*) *Property recovered in taxable year to which section 127(c)(3) is applicable.*—If, pursuant to an election made by the taxpayer under section 127(c)(5) and section 29.127(c)-1(*d*) of these regulations, the provisions of section 127(c)(3) are applicable to any taxable year in which the taxpayer recovered property in respect of a war loss under section 127, the unadjusted basis of such property shall be the fair market value of such property determined as of the date of the recovery, reduced by the amount of nonrecognized gain attributable to such recovery under the provisions of section 29.127(c)-1(*c*). However, if the property recovered is the same property or interest considered under section 127(a) as destroyed or seized, and if the taxpayer under section 127(c)(3)(A) includes such property or interest in the amount of the recovery at its adjusted basis (for determing loss) in his hands on the date such property or interest was considered under section 127(a) as destroyed or seized, the unadjusted basis of such property shall be such adjusted basis, reduced by the amount of nonrecognized gain attributable to such recovery under the provisions of section 29.127(c)-1(*c*). The fair market value of any property recovered, or the adjusted basis (for determining loss) of such property or interest if the same property or interest treated as a war loss under section 127 is recovered, shall not be reduced in determining the unadjusted basis of such property or interest by the amount of the obligations or liabilities with respect to the property treated as a war loss under section 127 in respect of which the recovery was received, if the taxpayer for any previous taxable year chose under section 127(b)(2) to treat such obligations or liabilities as discharged or satisfied out of such property but such obligations or liabilities were not so discharged or satisfied prior to the date of the recovery.

PAR. 5. Section 29.127(f)-1, as amended by Treasury Decision 5454, approved May 10, 1945 [26 CFR 29.127(f)-1], is further amended as follows:

(A) By inserting immediately after the term "chapter 1" in each place where such term appears therein the following: "or chapter 2".

(B) By inserting immediately after the words "or of any tax imposed in lieu of such taxes" in the first sentence of the first paragraph thereof the following: "or of any tax imposed by chapter 2 of the Internal Revenue Code".

PAR. 6. There is inserted immediately preceding section 29.131-1 [26 CFR 29.131-1] the following:

SEC. 341. WAR LOSSES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(c) CREDIT FOR FOREIGN TAXES.—Section 131(a) (relating to allowance of credit for taxes of foreign countries and possessions of the United States) is hereby amended by inserting after "section 102" the following: "and except the additional tax imposed for the taxable year under the provisions of section 127(c)(3)".

(d) EFFECTIVE DATES.—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1941.

PAR. 7. Section 29.131-1, as amended by Treasury Decision 5893 [C. B. 1952-1, 126], approved April 4, 1952 [26 CFR 29.131-1], is further amended by striking the fifth undesignated paragraph thereof and inserting in lieu thereof the following:

For taxable years beginning before January 1, 1943, no credit for taxes shall be allowed against the tax imposed under section 102, relating to surtax on corporations improperly accumulating surplus, and for taxable years beginning after December 31, 1942, no credit for taxes shall be allowed against the tax imposed under section 102, relating to surtax on corporations improperly accumulating surplus, against the additional tax imposed under the provisions of section 127(c)(3), relating to war loss recoveries, or against the victory tax imposed under section 450. No credit for taxes shall be allowed against the tax on self-employment income imposed by section 480.

PAR. 8. Section 29.275-1, as amended by Treasury Decision 5942 [C. B. 1952-2, 122], approved October 24, 1952 [26 CFR 29.275-1], is further amended by adding at the end thereof the following:

For the period of limitation for assessing amounts determined under section 127(c)(3) (relating to war loss recoveries) or any deficiency attributable to the basis of recovered property being determined under section 127(d)(2), see section 127(c)(5) and the regulations thereunder.

PAR. 9. Section 29.322-7 as amended by Treasury Decision 5942, approved October 24, 1952 [26 CFR 29.322-7], is further amended as follows:

(A) By adding at the end of (*a*) thereof the following:

For special provisions in the case of an overpayment resulting from the application of section 127(c)(3) (relating to war loss recoveries), see section 127(c)(5) and the regulations thereunder.

(B) By adding at the end of (*d*) thereof the following:

For special provisions in the case of an overpayment resulting from the application of Section 127(c)(3) (relating to war loss recoveries), see section 127(c)(5) and the regulations thereunder.

(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) and in section 127(c) of the Internal Revenue Code (65 Stat. 511; 26 U. S. C. 127(c)).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 29, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 30, 1952, 11:32 a. m.)

SUPPLEMENT C.—CREDITS AGAINST TAX

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

SECTION 29.131-1: Analysis of credit for taxes. T. D. 5975
(Also Sections 29.131-4, 29.131-8, 29.131-10.)

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 section 302 of the Excess Profits Tax Act of 1950 and section 341 (c) and (d) of the Revenue Act of 1951.

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

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

On November 25, 1952, there was published in the Federal Register (17 F. R. 10705) a notice of proposed rule making to conform Regulations 111 [26 CFR, part 29] to section 302 of the Excess Profits Tax Act of 1950, relating to the foreign tax credit, approved January 3, 1951. No objection to the rules proposed having been received, the amendments set forth below, including a supplemental amendment (to conform section 29.131-8 of Regulations 111 to section 341 (c) and (d) of the Revenue Act of 1951) which was not published with the above notice, are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.131-1 [26 CFR 29.131-1] the following:

SEC. 302. FOREIGN TAX CREDIT [EXCESS PROFITS TAX ACT OF 1950, APPROVED JANUARY 3, 1951].

(a) That portion of section 131(a) of the Internal Revenue Code which precedes paragraph (1) thereof is hereby amended by inserting after "subchapter E" the following: "and except, with respect to the tax imposed under subchapter D, only to the extent provided in subsection (j)".

(b) Section 131 of such Code is hereby amended by adding at the end thereof the following new subsection:

"(j) TAX IMPOSED BY SUBCHAPTER D.—This section shall be applicable for purposes of the tax imposed by subchapter D, but the tax paid or accrued to any country shall be deemed to be the amount of such tax reduced by the amount of the credit allowed under this section with respect to such tax against the tax imposed by this chapter without regard to subchapter D. The amount of the credit taken under this subsection shall be subject to each of the following conditions:

"(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources within such country bears to its entire excess profits net income for the same taxable year; and

"(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources without the United States bears to its entire excess profits net income for the same taxable year."

PAR. 2. Section 29.131–1, as amended by Treasury Decision 5968 [page 206, this Bulletin], approved December 30, 1952 [26 CFR 29.131–1], is further amended by adding at the end of the fifth paragraph thereof the following sentence:

For taxable years ending after June 30, 1950, credit for taxes shall be allowed against the excess profits tax imposed by subchapter D of chapter 1, but only to the extent provided in section 131(j) and section 29.131–10.

PAR. 3. Section 29.131–4, as amended by Treasury Decision 5812 [C. B. 1950–2, 55], approved October 6, 1950 [26 CFR 29.131–4], is further amended by deleting "income" from the second sentence of (*a*) thereof, so that such sentence will read as follows:

The Commissioner will thereupon redetermine the amount of the tax of such taxpayer for the year or years for which such incorrect credit was granted.

PAR. 4. Section 29.131–8, as amended by Treasury Decision 5855 [C. B. 1951–2, 141], approved September 13, 1951 [26 CFR 29.131–8], is further amended as follows:

(A) By inserting "for purpose of the income tax" in that part of the first sentence of the first paragraph thereof which reads "is the tentative credit in respect of the taxes paid or accrued to such country or possession.", immediately after "tentative credit", so that such part will read as follows:

is the tentative credit for purpose of the income tax in respect of the taxes paid or accrued to such country or possession.

(B) By striking out that part of the first paragraph thereof which follows the words "paid or accrued to foreign countries or possessions of the United States." and inserting in lieu thereof the following:

In computing the tax against which the credit is taken there must, for taxable years beginning before January 1, 1943, be excluded the tax, if any, imposed by section 102; and, for any of such taxable years as begin after December 31, 1941, there must also be excluded the additional tax, if any, imposed for the taxable year under the provisions of section 127(c)(3). For taxable years beginning after December 31, 1942, there must be excluded, in computing the tax against which the credit is taken, the tax imposed by section 102, the additional tax imposed for the taxable year under the provisions of section 127(c)(3), the tax imposed by section 450 (prior to its repeal by section 6(a) of the Individual Income Tax Act of 1944), and also for taxable years beginning after December 31, 1950, the tax imposed by section 480; and, for taxable years ending after June 30, 1950, there must also be excluded, except to the extent provided in section 131(j) and section 29.131–10, the excess profits tax imposed by subchapter D of chapter 1.

(C) By adding at the end of the seventh paragraph thereof, which paragraph precedes example (4) and begins with the words "As to the allowance of credit", the following new sentence:

As to the allowance of credit for such taxes against the excess profits tax imposed by subchapter D of chapter 1, see section 131(j) and section 29.131–10.

PAR. 5. There is inserted immediately after section 29.131–9 [26 CFR 29.131–9] the following new section:

SEC. 29.131–10. CREDIT AGAINST EXCESS PROFITS TAX IMPOSED BY SUBCHAPTER D.—For taxable years ending after June 30, 1950, a domestic corporation is allowed a credit against the excess profits tax imposed by subchapter D of chapter 1 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States. To the extent pertinent, the provisions of section 131 and sections 29.131–1 through 29.131–9 are applicable for the purpose of claiming credit for taxes under this section, except that for such purpose the amount of income and profits taxes paid or accrued during the taxable year to any foreign country or possession shall be deemed to be the amount of such taxes actually paid or accrued reduced by the amount of such taxes allowed as a credit under section 131 against the tax imposed by chapter 1 without regard to the excess profits tax imposed by subchapter D. See section 29.131–8 as to the amount of such credit allowable and as to the computation of the tax against which such credit may be taken.

The amount of the income and profits taxes paid or accrued (including the taxes which, in accordance with the provisions of section 131(f), are deemed to have been paid) during the taxable year to each foreign country or possession of the United States, limited under section 131(j)(1) so as not to exceed that proportion of the excess profits tax which the taxpayer's excess profits net income from sources within such country or possession bears to its entire excess profits net income for the same taxable year, is the tentative credit for the purpose of this section in respect of the taxes paid or accrued to such country or possession. The sum of these tentative credits, limited under section 131(j)(2) so as not to exceed that proportion of the excess profits tax which the taxpayer's excess profits net income from sources without the United States bears to its entire excess profits net income for the same taxable year, is the amount allowable as a credit against the excess profits tax for income or profits taxes paid or accrued to foreign countries or possessions of the United States. For the determination of the excess profits net income, see sections 40.433(a)–1 and 40.433(a)–2 of Regulations 130. For the determination of the source of such net income, see section 119 and the regulations thereunder.

The application of this section may be illustrated by the following examples involving the calendar year 1951.

Example (1). In this example it is assumed that the taxpayer has no income or loss from any foreign country other than Country X. Accordingly, the limitation under section 131(j)(2) will not change the credit determined after applying section 131(j)(1).

(A) Normal tax net income from all sources	$100,000
(B) Total normal tax and surtax (before section 131 credit)	45,250
(C) Normal tax net income from foreign Country X	90,000
(D) Foreign tax paid on Country X income	49,500
(E) Limitation on foreign tax under section 131(b) (1) and (2) to determine section 131(a) credit allowable against normal tax and surtax: $\frac{\$90,000}{\$100,000} \times \$45,250 =$	40,725
(F) Foreign tax credit allowable against normal tax and surtax (foreign tax, but not in excess of above limitation of $40,725)	40,725
(G) Excess profits net income from all sources	80,000
(H) Excess profits net income from foreign Country X	75,000
(I) Excess profits credit	60,000
(J) Excess profits tax (before section 131 credit)	6,000
(K) Foreign tax paid on Country X income for the purpose of section 131(j): $49,500—$40,725=	8,775

(L) Limitation on foreign tax under section 131(j) (1) and (2) to determine section 131(j) credit allowable against excess profits tax:

$\frac{\$75,000}{\$80,000} \times \$6,000 =$ $5,625

(M) Foreign tax credit allowable against excess profits tax (foreign tax for purpose of section 131(j), but not in excess of above limitation of $5,625) 5,625

(N) Total income and excess profits tax (before section 131 credit):

$45,250 plus $6,000= 51,250

(O) Total credit under section 131:

$40,725 plus $5,625= 46,350

(P) Total income and excess profits tax after credit under section 131:

$51,250—$46,350= 4,900

Example (2). The facts are assumed to be the same as those under example (1), except that there is a net loss of $10,000 allocable to foreign Country Y, which net loss was taken into account in determining the normal tax net income from all sources of $100,000 (item (A), example (1)) and the excess profits net income from all sources of $80,000 (item (G), example (1)). The total income and excess profits tax after credit under section 131 is computed as follows:

(A) Tentative foreign tax credit under section 131(b)(1) allowable against normal tax and surtax (foreign tax paid on Country X income, but not in excess of limitation under section 131(b)(1)):

$\frac{\$90,000}{\$100,000} \times \$45,250 =$ $40,725

(B) Limitation on foreign tax under section 131(b)(2) to determine section 131(a) credit allowable against normal tax and surtax:

$\frac{\$80,000}{\$100,000} \times \$45,250 =$ 36,200

(C) Foreign tax credit allowable against normal tax and surtax (tentative credit under section 131(b)(1), but not in excess of $36,200, limitation under section 131(b)(2)) 36,200

(D) Foreign tax paid for the purpose of section 131(j):

$49,500—$36,200= 13,300

(E) Tentative foreign tax credit under section 131(j)(1) allowable against excess profits tax (foreign tax for purpose of section 131(j), but not in excess of limitation under section 131(j)(1)):

$\frac{\$75,000}{\$80,000} \times \$6,000 =$ 5,625

(F) Limitation on foreign tax under section 131(j)(2) to determine section 131(j) credit allowable against excess profits tax:

$\frac{\$65,000}{\$80,000} \times \$6,000 =$ 4,875

(G) Foreign tax credit allowable against excess profits tax (tentative credit under section 131(j)(1), but not in excess of $4,875, limitation under section 131(j)(2)) 4,875

(H) Total income and excess profits tax (before section 131 credit):

$45,250 plus $6,000= 51,250

(I) Total credit under section 131:

$36,200 plus $4,875= 41,075

(J) Total income and excess profits tax after credit under section 131:

$51,250—$41,075= 10,175

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

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 28, 1953.

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

(Filed with the Division of the Federal Register February 2, 1953, 8:52 a. m.)

SECTION 29.131–1: Analysis of credit for taxes. Rev. Rul. 7

INTERNAL REVENUE CODE

The tax imposed under section 22(*b*) of the National Internal Revenue Code of the Republic of the Philippines, upon the net income of nonresident alien individuals not engaged in trade or business within the Philippines or not having an office or place of business therein, falls within the United States concept of an income tax and is allowable as a credit against United States income tax to the extent provided by section 131 of the Internal Revenue Code.

Advice is requested whether the tax imposed under section 22(*b*) of the National Internal Revenue Code of the Republic of the Philippines, upon the net income of nonresident alien individuals not engaged in trade or business within the Philippines or not having an office or place of business therein, qualifies as an income tax which may be allowed as a credit against United States income tax.

Section 22(*b*) of the National Internal Revenue Code of the Republic of the Philippines reads as follows:

(*b*) *Nonresident alien not engaged in trade or business within the Philippines or not having an office or place of business therein.*—There shall be levied, assessed, collected, and paid for each taxable year upon the entire net income received from all sources within the Philippines by every nonresident alien individual not engaged in trade or business within the Philippines or not having an office or place of business therein a tax equal to sixteen *per centum* thereof: *Provided,* That if the total net income of such nonresident alien individual from all sources within the Philippines exceeds fourteen thousand seven hundred and fifty pesos, the rates established in section twenty-one shall apply.

Section 21 of the Philippine National Internal Revenue Code prescribes the rates of tax applicable to net incomes of citizens or residents of the Republic of the Philippines. The provisions of the Philippine Code defining gross income and allowing the deduction of certain expenses in computing net income are analogous to the corresponding provisions of the United States Internal Revenue Code.

Section 131 of the United States 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] * * * shall be credited with:

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

In construing the provisions of the Federal internal revenue laws relative to credits for foreign income taxes, the Bureau has held that

in order for a tax to be allowable as a credit under section 131, the tax imposed by the foreign country must be a tax on "income" within the meaning of that term as used and understood for Federal income tax purposes. (See G. C. M. 18182, C. B. 1937-1, 149.)

It is held that the tax imposed under section 22(*b*) of the National Internal Revenue Code of the Republic of the Philippines, upon the net income of nonresident alien individuals not engaged in trade or business within the Philippines or not having an office or place of business therein, falls within the United States concept of an income tax and is allowable as a credit against United States income tax to the extent provided by section 131 of the Internal Revenue Code.

SECTION 29.131-1: Analysis of credit for taxes. Rev. Rul. 31

INTERNAL REVENUE CODE

The taxes imposed by chapter IV of Cuban Law No. 7, approved April 5, 1943, as amended by article 25, chapter IV of Cuban Law No. 2, approved May 22, 1951, do not constitute income taxes or taxes in lieu of income taxes, for which a credit is allowable against United States income tax under section 131 of the Internal Revenue Code.

Advice is requested whether the taxes imposed by chapter IV of Cuban Law No. 7, approved April 5, 1943, as amended by article 25, chapter IV of Cuban Law No. 2, approved May 22, 1951, fall within the United States concept of an income tax for which a credit against United States income tax is allowable under section 131 of the Internal Revenue Code.

The pertinent provisions of chapter IV of Cuban Law No. 7, as amended, read as follows:

ARTICLE 14. A tax of four pesos ($4.00) is hereby levied on each one thousand pesos or fraction thereof, on the capital, estimated at its real worth, with which every partnership or company of any sort or description, whether civil or mercantile, national or foreign, may be operating in Cuba.

ARTICLE 15. Without prejudice to the tax on profits, referred to in the Law of January 29, 1931, and its modifications, which will continue to be paid as heretofore, a tax is established of fifteen per centum (15%) additional on any profits in excess of ten per centum of the capital taxed in the manner specified in the preceding Article.

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] * * * shall be credited with:

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

* * * * * * *

(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 or by any possession of the United States.

In order for a tax paid to a foreign country to be allowable as a credit against United States income tax under section 131 of the Code

it must be shown that the tax imposed by the foreign country is an income tax as that term is used and understood for United States income tax purposes, or is a tax in lieu of an income tax. (See G. C. M. 18182 (C. B. 1937-1, 149) and I. T. 4065 (C. B. 1951-2, 74).)

The Cuban tax referred to above consists of two levies: (1) a tax of 4 pesos on each one thousand pesos or fraction thereof on the capital with which a taxpayer may be operating in Cuba (article 14 as amended, *supra*), and (2) a tax of 15 per centum on profits in excess of 10 per centum of the capital declared for the purposes of article 14 (article 15, *supra*). The first levy is comparable in nature to the Capital Stock Tax imposed by section 105 of the United States Revenue Act of 1935 (49 Stat. 1014, C. B. XIV-2, 556, 559 (1935)) and the second levy is comparable in nature to the Excess Profits Tax imposed by section 106 of the same act.

In determining whether the tax imposed by section 106 of the Revenue Act of 1935, *supra*, qualified as an income tax the United States Circuit Court of Appeals, in *Superheater Co.* v. *Commissioner* (125 Fed. (2d) 514), stated in part as follows:

> * * * Congress did not have in mind merely additional income taxes imposed in special rates applicable to specific income but * * * its aim was much broader. These excess profits taxes are closely related in purpose to making workable the capital stock tax provisions of section 105 of the Revenue Act of 1935. * * * They are laid in section 106 * * * "upon the net income of every corporation for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 105." Under the latter section an excise tax * * * was imposed on each one thousand dollars of the adjusted declared value of the capital stock of every domestic corporation carrying on business for any part of a taxable year. This declared value was whatever the corporation chose to make it. And so to make it worth while for the corporation to put the declared value in proper relation to the actual value the excess profits tax here involved was laid in section 106 on the excess of the corporation's net income over a stated percentage of the adjusted declared value of its capital stock. * * * It is more of a check upon the exercise of * * * discretion than anything else. * * * And it is interesting to note in this connection that when the excess profits tax in the Second Revenue Act of 1940 was enacted, c. 757, 54 Stat. 974, the excess profits tax here involved was * * * referred to in section 506 of the 1940 * * * Act as the "declared value excess-profits tax".
>
> While it cannot be gainsaid that this tax is laid on specific income and in that sense is related to the ordinary income tax which is, indeed, computed under a formula which has as one factor the deduction of any such excess profits tax, its closer kinship is to the capital stock tax which obviously is not an income tax at all.

The tax imposed by article 14, *supra*, is clearly a levy on the capital with which an organization is operating in Cuba. The tax imposed by article 15, *supra*, is, by United States standards, a declared value excess profits tax. Accordingly, it is held that such taxes do not constitute income taxes or taxes in lieu of income taxes for which a credit is allowable against United States income tax under section 131 of the Internal Revenue Code.

SECTION 29.131-1: Analysis of credit for taxes.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5968, page 206.)

SECTION 29.131-1: Analysis of credit for taxes.

INTERNAL REVENUE CODE

Guamanian income tax with respect to compensation received by United States citizens for services performed on Guam. (See Rev. Rul. 8, page 300.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX

SECTION 141.—CONSOLIDATED RETURNS

SECTION 24.11, REGULATIONS 129: Consolidated returns for subsequent years. Rev. Rul. 17

INTERNAL REVENUE CODE

Filing of consolidated Federal income tax returns for the calendar year 1952 and for fiscal years ending in 1953 by affiliated corporations.

Section 141(a) of the Internal Revenue Code provides in part that the making of a consolidated return shall be upon the condition that all corporations which were members of the affiliated group consent to all the consolidated return regulations prescribed under section 141(b) prior to the last day prescribed by law for the filing of such returns.

Section 24.11(a) of Regulations 129 provides that if a consolidated return is made for any taxable year, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence unless certain conditions are met. One such condition set forth in clause (2) is that, subsequent to the exercise of the election to make consolidated returns, chapter 1 of the Internal Revenue Code to the extent applicable to corporations, or the consolidated return regulations which have been consented to, have been so amended as to make less advantageous to affiliated groups as a class the continued filing of consolidated returns, regardless of the effective date of such amendment.

Neither the provisions of the Internal Revenue Code nor the consolidated return regulations (as amended by Treasury Decision 5915, C. B. 1952-2, 148) which were applicable to the filing of consolidated returns for the calendar year 1951 and fiscal years ending in 1952 have been further amended so as to make less advantageous to affiliated groups as a class the continued filing of consolidated returns for subsequent years. Accordingly, an affiliated group of corporations which filed a consolidated Federal income tax return for the calendar year 1951 or for a fiscal year ending in 1952 must file a consolidated Federal income tax return for the calendar year 1952 or for the fiscal year ending in 1953, whichever is applicable, unless a change of the type which will give rise to a new election is made in the Internal Revenue Code, or the consolidated return regulations, prior to the last day prescribed by law for the filing of such return, or unless a new election is available to the affiliated group by reason of the provisions of section 24.11(a)(1) or section 24.11(a)(3) of Regulations 129.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE

SECTION 29.143-1: Withholding tax at source. T. D. 5956
(Also Section 144, Section 29.144-1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 7.—TAXATION PURSUANT TO TREATIES.—SUBPART—NORWAY, REGULATIONS EFFECTIVE JANUARY 1, 1952

Release or refund of excess tax withheld, and exemption from withholding under sections 143 and 144 of the Internal Revenue Code in the case of residents of Norway and of Norwegian corporations, as affected by the reciprocal income tax convention between the United States and the Kingdom of Norway proclaimed by the President of the United States on December 13, 1951.

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

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

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SECTION 7.100. INTRODUCTORY.—The income tax convention between the United States and the Kingdom of Norway, signed June 13, 1949, proclaimed by the President of the United States on December 13, 1951, and effective for taxable years beginning on or after January 1, 1951, 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 Norway: The national and the communal income taxes, including the old age pension tax, the war pension tax, the tax on bank deposits, and the seamen's tax.

(2) The present convention shall also apply to any other income 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 "Norway" means the Kingdom of Norway; the provisions of the convention shall not, however, extend to Svalbard and Jan Mayen, nor do they apply to the Norwegian dependencies outside Europe.

(c) The term "permanent establishment" means a branch office, factory, workshop, 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 "Norwegian 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 by a resident of the United States 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 or under the law of the United States or of any State or Territory of the United States.

(g) The term "Norwegian enterprise" means an enterprise carried on in Norway by a resident of Norway or by a Norwegian corporation or other entity; the term "Norwegian corporation or other entity" means a partnership, corporation, or other entity created or organized in Norway or under Norwegian 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 Norway, the Ministry of Finance and Customs.

(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.

* * * * * * *

ARTICLE VI

Interest on bonds, securities, notes, debentures, or on 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 taxation in such former state.

ARTICLE VII

Royalties and other amounts derived, as consideration for the right to use copyrights, artistic and scientific works, patents, designs, secret processes and formulas, trade-marks and other like property (including rentals and like payments in respect of motion picture films), 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: *Provided*, That each of the contracting states reserves the right according to the principles of Article IV to deny a deduction to the payor thereof for such royalty or any portion thereof as is not considered by the revenue authorities of such state to be reasonable consideration for the right to use the property referred to in this Article.

ARTICLE VIII

(1) Income from real property (not including interest derived from mortgages and bonds secured by real property) and royalties in respect of the operation of mines, quarries, or other natural resources, shall be taxable only in the

contracting state in which such property, mines, quarries, or other natural resources are situated.

(2) A resident or corporation of one of the contracting states deriving any such income from sources within the other contracting state may, for any taxable year, elect to be subject to the tax of such other contracting state, on a net basis, as if such resident or corporation were engaged in trade or business within such other contracting state through a permanent establishment therein during such taxable year.

* * * * * * *

ARTICLE XI

* * * * * * *

(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 "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 XV

With a view to the more effective imposition of the taxes to which the present convention relates, each of the contracting states undertakes, subject to reciprocity, to furnish such information in the matter of taxation, which the authorities of the state concerned have at their disposal or are in a position to obtain under their own law, as may be of use to the authorities of the other state in the assessment of the taxes in question and to lend assistance in the service of documents in connection therewith. Any information so exchanged shall be treated as secret and shall only be disclosed to persons (including a court) concerned with the assessment, determination, and collection of the taxes which are the subject of the present convention, or the determination of appeals in relation thereto. No information shall be exchanged which would disclose a trade, business, industrial, or professional secret. Information and correspondence relating to the subject matter of this Article shall be exchanged between the competent authorities of the contracting states in the ordinary course or on request.

ARTICLE XVI

In accordance with the preceding Article and insofar as may be found to be practicable, the competent authorities of each contracting state shall forward to the competent authorities of the other contracting state as soon as practicable after the close of each calendar year the following information relating to such calendar year:

> The names and addresses of all addressees within such other State deriving from sources within the former State dividends, interest, royalties, pensions, annuities, wages, salaries, rents, or other fixed or determinable annual or periodical income, showing the amount of such income with respect to each addressee.

* * * * * * *

ARTICLE XVIII

The state to which application is made for information or assistance shall comply as soon as possible with the request addressed to it except that such state may refuse to comply with the request for reasons of public policy or if compliance would involve violation of a trade, business, industrial, or professional secret.

* * * * * * *

ARTICLE XX

(1) The provisions of this convention shall not be construed to deny or affect in any manner the right of diplomatic and consular officers to other or additional exemptions now enjoyed or which may hereafter be granted to such officers.

(2) The provisions of the present convention shall not be construed to restrict in any manner any exemption, deduction, credit, or other allowance now or hereafter accorded by the laws of one of the contracting states in the determination of the tax imposed by such state.

(3) Should any difficulty or doubt arise as to the interpretation or application of the present convention, or its relationship to conventions between one of the contracting states and any other state, the competent authorities of the contracting states may settle the question by mutual agreement.

ARTICLE XXI

(1) The competent authorities of the two contracting states may prescribe regulations necessary to carry into effect the present convention within the respective states. With respect to the provisions of this convention relating to exchange of information, service of documents, and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, costs of collection, minimum amounts subject to collection, and related matters.

(2) The competent authorities of the two contracting states may communicate with each other directly for the purpose of giving effect to the provisions of this convention.

ARTICLE XXII

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible. It shall have effect for the taxable years beginning on or after the 1st day of January of the year in which such exchange takes place.

(2) 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 for the taxable years beginning on or after the 1st day of January next following the expiration of the 6-month period.

* * * * * * *

As used in this Treasury Decision, any term defined in the above articles of the convention shall have the meaning so assigned to it; any term not so defined shall, unless the context otherwise requires, have the meaning which such term has under the Internal Revenue Code.

SEC. 7.101. INTEREST.—(*a*) *General.*—Interest on bonds, securities, notes, debentures, or on any other form of indebtedness, including interest on obligations of the United States, obligations of instrumentalities of the United States, and mortgages and bonds secured by real property, derived from sources within the United States and received in taxable years beginning on or after January 1, 1951, by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Norway, or by a Norwegian corporation or other entity, is exempt from United States tax under the provisions of Article VI of the convention if such alien, corporation, or other entity at no time during the taxable year had a permanent establishment in the United States. Such interest is, 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.

(*b*) *Application of exemption from withholding.*—To stop withholding at the source in the case of coupon bond interest the nonresident alien resident in Norway, or the Norwegian corporation or other

entity, shall for each issue of bonds submit Form 1001–NO 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, 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 (1) is a resident of Norway, or is a Norwegian corporation or other entity, and (2) has no permanent establishment in the United States.

The exemption from United States tax contemplated by Article VI of the convention, insofar as it concerns coupon bond interest, is 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 from tax be deemed to be the owner of the interest only if he is, at the time the coupon is presented for payment, the owner of the bond from which the coupon has been detached. If the person presenting the coupon is not the owner of the bond, Form 1001, and not Form 1001–NO, shall be executed.

The original and duplicate ownership certificates, Form 1001–NO, shall be forwarded to the Commissioner of Internal Revenue by the withholding agent with the quarterly return on Form 1012, as provided in existing regulations with respect to Form 1001. See section 29.143–7 of this chapter [Regulations 111]. Form 1001–NO need not be listed on Form 1012.

For general provisions pertaining to the use, without reference to the provisions of the convention, of ownership certificate, Form 1001, by nonresident aliens and nonresident foreign corporations, see section 29.143–4 and section 29.143–6 of this chapter.

To stop withholding at the source in the case of interest, other than interest payable by means of coupons, the nonresident alien resident in Norway, or the Norwegian corporation or other entity, shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of Article VI of the convention. The letter of notification 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. It shall also contain a statement that the owner is (1) neither a citizen nor a resident of the United States but is a resident of Norway or (2) a Norwegian corporation or other entity and that such owner has at no time during the current taxable year had a permanent establishment in the United States. In addition, it shall contain a declaration that it is made under the penalties of perjury, such declaration to consist of a statement similar to the following: "I declare under the penalties of perjury that this letter has been examined by me and to the best of my knowledge and belief is true and correct".

This letter of notification, which shall constitute authorization for the payment of such interest without withholding of United States tax at source, shall be filed with the withholding agent for each successive three-calendar-year period during which such income is paid. For this purpose, the first such period shall commence with the beginning of the calendar year in which such income is first paid on or after January 1, 1952. Each such letter filed with any withholding agent shall be filed not later than 20 days preceding the date of the first payment within each successive period; or, if such first payment first

occurs in the calendar year 1952, not later than 45 days following the date of approval of this Treasury Decision.

If such letter is also to be used as authorization for the release, pursuant to section 7.106(*a*), of excess tax withheld from interest, other than interest payable by means of coupons, it shall also contain a statement that the owner was, at the time when the interest was derived from which the excess tax was withheld, (1) neither a citizen nor a resident of the United States but was a resident of Norway, or (2) a Norwegian corporation or other entity, and that such owner at no time during the taxable year in which the interest was derived had a permanent establishment in the United States.

Once a letter has been filed in respect of any three-calendar-year period, no additional letter need be filed in respect thereto unless the Commissioner of Internal Revenue notifies the withholding agent that an additional letter shall be filed by the taxpayer. If, after filing a letter of notification, the taxpayer ceases to be eligible for the exemption from United States tax provided by the convention in respect to such income, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of the interest as recorded on the books of the payer, the exemption from United States tax will no longer apply unless a letter of notification is duly executed and filed with the withholding agent by the new owner of record of such interest.

Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the Commissioner of Internal Revenue, Uniform Audit Branch, Alien Returns Section, Washington 25, D. C.

SEC. 7.102. DIVIDENDS.—The convention does not change the rate of tax imposed by sections 211(a) and 231(a) of the Internal Revenue Code upon dividends. The withholding of the tax with respect to such income derived from sources within the United States by nonresident aliens who are residents of Norway, or by Norwegian corporations or other entities, is not affected by the convention. See sections 143(b) and 144 of the Internal Revenue Code.

SEC. 7.103. PATENT AND COPYRIGHT ROYALTIES AND FILM RENTALS.—(*a*) *General.*—Royalties and other amounts (including rentals and like payments for the use of, or for the right to use, motion picture films) derived from sources within the United States and received in taxable years beginning on or after January 1, 1951, by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Norway, or by a Norwegian corporation, or other entity, as consideration for the right to use copyrights, artistic and scientific works, patents, designs, secret processes and formulas, trade-marks, and other like property, are exempt from United States tax under the provisions of Article VII of the convention if such alien, corporation, or other entity at no time during the taxable year had a permanent establishment in the United States. Such items of income 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.

(*b*) *Application of exemption from withholding.*—To stop withholding at the source in the case of the items of income described in (*a*) of this section, the nonresident alien resident in Norway, or the

Norwegian corporation or other entity, shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of Article VII of the convention. The provisions of section 7.101(*b*) of these regulations relating to the execution, filing, and effective period of the letter of notification prescribed therein with respect to interest (other than coupon bond interest), including its use for the release of excess tax withheld, are equally applicable with respect to the income falling within the scope of this section.

Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the Commissioner of Internal Revenue, Uniform Audit Branch, Alien Returns Section, Washington 25, D. C.

SEC. 7.104. NATURAL RESOURCE ROYALTIES AND REAL PROPERTY RENTALS.—The convention does not change the rate of tax imposed by sections 211(a) and 231(a) of the Internal Revenue Code 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 Norway, or by Norwegian corporations or other entities, is not affected by the convention. See sections 143(b) and 144 of the Internal Revenue Code and Article VIII of the convention.

SEC. 7.105. PENSIONS AND LIFE ANNUITIES.—(*a*) *General.*—Private pensions and life annuities, as defined in Article XI (3) and (4) of the convention, derived from sources within the United States and paid in taxable years beginning on or after January 1, 1951, to a nonresident alien individual who is a resident of Norway are exempt from United States tax under the provisions of Article XI (2) of the convention. Such items of income are, therefore, not subject to the withholding provisions of the Internal Revenue Code.

(*b*) *Application of exemption from withholding.*—To stop withholding at the source in the case of the items of income described in (*a*) of this section, the nonresident alien individual who is a resident of Norway shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of Article XI of the convention. The letter of notification shall show the name and address of both the payer and the owner of the income and shall contain a statement that the owner, an individual, is neither a citizen nor a resident of the United States but is a resident of Norway. In addition, it shall be signed by the owner and shall contain a written declaration that it is made under the penalties of perjury, such declaration to consist of a statement similar to the following: "I declare under the penalties of perjury that this letter has been examined by me and to the best of my knowledge and belief is true and correct".

If such letter is also to be used as authorization for the release, pursuant to section 7.106(*a*), of excess tax withheld from such items of income, it shall also contain a statement that the owner was, at the time when the income was paid from which the excess tax was withheld, neither a citizen nor a resident of the United States but was an individual resident of Norway.

This letter shall constitute authorization for the payment of such items of income without withholding of United States tax at source

unless the Commissioner of Internal Revenue subsequently notifies the withholding agent that the tax shall be withheld with respect to payments of such items of income made after receipt of such notice. If, after filing a letter of notification, the owner of the income ceases to be eligible for the exemption from United States tax provided by the convention in respect to such income, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of such income as recorded on the books of the payer, the exemption from United States tax will no longer apply unless a letter of notification is duly executed and filed with the withholding agent by the new owner of record of such income.

Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the Commissioner of Internal Revenue, Uniform Audit Branch, Alien Returns Section, Washington 25, D. C.

SEC. 7.106. RELEASE OF EXCESS TAX WITHHELD AT SOURCE.—(*a*) *General.*—In order to bring the convention into force and effect at the earliest practicable date, the exemption from tax otherwise withheld at the source from interest, patent royalties, copyright royalties, film rentals, and the like, and from private pensions and life annuities is hereby made effective beginning January 1, 1952, contingent upon compliance with the provisions of sections 7.101, 7.103, and 7.105.

In the case of every taxpayer whose address at the time of payment was in Norway and who furnishes to the withholding agent the letter of notification prescribed in section 7.101(*b*), section 7.103(*b*), or section 7.105(*b*) as authorization for the release of excess tax withheld, where United States tax at the statutory rate (30 percent as of the date of approval of this Treasury Decision) has been withheld on or after January 1, 1952, from interest (other than coupon bond interest), patent royalties, copyright royalties, film rentals, and the like, and from private pensions and life annuities, there shall be released by the withholding agent and paid over to the person from whom it was withheld an amount equal to the tax so withheld.

In the case of every owner, trustee, or agent whose address at the time of payment was in Norway and who furnishes to the withholding agent Form 1001-NO clearly marked "SUBSTITUTE", where United States tax at the statutory rate (28 percent or 30 percent, as the case may be, as of the date of approval of this Treasury Decision) has been withheld on or after January 1, 1952, 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 so withheld, if such taxpayer also attaches to the original copy only of such form a letter signed by the owner, trustee, or agent and containing the following:

(1) The name and address of the obligor;

(2) The name and address of the owner of the coupon bond interest from which the excess tax was withheld (See section 7.101(*b*) as to who shall be deemed to be the owner.);

(3) The amount of the interest from which the excess tax was withheld, and, if possible, the date of payment;

(4) A statement that the owner was, at the time when the interest was derived from which the excess tax was withheld, (i) neither a citizen nor a resident of the United States but was a resi-

dent of Norway, or (ii) a Norwegian corporation or other entity;

(5) A statement that the owner at no time during the taxable year in which such interest was derived had a permanent establishment in the United States; and

(6) A written declaration that the letter is made under the penalties of perjury, such declaration to consist of a statement similar to the following: "I declare under the penalties of perjury that this letter has been examined by me and to the best of my knowledge and belief is true and correct".

One such substitute form shall be filed in duplicate (but with one copy only of the letter) with respect to each issue of bonds and will serve with respect to that issue to replace all Forms 1001 previously filed by the taxpayer in the calendar year in which the excess tax was withheld and with respect to which such excess is released.

The original (with attachment) and duplicate of substitute Form 1001-NO shall be forwarded to the Commissioner of Internal Revenue by the withholding agent with the quarterly return on Form 1012, as provided in existing regulations with respect to Form 1001. See section 29.143-7 of this chapter [Regulations 111]. Substitute Form 1001-NO need not be listed on Form 1012.

(*b*) *Amounts withheld during 1951.*—For provisions respecting the refund of excess tax withheld during the calendar year 1951, see section 7.109.

SEC. 7.107. INFORMATION TO BE FURNISHED IN ORDINARY COURSE.—In compliance with the provisions of Articles XV, XVI, and XVIII of the convention the Commissioner of Internal Revenue will transmit to the Norwegian Ministry of Finance and Customs, as soon as practicable after the close of the calendar year 1952 and of each subsequent calendar year during which the convention is in effect, the following information relating to such preceding calendar year:

(*a*) The name and address of each person whose address as disclosed on each available Form 1012 and Form 1042 is in Norway deriving from sources within the United States dividends, interest, rent, royalties, salaries, wages, pensions, annuities, and other fixed or determinable annual or periodical income; and the amount of such income as disclosed on such form with respect to each such person.

(*b*) The duplicate copy of each available ownership certificate, Form 1001-NO, filed pursuant to section 7.101(*b*), and substitute Form 1001-NO, filed pursuant to section 7.106(*a*), in connection with coupon bond interest.

To facilitate compliance with the above Articles of the convention, every withholding agent shall report on Form 1042 for the calendar year 1952 and each subsequent calendar year, in addition to the items of income upon which United States tax is required to be withheld at source, those items of income paid to a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Norway, and to a nonresident Norwegian corporation or other entity, upon which United States tax is not required to be withheld at the source. Such return shall show the same information with respect to such items of income upon which tax is not required to be withheld at the source as is shown with respect to items of income

upon which the tax is required to be withheld at the source. For provisions pertaining to the return on Form 1042, see section 29.143-7 of this chapter.

SEC. 7.108. BENEFICIARIES OF A DOMESTIC ESTATE OR TRUST.—A nonresident alien who is a resident of Norway and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption from United States tax provided in Articles VI and VII of the convention with respect to interest, royalties, and other like amounts to the extent such item or items are included in his share of the distributed or distributable income of such estate or trust. In order to be entitled in such instance to the exemption from withholding of United States tax, such beneficiary must otherwise satisfy the requirements of these respective Articles of the convention and must execute and submit to the fiduciary of such estate or trust in the United States the appropriate letter of notification prescribed in section 7.101(*b*) and section 7.103(*b*).

SEC. 7.109. REFUND OF EXCESS TAX WITHHELD DURING 1951.—If United States tax withheld at the source during the calendar year 1951 from interest, royalties, pensions, or life annuities is in excess of the tax imposed by chapter 1 (relating to the income tax) of the Internal Revenue Code, as modified by the convention, a claim by the taxpayer for the refund of any overpayment shall be made under section 322 of the Internal Revenue Code by filing Form 843 together with Form 1040NB, Form 1040NB-a, Form 1040B, or Form 1120NB, whichever is applicable, or with an amended return.

The taxpayer's total gross income from sources within the United States, including every item of capital gain subject to tax under the provisions of section 211(a)(1)(B) or 211(c) of the Internal Revenue Code, shall be disclosed on the return. In the event that securities are held in the name of a person other than the actual or beneficial owner, the name and address of such person shall be furnished with the claim. There shall also be included in such claim for refund a statement:

(*a*) That the taxpayer was, at the time when the item or items of income were derived (or "paid", in the case of private pensions and life annuities) from which the excess tax was withheld, (1) a nonresident alien (including a nonresident alien individual, fiduciary, or partnership) who at such time was a resident of Norway, or (2) a Norwegian corporation or other entity; and

(*b*) That the taxpayer at no time during the taxable year in which such item or items of income were derived had a permanent establishment in the United States.

If, however, the taxpayer is an individual who during the taxable year was paid from sources within the United States income which consists exclusively of pensions or life annuities entitled to the benefit of Article XI of the convention, the statement specified in (*b*) above shall not be required.

Because it is necessary to bring into effect at the earliest practicable date the rules of this Treasury Decision respecting exemptions from tax and the rules respecting release or refund of amounts withheld with respect to exempt income, it is hereby found that it is impracti-

cable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

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

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 9, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 12, 1952, 8:51 a. m.)

SECTION 29.143-1: Withholding tax at source. T. D. 5957
(Also Section 144, Section 29.144-1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 7.—TAXATION PURSUANT TO TREATIES.—SUBPART—NEW ZEALAND, REGULATIONS EFFECTIVE JANUARY 1, 1952

Release or refund 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 New Zealand, of foreign corporations managed and controlled in New Zealand, and of corporations incorporated under the laws of New Zealand, as affected by the reciprocal income tax convention between the United States and New Zealand proclaimed by the President of the United States on December 20, 1951.

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

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

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SECTION 7.600. INTRODUCTORY.—The income tax convention between the United States and New Zealand, signed March 16, 1948, proclaimed by the President of the United States on December 20, 1951, and effective as respects the United States tax for taxable years beginning on or after January 1, 1951, 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 New Zealand:
The income tax and social security charge (hereinafter referred to as New Zealand tax).
(b) In the United States of America:
The Federal income taxes, including surtaxes (hereinafter referred to as United States tax).
(2) The present convention shall also apply to any other taxes of a substantially similar character imposed by either contracting government subsequently to the date of signature of the present convention or by the government of any territory to which the present convention is extended under Article XX.

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) For the purposes of this convention New Zealand includes all islands and territories within the limits thereof for the time being including the Cook Islands.
(c) The terms "territory of one of the contracting governments" and "territory of the other contracting government" mean the United States or New Zealand, as the context requires.
(d) The term "tax" means United States tax or New Zealand tax, as the context requires.
(e) The term "person" includes any body of persons, corporate or not corporate.
(f) The term "company" means any body corporate.
(g) The term "United States corporation" means a corporation, association or other like entity created or organized in, or under the laws of, the United States.
(h) The term "New Zealand corporation" means any kind of juridical person created under the laws of New Zealand.
(i) The terms "corporation of one Contracting Government" and "corporation of the other Contracting Government" mean a United States corporation, or a New Zealand corporation, as the context requires.
(j) The term "resident of New Zealand" means any person (other than a citizen of the United States or a United States corporation) who is resident in New Zealand for the purposes of New Zealand tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in New Zealand if it is incorporated under the laws of, or if its business is managed and controlled in, New Zealand.
(k) The term "resident of the United States" means any individual who is resident in the United States for the purposes of United States tax and not resident in New Zealand for the purposes of New Zealand tax, and any United States corporation and any partnership created or organized in, or under the laws of, the United States, being a corporation or partnership which is not resident in New Zealand for the purposes of New Zealand tax.
(l) The terms "resident of the territory of one of the contracting governments" and "resident of the territory of the other contracting government" mean a resident of the United States or a resident of New Zealand, as the context requires.
(m) The terms "United States enterprise" and "New Zealand enterprise" mean, respectively, an industrial or commercial enterprise or undertaking carried on by a resident of the United States and an industrial or commercial enterprise or undertaking carried on by a resident of New Zealand; and the terms "enterprise of one of the contracting governments" and "enterprise of the other contracting government" mean a United States enterprise or a New Zealand enterprise, as the context requires.
(n) The term "industrial or commercial profits" includes manufacturing, mercantile, mining, financial and farming profits, but does not include income in the form of dividends, interest, rents or royalties, insurance premiums, management charges, or remuneration for personal services.

(o) The term "permanent establishment", when used with respect to an enterprise of one of the contracting governments, means a branch, management, factory, mine, farm, 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 regularly fills orders on its behalf from a stock of goods or merchandise.

An enterprise of one of the contracting governments shall not be deemed to have a permanent establishment in the territory of the other contracting government merely because it carries on business dealings in that territory through a *bona fide* broker or general commission agent acting in the ordinary course of his business as such.

The fact that an enterprise of one of the contracting governments maintains a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute that fixed place of business a permanent establishment of the enterprise.

The fact that a corporation of one contracting government has a subsidiary corporation which is a corporation of the other contracting government or which is engaged in trade or business in the territory of such other contracting government (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation. The maintenance within the territory of one of the contracting governments by an enterprise of the other contracting government of a warehouse for convenience of delivery and not for purposes of display shall not of itself constitute a permanent establishment within that territory even though offers of purchase have been obtained by an agent of the enterprise in that territory and transmitted by him to the enterprise for acceptance.

(2) In the application of the provisions of the present convention by one of the contracting governments any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that contracting government relating to the taxes which are the subject of the present convention.

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ARTICLE VI

(1) The rate of United States tax on dividends derived from sources within the United States by a resident of New Zealand not engaged in trade or business within the United States through a permanent establishment therein shall not exceed 15 percent: *Provided* that such rate of tax shall not exceed 5 percent if such resident is a corporation controlling, 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 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.

(2) In the event that New Zealand should impose at any time tax on dividends derived from sources within New Zealand by a nonresident thereof, including a resident of the United States, not engaged in trade or business within New Zealand through a permanent establishment therein at a rate in excess of 15 percent (or 5 percent in cases corresponding to those within the scope of the proviso in paragraph (1) of this Article), either of the contracting governments may terminate this Article provided that notice of termination is given in writing, and, in such event, this Article shall cease to be effective as respects United States tax for the taxable years beginning on or after the 1st day of January next following the date on which such notice is given.

ARTICLE VII

(1) A resident of the territory of one of the contracting governments deriving from sources within the territory of the other contracting government—

(a) royalties in respect of the operation of mines, quarries or natural resources, or

(b) rentals from real property, or

(c) royalties or other amounts paid as consideration for the use of, or for the privilege of using, any copyright, patent, design, secret process or formula, trade-mark or other like property,

may elect for any taxable year to be subject to the tax of such other contracting government, on a net basis, as if such resident were engaged in trade or business within the territory of such other contracting government through a permanent establishment therein during such taxable year.

(2) The provisions of this Article shall not apply to income falling within the scope of Article VIII of the present convention.

ARTICLE VIII

(1) Rentals in respect of motion picture films derived from sources within the territory of one of the contracting governments by a resident of the territory of the other contracting government who is not engaged in trade or business through a permanent establishment in the former territory shall be exempt from tax by the former government.

(2) The provisions of this Article shall not be construed to affect the New Zealand film hire tax or the income tax imposed by New Zealand on income which is taxable under New Zealand law and which is derived by any person from the business of renting motion picture films.

* * * * * * *

ARTICLE XII

(1) Dividends paid by a New Zealand corporation shall be exempt from United States tax except where the recipient is a citizen of, or resident in, the United States or a United States corporation.

(2) Dividends paid by a United States corporation shall be exempt from New Zealand tax except where the recipient is resident in New Zealand.

* * * * * * *

ARTICLE XVI

(1) The taxation authorities of the contracting governments shall exchange such information (being information available under the respective taxation laws of the contracting governments) as is necessary for carrying out the provisions of the present convention or for the prevention of fraud or for the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than persons (including a court) concerned with the assessment or collection of the taxes which are the subject of the present convention or the determination of appeals in relation thereto. No information shall be exchanged which would disclose any trade secret or trade process.

(2) The term "taxation authorities" means, in the case of New Zealand, the Commissioner of Taxes or his authorized representative; in the case of the United States, the Commissioner of Internal Revenue or his authorized representative.

ARTICLE XVII

Each of the contracting governments may collect such tax imposed by the other contracting government as will ensure that the exemption or reduced rate of tax granted under the present convention by such other government shall not be enjoyed by persons not entitled to such benefits.

ARTICLE XVIII

* * * * * * *

(2) The taxation authorities of the two contracting governments may prescribe regulations to carry into effect the present convention within the respective states and rules with respect to the exchange of information.

(3) The taxation authorities of the two contracting governments may communicate with each other directly for the purpose of giving effect to the provisions of the present convention.

ARTICLE XIX

The provisions of the present convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the contracting governments in the determination of the tax imposed by such government.

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ARTICLE XXI

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) Upon exchange of instruments of ratification, the present convention shall have effect—

(a) as respects United States tax, for the taxable years beginning on or after the 1st day of January in the calendar year in which occurs the exchange of the instruments of ratification,

(b) as respects New Zealand tax, for the year of assessment beginning on the 1st day of April next following the calendar year in which occurs the exchange of the instruments of ratification.

ARTICLE XXII

The present convention shall continue effective for a period of 2 years and indefinitely after that period, but may be terminated by either contracting government at the end of such period or at any time thereafter, provided that at least 6 months' prior notice of termination has been given in writing 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 New Zealand tax, for the years of assessment beginning on or after the 1st day of April in the second year following the expiration of the 6-month period.

* * * * * * *

As used in this Treasury Decision, any term defined in the provisions of the convention shall have the meaning so assigned to it; any term not so defined shall, unless the context otherwise requires, have the meaning which such term has under the Internal Revenue Code.

SEC. 7.601. DIVIDENDS.—(*a*) *General.*—Under Article VI of the convention the rate of tax imposed with respect to dividends 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 reduced to 15 percent in the case of dividends derived from sources within the United States and received in taxable years beginning on or after January 1, 1951, by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is resident in New Zealand for the purposes of New Zealand tax, or by a foreign corporation (whether or not created or organized in or under the laws of New Zealand) whose business is managed and controlled in New Zealand, or by a corporation incorporated under the laws of New Zealand, if such alien or corporation at no time during the taxable year was engaged in trade or business within the United States through a permanent establishment situated therein. As to what constitutes a permanent establishment, see Article II(1)(o) of the convention.

Thus, if a nonresident alien individual who is resident in New Zealand for the purposes of New Zealand tax performs personal services within the United States during the taxable year, but has at no time during such year a permanent establishment within the United States, he is entitled to the reduced rate of tax with respect to dividends derived in that year from United States sources, as provided in Article VI of the convention, even though under the provisions of section

211(b) of the Internal Revenue Code he has engaged in trade or business within the United States during such year by reason of his having rendered personal services therein.

In the case of dividends paid on or after January 1, 1951, by a New Zealand corporation, as defined in Article II(1)(h) of the convention, no withholding of United States tax is required. See Article XII(1) of the convention.

(*b*) *Dividends paid by related corporation.*—Under the proviso of Article VI(1) of the convention, dividends derived from sources within the United States by a foreign corporation whose business is managed and controlled in New Zealand, or by a corporation incorporated under the laws of New Zealand, which controls directly or indirectly at the time the dividend is paid 95 percent or more of the entire voting power in the corporation paying the dividend are, when received in taxable years beginning on or after January 1, 1951, subject to United States tax at the rate of only 5 percent, if (1) not more than 25 percent of the gross income of the 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 received by such paying corporation from its own subsidiary corporations, if any), (2) the relationship between the paying corporation and the foreign corporation, or between the paying corporation and the corporation incorporated under the laws of New Zealand, has not been arranged or maintained primarily with the intention of securing the reduced rate of 5 percent, and (3) the foreign corporation, or the corporation incorporated under the laws of New Zealand, at no time during the taxable year was engaged in trade or business within the United States through a permanent establishment situated therein.

Any corporation (hereinafter referred to as the claimant) which claims or contemplates claiming that dividends paid or to be paid by it are subject only to the 5 percent rate shall file the following information with the Commissioner of Internal Revenue as soon as practicable: (1) the date and place of its organization; (2) the number of outstanding shares of stock of the claimant having voting power and the voting power thereof; (3) the person or persons beneficially owning such stock of the claimant and their relationship to the foreign corporation, or to the corporation incorporated under the laws of New Zealand; (4) the location, where applicable, of the management and control of the foreign corporation; (5) the amount of the gross income by years of the claimant for the 3-year period immediately preceding the taxable year in which the dividend is paid; (6) the amount of interest and dividends by years included in the gross income of the claimant, and the amount of interest and dividends by years received by the claimant from its own subsidiary corporations, if any; and (7) the relationship between the claimant and the foreign corporation, or between the claimant and the corporation incorporated under the laws of New Zealand, deriving the dividend from sources within the United States.

As soon as practicable after such information is filed, the Commissioner will determine whether the dividends concerned fall within the scope of the proviso of Article VI(1) of the convention and may

authorize the release or refund of excess tax withheld with respect to dividends which come within such proviso. For additional requirements respecting the refund of excess tax withheld during 1951, see section 7.610.

In any case in which the Commissioner has notified the claimant that the dividends fall within the scope of the proviso of Article VI(1) of the convention the reduced withholding rate of 5 percent, to the extent withholding of United States tax is required, will apply to any dividends subsequently paid by the claimant and derived by the foreign corporation, or by the corporation incorporated under the laws of New Zealand, unless the stock ownership of the claimant, or the character of its income, or, where applicable, the place of management and control of the foreign corporation deriving the dividend materially changes; or unless the Commissioner determines that the relationship between the two corporations concerned is being maintained primarily with the intention of securing the reduced rate of tax. In such instance, if such change in stock ownership, character of income, or place of management and control occurs, the claimant shall promptly notify the Commissioner of the then existing facts with respect thereto. The continued application of the reduced rate of 5 percent is also dependent upon the continued fulfillment of condition (3) of the first paragraph of (*b*) of this section.

(*c*) *Effect of address in New Zealand on withholding in case of dividends.*—For the purpose of withholding of United States tax in the case of dividends every nonresident alien (including a nonresident alien individual, fiduciary, and partnership) whose address is in New Zealand shall be deemed by United States withholding agents to be a nonresident alien who is (1) resident in New Zealand for the purposes of New Zealand tax and (2) not engaged in trade or business within the United States through a permanent establishment situated therein; and every foreign corporation whose address is in New Zealand shall be deemed by such withholding agents to be either a foreign corporation whose business is managed and controlled in New Zealand or a corporation incorporated under the laws of New Zealand, neither engaged in trade nor business within the United States through a permanent establishment situated therein.

(*d*) *Rate of withholding.*—Withholding at source in the case of dividends derived from sources within the United States and paid on or after January 1, 1952, to nonresident aliens (including a nonresident alien individual, fiduciary, and partnership) and to foreign corporations, whose addresses are in New Zealand, shall be at the rate of 15 percent in every case except that in which, prior to the date of payment of such dividends, the Commissioner of Internal Revenue has (1) pursuant to (*b*) of this section notified the claimant that such dividends fall within the scope of the proviso of Article VI (1) of the convention or (2) notified the withholding agent that the reduced rate of withholding shall not apply.

The preceding provisions respecting the application of the reduced withholding rate in the case of dividends paid to nonresident aliens and foreign corporations with addresses in New Zealand are based upon the assumption that the payee of the dividend is the actual owner of the capital stock from which the dividend is derived and consequently is the person liable to United States tax upon such

dividend. As to action by the recipient who is not the owner of the dividend, see section 7.607.

The rate at which United States tax has been withheld from any dividend paid at any time after the expiration of the 30th day after the date on which this Treasury Decision is published in the Federal Register to any person whose address is in New Zealand at the time the dividend is paid shall be shown either in writing or by appropriate stamp on the check, draft, or other evidence of payment, or on an accompanying statement.

SEC. 7.602. INTEREST.—The convention does not change the rate of tax imposed by sections 211(a) and 231(a) of the Internal Revenue Code upon interest. The withholding of the tax with respect to such income derived from sources within the United States by a nonresident alien who is resident in New Zealand for the purposes of New Zealand tax, by a foreign corporation whose business is managed and controlled in New Zealand, or by a corporation incorporated under the laws of New Zealand, is not affected by the convention. See sections 143 and 144 of the Internal Revenue Code.

SEC. 7.603. PATENT AND COPYRIGHT ROYALTIES, NATURAL RESOURCE ROYALTIES, AND REAL PROPERTY RENTALS.—The convention does not change the rate of tax imposed by sections 211(a) and 231(a) of the Internal Revenue Code upon royalties and like amounts (other than film rentals). The withholding of the tax with respect to such income derived from sources within the United States by a nonresident alien who is resident in New Zealand for the purposes of New Zealand tax, by a foreign corporation whose business is managed and controlled in New Zealand, or by a corporation incorporated under the laws of New Zealand, is not affected by the convention. See sections 143(b) and 144 of the Internal Revenue Code and Article VII of the convention. For special provisions relating to motion picture film rentals, see section 7.604.

SEC. 7.604. FILM RENTALS.—(*a*) *General.*—Rentals derived from sources within the United States as consideration for the use of, or for the right to use, motion picture films and received in taxable years beginning on or after January 1, 1951, by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is resident in New Zealand for the purposes of New Zealand tax, or by a foreign corporation (whether or not created or organized in or under the laws of New Zealand) whose business is managed and controlled in New Zealand, or by a corporation incorporated under the laws of New Zealand, are 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 was engaged in trade or business within the United States through a permanent establishment situated therein. Such rentals are, therefore, not subject to the withholding provisions of the Internal Revenue Code. As to what constitutes a permanent establishment, see Article II (1) (o) of the convention.

(*b*) *Application of exemption from withholding.*—To stop withholding at the source in the case of the rentals described in (*a*) of this section, the nonresident alien resident in New Zealand for the purposes of New Zealand tax, the foreign corporation whose business is managed and controlled in New Zealand, or the corporation incorporated

under the laws of New Zealand shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of Article VIII of the convention. The letter of notification shall be signed by the owner of the rentals, trustee, or agent and shall show the name and address of the obligor and the name and address of the owner of such rentals. It shall also contain a statement that the owner is (1) neither a citizen nor a resident of the United States but is resident in New Zealand for the purposes of New Zealand tax, or (2) a foreign corporation whose business is managed and controlled in New Zealand, or (3) a corporation incorporated under the laws of New Zealand, and that such owner has at no time during the current taxable year been engaged in trade or business within the United States through a permanent establishment situated therein. In addition, it shall contain a declaration that it is made under the penalties of perjury, such declaration to consist of a statement similar to the following: "I declare under the penalties of perjury that this letter has been examined by me and to the best of my knowledge and belief is true and correct".

This letter of notification, which shall constitute authorization for the payment of such rentals without withholding of United States tax at source, shall be filed with the withholding agent for each successive three-calendar-year period during which such income is paid. For this purpose, the first such period shall commence with the beginning of the calendar year in which such income is first paid on or after January 1, 1952. Each such letter filed with any withholding agent shall be filed not later than 20 days preceding the date of the first payment within each successive period, or, if that is not possible because of special circumstances, as soon as possible after such first payment.

If such letter is also to be used as authorization for the release, pursuant to section 7.606(a), of excess tax withheld from such rentals, it shall also contain the following:

(1) The amount of the film rentals from which the excess tax was withheld, and, if possible, the date of payment;

(2) A statement that the owner was, at the time when the rentals were derived from which the excess tax was withheld, (i) neither a citizen nor a resident of the United States but was resident in New Zealand for the purposes of New Zealand tax, or (ii) a foreign corporation whose business at such time was managed and controlled in New Zealand, or (iii) a corporation incorporated under the laws of New Zealand; and

(3) A statement that the owner at no time during the taxable year in which such film rentals were derived was engaged in trade or business within the United States through a permanent establishment situated therein.

Once a letter has been filed in respect of any three-calendar-year period, no additional letter need be filed in respect thereto unless the Commissioner of Internal Revenue notifies the withholding agent that an additional letter shall be filed by the taxpayer. If, after filing a letter of notification, the taxpayer ceases to be eligible for the exemption from United States tax provided by the convention in respect to such rentals, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of the rentals as recorded on the books of the payer, the exemption from with-

holding of United States tax shall no longer apply unless a letter of notification is duly executed and filed with the withholding agent by the new owner of record of such rentals.

Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the Commissioner of Internal Revenue, Uniform Audit Branch, Alien Returns Section, Washington 25, D. C.

SEC. 7.605. PENSIONS AND LIFE ANNUITIES.—The convention does not change the rate of tax imposed by section 211(a) of the Internal Revenue Code upon private pensions and life annuities. The withholding of the tax with respect to such items of income derived from sources within the United States by a nonresident alien individual who is resident in New Zealand for the purposes of New Zealand tax is not affected by the convention. See section 143(b) of the Internal Revenue Code.

SEC. 7.606. RELEASE OF EXCESS TAX WITHHELD AT SOURCE.—(*a*) *General.*—In order to bring the convention into force and effect at the earliest practicable date, the reduced rate of tax of 15 percent to be withheld at the source from dividends and the exemption from tax otherwise withheld at the source from film rentals are hereby made effective beginning January 1, 1952, contingent upon compliance with the provisions of sections 7.601 and 7.604.

In the case of dividends derived from sources within the United States and paid to a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) or to a foreign corporation, whose address at the time of payment was in New Zealand, where United States tax at the statutory rate (30 percent as of the date of approval of this Treasury Decision) has been withheld from such dividends on or after January 1, 1952, there shall be released (except as provided in (*b*) of this section) by the withholding agent and paid over to the person from whom it was withheld an amount which is equal to the amount obtained by subtracting 15 percent of such dividends from the tax so withheld.

In the case of every taxpayer whose address at the time of payment was in New Zealand and who furnishes to the withholding agent the letter of notification prescribed in section 7.604(*b*) as authorization for the release of excess tax withheld, where United States tax at the statutory rate (30 percent as of the date of approval of this Treasury Decision) has been withheld from motion picture film rentals on or after January 1, 1952, there shall be released by the withhholding agent and paid over to the person from whom it was withheld an amount equal to the tax so withheld.

(*b*) *Dividends paid by related corporation.*—In the case of every corporation receiving notification from the Commissioner of Internal Revenue under the provisions of section 7.601(*b*) that dividends paid or to be paid by it fall within the scope of the proviso of Article VI(1) of the convention, where United States tax in excess of the applicable rate of 5 percent has been withheld on or after January 1, 1952, from dividends which come within the scope of such proviso, the withholding agent shall, if so authorized in such notification, release and pay over to the corporation from which it was withheld the excess tax withheld with respect to such dividends.

(*c*) *Amounts withheld during 1951.*—For provisions respecting the refund of excess tax withheld during the calendar year 1951, see section 7.610.

SEC. 7.607. ADDRESSEE NOT ACTUAL OWNER.—If the recipient in New Zealand of any dividend from sources within the United States, with respect to which United States tax at the reduced rate of 15 percent has been withheld at source pursuant to section 7.601(*d*), is a nominee or representative through whom such dividend flows to a person other than one described in section 7.601(*a*) as being entitled to such reduced rate, such recipient in New Zealand shall withhold an additional amount of United States tax equivalent to the United States tax which would have been withheld if the convention had not been in effect (30 percent of such dividend as of the date of approval of this Treasury Decision) minus the 15 percent which has been withheld at the source.

In any case in which a fiduciary or partnership with an address in New Zealand receives, otherwise than as a nominee or representative, a dividend from sources within the United States with respect to which United States tax at the reduced rate of 15 percent has been withheld at source pursuant to section 7.601(*d*), 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(1) of the convention, the fiduciary or partnership shall withhold an additional amount of United States tax with respect to the portion of such dividend included in such beneficiary's share of the distributed or distributable income, or in such partner's distributive share of the income, of such fiduciary or partnership, as the case may be. The amount of the additional tax is to be calculated in the same manner as under the immediately preceding paragraph.

If any amount of United States tax is released pursuant to section 7.606(*a*) by the withholding agent in the United States with respect to a dividend received by such a person with an address in New Zealand, the latter shall also withhold from such released amount any additional amount of United States tax, otherwise required to be withheld by the preceding provisions of this section in respect of such dividend, in the same manner as if at the time of payment of such dividend United States tax at the rate of only 15 percent had been withheld at source therefrom.

The amounts so withheld by such withholding agents in New Zealand shall be deposited, without converting such amounts into United States dollars, with the New Zealand Commissioner of Taxes on or before the 15th day after the close of the quarter of the calendar year in which such withholding in New Zealand occurs. Each withholding agent making such deposit shall render therewith the appropriate New Zealand form as prescribed in regulations issued by the Commissioner of Taxes. The Commissioner of Taxes has arranged that the amounts so deposited will be remitted by draft in United States dollars to the Director of Internal Revenue, Baltimore, Maryland, U. S. A., on or before the end of the calendar month in which the deposits are made, such draft to be accompanied by the New Zealand form rendered by the withholding agents in New Zealand in connection with such deposits.

SEC. 7.608. INFORMATION TO BE FURNISHED IN ORDINARY COURSE.—In compliance with the provisions of Article XVI of the convention the Commissioner of Internal Revenue will transmit to the New Zealand Commissioner of Taxes, as soon as practicable after the close of the calendar year 1952 and of each subsequent calendar year during which the convention is in effect, the following information relating to such preceding calendar year:

The name and address of each person, whose address as disclosed on each available Form 1012 and Form 1042 is in New Zealand, deriving from sources within the United States dividends, interest, rent, royalties, salaries, wages, pensions, annuities, and other fixed or determinable annual or periodical income; and the amount of such income as disclosed on such form with respect to each such person.

To facilitate compliance with the above Article of the convention, every withholding agent shall report on Form 1042 for the calendar year 1952 and each subsequent calendar year, in addition to the items of income upon which United States tax is required to be withheld at source, those items of income paid to a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is resident in New Zealand for the purposes of New Zealand tax, or to a nonresident foreign corporation whose business is managed and controlled in New Zealand, or to a nonresident corporation incorporated under the laws of New Zealand, upon which United States tax is not required to be withheld at the source. Such return shall show the same information with respect to such items of income upon which tax is not required to be withheld at the source as is shown with respect to items of income upon which the tax is required to be withheld at the source. For provisions pertaining to the return on Form 1042, see section 29.143–7 of this chapter.

SEC. 7.609. BENEFICIARIES OF A DOMESTIC ESTATE OR TRUST.—A nonresident alien who is resident in New Zealand for the purposes of New Zealand tax and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption from, or reduction in the rate of, United States tax provided in Articles VI, VIII, and XII of the convention with respect to dividends and film rentals to the extent such item or items are included in his share of the distributed or distributable income of such estate or trust. In order to be entitled in such instance to the exemption from, or reduction in the rate of, withholding of United States tax such beneficiary must otherwise satisfy the requirements of these respective Articles of the convention and must, where applicable, execute and submit to the fiduciary of such estate or trust in the United States the letter of notification prescribed in section 7.604(b).

SEC. 7.610. REFUND OF EXCESS TAX WITHHELD DURING 1951.—If United States tax withheld at the source during the calendar year 1951 from dividends or film rentals is in excess of the tax imposed by chapter 1 (relating to the income tax) of the Internal Revenue Code, as modified by the convention, a claim by the taxpayer for the refund of any overpayment shall be made under section 322 of the Internal Revenue Code by filing Form 843 together with Form 1040NB, Form 1040NB–a, Form 1040B, or Form 1120NB, whichever is applicable, or with an amended return.

The taxpayer's total gross income from sources within the United States, including every item of capital gain subject to tax under the provisions of section 211(a)(1)(B) or 211(c) of the Internal Revenue Code, shall be disclosed on the return. In the event that securities are held in the name of a person other than the actual or beneficial owner, the name and address of such person shall be furnished with the claim. There shall also be included in such claim for refund a statement:

(a) That the taxpayer was, at the time when the item or items of income were derived, (1) a nonresident alien as to the United States (including a nonresident alien individual, fiduciary, or partnership) who at such time was resident in New Zealand for the purposes of New Zealand tax, (2) a foreign corporation whose business at such time was managed and controlled in New Zealand, or (3) a corporation incorporated under the laws of New Zealand; and

(b) That the taxpayer at no time during the taxable year in which the income was derived was engaged in trade or business within the United States through a permanent establishment situated therein.

As to additional information required in the case of a foreign corporation, or of a corporation incorporated under the laws of New Zealand, claiming the benefit of the 5 percent rate on dividends paid by a related corporation, see section 7.601(b).

Because it is necessary to bring into effect at the earliest practicable date the rules of this Treasury Decision respecting reduced rates of, or exemptions from, tax and the rules respecting release or refund of amounts withheld in excess of such reduced rates, or with respect to exempt income, it is hereby found that it is impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in sections 62 and 3791 (53 Stat. 32, 467; 26 U. S. C. 62, 3791) of the Internal Revenue Code and in Article XVIII(2) of the convention.)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 9, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 12, 1952, 8:55 a. m.)

SECTION 144.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE

SECTION 29.144-1: Withholding in the case of nonresident foreign corporations.

INTERNAL REVENUE CODE

Release or refund of excess tax withheld, and exemption from, withholding in case of Norwegian corporations, as affected by the

reciprocal income tax convention between the United States and the Kingdom of Norway. (See T. D. 5956, page 228.)

SECTION 29.144-1: Withholding in the case of nonresident foreign corporations.

INTERNAL REVENUE CODE

Release or refund of excess tax withheld, and exemption from, or reduction in rate of, withholding in the case of New Zealand corporations, as affected by the reciprocal income tax convention between the United States and New Zealand. (See T. D. 5957, page 238.)

SECTION 147.—INFORMATION AT SOURCE

SECTION 29.147-1: Return of information as to payment of $600 ($500 for years prior to 1948). Ct. D. 1758

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

PENALTIES—INFORMATION RETURNS—FAILURE TO FILE RETURNS.

An indictment against taxpayer contained 101 counts. Each count alleges that appellee made payment of a sum in excess of $600 a year to a named individual. The offense charged as to each such payment is willful failure to make a return on Form 1099, in violation of section 145(a) of the Internal Revenue Code, as amended. Form 1099 is called an "Information Return" to be forwarded with Form 1096, and contains no formal declaration by the payor nor any signature by him. Form 1096 is called an "Annual Information Return," which must be signed by the payor with a statement of the number of reports on Form 1099 which are attached. *Held:* The district court reached the correct result in ruling that the "return" specified in section 145(a) was that provided in Form 1096, and that since the only offenses charged in the counts were failures to file Form 1099, the indictment should be dismissed.

SUPREME COURT OF THE UNITED STATES

The United States of America, appellant, v. *James J. Carroll*

Appeal from the United States District Court for the Western District of Missouri

[April 27, 1953]

OPINION

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

This is an appeal under the Criminal Appeals Act, 18 U. S. C. section 3731, from an order of the district court dismissing an indictment. The indictment contains 101 counts. Each count alleges that appellee made payment of a sum in excess of $600 a year to a named individual—some in 1948, some in 1949, and the rest in 1950. The offense charged as to each such payment is a willful failure to make a return on Treasury Form 1099 in violation of section 145(a) of the Internal Revenue Code, as amended, section 5(c), Current Tax Payment Act of 1943, 57 Stat. 126, 26 U. S. C. section 145(a).

Section 147 of the Act, as amended by section 202(c)(3) of the Revenue Act of 1948, 62 Stat. 110, provides that any person making a payment to another of $600 or more in any calendar year "shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary."

Treasury Regulations 111, section 29.147-1, as amended T. D. 5313, C. B. 1944, 308, T. D. 5687, C. B. 1949-1, 9, provides that all persons making any such payment in any calendar year (with exceptions not relevant here) shall make a "return" on Form 1099, "accompanied by transmittal Form 1096 showing the number of returns filed." Form 1099 is required to be prepared and filed for

each payee, showing the name and address of the payee, the kind and amount of income paid, and the name and address of the person making the payment. Form 1099 on its face is called an "Information Return"; and its instructions say that it is to be forwarded "with return Form 1096." Form 1099 contains no formal declaration by the payor nor any signature by him. Those are provided in Form 1096.

Form 1096 is called "Annual Information Return." It must be signed by the payor with a statement of the number of reports on Form 1099 which are attached. It contains a declaration that "to the best of my knowledge and belief the accompanying reports on Form 1099" constitute "a true and complete return of payments" of the prescribed character made during the specified calendar year.

Section 145(a) of the act provides that any person required by law or regulations "to make a return * * * for the purposes of the computation, assessment, or collection of any estimated tax or tax imposed by this chapter, who willfully fails to * * * make such return" shall be guilty of a misdemeanor and on conviction be fined not more than $10,000 or imprisoned for not more than 1 year, or both.

The district court ruled that the "return" specified in section 145(a) was that provided in Form 1096, not the one provided in Form 1099 and that since the only offenses charged in the 101 counts were failures to file Form 1099 the indictment should be dismissed.[1]

The question is not without difficulty. But we conclude that the district court reached the correct result.

The "return" required by section 147(a) is to be made "in such form and manner" as are prescribed in the regulations. The regulations provide in section 29.147-1, as we have noted, that a "return shall be made in each case on Form 1099, accompanied by transmittal Form 1096 showing the number of returns filed." The "form and manner" prescribed therefore seem to consist of the verified Form 1096 together with the Forms 1099. All of them together apparently constitute the "return" referred to in section 147(a). The various Forms 1099 seem to have the same relation to Form 1096 as schedules have to an ordinary income tax return. Form 1099 supplies the details which underly Form 1096. That conclusion is supported by the fact that Form 1096 is the only one which is signed and verified.

We hesitate to conclude that a failure to file a unverified schedule is given the same dignity as the failure to file the verified return. We are dealing with criminal sanctions in the complicated, technical field of the revenue law. The Code and the regulations must be construed in light of the purpose to locate and check upon recipients of income and the amounts they receive. See S. Rept. No. 103, 65th Cong., 1st sess. 20. But at the same time every citizen is entitled to fair warning of the traps which the criminal law lays. Where the "return" prescribed is a verified Form 1096 together with all the unverified Forms 1099 it does not seem fair warning to charge a person for more than the failure to make that return. To multiply the crimes by the number of Forms 1099 required to be filed is to revise the regulatory scheme. So far as these information returns are concerned, the purpose of section 145(a) seems to us to be fulfilled when the sanction is applied only to a failure to file Form 1096.

Affirmed.

SECTION 148.—INFORMATION BY CORPORATIONS

SECTION 29.148-4: Returns of information as to patronage dividends, rebates, or refunds.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 6014, page 110.)

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[1] We postponed the question of jurisdiction to a hearing on the merits in view of appellee's contention in his statement opposing jurisdiction that the dismissal was based not only upon the "construction of the statute" within the meaning of the Criminal Appeals Act, 18 U. S. C. sec. 3731, but also, as respects the first 45 counts, on a question of venue. We do not read the oral opinion of the district court that way. We think the district court rested its decision as respects all 101 counts on the construction of the statute. Whether there are other objections to the indictment which might also lead to dismissal are therefore not properly here on this appeal. See *United States* v. *Borden Co.*, 308 U. S. 188, 193.

SECTION 153.—INFORMATION REQUIRED FROM CERTAIN TAX-EXEMPT ORGANIZATIONS AND CERTAIN TRUSTS

SECTION 29.153-2: Information required of trusts claiming charitable or other deductions under section 162(a). T. D. 5988

(Also Section 162, Sections 29.162-1, 29.162-3.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29 AND PART 601

Regulations 111 amended to conform to part II of title III of the Revenue Act of 1950, and to Public Law 35 (82d Cong.) [C. B. 1951-1, 184].

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

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

On October 1, 1952, notice of proposed rule making to conform Regulations 111 to part II of title III of the Revenue Act of 1950, approved September 23, 1950, and to Public Law 35, Eighty-second Congress [C. B. 1951-1, 184], approved May 17, 1951, to provide for a technical amendment made to 26 CFR 601.17(a), respecting forms required of trusts claiming deductions under section 162(a) of the Internal Revenue Code, was published in the Federal Register (17 F. R. 8704). No objection to the rules proposed having been received, the amendments of Regulations 111 and the technical amendment made to 26 CFR 601.17(a) set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immmediately preceding section 29.153-1, as added by Treasury Decision 5838 [C. B. 1951-1, 35], approved April 17, 1951 [26 CFR 29.153-1], the following:

PUBLIC LAW 35, EIGHTY-SECOND CONGRESS, APPROVED MAY 17, 1951

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, effective with respect to taxable years beginning after December 31, 1949, section 153(b) of the Internal Revenue Code (relating to special returns required from trusts claiming charitable, etc., deductions under section 162(a) of such Code) is hereby amended by adding at the end thereof the following:

"This subsection shall not apply in the case of a taxable year if all the net income for such year, determined under the applicable principles of the law of trusts, is required to be distributed currently to the beneficiaries."

PAR. 2. Section 29.153-2, as added by Treasury Decision 5838 [26 CFR 29.153-2], is hereby amended as follows:

(A) By changing the heading and the first sentence thereof to read as follows:

SEC. 29.153-2. INFORMATION REQUIRED OF CERTAIN TRUSTS CLAIMING CHARITABLE OR OTHER DEDUCTIONS UNDER SECTION 162(a).—(*a*) *In general.*—For taxable years beginning after December 31, 1949, every trust (other than a trust described in (*b*) of this section) claiming a charitable or other deduction under section 162(a) shall file, with respect to the taxable year for which such deduction is claimed, a return of information on Form 1041-A.

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

(*b*) *Exception.*—The provisions of (*a*) of this section with respect to the filing of information returns shall not be applicable to the taxable year of a trust if the trustee is bound by the instrument creating the trust to distribute each year to the beneficiaries all the net income of the trust (such net income being determined under the applicable principles of the law of trusts).

PAR. 3. There is inserted immediately preceding section 29.162-1 [26 CFR 29.162-1] the following:

SEC. 321. CHARITABLE, ETC., DEDUCTIONS OF TRUSTS [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

(a) AMENDMENT OF SECTION 162.—Section 162 is hereby amended by adding at the end thereof the following:

"(g) RULES FOR APPLICATION OF SUBSECTION (a) IN THE CASE OF TRUSTS.—

"(1) TRADE OR BUSINESS INCOME.—In computing the deduction allowable under subsection (a) to a trust for any taxable year beginning after December 31, 1950, no amount otherwise allowable under subsection (a) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its Supplement U business income for such year. As used in this paragraph the term 'Supplement U business income' means an amount equal to the amount which, if such trusts were exempt under section 101(6) from taxation, would be computed as its unrelated business net income under section 422 (relating to income derived from certain business activities and from certain leases).

"(2) OPERATIONS OF TRUSTS.—

"(A) Limitation on Charitable, Etc., Deduction.—The amount otherwise allowable under subsection (a) as a deduction shall not exceed 15 per centum of the net income of the trust (computed without the benefit of subsection (a)) if the trust has engaged in a prohibited transaction, as defined in subparagraph (B) of this paragraph.

"(B) Prohibited Transactions.—For the purposes of this paragraph the term 'prohibited transaction' means any transaction after July 1, 1950, in which any trust while holding income or corpus which has been permanently set aside or is to be used exclusively for charitable or other purposes described in subsection (a)—

"(i) lends any part of such income or corpus, without receipt of adequate security and a reasonable rate of interest, to;

"(ii) pays any compensation from such income or corpus, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

"(iii) makes any part of its services available on a preferential basis to;

"(iv) uses such income or corpus to make any substantial purchase of securities or any other property, for more than an adequate consideration in money or money's worth, from;

"(v) sells any substantial part of the securities or other property comprising such income or corpus, for less than an adequate consideration in money or money's worth, to; or

"(vi) engages in any other transaction which results in a substantial diversion of such income or corpus to;

the creator of such trust; any person who has made a substantial contribution to such trust; a member of the family (as defined in section 24(b)(2)(D)) of an individual who is the creator of the trust or who has made a substantial contribution to the trust; or a corporation controlled by any such creator or person through the ownership, directly or indirectly, of 50 per centum or more of the total combined voting power of all

classes of stock entitled to vote or 50 per centum or more of the total value of shares of all classes of stock of the corporation.

"(C) Taxable Years Affected.—The amount otherwise allowable under subsection (a) as a deduction shall be limited as provided in subparagraph (A) only for taxable years subsequent to the taxable year during which the trust is notified by the Secretary that it has engaged in such transaction, unless such trust entered into such prohibited transaction with the purpose of diverting such corpus or income from the purposes described in subsection (a), and such transaction involved a substantial part of such corpus or income.

"(D) Future Charitable, Etc., Deductions of Trusts Denied Deduction Under Subparagraph (C).—If the deduction of any trust under subsection (a) has been limited as provided in this paragraph, such trust, with respect to any taxable year following the taxable year in which notice is received of limitation of deduction under subsection (a), may, under regulations prescribed by the Secretary, file claim for the allowance of the unlimited deduction under subsection (a), and if the Secretary, pursuant to such regulations, is satisfied that such trust will not knowingly again engage in a prohibited transaction, the limitation provided in subparagraph (A) shall not be applicable with respect to taxable years subsequent to the year in which such claim is filed.

"(E) Disallowance of Certain Charitable, Etc., Deductions.—No gift or bequest for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), otherwise allowable as a deduction under section 23(o)(2), 23(q)(2), 162(a), 505(a)(2), * * * shall be allowed as a deduction if made in trust and, in the taxable year of the trust in which the gift or bequest is made, the deduction allowed the trust under subsection (a) is limited by subparagraph (A). With respect to any taxable year of a trust in which such deduction has been so limited by reason of entering into a prohibited transaction with the purpose of diverting such corpus or income from the purposes described in subsection (a), and such transaction involved a sustantial part of such income or corpus, and which taxable year is the same, or prior to the, taxable year of the trust in which such prohibited transaction occurred, such deduction shall be disallowed the donor only if such donor or (if such donor is an individual) any member of his family (as defined in section 24(b)(2)(D) was a party to such prohibited transaction.

"(F) Definition.—For the purposes of this paragraph the term 'gift or bequest' means any gift, contribution, bequest, devise, legacy, or transfer.

"(3) CROSS REFERENCE.—For disallowance of certain charitable, etc., deductions otherwise allowable under subsection (a), see section 3813.

"(4) ACCUMULATED INCOME.—If the amounts permanently set aside, or to be used exclusively, for the charitable and other purposes described in subsection (a) during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—

"(A) are unreasonable in amount or duration in order to carry out such purposes of the trust; or

"(B) are used to a substantial degree for purposes other than those described in subsection (a); or

"(C) are invested in such a manner as to jeopardize the interests of the religious, charitable, scientific, etc., beneficiaries,

amount otherwise allowable under subsection (a) as a deduction shall be limited to the amount actually paid out during the taxable year and shall not exceed 15 per centum of the net income of the trust (computed without the benefit of subsection (a))."

(b) TECHNICAL AMENDMENT.—Section 162(a) is hereby amended by striking out "There shall be allowed as a deduction" and inserting in lieu thereof "Subject to the provisions of subsection (g), there shall be allowed as a deduction".

SEC. 322. EFFECTIVE DATE OF PART II [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

The amendments made by this part [sections 321 and 322 of the Revenue Act of 1950] shall be applicable only with respect to taxable years beginning after December 31, 1950, except that subsection (g)(2)(E) of section 162 of the Internal Revenue Code, added by section 321(a) of this Act, shall apply only with respect to gifts or bequests (as defined in section 162(g)(2)(F) of the Internal Revenue Code) made on or after January 1, 1951.

PAR. 4. Section 29.162–1, as amended by Treasury Decision 5962 [page 261, this Bulletin], approved December 16, 1952 [16 CFR 29.162–1], is further amended as follows:

(A) By adding immediately after the fifth sentence in the first paragraph thereof the following:

For limitations on the deduction otherwise allowable under section 162(a), see section 3813. See also (*a*), below, and sections 29.162–3 and 29.162–4.

(B) By striking therefrom the last sentence of (*a*) (which sentence begins "See section 29.153–2") and inserting in lieu thereof the following:

In the case of a trust, the deduction otherwise allowable under section 162(a) for any taxable year beginning after December 31, 1950, is subject to the limitations of section 162(g). See sections 29.162–3 and 29.162–4. See section 29.153–2 relating to the annual information return that must be filed for any taxable year beginning after December 31, 1949, by certain trusts claiming charitable, etc., deductions under section 162(a) for the taxable year.

PAR. 5. There is added immediately after section 29.162–2 [26 CFR 29.162–2] the following:

SEC. 29.162–3 RULES FOR THE APPLICATION OF SECTION 162(a) IN THE CASE OF TRUSTS.—(*a*) *Limitation on charitable, etc., deduction of trusts with trade or business income.*—In computing the deduction allowable under section 162(a) to a trust for any taxable year beginning after December 31, 1950, no amount otherwise allowable under section 162(a) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to the trust's Supplement U business income for such year. For the purpose of this section, the term "Supplement U business income" means an amount equal to the amount which, if such trust were exempt from taxation under section 101(6), would be computed as its unrelated business net income under section 422 and the regulations thereunder. For the purpose of such computation under section 422, the term "unrelated trade or business" includes any trade or business regularly carried on by such a trust, or by a partnership of which it is a member.

Unless the facts clearly indicate the contrary, the deduction otherwise allowable under section 162(a) is allocable to the Supplement U business income on the basis of the ratio which the Supplement U business income bears to the net income of the trust computed without any deduction under section 162.

Example (1). The X trust has net income of $50,000 computed without any deduction under section 162. There is included in this amount a net profit of $30,000 from the operation of a trade or business. The trustee is required to pay one-half of the net income to A, an individual, and the balance of the net income to the Y charity, an organization described in section 23(o)(2). The trustee pays each beneficiary $25,000. Under these facts, the Supplement U business income of the trust (computed after the deduction allowable under section 422(a)(9) for charitable contributions) is $25,500. The deduction otherwise allowable under section 162(a) is $25,000, the amount paid to the Y charity. The portion thereof allocable to the Supplement U business income and therefore disallowed as a deduction is $12,750, that is, an amount which bears the same ratio to $25,000 as $25,500 bears to $50,000.

Example (2). Assume the same facts as in example (1), above except that the trustee has discretion as to the portion of the net income to be paid to each beneficiary, and the trustee pays $40,000 to A and $10,000 to the Y charity. The deduction otherwise allowable under section 162(a) is $10,000. The portion thereof allocable to the Supplement U business income and therefore disallowed as a deduction is $5,100, that is, an amount which bears the same ratio to $10,000 as $25,500 bears to $50,000.

Example (3). Assume the same facts as in example (1), above, except that the terms of the trust instrument require the trustee to pay to the Y charity the net income, if any, derived from the trade or business, and to pay to A all the net income derived from other sources. The trustee pays $30,000 to the Y charity and $20,000 to A. The deduction otherwise allowable under section 162(a) is $30,000. Under the facts in this case, $25,500 of the amount paid to the Y charity is allocable to the Supplement U business income and is therefore disallowed as a deduction.

(*b*) *Limitation on charitable, etc., deduction of trusts engaged in prohibited transactions.*—In the case of a trust which has engaged in any prohibited transaction (as described in section 162(g)(2)(B)) after July 1, 1950, the amount otherwise allowable under section 162(a) as a deduction shall not exceed 15 percent of the net income of such trust (computed without the benefit of section 162(a)) for any taxable year subsequent to the taxable year in which there is mailed to it a notice in writing by the Commissioner that it has engaged in such prohibited transaction. Such notification by the Commissioner shall be by registered mail to the last known address of the fiduciary. However, notwithstanding the requirement of notification by the Commissioner, such limitation (on the amount otherwise allowable under section 162(a) as a deduction) shall apply with respect to any taxable year beginning after December 31, 1950, if such trust during or prior to such taxable year commenced the prohibited transaction with the purpose of diverting such income or corpus from the purposes described in section 162(a) and such transaction involved a substantial part of such income or corpus. See examples under sections 29.162–4 and 29.3813–1.

A trust whose deduction under section 162(a) has been limited by reason of the provisions of section 162(g)(2)(A) may file, in any taxable year following the taxable year in which notice of limitation of deduction was issued, a claim for allowance of unlimited deduction under section 162(a). This claim shall be filed with the director for the district in which the fiduciary resides or has his principal place of business. The claim must contain or have attached to it an affidavit by the fiduciary that the trust will not knowingly again engage in a prohibited transaction.

If the Commissioner is satisfied that the trust will not knowingly again engage in a prohibited transaction, he shall so notify the trust in writing. In such case the trust will be allowed unlimited deduction under section 162(a) (subject to the provisions of section 162(g)) with respect to taxable years subsequent to the taxable year in which such claim is filed. Section 162(g)(2)(C) contemplates that a trust whose charitable, etc., deduction has been limited as prescribed therein shall be subject to such limitation for at least 1 full taxable year.

(*c*) *Limitation on charitable, etc., deduction of trusts accumulating income.*—For any taxable year beginning after December 31, 1950, the amount otherwise allowable under section 162(a) as a deduction shall be limited to the amount actually paid out during the taxable year and shall not exceed 15 percent of the net income of the trust (computed without the benefit of section 162(a)), if the amounts permanently set aside, or to be used exclusively, for the charitable and other purposes described in section 162(a) during the taxable year or any prior taxable year (including taxable years beginning prior to January 1, 1951) and not actually paid out by the end of the taxable year are unreasonable. Amounts accumulated out of income for purposes described in section 162(a) become unreasonable when more income is accumulated than is needed, or when the duration of the accumulation is longer than is needed, in order to carry out the charitable or other purpose described in section 162(a) for which such amounts were set aside. Furthermore, such limitation on the deduction otherwise allowable under section 162(a) shall apply if amounts accumulated out of income for purposes described in section 162(a) are used to a substantial degree for purposes other than those described in section 162(a), or if such amounts are invested in such a manner as to jeopardize the interests of the religious, charitable, scientific, etc., beneficiaries.

For the purpose of section 162(g)(4), the term "income" means gains, profits, an income determined under the principles applicable in determining the earnings or profits of a corporation. The amount accumulated out of income during the taxable year or any prior taxable year shall be determined under the principles applicable in determining the accumulated earnings or profits of a corporation. In determining the reasonableness of an accumulation out of income there will be disregarded the following: (1) The accumulation of gain upon the sale or exchange of a donated asset to the extent that such gain represents the excess of the fair market value of such asset when acquired by the trust over its substituted basis in the hands of the organization; (2) the accumulation of gain upon the sale or exchange of property held for the production of investment income, such as dividends, interest, and rents, where the proceeds of such sale or exchange are within a reasonable time reinvested in property acquired and held in good faith for the production of investment income.

Whether the conditions specified in subparagraphs (A), (B), and (C) of section 162(g)(4) are present in any case must be determined from all the facts. The conditions specified in section 162(g)(4) (A), (B), and (C) may result from the use of only one trust or of a chain of two or more organizations.

A trust whose deduction under section 162(a) has been limited by reason of the provisions of section 162(g)(4) may file a claim for allowance of unlimited deduction under section 162(a). This claim shall be filed with the director for the district in which the fiduciary resides or has his principal place of business. The claim must contain or be accompanied by information or evidence showing that the circumstances that caused the limitation on deduction prescribed under section 162(g)(4) no longer exist, and an affidavit by the fiduciary that the trust will not knowingly again violate the terms of such section. Section 162(g)(4) contemplates that a trust whose charitable, etc., deduction has been limited as prescribed therein shall be subject to such limitation for at least 1 full taxable year.

In the case of a trust the deduction under section 162(a) of which has been limited solely by reason of the provisions of section 162(g)(4), deductions otherwise allowable under section 23(o)(2), 23(q)(2), 162(a), or 505(a)(2), for gifts or contributions made to such a trust in trust for charitable, etc., purposes, shall not be disallowed.

SEC. 29.162–4. DISALLOWANCE TO DONORS OF CERTAIN CHARITABLE, ETC., DEDUCTIONS FOR GIFTS MADE IN TRUST.—No gift or contribution made on or after January 1, 1951, which would otherwise be allowable as a charitable or other deduction under section 23(o)(2), 23(q)(2), 162(a), or 505(a)(2), shall be allowed as a deduction if made in trust and, in the taxable year of the trust in which the gift or contribution is made, the deduction allowed the trust under section 162(a) is limited by reason of the provisions of section 162(g)(2)(A).

The prohibited transactions enumerated in section 162(g)(2)(B) are in addition to and not in limitation of the restrictions contained in section 23(o)(2), 23(q)(2), 162(a), or 505(a)(2). A deduction may not be allowed in view of the general provisions of those sections, even though the trust has not engaged in any of the prohibited transactions referred to in section 162(g)(2)(B). Thus, if the donor or the fiduciary of the trust enters into a transaction with the trust, such transaction will be closely scrutinized to ascertain whether the contribution is in fact made for the stated exempt purposes.

If a trust, which receives a gift or contribution for charitable, etc., purposes after December 31, 1950, is not entitled to the unlimited deduction under section 162(a) because it engaged in a prohibited transaction with the purpose of diverting its income or corpus from the purposes described in section 162(a), and such transaction involved a substantial part of such income or corpus, and if the taxable year of the trust during which such gift or contribution is made begins after December 31, 1950, and is the same as, or is prior to, the taxable year of the trust in which such transaction occurred, then a deduction by the donor with respect to the gift or contribution shall not be disallowed under the first paragraph of this section unless the donor (or any member of his family if the donor is an individual) is a party to such prohibited transaction. For the purpose of the preceeding sentence, the members of an individual donor's family include only his brothers and sisters, whether by whole or half blood, spouse, ancestors, and lineal descendants. See section 29.3813–3 for disallowance of certain charitable, etc., deductions otherwise allowable under section 162(a).

Example. Under the terms of an irrevocable trust established by A in 1949, the trustees were to pay one-half of the income of the trust to A's wife for life, and the trustees were given discretion either to accumulate or distribute the remaining one-half of the income to a specified charitable beneficiary. Upon the death of the wife, the entire corpus was to be paid to the named charity. The trust makes its income tax returns on the basis of the calendar year. For 1949, A takes a charitable deduction for the amount of the gift in trust to the charity. In 1952, 1953, 1954, and 1955, A makes further contributions to the trust and takes charitable deductions for such years under section 23(o)(2). In 1953, 1954, and 1955, B (not a member of A's family) makes contributions to the trust for its designated charitable purpose and takes charitable deductions for such years. In 1953, the trust commences purposely to divert income and corpus which had been set aside for its charitable purpose and to turn such income and corpus over to A, the creator of the trust, and a substantial amount of such income and corpus is so diverted by the close of the taxable year 1954. For 1953 and subsequent taxable years, the deduction allowed the trust under section 162(a) is limited by reason of the provisions of section 162(g)(2)(A). Both A and B are disallowed any charitable deduction for their charitable contributions made during 1955 to the trust. Moreover, the charitable deduction taken by A for contributions to the trust in the years 1953 and 1954 would also be disallowed since A was a party to the prohibited transaction. If the facts and surrounding circumstances indicate that the contribution in 1952 by A was for the purpose of the prohibited transaction, then the charitable deduction for the year 1952 shall also be disallowed with respect to A, since the prohibited transaction would then have commenced with the making of such contribution and the deduction allowed the trust under section 162(a) would then be limited for 1952 by reason of the provisions of section 162(g)(2)(A).

PAR. 6. The Statement of Procedure contained in F. R. Doc. 46–15357, appearing at page 177A–22, part II section 1, of the issue for September 11, 1946, as amended (26 CFR, part 601; 14 F. R. 2063; 15 F. R. 6888; 17 F. R. 6948), is hereby further amended by changing the part of section 601.17 *Forms*—(a) *Description* relating to *Form 1041* to read as follows:

Form 1041–A.—Fiduciary information return required of trusts claiming charitable or other deductions under section 162(a), I. R. C. for taxable years beginning after December 31, 1949.

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

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 16, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 19, 1953, 8:45 a. m.)

SECTION 154.—INCOME TAXES OF MEMBERS OF ARMED FORCES UPON DEATH

SECTION 29.154–1: Abatement of income taxes of certain members of the Armed Forces of the United States upon death. (Also Section 482, Section 29.482–1.) Rev. Rul. 55

INTERNAL REVENUE CODE

The cancellation, pursuant to section 154 of the Internal Revenue Code, of the liability for Federal taxes imposed under chapter 1 of

the Code, of an individual killed in action after June 24, 1950, and prior to January 1, 1954, while serving with the Armed Forces of the United States in a combat zone, does not eliminate the income on which such liability was based. A refund of self-employment taxes made in accordance with this section of the Code, does not change the amount of self-employment income previously reported and does not necessitate a correction of the records previously forwarded by the office of the director of internal revenue to the Social Security Administration.

Advice is requested whether the cancellation of the liability for the Federal taxes imposed under chapter 1 of the Internal Revenue Code, of an individual killed in action after June 24, 1950, and prior to January 1, 1954, while serving with the Armed Forces of the United States in a combat zone, eliminates the income on which such liability is based, thereby necessitating a correction of the records forwarded by the office of a director of internal revenue to the Social Security Administration.

In the instant case, an individual was killed in action on February 1, 1952, while serving with the United States Air Force in a combat zone as designated in E. O. 10195, C. B. 1951-1, 6. Subsequent to his death, distribution of the net income of a partnership of which he was a member was made, and self-employment tax based on his distributive share was assessed and paid.

Section 154 of the Internal Revenue Code, added by the Revenue Act of 1951, provides as follows:

In the case of any individual who dies after June 24, 1950, and prior to January 1, 1954, while in active service as a member of the Armed Forces of the United States, if such death occurred while serving in a combat zone (as determined under section 22(b)(13) or as a result of wounds, disease, or injury incurred while so serving—

(a) the tax imposed by this chapter shall not apply with respect to the taxable year in which falls the date of his death, or with respect to any prior taxable year ending on or after the first day he so served in a combat zone after June 24, 1950; and

(b) the tax under this chapter and under the corresponding title of each prior revenue law for taxable years preceding those specified in clause (a) which is unpaid at the date of his death (including interest, additions to the tax, and additional amounts) shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

It is the position of the Bureau that, since section 154 of the Code, quoted above, provides specifically for the cancellation of tax liability and contains no specific provision with respect to the income on which such liability is based, the individual's income remains unchanged.

Accordingly, it is held that the cancellation, pursuant to section 154 of the Internal Revenue Code, of the liability for the Federal taxes imposed under chapter 1 of the Code, of an individual killed in action after June 24, 1950, and prior to January 1, 1954, while serving with the Armed Forces of the United States in a combat zone, does not eliminate the income on which such liability was based. A refund of self-employment taxes made in accordance with this section of the Code, does not change the amount of self-employment income previously reported and does not necessitate a correction of the records previously forwarded by the office of the director of internal revenue to the Social Security Administration.

SECTION 29.154–1: Abatement of income taxes of certain members of the Armed Forces of the United States upon death.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5976, page 26.)

SUPPLEMENT E.—ESTATES AND TRUSTS

SECTION 162.—NET INCOME

SECTION 29.162–1: Income of estates and trusts. T. D. 5962

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 section 345 of the Revenue Act of 1951, relating to abatement of tax on certain trusts for members of Armed Forces dying in service.

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

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

On October 25, 1952, notice of proposed rule making, regarding amendments to the income tax regulations made necessary by section 345 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 9669). No objection to the rules proposed having been received, the amendments to Regulations 111 [26 CFR, part 29] set forth below are hereby adopted:

PARAGRAPH 1. Section 29.162–1, as amended by Treasury Decision 5951 [C. B. 1952–2, 81], approved December 2, 1952 [26 CFR 29.162–1], is further amended by adding after (c) of the second paragraph thereof the following:

(d) For the deduction allowed a trust which accumulated income for a beneficiary who died on or after December 7, 1941, and before January 1, 1948, while in active service as a member of the military or naval forces of the United States or of any of the other United Nations, see section 29.421-1.

PAR. 2. There is inserted immediately preceding section 29.421-1 [26 CFR 29.421–1] the following:

SEC. 345. ABATEMENT OF TAX ON CERTAIN TRUSTS FOR MEMBERS OF ARMED FORCES DYING IN SERVICE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

In the case of a trust which accumulated income for a beneficiary who died on or after December 7, 1941, and before January 1, 1948, while in active service as a member of the military or naval forces of the United States or of any of the other United Nations, there shall be allowed as a deduction in computing the net income of such trust (in addition to other deductions allowable under sections 23 and 162 of the Internal Revenue Code) income of the trust for any taxable year (before diminution for income tax) which was accumulated for such beneficiary if—

(1) the income accumulated was for a taxable year of the trust which ended with or within a taxable year (ending on or after December 7, 1941) of such beneficiary during any part of which he was a member of such military or naval forces, or, in the case of the taxable year of the trust during which such beneficiary died, the income accumulated was for the period in such taxable year prior to the death of such beneficiary; and

(2) the amount of such accumulated income was, without regard to this section, taxable to the trust, and

(3) the income for such taxable year accumulated for the beneficiary, if not distributed to him prior to his death, was payable by the trust at or after his death only to his estate, spouse, or lineal ancestors or descendants.

PAR. 3. Section 29.421–1, as amended by Treasury Decision 5645 [C. B. 1948–2, 14], approved July 20, 1948 [26 CFR 29.421–1], is hereby amended by inserting after the third paragraph thereof the following:

In the case of a trust which accumulated income for a beneficiary who died on or after December 7, 1941, and before January 1, 1948, while in active service as a member of the military or naval forces of the United States or of any of the other United Nations, there shall be allowed as a deduction in computing the net income of the trust for any taxable year the income of the trust for such taxable year, before diminution for income taxes with respect thereto, which was, or would have been but for such diminution, accumulated for such beneficiary. This deduction shall be allowed, however, only if (1) the income accumulated was for a taxable year of the trust which ended with or within a taxable year (ending on or after December 7, 1941) of such beneficiary during any part of which he was a member of such military or naval forces, or, in the case of the taxable year of the trust during which such beneficiary died, the income accumulated was for the period in such taxable year prior to the death of such beneficiary, and (2) the amount of such accumulated income was, without regard to this paragraph, taxable to the trust, and (3) the income for such taxable year accumulated for the beneficiary, if not distributed to him prior to his death, was payable by the trust at or after his death only to his estate, spouse, or lineal ancestors or descendants.

The amendments to sections 29.162–1 and 29.421–1 of Regulations 111, covering taxable years beginning after December 31, 1941, set forth in this Treasury Decision, are hereby made applicable to any taxable year affected which is covered by Regulations 103.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 16, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 19, 1952, 8:57 a. m.)

SECTION 29.162–1: Income of estates and trusts.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5988, page 253.)

SECTION 29.162-2: Allocation of estate and trust income to legatees and beneficiaries. (Also Section 115, Section 29.115-7.) Rev. Rul. 24

INTERNAL REVENUE CODE

The distribution of principal cash to an income life beneficiary of a trust in lieu of a nontaxable stock dividend which was not permitted to be distributed under State law, does not result in taxable income to the life beneficiary except to the extent that income was realized by the trust upon conversion of the dividend stock to cash and was properly distributed with the principal.

Advice is requested whether taxable income is realized by a beneficiary of a trust who is entitled to the trust income for life, where, according to State law the trust is not permitted to distribute a nontaxable stock dividend received by it and in lieu thereof distributes cash from the principal.

In the instant case, the taxpayer's husband died, and under his will he bequeathed and devised all of his personal property and real estate in trust with the entire net income therefrom payable to his wife as long as she remained his widow. During the taxable year, the trustees received a nontaxable stock dividend with respect to certain stock held in trust. In accordance with the local apportionment laws the trustees retained the stock dividend in the principal account and distributed cash to the widow to the extent that such stock dividend represented earnings accumulated subsequent to the husband's death and capitalized upon issuance of the dividend shares. The cash was derived from principal cash on hand as well as from the sale of a portion of the stock received as a dividend by the trust. Under the apportionment laws of the State in which the trust was created, the trustees were not permitted to distribute the actual stock dividend to the widow, but only principal cash which might be on hand or obtained from the sale of such stock.

In *Theodore R. Plunkett* v. *Commissioner*, 118 Fed. (2d) 644, where certain securities held by a testamentary trust were sold and the proceeds improperly invested in unproductive securities, the probate court instructed the trustees to substitute cash for the securities which were sold and to transfer from the principal account and distribute to the income beneficiary a portion of such cash which represented the income he would have received had the funds been properly invested. The distribution was held to be taxable to the income beneficiary as ordinary income. In *Robert W. Johnston et al.* v. *Commissioner*, 141 Fed. (2d) 208, certiorari denied, 323 U. S. 715, where certain real estate, which had been acquired through foreclosure, was sold by the trust at a loss and a portion of the proceeds was distributed to the income beneficiary to compensate him for the interest which he would have received had there been no default in the mortgage, it was held that the distribution was taxable income to the beneficiary although the trust had no income from which distribution could be made.

The instant case is distinguishable on its facts from the Plunkett and Johnston cases, in that it, unlike those cases, involves the treatment of principal cash distributed by a trust to the life income beneficiary in lieu of a nontaxable stock dividend received by the trust.

In *Hall Park McCullough* v. *Commissioner*, 153 Fed. (2d) 345, the court relying upon the decisions in the Plunkett and Johnston cases, held that although dividend shares were not taxable income when received by the executors of an estate under the rule established in the case of *Mark Eisner* v. *Myrtle H. Macomber*, 252 U. S. 189, T. D. 3010, C. B. 3, 25 (1920), it did not preclude the holder of the life estate from receiving taxable income in satisfaction of a right to receive income. The Bureau has for many years followed its position in I. T. 1622, C. B. II-1, 135 (1923), that income of a trust retains in the hands of the beneficiary the same character which it possessed in the hands of the trustee, and notwithstanding the McCullough case, has decided to maintain such position. The fact that under State law a stock dividend received by a trust may not be distributed in kind and that cash from the principal of the trust is distributed to the beneficiary in lieu thereof does not in itself serve to alter the character of such distribution in the hands of the beneficiary. If capital gain income resulted from the sale of the dividend stock by the trustee and such income was properly distributed to the beneficiary, it is taxable to the beneficiary at capital gain rates provided in section 117 of the Internal Revenue Code.

In view of the foregoing, it is held that the distribution of principal cash to an income life beneficiary of a trust in lieu of a nontaxable stock dividend which was not permitted to be distributed under State law, does not result in taxable income to the life beneficiary except to the extent that income was realized by the trust upon conversion of the dividend stock to cash and was properly distributed with the principal.

SECTION 29.162-3: Rules for the application of section 162(a) in the case of trusts. (Also Section 3813, Section 29.3813-1.) Rev. Rul. 96

INTERNAL REVENUE CODE

A trust which qualifies for exemption from Federal income tax under section 101(6) of the Internal Revenue Code or a trust which has paid or permanently set aside contributions during a taxable year for purposes described in section 162(a) of the Code will not be considered to be engaging in any prohibited transaction referred to in section 3813(b) or 162(g)(2)(B) of the Code by reason of distributions made by it to public organizations which are charitable and/or educational, regardless of the fact that indirect benefits may inure to members of families of employees of a corporation which is the creator of the trust. Thus, where it is evident from all the facts in any case that the organization to which a trust distributes its funds is a public organization which is charitable and/or educational, such as a Parent-Teachers Association, the trust will not be considered to be engaging in a prohibited transaction within the meaning of the statute even though some of the students at the local public school who may benefit from the distributions made to such public organization by the trust are children of employees of the creator corporation.

SECTION 165.—EMPLOYEES' TRUSTS

SECTION 29.165-1: Employees' trusts. Rev. Rul. 32
(Also Section 23(p), Section 29.23(p)-2.)

INTERNAL REVENUE CODE

Procedures applicable to the issuance of advance rulings with respect to the qualification of pension, annuity, profit-sharing, and stock bonus plans under section 165(a) of the Internal Revenue code.

1. Advance rulings as to the qualification of pension, annuity, profit-sharing, and stock bonus plans under section 165(a) of the Internal Revenue Code, as amended, are not required under the Code or corresponding regulations as a condition precedent for obtaining any of the tax benefits pertaining to qualified plans. Such advance rulings, however, are issued if requested by taxpayers. The procedure herein set forth is intended to facilitate the processing of such rulings and to provide for uniform treatment throughout the respective field offices.

2. The advance rulings herein contemplated are issued with respect to consummated or proposed transactions relating to:

(*a*) The initial qualification of a plan and, if trusteed, the status for exemption of the trust forming a part thereof;

(*b*) Amendments to plans and trusts;

(*c*) Curtailments of plans;

(*d*) Terminations of plans; and

(*e*) The effect on qualification of the plan of an investment of trust funds in the stock or securities of the employer.

3. All requests for rulings within the purview of paragraph 2 hereof are to be filed in the office of the director of internal revenue having jurisdiction in the area prescribed as follows:

(*a*) In the case of a plan of a single employer, where the principal place of business of such employer is located;

(*b*) In the case of a plan of a parent and subsidiary companies, where the principal place of business of the parent company is situated regardless of whether consolidated returns are filed;

(*c*) In the case of an industry-wide plan (a plan established in a particular industry by all subscribing employers, some of whom are located in areas within the jurisdiction of more than one director's office), where the trustee's principal place of business is located or, if more than one trustee, where the usual place of meeting of the trustees is held, and

(*d*) In the case of a plan of multiple employers not provided for in the categories set forth in subparagraphs (*b*) and (*c*) hereof, where the trustee's principal place of business is located or, if more than one trustee or if nontrusteed, where the usual place of meeting of the trustees or plan supervisors is held.

4. All requests for rulings are to be accompanied by information in duplicate, to the extent pertinent, as follows:

(*a*) For initial qualification of a plan, the information called for under section 29.23(p)-2 of Regulations 111 and, if trusteed, the information under section 29.165-1(c) of Regulations 111, without duplicating the section 29.23(p)-2 information;

(*b*) For a ruling on an amendment, a copy of the amendment without the information under sections 29.23(p)–2 and 29.165–1(c), unless requested;

(*c*) For a ruling on a curtailment or termination, the information called for in Exhibit "A" hereof; and

(*d*) For a ruling as to the effect on qualification of the plan of an investment of trust funds in the stock or securities of the employer, the information called for in Exhibit "B" hereof. (It should be noted, however, that even if such a ruling is not requested, section 29.165–1(a) of Regulations 111 requires that the Commissioner be notified if investment in the employer's stock or securities is made. The notification is to consist of the information set forth in Exhibit "B" and is to be filed with the appropriate Director, as provided for in paragraph 3 hereof.)

5. The director of internal revenue is responsible for the issuance of rulings within the contemplation of paragraph 2 hereof. Such rulings are limited to the status of plans and trusts under section 165(a) of the Internal Revenue Code. Advance rulings and opinions under paragraphs (b), (c), and (d) of section 165, and sections 22(b)(2)(B) and 23(p) of the Internal Revenue Code, are issued by the Bureau in Washington. Requests therefor should be addressed to the Commissioner, marked for the attention of T:S:P.

POST REVIEW

6. Rulings issued by a director are subject to post review in Washington under procedures established for such purposes, with the exception that such post review will be made by the Assistant Commissioner (Technical).

REQUESTS FOR ADVICE FROM FIELD OFFICES

7. Requests for advice from field offices concerning matters within the contemplation of paragraph 2 above will be made and processed pursuant to established procedure for requesting advice from Washington, except that such requests should be addressed to the Assistant Commissioner (Technical), Attention: Pension Trust Branch, Special Technical Services Division.

8. The provisions of this Revenue Ruling shall take effect on the 31st day following March 16, 1953, and are to be applied in all cases specified.

EXHIBIT A

Information to be filed with application for ruling in connection with termination or curtailment of employees' plans and trusts

1. The date as of which the plan (is proposed to be) terminated.

2. A statement setting forth the reasons and circumstances relative to the (proposed) termination.

3. A tabulation in columnar form showing the information specified below with respect to each of the 25 highest paid employees, listed in the order of their compensation, and for all other employees as a group (showing the number in such group), covered by the plan:

(*a*) Name.

(*b*) Whether an officer.

(*c*) Percentage of each class of stock owned directly or indirectly by the employee or members of his family.

(*d*) Data, separately *for each year of the plan's operation*, with respect to:

(i) Total compensation, other than deferred compensation.

(ii) Employer's contribution.

(iii) Employee's share in forfeitures.
(iv) Employee's contributions.
(*e*) Totals for each of the columns under (*d*) above, for each year.
(*f*) Summary columns showing in aggregate (totaled horizontally) for all years, with respect to each of the employees listed and all others, data similar to the items called for under (*d*) above.
(*g*) A final column showing the total value of benefits distributed or to be distributed to each of the 25 highest paid employees and to all others.

4. A schedule, showing for *each of the years* of the plan's operation:
(*a*) The number of participants at the beginning of the period.
(*b*) The number added.
(*c*) The number who dropped out.
(*d*) The number remaining at the end of the period.

5. A statement as to whether any of the funds under the plan will revert to or become available to the employer; if so, details are to be furnished.

6. A statement with full particulars as to any funds under the plan which at any time were contributed in the form of or invested in obligations or property of the employer or related companies.

EXHIBIT B

Information to be filed with application for ruling and by way of notification with respect to investment of trust funds in the stock or securities of the employer

1. Balance sheets of the employer as at the close of the last accounting period and for the taxable year ended prior thereto;
2. Comparative statements of income and profit and loss for the last and the 4 prior taxable years;
3. An analysis of the surplus account for the last 5 years and specifically showing the amount and rate of dividends paid on each class of stock;
4. A statement accounting for all material changes from the latest dates of the aforesaid statements to the date of filing the information;
5. A schedule showing the nature and amounts of the various assets in the trust fund;
6. A statement setting forth the amount to be invested in the stock or securities of the employer, the nature of the investment, the present rate of return, and the reasons for the investment.

SECTION 29.165-1: Employees' trusts. (Also Sections 29.165-2, 29.165-3, and 29.165-4.) Rev. Rul. 33

INTERNAL REVENUE CODE

Compilation of guides applicable to the qualification of stock bonus, pension, profit-sharing, and annuity plans under section 165(a) of the Internal Revenue Code, as amended by the Revenue Act of 1942.

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PART 1: INTRODUCTION

(a) *Purpose.*—Exemption from income tax is granted to an employees' trust which is part of a stock bonus, pension, or profit-sharing plan meeting the requirements set forth in paragraphs (1) through (6) of section 165(a) of the Internal Revenue Code. Nontrusteed annuity

plans with respect to which deductions for contributions thereto are claimed under section 23(p)(1)(B) of the Code must, as part of the requirements of such section, also meet the requirements of paragraphs (3) through (6) of section 165(a) of the Code. Numerous issues relative to qualification have arisen and have been determined since section 165(a) of the Code was amended by section 162(a) of the Revenue Act of 1942. It is the purpose of this release to set forth the rules which have been developed as a result of such determinations and to codify various individual releases, except in cases where to do so would merely be repetitious or cumulative and, in such cases, reference will be made to the specific release in point. The issues herein discussed are not all inclusive but are those which have been found to be most commonly present in many plans. As new issues of general import arise supplemental releases will be issued.

(*b*) *References.*—Certain policy issues are common to all types of plans; others to pension and annuity plans, or profit-sharing and stock bonus plans. Accordingly, the various groups will be discussed in their appropriate places and reference made to the applicable sections of the Code and Regulations 111. Rulings listed in the appendix are incorporated by reference and made a part hereof. Internal Revenue Bulletin citations are furnished with respect to published material. P. S. Rulings have also been made public although not published in the Bulletin. Copies are available in the respective offices of directors of internal revenue and the Bureau in Washington. The omission of certain rulings from the appendix is not to be construed as a rescission or modification of any such rulings. Only those rulings which are appropriate to the particular textual material are referred to.

PART 2: EMPLOYEES' TRUSTS IN GENERAL

SECTION 165(a) OF THE INTERNAL REVENUE CODE

SECTION 29.165-1(a) OF REGULATIONS 111

(*a*) *Stock bonus, pension, or profit-sharing plan.*—A trust, to be exempt under section 165(a) of the Code, must be part of a stock bonus, pension, or profit-sharing plan established by an employer for his employees. For a definition of each such type of plan, see the second paragraph of section 29.165-1(*a*) of Regulations 111, as amended by T. D. 5422, C. B. 1944, 318. From the last sentence of such paragraph, it will be noted also that section 165(a) of the Code does not apply to a plan which is primarily a dismissal wage plan.

(*b*) *Exclusive benefit of employees or their beneficiaries.*—The plan must be for the exclusive benefit of employees or their beneficiaries.

(1) *Partners.*—Partners are employers and, as such, are not eligible to participate in the plan. See I. T. 3350, C. B. 1940-1, 64, and P. S. No. 23. Neither are they to be credited for services as partners prior to becoming employees in a successor corporation.

(2) *Attorney participants.*—An attorney, or other professional person, may be a bona fide employee and, as such, eligible to participate in the plan. The mere fact that such practitioner also has an independent income from the practice of his profession will not necessarily preclude him from participating in the plan.

He must, however, be an employee for all purposes, including coverage as an employee for social security or similar public program, if applicable to other employees, and for income tax withholding purposes. Thus, if his actual employment for such purposes commences as of a certain date he is not entitled to credit for services prior thereto, such as, for example, for the purpose of meeting the years of service requirement to be eligible to participate in the plan or to be entitled to past service credits.

(3) *Insurance agents.*—Section 3797(a) of the Internal Revenue Code has been amended by section 343 of the Revenue Act of 1951 to add a new paragraph (20) providing that, with respect to stock bonus, pension, profit-sharing, and annuity plans, the term "employee" shall include a full-time life insurance salesman who is considered an employee for the purpose of subchapter A of chapter 9, or, in the case of services performed before January 1, 1951, who would be considered an employee if his services were performed during 1951. This amendment is applicable with respect to taxable years beginning after December 31, 1938. A full-time life insurance salesman is included in the term "Employee" under section 1426(d)(3)(B) of the Code for old-age and survivors insurance tax purposes. Thus, the same rules apply with respect to treating life insurance salesmen as employees for inclusion in a plan under section 165(a) of the Code as for taxability for old-age and survivors insurance purposes. This inclusion does not, however, extend to insurance brokers and others who are not full-time life insurance agents within the purview of section 1426(d)(3)(B).

(*c*) *Designation of beneficiaries.*—Employees must have the right to designate their own beneficiaries. Section 29.165-1(*a*) of Regulations 111 includes as beneficiaries entitled to benefits under a qualified plan (concluding sentence of paragraph preceding the last) "* * * any persons designated by the employee to share in the benefits of the plan after the death of the employee." Thus, a restriction in the plan to a prescribed group deprives the employee of freedom of choice in designating "any persons" and is contrary to the provision quoted above. The plan, however, may provide that, in the absence of a designation by the employee, payment in the event of death will be made to certain stated beneficiaries, in order of priority, such as, spouse, children, parents, brothers and sisters, or to the estate of the deceased. A plan under which an advisory committee, or other administrative body, designates employees' beneficiaries after consultation with such employees, or under which the committee designates beneficiaries from lists restricted to a specified group submitted by employees, is not for the exclusive benefit of employees or *their beneficiaries.* A plan, however, may provide that amounts allocated to an employee and standing to his credit at the time of his death shall be paid to his estate. In such case the right of designation of a beneficiary is reserved to the employee since he can name a beneficiary by will with respect to such credit.

(*d*) *Feeder plan.*—A stock bonus or profit-sharing plan which provides that the funds therein may be used to meet the costs of a pension or annuity plan operated concurrently and covering the same employees, if and when the employer suspends contributions to such

latter plan, is a feeder plan since it relieves the employer from contributing to the pension or annuity plan and is therefore not for the exclusive benefit of employees or their beneficiaries. An employee who has a vested right under a profit-sharing or stock bonus plan may, however, if the plan so provides, authorize a transfer of all or part of his vested interest to make up for a deficiency in the employer's contribution under a pension or annuity plan. In such case he will be taxable on the transfer as though a distribution of such interest had been made. See P. S. No. 37.

(*e*) *Permanency.*—A plan within the meaning of section 165(a) of the Code is a permanent and continuing program. A plan which is set up during years of high tax rates and is abandoned without a valid business reason when profits fall off is not within the intent of such section. Also, especially in the case of a pension plan under which benefits are funded at a higher rate for employees in whose favor discrimination is prohibited than for other employees, if the plan is discontinued before ample provision for comparable benefits is made for such other employees it will be deemed, from its inception, not to have been a bona fide program for the exclusive benefit of employees in general. For a more detailed discussion of the applicable principles and illustrative cases, see Mimeograph 6136, C. B. 1947–1, 58. See also P. S. No. 60 for the information to be filed for a ruling as to the effect of a termination or curtailment of a plan on its prior qualification, P. S. No. 56 as to notice by the trustee of the termination of a plan, and P. S. No. 57 as to the effect of a suspension of contributions.

(*f*) *Written documents.*—The plan must be a definite written program setting forth all provisions essential to qualification. See section 29.165–1(a) of Regulations 111, first paragraph. In the case of a trusteed plan, the trust must be evidenced by an executed written document setting forth the terms thereof. See Mimeograph 6394, C. B. 1949–1, 118. In the case of a nontrusteed annuity plan which is evidenced by insurance contracts, the plan is not in effect until such contracts are executed and issued. See Mimeograph 6020, C. B. 1946–1, 74.

(*g*) *Stockholder participation.*—Stockholders who are bona fide employees of a corporation may participate in the corporation's plan to the same extent as other employees. If, however, the plan is designed as a subterfuge for the distribution of profits to stockholders, even if it includes other employees who are not stockholders, it will not qualify as a plan for the exclusive benefit of employees. The plan must not be weighted in favor of stockholder-employees either with respect to the requirements for participation or for contributions and benefits. See I. T. 4020, C. B. 1950–2, 61, for further details.

(*h*) *Communication to employees.*—Employees are to be apprised of the establishment of a plan and the salient provisions thereof. The most effective way of doing so is to furnish each employee with a copy of the plan. To do so, however, may not be feasible in all cases. Various substitutes, therefore, may be used. For example, it will be sufficient that a booklet summarizing the plan in all its essential features be furnished the employees, or that a notice be posted on the company's bulletin board, which must be in conspicuous view, that a plan has been established, setting forth the type thereof, the eligibility requirements, a synopsis of all benefits provided thereunder, whether

employees are to contribute and, if so, the amount of contributions, vesting provisions, and, if a profit-sharing or stock bonus plan, the employer contribution commitment, and a statement that a copy of the complete plan may be inspected at a designated place on the company's premises during specified times.

(*i*) *Investment of trust funds.*—Trust investments must be for the exclusive benefit of employees or their beneficiaries. While an incidental benefit may also inure to others the primary purpose of benefiting employees or their beneficiaries must be maintained. For example, a sale of securities to the trust may benefit the vendor in that it may have resulted in a profit to him, but essentially the purchase by the trustee must have been for the best interests of the trust; i. e., the cost must not exceed fair market value at time of purchase, a fair return commensurate with the prevailing rate should be provided, sufficient liquidity should be maintained so as to permit distributions in accordance with the terms of the plan, and the safeguards that a prudent investor would look to should exist. These essentials are equally applicable to the stock or securities of the employer. If the trust instrument and local law permit such investments they are not otherwise precluded for the purposes of section 165(a) of the Code. The Commissioner, however, should be notified if stock or securities of the employer are purchased by the trust so that a determination may be made whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees. The notification shall include information certified to by the accounting or other responsible officer as follows:

1. Balance sheets of the employer as at the close of the last accounting period and for the taxable year ended prior thereto.
2. Comparative statements of income and profit and loss for the last and 4 prior taxable years.
3. An analysis of the surplus account for the last 5 years, specifically showing the amount and rate of dividends paid on each class of stock.
4. A statement accounting for all material changes from the latest dates of the aforesaid statements to the date of filing the information.
5. A schedule showing the nature and amounts of the various assets in the trust fund.
6. A statement setting forth the amount invested, the nature of the investment, the present rate of return and the reasons for the investment.

(*j*) *Valuation of securities on inventory date.*—Any type of qualified plan which provides for distributions in accordance with amounts, stated or ascertainable, credited to participants (i. e., profit-sharing, stock bonus, and some self-administered trusteed money purchase pension plans) must provide for a valuation of securities held by the trust, at least once a year, on a specified inventory date, in accordance with a method consistently followed and uniformly applied. For such purpose, fair market value on the inventory date is generally acceptable. The respective accounts of participants are then to be adjusted in accordance with the valuation. For example, if as a result of an inventory on December 31, 1951, John Doe's account, which theretofore showed a balance of $1,000 is to be increased by one-tenth

of 1 percent of the increase in the value of the trust securities, and such increase is $50,000, his interest is to be increased by $50.

(*k*) *Allocation of stock bonus and profit-sharing funds.*—All funds in an exempt profit-sharing or stock bonus trust must be allocated to participants in accordance with a definite formula. Thus, no reserves are to be provided for by withholding allocations from participants. If suspense accounts are maintained, provisions should be made for ascertaining the respective shares of participants in such accounts and such shares are to be included in any distributions.

PART 3: IMPOSSIBILITY OF DIVERSION UNDER THE TRUST INSTRUMENT

SECTION 165(a)(2) OF THE INTERNAL REVENUE CODE

SECTION 29.165-2 OF REGULATIONS 111

(*a*) *Trust instrument must make prohibited diversion impossible.*—The *trust instrument* must make it 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 * * *." The term "trust instrument" means a *written* agreement. Although an oral trust may be effective within the purview of the applicable local law, for the purposes of paragraph (2) of section 165(a) of the Code, there must be a *written* trust instrument. It must also constitute a valid trust under the law prevailing in the jurisdiction to which it is subject. In addition, it must definitely and affirmatively make it impossible for the nonexempt diversion or use to occur. See Mimeograph 5985, C. B. 1946-1, 72, as to the requisites for the existence of a valid trust and a plan in effect and, also Mimeograph 6394, C. B. 1949-1, 118, as to the requirements for compliance with the provisions of section 165(a)(2) of the Code.

(*b*) *Erroneous actuarial computation.*—Trust funds must not be used for purposes other than for the exclusive benefit of employees or their beneficiaries prior to the termination of the trust and the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, and then recovery may be had only to the extent of any surplus existing because of an actuarial error. In determining whether any surplus exists on termination of a trust, and the amount thereof, all liabilities, contingent as well as fixed, with respect to employees and their beneficiaries under the trust must be taken into account. Fixed liabilities are the benefits payable to those who have become entitled to them. Contingent liabilities are the benefit credits accrued up to the time of termination of the trust for employees (and their beneficiaries) who might have become entitled to benefits if the trust had been continued indefinitely. If such liabilities are to be discharged by commuting the payments (other than through the purchase of insurance company contracts), the values thereof at the time of termination of the trust must be determined for this purpose by use of assumptions no less conservative in any respect than were used in determining costs during the previous life of the trust, and no discount for severances other than death may be assumed.

(*c*) *No reversion in profit-sharing or stock bonus plans.*—Allocations under profit-sharing and stock bonus plans are not predicated

upon amounts actuarially necessary to provide stipulated retirement benefits. See I. T. 3660, C. B. 1944, 136. See also section 29.165-1 (*a*) of Regulations 111 to the effect that a plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for the purposes of section 165(a) of the Code, be considered a pension plan if under the plan either the benefits payable to the employee or the required contributions by the employer can be determined actuarially. Consequently, in profit-sharing and stock bonus plans there can be no reversion of any kind since such plans do not provide benefits which are predicated on actuarial assumptions or computations.

(*d*) *Application of dividends and other credits under group annuity contracts.*—A provision analogous to that set forth in section 165(a)(2) of the Code, prohibiting diversion of funds from exempt trusts, is contained in section 23(p)(1)(B) of the Code relating to deductions of contributions under nontrusteed annuity plans. The latter section requires that, where retirement annuities are purchased, refunds of premiums, if any, must be applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities. To satisfy such requirement, there must be a definite written arrangement between the employer and the insurer, either as part of the annuity contract or by separate written direction from the employer to the insurer, or partly in one form and partly in the other, providing that:

(1) No credits or returns, other than those arising from corrections of errors in records or computations, such as misstated ages or similar corrections, may be paid to the employer prior to permanent discontinuance of contributions.

(2) All dividends, experience rating credits, or employer surrender or cancellation credits ascertained prior to permanent discontinuance of contributions are to be applied regularly as they are determined toward the premiums next due for purchase of annuities under the plan before any further employer contributions are so applied.

(3) If surrender or cancellation credits may be made after discontinuance of the plan but before all retirement annuities with respect to service prior to discontinuance of the plan have been purchased, such credits will be applied regularly as they are determined to purchase such retirement annuities by a procedure which does not contravene the conditions of section 165(a)(4) of the Code.

(4) Any dividends or experience credits similar to dividends made after permanent discontinuance of contributions or any surrender or cancellation credits made after permanent discontinuance of contributions and after all retirement annuities with respect to service prior to discontinuance of the plan have been purchased may be paid to the employer provided they are paid as nearly as practicable as they are determined so that no substantial accumulation results. (It may be noted that this possibility of return to the employer after discontinuance is analogous to the provision permitting return to the employer, on termination of an exempt trust, of any surplus arising from erroneous actuarial computations.)

PART 4: REQUIREMENTS AS TO COVERAGE

SECTION 165(a)(3) (A) AND (B), (5), AND (6) OF THE INTERNAL REVENUE CODE

SECTION 29.165-3 OF REGULATIONS 111

(*a*) *Plan must benefit employees in general.*—Section 165(a)(3) of the Code permits an employer to designate several pension, stock bonus, profit-sharing, and annuity plans as constituting parts of a plan which he intends to qualify under such section. If all of the plans so designated cover a sufficient portion of all employees, there is no requirement that a definite proportion of the employees be included in any one plan. The plan, or plans, must benefit employees in general and, towards this end, must cover either a number which is at least equal to that determined under the percentage provisions of section 165(a)(3)(A) of the Code, or such employees as qualify under a nondiscriminatory classification within the purview of section 165(a)(3)(B) of the Code.

(*b*) *Percentage coverage requirements.*—The percentage coverage requirements of section 165(a)(3)(A) of the Code may be met by including in the plan a number of employees at least equal to that determined by applying either of the alternative percentage provisions. The percentages are applied after excluding certain short service, seasonal, and part-time employees. For example, if out of a total of 1,200 employees, 100 have less than 3 years of service (the minimum period prescribed by the plan), 25 do not customarily work for more than 20 hours in any 1 week, and 75 are employees whose customary employment is for not more than 5 months in any calendar year, the percentages are applied to the balance of 1,000. The alternative percentage provisions are:

1. Seventy percent or more of all employees (70% of 1,000 in the above example) must be covered under the plan.
2. Seventy percent or more of all employees (70% of 1,000 in the above example) must be eligible to benefit under the plan, and, if so, at least 80 percent of all eligible employees must actually be covered.

Under the first alternative, on the basis of the figures used, if at least 700 employees are covered, the requirements of section 165(a)(3)(A) of the Code are satisfied. Under the second alternative, on the same basis, 700 or more employees must be eligible to participate and at least 80 percent of these eligible must actually participate. For example, if employees are also required to contribute 5 percent of compensation in order to participate, and, say, 750 of them are eligible to do so, then if at least 600 actually do contribute and are covered under the plan, the requirements of section 165(a)(3)(A) of the Code are also met.

(*c*) *Classification of employees.*—In lieu of meeting the percentage requirements of section 165(a)(3)(A) of the Code, an employer may set up a classification of employees which, if found by the Commissioner not to discriminate in favor of officers, shareholders, supervisors, or highly compensated employees, will satisfy the requirements of section 165(a)(3)(B) of the Code. Under such provision plans may qualify which are limited to employees who are within a prescribed age group, have been employed for a stated number of years, have been employed in certain designated departments, or are in

other classifications, provided that the effect of covering only such employees does not discriminate in favor of employees within the enumerations with respect to which discrimination is prohibited.

(*d*) *Different eligibility requirements for present and future employees.*—A provision for different eligibility requirements for present and future employees is not necessarily discriminatory within the purview of section 165(a)(3)(B) of the Code. If present employees who are officers, shareholders, supervisors, or highly compensated can meet the requirements for new employees there is no objection to the dual requirements. For example, if all present employees regardless of age are eligible and only those new employees who are at least 30 years old may participate, but all present employees who fall within one or more of the categories enumerated in section 165(a)(3)(B) of the Code are at least 30 years of age, the eligibility provision is not objectionable, even though there are other present employees who are under 30 years of age. Similarly, if all present employees are eligible regardless of years of service but only those future employees who will complete 5 years of service will be eligible, but all present employees who are officers, shareholders, supervisors, and highly compensated have at least 5 years of service, although there are other present employees who have less than 5 years, the eligibility provision is acceptable. If, however, in the above illustrations, there are employees within the enumerated categories who are under 30 years of age or have less than 5 years of service, the prohibited discrimination is likely to arise in operation when new employees are added, and, therefore, in such a case such a provision would not be acceptable as a basis for a favorable advance ruling.

(*e*) *Burdensome contributions.*—Section 29.165-3 of Regulations 111 provides in part: "If a contributory plan is offered to all of the employees, but the requirement of contribution by the employee participants is so burdensome as to make the plan acceptable only to the highly paid employees, the classification will be considered discriminatory in favor of such highly paid employees." For example, if the plan requires employee contributions of 10 percent of compensation, it will be necessary to determine whether lower paid employees are kept out of the plan because of such requirement. If it is found that lower paid employees are not participating because of the contribution requirement, the classification may be held to discriminate in favor of a group enumerated in section 165(a)(3)(B) and (4) of the Code. As a general rule, however, employee contributions of 6 percent or less are not deemed to be burdensome. In cases where the plan provides for optional rates of contribution by employees, and employer contributions or the benefits are geared to the employee contributions in such a way that a higher rate of employee contributions will result in larger benefits from employer contributions, the employee contributions may similarly be found to be burdensome and result in discrimination in contributions and benefits in contravention of section 165(a)(4) of the Code, but generally only if the highest rate of employee contribution permitted is in excess of 6 percent of compensation. The test is whether the contribution provisions operate to deprive lower paid employees of benefits at least as high in proportion to compensation as are provided for higher paid employees, after taking into account differentials permitted under the requirements for integration with social security benefits. See paragraph (*g*) below.

(*f*) *Classification within purview of statute but discriminatory in operation.*—A classification may appear to be satisfactory on paper but if in actual operation of the plan it discriminates in favor of employees who are highly compensated, etc., the plan will fail of qualification. For example, a plan ostensibly covers all employees regardless of service but nonforfeitable rights are provided only for those who have at least 15 years of service and stay on until normal retirement age 65. Except for a handful of executives who are shareholders and officers, employees are migratory workers who stay on a job for a relatively short time and then move elsewhere. Although the coverage provisions on paper seem satisfactory, in actual operation only the executive employees will benefit. Accordingly, both paragraphs (3) (B) and (4) of section 165(a) of the Code are considered together in determining whether the requirements of each are met. It is possible in the illustration used that the plan may qualify if satisfactory provisions for vesting are incorporated therein. See part 5(*b*) hereof.

(*g*) *Integration.*—Plans which exclude employees who earn less than a specified amount or provide proportionately lesser benefits for such employees may qualify if the benefits under the plan integrate with those provided under the social security or similar (e. g., Railroad Retirement Act) program. The total benefits, inclusive of those under the social security or similar program, are used for comparative purposes. If such total benefits are proportionately no greater for employees earning above a specified amount than for those earning below such amount, considering employees excluded from the plan on account of a minimum salary requirement as well as those included, the nondiscrimination requirements of section 165(a) (3)(B) and (4) of the Code are satisfied.

(1) *Integration rules.*—The rules for integrating benefits under a plan with those provided under the Social Security Act, prior to the 1950 amendments, are set forth in Commissioner's Mimeograph 5539, C. B. 1943, 499. Supporting rulings under that mimeograph are contained in I. T.'s 3613, 3614, and 3615, C. B. 1943, 475, 476, and 477, respectively, and in P. S. Nos. 5, 13, and 30. Rules as to integration of deferred benefit plans of employers with the old-age and survivors insurance benefits provided by the Social Security Act Amendments of 1950 are contained in Mimeograph 6641, C. B. 1951–1, 41, and the modification effected as a result of amendments to the Social Security Act by Public Law 590, Eighty-second Congress, second session, approved July 18, 1952, are set forth in IR-Mimeograph 97, promulgated January 5, 1953, Rev. Rul. 13, page 294, this Bulletin. P. S. No. 34 sets forth the rules applicable to integrating benefits under a plan with those under the Railroad Retirement Act, as in effect as of September 23, 1944, and IR-Mimeograph 96, promulgated January 5, 1953, Rev. Rul. 12, page 290, this Bulletin, prescribed the applicable integration rules as effected by amendments to the Railroad Retirement Act through October 1951.

(2) *Death benefits involved in integration under Mimeograph 5539.*—In applying integration tests under Mimeograph 5539, any benefits payable in the event an employee dies before retirement (or before normal retirement age) may be disregarded

to the extent that such benefits do not exceed the reserve or the accumulated prior contributions. In the event employees contribute under a plan, the increase in limits provided by paragraph 9 of Mimeograph 5539, *supra*, applies only to employee contributions which are exclusive of those applicable to the current cost of insurance or death benefits in excess of the reserve or cash value. Where integration is required and the normal form of benefits beginning at retirement (or at normal retirement age) include death benefits provided by employer contributions and payable on behalf of the employee which are more valuable than a life annuity with a 10 year certain provision, it must be shown that the equivalent benefits on a life annuity 10 year certain basis satisfy the integration requirements. For the purpose of demonstrating such equivalence there may be used the factors in the insurance or annuity contract involved or, where normal retirement age is 65 and the normal form of benefit is one of those indicated below, there may be used the corresponding factor shown:

Normal form of benefit	*Reduction factor to basis of life annuity 10 years certain*
Life annuity, 15 years certain	90 percent.
Life annuity, 20 years certain	80 percent.
Installment refund life annuity	90 percent.
Cash refund life annuity	85 percent.

Thus, for example, if in a particular case integration requires that benefits be not more than 25 percent of average salary in excess of $3,000 a year and the normal form of retirement benefits is a cash refund life annuity at age 65, income benefits of 21¼ percent of average salary in excess of $3,000 a year would be acceptable. These forms of benefits are commonly found in plans insured by individual insurance or annuity contracts but are not often used as the normal form. Optional forms of income other than the normal form which determines the actual value of the benefits should be disregarded for the purposes hereof.

(*3*) Death benefits within the purview of Mimeograph 6641, *supra*, and integration of profit-sharing plans are discussed in such mimeograph.

(*h*) *Coverage requirements must be met on at least 1 day in each quarter.*—The coverage requirements of section 165(a)(3) of the Code, either on the percentage basis under subparagraph (A) or on the basis of a nondiscriminatory classification under subparagraph (B), may be satisfied if such requirements are met on at least 1 day in each quarter of the taxable year. For example, assuming that the taxable year coincides with the calendar year, if the percentage basis is applicable and on the first day of the taxable year 1,000 employees have at least the minimum service requirements prescribed by subparagraph (A), it is sufficient if not less than 700 employees are eligible to participate and not less than 80 percent of those eligible are actually participating on that day even though employee turnover changes the percentages to less than 70 and 80 on all other days prior to April 1 of the same year. The percentage requirements will again have to be met on at least 1 day during the quarter commencing with April 1, and so on for the other quarters during the year.

(*i*) *Denial of participation for failure to enter plan upon becoming eligible.*—Plans may provide for denial of participation for failure to enter plan upon becoming eligible provided that participation requires something snbstantially more than mere consent on the part of the employee. For example, under an employee contributory plan, if the employee refuses to sign a prescribed form for participation authorizing salary deductions in accordance with the plan, the plan may provide for the denial of participation at any other time or for a limited time. Similarly, under an insured plan which requires a physical examination and information as to condition of health, the plan may provide that refusal to take the examination or furnish the information will bar the employee from participation. Adequate notice, however, must be given the employee and the consequences of his failure to comply must be clearly presented to him after which, if he refuses to join, the exclusion provisions of the plan become operative as to such employee. Such provisions must be uniformly applied so as not to result in the prohibited discrimination.

(*j*) *Reentry into plan after discontinuance of participation.*—Plans may provide for reentry after discontinuance of original participation upon severance of employment or for other reasons, such as failure to continue contributions on the part of the employee. Such provisions, however, must be uniformly applied and in no event should they permit a duplication of benefits.

(*k*) *Delay in purchasing insurance contracts.*—Generally, a statement in a plan exonerating the trustee from liability in the event of a reasonable delay in the purchase of insurance contracts for participants will not adversely affect the qualification of the plan, provided, however, that the benefits are calculated from the effective date of participation.

(*l*) *Continuing participation in the event of leave of absence.*—Plans may provide for continued participation in the event of leave of absence for a specified purpose, such as service in the Armed Forces, sickness, or disability. All participants under similar circumstances, however, must be treated alike.

Part 5: Discrimination as to Contributions or Benefits

Section 165(a)(4) of the Internal Revenue Code

Section 29.165-4 of Regulations 111

(*a*) *Nondiscriminatory contributions or benefits.*—Under a plan which is intended to qualify under section 165(a) of the Code there must be no discrimination in contributions or benefits in favor of officers, shareholders, supervisors, or highly compensated employees as against other employees either within or without the plan. Thus, for example, a profit-sharing plan which provides employer allocations of 20 percent of compensation for participants who are within a group in whose favor discrimination is prohibited, and only 10 percent for all other participants, fails to meet the requirements of section 165(a)(4) of the Code. See I. T. 3678, C. B. 1944, 321. Similar considerations apply to contributions and benefits in a pension or annuity plan, except that certain differences in favor of higher paid employees

may be acceptable if integration rules are satisfied. See part 4(*g*) hereof.

(*1*) *Application of forfeitures.*—Funds under a qualified plan arising from forfeitures because of termination of service, or other reason, must not be allocated to the remaining participants in a manner that will effect the prohibited discrimination. In a pension plan, this requirement is met by complying with the rule regarding definitely determinable benefits, to wit: "Benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reason, may be used to provide increased benefits for the remaining participants instead of being used to reduce the amount of contributions by the employer." Similarly, in a stock bonus or profit-sharing plan the contribution formula may provide that forfeitures be used to reduce the employer contributions which would otherwise be required by the formula, but such application of forfeitures is not mandatory in such plans. Nevertheless, it should be observed that whatever provision is made for absorbing forfeitures under a stock bonus or profit-sharing plan the prohibited discrimination must not result.

(*2*) *Variations in contributions or benefits.*—Contributions or benefits for the respective participants may vary provided that the plan in its over-all operations does not discriminate in favor of officers, etc. In some cases, benefits in a profit-sharing plan may vary by reason of a distribution formula which takes into consideration years of service. See I. T.'s 3685 and 3686, C. B. 1944, 324 and 326, respectively, and P. S. No. 28. While the case covered in I. T. 3685, *supra*, illustrates the result, in that case, of the addition of units of compensation and units of service as not creating the prohibited discrimination and the case mentioned in I. T. 3686, *supra*, illustrates the result, in that case, of the multiplication of units of compensation by units of service as creating such discrimination, it was not intended to imply, by the promulgation of those rulings, that any formula using the method shown in I. T. 3685, *supra*, would be acceptable and any formula using the method shown in I. T. 3686, *supra*, would not be acceptable. The result of the operation of such formula is controlling in each case. If the application of either type of formula is found to result in the prohibited discrimination, as measured by ratio of benefits to compensation, then such formula is objectionable.

(*b*) *Vested rights in employer's contributions.*—The Code does not require that an employee be granted immediate vested rights in his employer's contributions as a condition for qualification of a plan. Various provisions for vesting are in use, ranging from complete and immediate vesting through different forms of graduated vesting, upon completion of stated service or participation requirements, to no vesting until attainment of normal or stated retirement age.

(*1*) *Determination as to provision for vesting.*—A determination as to satisfactory vesting provisions will of necessity depend on the facts in the particular case involved. For example, a company which ordinarily employs few people obtains a defense

contract, engages a larger number of employees to work on such contract, establishes a plan under which all employees are eligible to participate, makes contributions on the basis of all employees, but vested rights are not granted until normal retirement age, and it has no need for the additional employees except for work on the defense contract. It is apparent that upon termination of the defense contract, if another contract is not obtained, the additional employees will be released and whatever credits may have inured to them under the plan will be forfeited. A favorable ruling on such a plan is not warranted unless satisfactory provision is made for effectuating benefits to all covered employees. This may be accomplished, for example, by granting fully vested rights after a reasonable waiting period. See P. S. No. 22.

(2) *Requirement for ultimate vesting.*—A plan will not be acceptable as to qualification unless an employee who has reached the normal retirement age (in a pension or annuity plan) or the stated age (or other definitely determinable event has transpired, in a profit-sharing or stock bonus plan), and has satisfied any reasonable and uniformly applicable requirements as to length of service or participation, is permitted to receive the benefits under the plan without the consent of the employer. This, however, does not preclude a provision for discontinuance of benefits to a retired employee for cause, which must be distinctly specified, such as, for example, taking a position with a competitor of the employer or divulging the employer's trade secrets to competitors. Similarly, provision may be made for the granting of less liberal rights under such circumstances. Provisions for the vesting of rights in employees, however, must not discriminate in favor of officers, shareholders, supervisors, or highly compensated employees.

(*c*) *Topheaviness.*—Paragraph (5) of section 165(a) of the Code provides in part that a plan shall not be considered discriminatory within the meaning of paragraphs (3)(B) or (4) of such section merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees. However, in the case of pension and annuity plans which are based on a salary classification, i. e., exclusion of employees earning less than a specified amount, such as $3,000 or $3,600 per annum, the benefits under the plan must integrate with those provided under the Social Security Act or similar public retirement plan. See part 4(*g*) hereof. If under the benefit formula of a pension or annuity plan benefits are provided which bear a uniform relationship to compensation or which do not discriminate in favor of the group with respect to which discrimination is prohibited when social security or similar Federal or State retirement benefits are taken into account, the benefits and contributions are not discriminatory provided the plan contains adequate safeguards against discrimination in the event of termination of the plan or failure to meet the current costs during the first 10 years. See part 5(*d*) hereof. A pension or annuity plan which is not in conformance with the aforesaid does not comply with the requirements of paragraph (4) of section 165(a) of the Code, with respect to nondiscrimination as to contributions or

benefits. A ceiling or similar limitation on the amount of benefits is not required in view of the provisions of section 165(a)(5) of the Code, but a plan under which benefits are limited may satisfy the applicable requirements whereas otherwise certain essential requirements may not be fully met.

(*d*) *Termination rule.*—If benefits for employees who are officers, etc., are funded, or substantially so, because of their nearness to retirement, and benefits for other employees are not similarly funded prior to termination of the plan, the prohibited discrimination will result. Consequently, under the applicable circumstances, an advance favorable ruling as to the qualification of a pension or annuity plan will not be issued unless the plan contains satisfactory provisions limiting the benefits for officers, etc., in the event of early termination of the plan. The rules for this purpose are set forth in Mimeograph 5717, C. B. 1944, 321. Explanatory releases consist of P. S. Nos. 8, 25, 29, 31, 38, 42, 50, and 52. Similar rules are not applicable to stock bonus and profit-sharing plans since acceptable allocation formulae under such plans are designed to preclude the prohibited discrimination under comparable circumstances. The requirements pertaining to permanency, however, are applicable to all types of plans. See Part 2(*e*) hereof.

(*e*) *Normal retirement age.*—The normal retirement age in a pension or annuity plan is the lowest age specified in the plan at which the employee has the right to retire without the consent of the employer and receive retirement benefits based on service to date of retirement at the full rate set forth in the plan (i. e., without actuarial or similar reduction because of retirement before some later specified age). Ordinarily, the normal retirement age under pension and annuity plans is 65, the same as the retirement age in the old-age and survivors insurance provisions of the Social Security Act. A different age may be specified, provided that if it is lower than 65 it represents the age at which employees customarily retire in the particular company or industry and is not a device to accelerate funding. In profit-sharing or stock bonus plans, where there is a stated retirement age it is merely one of several events which may be designated as fixing the time for making distributions. Since the amount of the distributions is dependent upon profits, there is no definitely stated rate of benefits payable at such age. Consequently, the stated retirement age in a profit-sharing or stock bonus plan does not have the same meaning as "normal retirement age" in a pension plan.

(*f*) *Optional retirement prior to normal retirement age.*—Any reasonable optional early retirement ages will generally be acceptable whether or not the consent of the employer is required for retirement at such ages or for payment of benefits beginning upon retirement at such ages.

If the optional early retirement age is earlier than 65 for males or 60 for females and either:

(1) the employer's consent is required for such early retirement benefits, or

(2) there is a minimum salary required for participation or the benefit formula involves a step-up in the rate for salaries in excess of a specified amount so that integration requirements must be satisfied,

then the amount of benefits payable upon early retirement must be such that they meet the appropriate limit indicated below:

a. In a unit benefit plan the actuarial value of benefits payable upon such retirement must not substantially exceed the actuarial value at that time of the benefits which would be payable beginning at normal retirement age on the basis of service credits accrued to the time of actual retirement.

b. In a fixed benefit plan the amount of benefits payable upon early retirement must not substantially exceed the actuarial value at that time of the normal retirement benefits multiplied by the ratio that the actual number of years of service of the employee at retirement bears to the total number of years of service he would have had if he had remained in service until normal retirement age. This requirement is assumed to be met when the benefits provided upon such early retirement are those obtained by application of the then cash value of an insurance or annuity policy calling for level premiums to normal retirement age.

c. In a money purchase plan the amount of benefits payable upon early retirement must not exceed those purchasable by the contributions based on compensation received up to the time of actual retirement.

Where the benefits payable upon such early retirement meet the above conditions they will be acceptable even if no benefits would be vested if the employee's service were terminated at that time for other reasons, unless it appears from the facts in a particular case that the prohibited discrimination is likely to result because of the provision for early retirement.

(*g*) *Participation after normal retirement age.*—The normal retirement age is the time from which definitely determinable benefits under a pension plan become fixed and payable. Accordingly, an employee who has reached such age and has fulfilled the service requirement and other uniformly applicable provisions of the plan must be permitted to retire and to commence receiving the benefits payable thereunder. Arrangements, however, may be mutually made for continued employment beyond normal retirement age. In such event provision may be made with respect to the treatment of the pension benefits such as, for example, payment as though the employee had actually retired, deferment to actual retirement without increment for the interval between normal retirement date and actual retirement, or actuarial equivalent on actual retirement of the benefit at normal retirement age. Whatever provisions are made, however, must be uniformly applied to all participants.

(1) *Additional benefits for service after normal retirement age.*—Provision may be made for additional benefits on account of service after normal retirement age provided such provision is uniformly applicable and does not result in the prohibited discrimination. In a unit benefit plan, the units may be continued during the time of the extended service and the total computed to the time of actual retirement. Under a money purchase plan, the regular rate of contributions may continue to actual retirement. Under a fixed benefit plan the benefits payable at actual retirement may be the actuarial equivalent of those payable at normal retirement age.

(2) *Continued participation under a profit-sharing or stock bonus plan.*—A provision for continued participation under a profit-sharing or stock bonus plan and for contributions to provide additional benefits for employees who remain in employment beyond the stage age does not adversely affect the qualification of the plan, provided, however, that such provision is uniformly applied and does not result in the prohibited discrimination.

(*h*) *Basis of compensation on which benefits are computed.*—Section 165(a)(5) of the Code provides in part: "Neither shall a plan be considered discriminatory * * * merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the *total compensation, or the basic or regular rate of compensation,* of such employees * * *." [Italics supplied.] Thus, total compensation (which may include bonuses, commissions, or overtime pay), basic compensation, or regular rate of compensation may be used, provided that whatever is used is consistently and uniformly applicable to all participants. In this respect, attention is invited to section 29.165-1(*a*) of Regulations 111 which provides in part: "* * * a plan is not for the exclusive benefit of employees in general if it discriminates either in eligibility requirements, contributions, or benefits by any device whatever in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees. See section 165(a) (3), (4), and (5)." Thus, benefits computed at a uniform rate of compensation for all participants may be nondiscriminatory [section 165(a)(5)] but if compensation is adjusted to favor one or a select few the plan may become discriminatory in operation. For example, under a 50 percent fixed benefit plan, a $10,000 a year officer who fulfills all requirements for retirement would be entitled to an annuity of $5,000, but if shortly before retirement his compensation is increased to $20,000 per annum his retirement annuity computed on final salary would be $10,000, or 100 percent of compensation before the increase, whereas others would only be receiving 50 percent. Section 29.165-1(*a*) of Regulations 111 also points out: "The law is concerned not so much with the form of any plan as it is with its effects in operation. For example, in section 165(a)(5) the law specifies certain provisions, which of themselves are not discriminatory, but this does not mean that a plan containing these provisions may not be discriminatory in actual operation." Accordingly, provision is generally made that increases in compensation during the last 5 years of employment are not to be considered for the purpose of computing benefits. Provision is also generally made that past service credits be computed on the average compensation for the 5-year period immediately preceding the establishment of the plan. If in a particular case, however, it can be demonstrated that the use of compensation for some other period does not result in the prohibited discrimination, compensation for such other period may be used.

(*i*) *Adjustment of benefits due to increases or decreases in compensation.*—Consistent and uniform bases of compensation for determin-

ing benefits under a plan are essential in order to preclude the prohibited discrimination from materializing. If benefits are based on compensation at the time the plan is established, and if certain highly compensated employees are within a few years of retirement, their benefits will be based on the highest, or nearly the highest, compensation, while lower paid employees who entered the service of the employer shortly before the plan was established will receive benefits based on the lowest, or nearly the lowest, compensation. To eliminate discrimination a consistent and uniform application should prevail as between both groups, e. g., where compensation within a few years before retirement, which includes salary increments since original employment, is used for the highly compensated employees, similar compensation should be used for the lower paid employees. Therefore, provision will have to be made for increases in benefits when compensation on which benefits are computed is increased. (See Mimeograph 5677, C. B. 1944, 320.) Plans may also provide for decreases in benefits because of decreases in compensation but since the aforesaid reason is not applicable such provision is not required.

(*j*) *Discretion as to payment of benefits under basic options.*—Plans may include various modes of settlement for payment of benefits under the plan if, in determining the mode used in any particular case, a more favorable treatment is not provided for employees who are officers, etc., than for other employees, and further, if, upon retirement (or event calling for a distribution in a profit-sharing plan) each participant is entitled to a fully vested right in the amount which has been accumulated for his benefit. In an insured plan, any type of benefit which is provided under the options contained in the insurance contract is the actuarial equivalent of any other option. Consequently, discretion in the trustee to determine under which option benefits will be paid does not result in the prohibited discrimination. Similar discretion may be provided for in a profit-sharing plan which, for example, permits the trustee to determine whether lump-sum or periodic distributions are to be made in particular cases. The total distributable must be fully vested in the employee in either situation, and, if periodic distributions are to be made to some as against lump-sum payments to others, the present value of all such periodic amounts payable to any employee should be equal to the immediate lump-sum otherwise distributable to him.

(*k*) *Provisions for disability and hardship cases.*—Plans may contain provisions for early retirement because of disability provided that the term "disability" is defined and the rules with respect thereto are uniformly and consistently applied to all employees in similar circumstances. Provisions may also be made in stock bonus and profit-sharing plans for accelerated distributions because of hardship provided that the term "hardship" is defined, the rules with respect thereto are uniformly and consistently applied, and the distributable portion does not exceed the employee's vested interest.

(*l*) *Provision that benefits be based on cash surrender value in insured plans.*—If an insured plan provides that benefits shall be based on cash surrender values, all contracts purchased must provide uniform cash surrender values with respect to all employees under similar circumstances.

(*m*) *Loan privileges.*—Provision may be made for the granting of loans to participants up to the extent of their vested interests subject to the application of specified uniform rules consistently followed. (It should be noted that so-called "loans" may constitute "distributions" if there is tacit understanding between the parties that collection is not intended.)

(*n*) *Past service benefits in plans which contain a minimum age or service requirement for eligibility.*—A plan which contains a minimum age or service requirement for eligibility and provides for past service credits for all prior service of original, but not subsequent, participants will generally be considered objectionable within the purview of section 165(a) (3)(B) and (4) of the Code unless it can be demonstrated that such credits do not result in the prohibited discrimination. (Where the difference is only 1 year, however, e. g., if there is a 1-year waiting period for eligibility, but original participants are given credit for all prior service, including the 1-year waiting period, and new participants do not receive credit based on the 1 year, such a provision may be acceptable.) Provision may, however, be made for credits on account of past services rendered after attainment of a specified age or completion of minimum service, if applied to original as well as subsequent participants.

(*o*) *Right of trustee to borrow on insurance contracts.*—Provision may be made granting the trustee the right to borrow against the loan values of insurance contracts provided that in doing so the remaining interest of employees who are officers, etc., is proportionately no greater than the interest of other employees.

(*p*) *Distribution of funds upon termination.*—Plans are to contain provision for distribution of funds upon termination. At such time the rights of all participants should be fully vested. Any provision for distribution will be acceptable if it specifies the method of distribution and cannot conflict with the restrictions set forth in Mimeograph 5717, *supra*, and cannot otherwise discriminate in favor of employees who are officers, etc. The distribution of unallocated funds may be in cash or in the form of other benefits provided under the plan. The distribution among employees other than those whose benefits have been restricted in accordance with Mimeograph 5717 need not necessarily benefit all such other employees. For example, a distribution which benefits only the employees then over age 50, or only those who then have at least 10 years of service, or only those who meet both such age and service requirements may be acceptable if there is no possibility of discrimination in favor of employees who are highly compensated, etc. Such a situation may exist in a plan covering only wage and hourly rated employees. Upon termination, the funds may be used first to continue benefits to retired employees, then for employees who have met the requirements for retirement but have not actually retired, then for employees over age 60, and so on until the funds are fully exhausted.

(*q*) *Earmarked investments under a profit-sharing plan.*—Where amounts to be distributed to participants under a profit-sharing plan are measured by earmarked investments (such as annuity and life insurance contracts), the trustee must invest each participant's interest under the plan proportionately unless all participants have the right to direct the trustee as to such investments.

APPENDIX

Rulings Incorporated by Reference

TREASURY DECISIONS

Number	*Reference*
5422	C. B. 1944, 318

COMMISSIONER'S MIMEOGRAPHS

5539	C. B. 1943, 499
5677	C. B. 1944, 320
5717	C. B. 1944, 321
5985	C. B. 1946–1, 72
6020	C. B. 1946–1, 74
6136	C. B. 1947–1, 58
6394	C. B. 1949–1, 118
6641	C. B. 1951–1, 41

I. R. MIMEOGRAPHS

96 (Published as Rev. Rul. 12)	I. R. B. 1953–3, 50
97 (Published as Rev. Rul. 13)	I. R. B. 1953–3, 54

I. T. RULINGS

3350	C. B. 1940–1, 64
3613	C. B. 1943, 475
3614	C. B. 1943, 476
3615	C. B. 1943, 477
3660	C. B. 1944, 136
3678	C. B. 1944, 321
3685	C. B. 1944, 324
3686	C. B. 1944, 326
4020	C. B. 1950–2, 61

P. S. RULINGS	*Dated*
5	July 29, 1944
8	August 4, 1944
13	August 24, 1944
22	September 2, 1944
23	September 2, 1944
25	September 2, 1944
28	September 2, 1944
29	September 16, 1944
30	September 16, 1944
31	September 16, 1944
34	September 23, 1944
37	October 7, 1944
38	October 7, 1944
42	November 11, 1944
50	July 12, 1945
52	August 9, 1945
56	June 27, 1946
57	August 5, 1946
60	June 19, 1947

SECTION 29.165–1: Employees' trusts. Rev. Rul. 46

INTERNAL REVENUE CODE

Factors to be considered in determining the qualification of a stock bonus, pension, or profit-sharing trust under section 165(a) of the Internal Revenue Code where the trust: (1) borrows capital, (2) invests in the securities of or enters into transactions with the employer by which it was established and from which it has received or does receive contributions, or with an entity closely related to that employer.

Advice is requested relative to the factors to be considered in determining the qualification of a stock bonus, pension, or profit-sharing

trust under section 165(a) of the Internal Revenue Code where the trust: (1) borrows capital, (2) invests in the securities of or enters into transactions with the employer by which it was established and from which it has received or does receive contributions, or with an entity closely related to that employer.

Section 165(a) of the Internal Revenue Code provides in part that a trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall not be taxable. There is no prohibition in the Code or in the regulations promulgated thereunder against such a trust borrowing funds to purchase investments. Accordingly, it is held that the borrowing of funds by a trust would not serve to disqualify a plan as one for the exclusive benefit of the employees unless it is shown that the borrowing is undertaken for the purpose of benefiting the employer as, for example, borrowing in order to furnish capital or property for use in the employer's business at a time when the employer's financial condition is such that it is unable to borrow money.

With respect to investments in the securities of or transactions with an employer by which a trust was established and from which it has received or does receive contributions, or with an entity closely related to that employer, which investments or transactions yield returns to the trust higher than normally expected and result, in effect, in contributions to the trust in excess of the applicable limitations imposed under section 23(p) of the Internal Revenue Code, it is held that neither the plan nor the trust is disqualified for that reason under section 165(a) of the Code. However, amounts paid to a trust, with respect to such investments or transactions by an employer or an entity closely related to that employer, to the extent that they exceed the applicable limitations imposed by section 23(p) of the Code, should be disallowed as deductions under other sections of the Code if they are found not to be bona fide but to be part of a scheme or device to circumvent the limitations imposed by section 23(p) of the Code.

SECTION 29.165-1: Employees' trusts. Rev. Rul. 82

INTERNAL REVENUE CODE

A pension plan which otherwise meets the requirements of section 165(a) of the Internal Revenue Code, will not fail to qualify as a plan established and maintained by an employer primarily to provide systematically for the payment of "definitely determinable" benefits within the meaning of section 29.165-1(*a*) of Regulations 111 merely because it provides that pension benefits shall be suspended for any period of time during which primary insurance payments under the Federal Social Security Act shall be discontinued because of employment after retirement date.

SECTION 29.165-1: Employees' trusts. Rev. Rul. 109
(Also Section 29.165-4.)

INTERNAL REVENUE CODE

So-called "money purchase" pension plans in which funds arising from forfeitures are used to provide increased benefits for the remaining participants in the plan instead of being applied against

subsequent contributions required to be made by the employer, do not meet the requirements of section 165(a) of the Internal Revenue Code.

Advice is requested whether under a so-called "money purchase" pension plan forfeitures which occur due to the severance of employment may be utilized to increase the benefits of remaining participants in the plan instead of being applied against subsequent contributions required to be made by the employer.

A pension plan within the meaning of section 165(a) of the Internal Revenue Code is clearly defined in section 29.165-1(a) of Regulations 111 as a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. That section further provides that benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reason, may be used to provide increased benefits for the remaining participants instead of being used to reduce the amount of contributions by the employer. The aforementioned section of the regulations, as amended by T. D. 5422, C. B. 1944, 318, makes no distinction as to application of forfeitures under any type of pension plan.

In view of the foregoing, it is held that in so-called "money purchase" pension plans in which funds arising from forfeitures are used to provide increased benefits for the remaining participants in the plan instead of being applied against subsequent contributions required to be made by the employer, do not meet the requirements of section 165(a) of the Code.

SECTION 29.165-3: Requirements as to coverage. T. D. 6011
(Also Section 29.165-4.)

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

Regulations 111 amended to reflect the increase, from $3,000 to $3,600, in the limitation on wages provided for by the Social Security Act Amendments of 1950.

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

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

In order that Regulations 111 [26 CFR, part 29] will reflect the increase, from $3,000 to $3,600, in the limitation on wages provided for by the Social Security Act Amendments of 1950, Public Law 734 (81st Cong.) [C. B. 1950-2, 217], approved August 28, 1950, such regulations are hereby amended as follows:

PARAGRAPH 1. Section 29.165-3 is amended as follows:

(A) By striking out in the first sentence of the sixth paragraph "$3,000" and inserting in lieu thereof "$3,600 (or, prior to 1951, $3,000)".

(B) By striking out in the seventh sentence of the sixth paragraph "earning $3,000 per annum" and inserting in lieu thereof "whose annual remuneration is $3,600 (or, prior to 1951, $3,000)".

PAR. 2. Section 29.165–4, as amended by Treasury Decision 5422 [C. B. 1944, 318], approved December 13, 1944, is further amended by striking the sixth sentence which begins "Thus, a plan" and substituting in lieu thereof the following sentence:

Thus, a plan will not be considered discriminatory merely because the contributions or benefits bear a uniform relationship to total compensation, or to the basic or regular rate of compensation, or merely because the contributions or benefits based on the first $3,600 (or, prior to 1951, the first $3,000) of annual compensation of employees subject to the Federal Insurance Contributions Act differ from the contributions or benefits based on the excess of such annual compensation over $3,600 (or, prior to 1951, over $3,000).

Because this Treasury Decision is merely to conform the regulations to the increase in the limitation on wages provided for by the Social Security Act Amendments of 1950, it is unnecessary to issue the 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 sections 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved May 21, 1953.

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

(Filed with the Division of the Federal Register May 26, 1953, 8:49 a. m.)

SECTION 29.165–3: Requirements as to coverage. Rev. Rul. 12*

INTERNAL REVENUE CODE

Integration of pension and annuity plans of railroad employers with the benefits of the Railroad Retirement Act as amended through October 1951.

1. *Introduction.*—Section 29.165–3 of Regulations 111 provides that a classification of employees under any plan which results in relatively or proportionately greater benefits for employees earning above any specified salary amount or rate than for those below such salary amount or rate may be found to be discriminatory within the meaning of section 165(a)(3)(B) of the Internal Revenue Code unless such relative or proportionate differences in benefits as between employees resulting from such classification are approximately offset by the retirement benefits provided by the Social Security Act. It is further provided that similar considerations, to the extent applicable in any case, will govern classifications under plans supplementing the benefits provided by other Federal or State laws. See also the second paragraph of section 29.165–4 of Regulations 111 as to differences in proportionate benefits or contributions which may be considered nondiscriminatory within the meaning of section 165(a)(4) of the Code because of integrating with benefits provided under State or Federal law.

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*Originally issued as IR-Mimeograph 96, dated January 5, 1953.

Integration rules for determining whether a plan is integrated with the benefits provided under the Railroad Retirement Act as amended through October 1951 are set forth below.

2. *Definitions.*—Where used herein certain terms will have the meaning indicated below:

(*a*) The term "plan" means a pension plan as defined in section 29.165–1(a) of Regulations 111, or an annuity plan as defined in section 29.23(p)–4 of Regulations 111, and in which benefits are related to service for an employer as defined in part I section 1 of the Railroad Retirement Act.

(*b*) The term "service" refers to service for the employer providing the plan, and may include service for associated employers whose employees are covered by the same plan.

(*c*) The term "integrated," as applied to a plan or benefits under a plan, means that differences in proportionate benefits favoring employees earning above any specified rate of compensation, as compared with those earning below such rate, resulting from a classification and/or difference in benefit rates under such plan will be considered approximately offset by the Railroad Retirement Act benefits, so that the plan is not considered discriminatory under the provisions of the regulations referred to in paragraph 1 by reason of such differences.

(*d*) The term "$3,600 excess plan" means a plan under which employees earning less than $3,600 a year are excluded from benefits, either by an eligibility requirement or by a benefit formula basing benefits only on compensation in excess of $3,600 a year.

3. *Basic rule for plans meeting certain conditions.*—A $3,600 excess plan is integrated if the rate of normal annual retirement benefit for each year of credited service cannot exceed 1.6 percent of annual compensation in excess of $3,600, *provided* that the plan conforms to all of the following conditions:

(*a*) The rate of normal retirement benefit for each year of credited service is applied to the *actual* compensation (or some lower amount) in excess of $3,600 for each year of such service, past or future. (For other cases, see paragraph 4.)

(*b*) There are no benefits payable in case of death before retirement. (For other cases, see paragraph 5.)

(*c*) The normal form of retirement benefit is a straight life annuity, and if there are optional forms the benefit payments are adjusted so that the total value of the optional form is the same as the value of the normal form of retirement benefit. (For other cases, see paragraph 6.)

(*d*) Normal retirement age is not lower than age 65 for men and not lower than age 60 for women, and if benefits of any kind are payable in case of retirement or severance of employment before normal retirement age such benefits are appropriately adjusted in accordance with paragraph 7.

(*e*) The employees do not contribute. (For other cases, see paragraph 8.)

4. *Benefits based on compensation, other than actual compensation, in excess of $3,600.*—A $3,600 excess plan which conforms to all the conditions of paragraph 3, except that benefits are based on compensation other than actual compensation in each year of credited service, is integrated:

(*a*) If the rate of normal retirement benefit for each year of credited service does not exceed 1.25 percent of the annual compensation in excess of $3,600 averaged over a definite period of at least 10 consecutive years; (if the total period of service of an employee is less than such definite period, the total period of service must be used for such employee).

(*b*) If the rate of normal retirement benefit for each year of credited future service does not exceed 1.6 percent of the *actual* compensation in excess of $3,600 in each year of credited future service and the rate of normal retirement benefit for each year of credited prior service does not exceed

(i) 1.25 percent of the annual compensation in excess of $3,600 averaged over a definite period of at least 10 consecutive years prior to the date on which an employee becomes eligible for membership in the plan or

(ii) 1 percent of the annual compensation in excess of $3,600 as of the date on which an employee becomes eligible for membership in the plan, or as of some earlier date.

For the purpose of paragraph 4 it is not acceptable to define the 10 year period as the period which will produce the highest average. However, for the purpose of paragraph 4(*a*) the 10 year period ending at actual retirement, or at the earlier of actual retirement or normal retirement age, or at the age 5 years before normal retirement age is acceptable.

5. *Benefits in case of death before retirement.*—A $3,600 excess plan which conforms to the conditions of paragraph 3, 4(*a*), or 4(*b*), except that it provides benefits in case of death before retirement not exceeding the higher of the reserve or the total prior contributions on a typical individual level annual premium funding method (and no other death benefits or life insurance except those for which the current cost is included in the income of the employee) is integrated if the rate of normal retirement benefit for any employee does not exceed 8/9 of the rate or rates specified in whichever of such paragraphs is applicable.

6. *Normal form of retirement benefit an annuity for 10 years certain and life thereafter.*—A $3,600 excess plan which conforms to the conditions of paragraph 3, 4(*a*), 4(*b*), or 5, except that the normal form of retirement benefit is an annuity for 10 years certain and life thereafter, is integrated if the rate of normal annual retirement benefit for each year of credited service does not exceed 90 percent of the rate or rates determined from whichever of such paragraphs is applicable.

7. *Retirement or severance benefits beginning before age 65 (60 for women).*—If a $3,600 excess plan provides benefits attributable to employer contributions in case of retirement or severance of employment before age 65 for men or 60 for women, and if such retirement or severance benefits are paid in the form of an annuity beginning at any time before age 65 (60 for women), then in order for such plan to be integrated, such retirement or severance benefits cannot exceed the maximum benefits accrued to the time of such retirement or severance, determined in accordance with paragraphs 3 through 6, reduced by one-fifteenth thereof for each year that the age of the employee at the time such benefits begin is less than age 65

(60 for women). In a plan providing for a normal retirement age not lower than 65 for men and not lower than 60 for women, this requirement will be considered satisfied if the benefits on such early retirement or severance are actuarially equivalent to the normal retirement benefits accrued to the time of such early retirement or severance, or are equal in value to the reserve for normal retirement benefits accumulated under a typical level premium funding method or unit credit cost method.

8. *Increase for employee contributions.*—A contributory $3,600 excess plan is integrated if the annual retirement benefit of any employee whose benefits do not commence before age 65 (60 for women) cannot exceed the applicable amount determined in accordance with the above rules, increase by one-tenth of his aggregate contributions *exclusive of those applicable to the current cost of insurance or death benefits in excess of the reserve or cash value.* If the benefits commence before age 65 (60 for women) such increase must be reduced by one-fifteenth for each year that the age of the employee at the time of commencement of such benefits is less than 65 (60 for women). Such increases are applicable regardless of the form of retirement benefit or provision for death benefits. It should be noted that where the plan provides for return of only *employee* contributions and interest thereon in case of death before or after retirement, such as when the retirement benefits are on a modified cash refund form, a reduction in otherwise allowable limits on account of such death benefits is not required. It should further be noted that if the increase for employee contributions is expressed in the form of a percentage of compensation, such percentage must be applied to the same compensation as such contributions were, even though compensation averaged over a shorter period is used as the basis for benefits attributable to employer contributions.

9. *Money purchase plans.*—A $3,600 excess plan which provides benefits with respect to service after the inception of the plan from employer contributions of a fixed amount or fixed percentage of each employee's compensation after the effective date of the plan is integrated if (*a*) the rate of employer *contributions* used for the benefit of any employee cannot exceed in any year 12 percent of such employee's *actual* compensation in excess of $3,600 in that year, and (*b*) the benefits for prior service of any employee do not exceed the amounts acceptable for prior service credits, as set forth in paragraphs 3 through 7.

10. *Offset plans.*—The term "offset plan" means a plan in which no employee and no portion of compensation is explicitly excluded by reason of a minimum compensation requirement, and in which all the provisions including the benefit rates apply uniformly to all covered employees regardless of compensation, except that the benefits otherwise provided by the plan formula are reduced or offset by a percentage of the employee's retirement annuity under the Railroad Retirement Act. An offset plan which conforms to conditions (*b*), (*c*), and (*e*) listed in paragraph 3 is integrated if the offset does not exceed 85 percent of the retirement annuity for which the employee is immediately eligible. If the plan is as described in the preceding sentence except that it provides for death benefits of the form described in paragraph 5, the offset must not exceed 75.5 percent of such retire-

ment annuity. If the plan is as described above except that the normal form of retirement benefit is an annuity for 10 years certain and life thereafter, the offset must not exceed 76.5 percent if the plan does not include death benefits of the form described in paragraph 5, or 68 percent if the plan does include such death benefits.

11. *Permissible minimum benefits.*—A plan is integrated if it conforms to the rules set forth in paragraphs 3 through 10 except that it provides a minimum retirement benefit not in excess of $240 a year, or $8 a year per year of service, plus increase for employee contributions as set forth in paragraph 8, or for minimum employer contributions with respect to any employee of $60 a year. However, such minimum is not to be used as a tolerance and may not be taken into account in determining whether higher benefits conform to the above rules.

12. Correspondence relating to this ruling should refer to its number and to the symbols T:S:P.

SECTION 29.165–3: Requirements as to coverage. Rev. Rul. 13*

INTERNAL REVENUE CODE

Integration of deferred benefit plans of employers with the old-age and survivors insurance benefits provided by the Social Security Act, as amended by Public Law 590, Eighty-second Congress, second session, approved July 18, 1952.

1. Mimeograph 6641 (C. B. 1951–1, 41), dated May 3, 1951, sets forth certain rules for determining whether a pension or profit-sharing plan is so integrated with the benefits provided by the Social Security Act Amendments of 1950 that the plan will not be considered discriminatory in favor of officers, shareholders, supervisors or highly compensated employees under the provisions of section 165(a) (3)(B), (4), and (5) of the Internal Revenue Code and sections 29.165–3 and 4 of Regulations 111. In view of the amendments to the Social Security Act effected by Public Law 590, Eighty-second Congress, second session, approved July 18, 1952, consideration has been given to the rules in Mimeograph 6641, *supra*, (sometimes referred to hereinafter as the basic mimeograph) for the purpose of making such modifications as are warranted.

2. Under the amended old-age and survivors insurance provisions, the monthly old-age insurance benefits under the "new start" formula, which will apply in most cases of retirement of insured individuals at or after reaching age 65 in the future, will be equal to 55 percent of the first $100 of average monthly wage plus 15 percent of the next $200 of average monthly wage. The maximum monthly old-age insurance benefit, payable in the case of an eligible retired worker whose average monthly wage is $300, will be $85 a month, or 28⅓ percent of his average monthly wage. As indicated in the basic mimeograph, the total Social Security benefits with respect to an employee may be considered for integration purposes as equal in value to 150 percent of his old-age insurance benefits. Thus, the total Social Security benefits with respect to an employee whose average monthly wage is $300

*Originally issued as IR-Mimeograph 97, dated January 5, 1953.

may be considered as equivalent to a straight life annuity beginning at age 65 or later retirement of 42½ percent of average monthly wage.

As pointed out in the basic mimeograph, employees covered under the old-age and survivors insurance provisions must contribute under the Federal Insurance Contributions Act, and the cost estimates indicate that in the long run employees in the aggregate will pay approximately half the cost of their benefits. It was recognized in the basic mimeograph, however, that employees retiring in the near future would contribute much less than half the cost of their benefits, and, in developing the integration rules, a relatively small adjustment was made on account of the required employee contributions. Further consideration has led to the conclusion that a larger adjustment is justified at the present time.

Consequently, it has been determined that no increase should be made in the basic integration limits for excess plans with a minimum compensation level of $3,600 a year. However, because of the heavier weight given in the new formula to the first $100 of average monthly wage, some increase appears warranted in the limits for excess plans with a minimum compensation level between $1,200 and $3,600 a year. Also, because of the greater recognition given to the required employee contributions, changes are required in the rules for integrating offset plans.

3. The definitions in paragraph 4 and the rules in paragraphs 5 through 10 of Mimeograph 6641, *supra*, remain unchanged.

4. Paragraph 11 of Mimeograph 6641, *supra*, is amended to read as follows:

11. *Excess plans with minimum compensation level between $1,200 and $3,600 a year.*—A noncontributory excess plan in which the minimum annual compensation level is lower than $3,600 but not lower than $1,200 is integrated if the annual retirement benefits for any employee cannot exceed an amount determined as follows:

(*a*) Divide $720 by the minimum annual compensation level. The fraction thus obtained should then be multiplied by 8/9 if the plan provides benefits in case of death before retirement as described in paragraph 6, and should also be appropriately adjusted in the manner provided in paragraphs 7 and 10 where the plan contains provisions described in those paragraphs. The resulting percentage is the maximum rate which may be applied to the portion of average annual compensation in excess of the minimum compensation level but not in excess of $3,600.

(*b*) Compute the *actual* normal annual benefit (but not in excess of the amount produced by applying the maximum rate determined in (*a*)) provided by the plan on the portion of average annual compensation between the minimum annual compensation level and $3,600. Divide this amount by $3,600. Add the percentage thus obtained to the appropriate percentage set forth or determined in accordance with paragraphs 5, 6, 7, or 10. The resulting percentage is the maximum rate which may be applied to the average annual compensation in excess of $3,600.

(*c*) The sum of the amounts determined in accordance with subparagraphs (*a*) and (*b*) should then be adjusted for cases of normal retirement with less than 15 years of service or early retirement or severance in the manner set forth in paragraphs 8 and 9.

Example: A noncontributory excess plan in which the minimum compensation level is $3,000 a year provides normal annual retirement benefits upon retirement at age 65 with at least 15 years of service of 18 percent of average annual compensation in excess of $3,000 but not in excess of $3,600 plus 33 percent of average annual compensation in excess of $3,600, on a 10 years certain and life form. In case of death or severance of employment for other reason before

normal retirement, benefits equal to the reserve accumulated on a typical level funding method are paid. Such plan is integrated; this is determined as follows:

(*a*) Step (1): \$720 divided by \$3,000 equals 0.24
(2): 0.24 × 8/9 × 90% equal 19.2%

Thus, the 18 percent rate provided by the plan does not exceed the maximum permissible rate.

(*b*) Step (1): 18% of \$600 equals \$108
(2): \$108 divided by \$3,600 equals 3%
(3): 3% plus 30% equals 33%

Thus the 33 percent rate provided by the plan does not exceed the maximum permissible rate.

(*c*) The benefits determined by application of the above percentages are appropriately adjusted in cases of severance of employment before normal retirement.

5. Paragraphs 12, 13, 14, 16, 17, 18, and 19 of Mimeograph 6641, *supra*, remain unchanged except that any references to paragraph 11 contained therein shall refer to paragraph 11 as amended in paragraph 4 of this supplement.

6. *Offset plans.*—A plan in which no employee and no portion of compensation is explicitly excluded by reason of a minimum compensation requirement, and in which all the provisions including the benefit rates apply uniformly to all covered employees regardless of compensation, except that the benefits otherwise provided by the plan formula are reduced or offset by a percentage of the employee's old-age insurance benefits, is often referred to as an "offset plan". In order for such a plan to be integrated:

(*a*) If the offset is applied to a percentage of the employee's old-age insurance benefit as computed under the formula in the Social Security Act Amendments of 1950 prior to the amendments effected by Public Law 590, Eighty-second Congress, second session, approved July 18, 1952, such percentage may not exceed the appropriate percentage set forth in or computed in accordance with paragraph 15 of the basic mimeograph.

(*b*) If the offset is applied to a percentage of the employee's old-age insurance benefit as computed under the formula contained in Public Law 590, Eighty-second Congress, second session, approved July 18, 1952, such offset may not exceed 130 percent of such old-age insurance benefits in a plan which conforms to conditions (*a*), (*b*), and (*e*) listed in paragraph 5 of the basic mimeograph. If the plan is as described in the preceding sentence except that it provides for death benefits of the form described in paragraph 6 of the basic mimeograph, the offset may not exceed 115 percent of such old-age insurance benefits. If the plan is as described in either of the two preceding sentences except that the normal form of retirement benefits is one of those listed in paragraph 7 of the basic mimeograph, the offset must not exceed such 130 percent or 115 percent, whichever is applicable, multiplied by the appropriate percentage set forth in such paragraph 7, of such old-age insurance benefits.

The acceptable methods of applying the offset in cases where benefit payments under the plan can commence before age 65, as set forth in paragraph 15 of the basic mimeograph, remain applicable.

Example: A plan covering all employees regardless of earnings provides normal annual retirement benefits at age 65, on a 10 year certain and life form, of 40 percent of annual compensation as defined

in the plan less 100 percent of the old-age insurance benefit to which the employee is, or would on filing application be, entitled. In case of death before retirement, there is a benefit equal to the reserve or the total prior contributions, whichever is greater. No other benefits are payable before age 65. Such plan is integrated because the offset of 100 percent of old-age insurance benefits does not exceed the maximum offset permissible in a plan of this type. Such maximum offset for this type of plan is determined as follows:

$$90\% \times 115\% = 103.5\%$$

Note that if the plan had been identical with that described in the example except that the retirement benefits were on an installment refund or more expensive form, the plan would *not* be integrated, since the 100 percent offset would be more than the maximum permissible, determined as follows in the case of an installment refund form:

$$80\% \times 115\% = 92\%$$

SUPPLEMENT F.—PARTNERSHIPS

SECTION 183.—COMPUTATION OF PARTNERSHIP INCOME

SECTION 29.183-1: Computation of partnership income.

INTERNAL REVENUE CODE

Costs attributable to meals, lodging, and other personal accommodations of the managing partner of a hotel business. (See Rev. Rul. 80, page 62.)

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 201.—LIFE INSURANCE COMPANIES

SECTION 29.201-1: Tax on life insurance companies. T. D. 5992

(Also Sections 29.201-5, 29.201-6; Section 202, Section 29.202-2; Section 203A, Sections 29.203A-1, 29.203A-2; Section 433, Section 40.433(a)-2, Regulations 130.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29 AND PART 40

Regulations 111 and 130 amended to conform to Public Law 468 (82d Cong.) [C. B. 1952-2, 357], approved July 8, 1952, relating to taxability of life insurance companies.

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

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

In order to conform Regulations 111 [26 CFR, part 29] and Regulations 130 [26 CFR, part 40] to Public Law 468, Eighty-second

Congress [C. B. 1952-2, 357], approved July 8, 1952, relating to taxability of life insurance companies, such regulations are amended as follows:

REGULATIONS 111 [26 CFR, PART 29]

PARAGRAPH 1. There is inserted immediately before section 29.201-1 the following:

PUBLIC LAW 468, EIGHTY-SECOND CONGRESS, APPROVED JULY 8, 1952

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 201(a)(1) (relating to imposition of tax on life-insurance companies) of the Internal Revenue Code is hereby amended by adding after "1951" wherever it appears, "and 1952".

* * * * * * *

SEC. 2. The provisions of section 201(f) * * * and sections 201(a)(1) * * * of the Internal Revenue Code as amended by this Act shall be applicable to taxable years beginning in 1952.

PAR. 2. Section 29.201-1, as amended by Treasury Decision 5885 [C. B. 1952-1, 121], approved February 21, 1952, is further amended as follows:

(A) By inserting in the first sentence after the words "with respect to taxable years beginning in 1951" the words "and 1952".

(B) By changing the last sentence of the second paragraph thereof to read as follows:

For computation of 1951 or 1952 adjusted normal-tax net income from the normal-tax net income for such year, see sections 29.203A-1 and 29.203A-2.

PAR. 3. Section 29.201-5, as amended by Treasury Decision 5885, is further amended by changing in the second sentence thereof the words "in the case of taxable years beginning in 1951" to read as follows: "in the case of a taxable year beginning in 1951 or 1952".

PAR. 4. Section 29.201-6, as amended by Treasury Decision 5885, is further amended by inserting in the first sentence in lieu of the words "for taxable years beginning in 1951" the words "in the case of a taxable year beginning in 1951 or 1952".

PAR. 5. Section 29.202-2, as amended by Treasury Decision 5885, is further amended by changing the last paragraph thereof to read as follows:

In the case of a taxable year beginning in 1951 or 1952, an amount equal to eight times the amount of the applicable adjustment provided in the preceding paragraph must be added to normal-tax net income for such year as a factor in determining 1951 or 1952 adjusted normal-tax net income.

PAR. 6. There is inserted immediately preceding section 29.203A-1, as added by Treasury Decision 5885, the following:

PUBLIC LAW 468, EIGHTY-SECOND CONGRESS, APPROVED JULY 8, 1952

* * * * * * *

(b) Section 203A (relating to adjusted normal-tax net income of life-insurance companies) of the Internal Revenue Code is hereby amended by adding after "1951", wherever it appears, "and 1952".

* * * * * * *

SEC. 2. The provisions of section * * * 203A * * * of the Internal Revenue Code as amended by this Act shall be applicable to taxable years beginning in 1952.

PAR. 7. Section 29.203A-1, as added by Treasury Decision 5885, is amended to read as follows:

TAX ON LIFE INSURANCE COMPANIES IN THE CASE OF A TAXABLE YEAR BEGINNING IN 1951 OR 1952.—Section 201(a), as amended by section 336 of the Revenue Act of 1951 and Public Law 468 (82d Cong.), provides that in the case of a taxable year beginning in 1951 or 1952, the tax imposed on a life insurance company for such year shall consist of a tax upon the 1951 adjusted normal-tax net income or the 1952 adjusted normal-tax net income of the company equal to 3¾ percent of the amount of such income not in excess of $200,000, plus 6½ percent of the amount of such income in excess of $200,000. The terms "1951 adjusted normal-tax net income" and "1952 adjusted normal-tax net income" mean the normal-tax net income (consisting of net income computed as provided in section 29.201-7 less the credit for partially tax-exempt interest allowed under section 26(a) and less the credit for dividends received allowed under section 26(b)) for the taxable year beginning in 1951 or 1952, as the case may be, plus eight times the amount of the adjustment for certain reserves computed as provided in section 202(c) (see section 29.202-2), and minus the reserve interest credit, if any, provided in section 203A(b) (see section 29.203A-2). The reserve and other policy liability credit is not allowed for purposes of the computation of 1951 adjusted normal-tax net income or 1952 adjusted normal-tax net income.

The tax imposed upon 1951 adjusted normal-tax net income or upon 1952 adjusted normal-tax net income, as the case may be, by section 201(a) is in lieu of the tax on adjusted normal-tax net income and the tax on adjusted surtax net income imposed by section 201(a) for taxable years other than taxable years beginning in 1951 and 1952.

PAR. 8. Section 29.203A-2, as added by Treasury Decision 5885, is amended by inserting after "1951" in the first sentence thereof the words "or 1952".

REGULATIONS 130 [26 CFR, PART 40]

PAR. 9. There is inserted immediately preceding section 40.433(a)-1 the following:

PUBLIC LAW 468, EIGHTY-SECOND CONGRESS, APPROVED JULY 8, 1952

* * * * * * *

(c) Section 433(a)(1)(H) (relating to excess profits net income of life-insurance companies) of the Internal Revenue Code is hereby amended by adding after "1951", wherever it appears, "and 1952".

SEC. 2. The provisions of section * * * 433(a)(1)(H) of the Internal Revenue Code as amended by this Act shall be applicable to taxable years beginning in 1952.

PAR. 10. Section 40.433(a)-2(h), as amended by Treasury Decision 5885, is further amended as follows:

(A) By inserting in the parenthetical phrase in the first sentence thereof after "1951" the following: "or 1952".

(B) By inserting in the parenthetical clause in the second sentence thereof after "1951" the following: "or 1952".

PAR. 11. Because this Treasury Decision merely makes applicable for taxable years beginning in 1952 the same rules as are applicable for taxable years beginning in 1951 for determining the income and excess profits tax liability of life insurance companies it is hereby found to be unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

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

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved February 17, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 20, 1953, 8:50 a. m.)

SECTION 202.—ADJUSTED NORMAL-TAX NET INCOME

SECTION 29.202–2: Adjustment for certain reserves.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5992, page 297.)

SECTION 203A.—1951 AND 1952 ADJUSTED NORMAL-TAX NET INCOME

SECTION 29.203A–1: Tax on life insurance companies in the case of a taxable year beginning in 1951 or 1952.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5992, page 297.)

SUPPLEMENT J.—POSSESSIONS OF THE UNITED STATES

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

SECTION 29.251–1: Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States. (Also Section 116, Section 29.116–1; Section 131, Section 29.131–1; Section 1621, Regulations 116, Section 405.102.) Rev. Rul. 8*

INTERNAL REVENUE CODE

Applicability of income tax and income tax withholding to earned income derived by United States citizens for services performed on Guam.

1. The purpose of this Revenue Ruling is to outline, in response to many inquiries, the basic principles, under the Organic Act of Guam (64 Stat. 384; C. B. 1950–2, 214), approved August 1, 1950, and the

*Originally issued as IR-Mimeograph 73, dated December 2, 1952.

amendments to the Internal Revenue Code effected by the Revenue Act of 1950 and later laws, for determining the liability incurred (*a*) by a citizen of the United States for reporting and paying income tax in respect to earned income derived from the performance of personal services on Guam, and (*b*) by an employer for withholding, pursuant to Code section 1622, income tax upon wages paid United States citizens for employee services performed on Guam.

2. Section 31 of the Organic Act of Guam which was placed in operation as of January 1, 1951, by Executive Order 10211 (C. B. 1951-1, 155), provides: "The income tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in Guam." The system of income taxation thus created has been held to be local in its nature and separate from the Federal income tax system. Thus, as explained in I. T. 4046 (C. B. 1951-1, 57), there are two separate tax systems, each arising from an identical statute, the one subject to administration by the Government of Guam and the other by the United States. In construing the Guamanian income tax law, it is necessary in some instances to substitute the word "Guam" for the expression "United States" where it occurs in the applicable statute, and to make such other substitutions as are indicated in order to give proper effect to the Guamanian system.

3. A citizen of the United States who is a resident of Guam is liable to Guam for tax on his income from whatever source derived, except such as may be exempt from the tax by statutory provisions. A citizen of the United States who is not a resident of Guam incurs income tax liability to Guam only as to income derived from sources within Guam. Compensation for personal services rendered in Guam by a United States citizen who is not a resident of Guam is, for Guamanian tax purposes, deemed by law not to be income derived from sources within Guam where it relates only to military or naval service. However, the government of Guam has informed the Bureau that it will not require any citizen of the United States, whether military or civilian, and whether resident or nonresident as to Guam, to report and pay to Guam income tax upon remuneration derived for services performed on Guam in the employ of the United States or any agency thereof. The primary reason for this is that satisfactory arrangements have been made to have the various Federal agencies with employees on Guam report to the Commissioner of Internal Revenue the amount of income tax withheld from the salaries and wages of such employees. Equivalent amounts are then transferred to the Treasury of Guam. Insurmountable administrative burdens prevent the use of similar procedures with respect to the United States citizens who are employees of private employers.

4. A citizen of the United States, wherever resident, is liable to the United States for tax on his income from whatever source derived, except such as may be exempt from the tax by statutory provisions. In the computation of tax due under the Federal income tax system, remuneration derived by a citizen of the United States for services performed on Guam in the employ of the United States or any agency thereof may not be excluded from the recipient's gross income for taxable years beginning after 1950 under the provisions of sections

116(a) or 251 of the Internal Revenue Code. In general, no exclusion will otherwise be found in the Code in respect of such income, which must, if taxable, be reported to the United States and the appropriate income tax paid with respect thereto. A citizen of the United States who is employed on Guam by an employer other than the United States or an agency thereof is entitled to the benefits of section 251 of the Code, provided the requirements of that section are met. An individual who is eligible for and elects to claim the benefits provided by section 251 is required to report to the United States only such income as is derived by him from sources within the United States or which is received within the United States. Such an individual must report such income, if any, on Form 1040; must file with such return a properly executed schedule on Form 1040E; may claim only one exemption under section 25(b) of the Internal Revenue Code; may not claim the standard deduction or compute his tax by the use of the tax table printed on page 4 of Form 1040; and may not claim the credit provided in section 131 of the Code for taxes paid or accrued to a foreign country or possession. If such individual is not eligible, or, being eligible, does not elect to claim, for purposes of computing the income tax due the United States, the benefits provided in section 251, his remuneration derived from services performed on Guam must be reported to the United States and the tax due the United States must be computed upon the total income disclosed in his return.

5. In any case where a citizen of the United States incurs liability both to Guam and to the United States for tax upon the same income, he may claim a credit for the tax paid to Guam, under the provisions of section 131 of the Internal Revenue Code, subject to the conditions and limitations of that section, provided that he does not also claim the benefits of section 251 of the Code and neither claims the standard deduction nor computes his tax by the use of the tax table printed on page 4 of Form 1040.

6. The withholding of United States income tax from remuneration paid on or after January 1, 1951, by an employer to citizens of the United States for services performed on Guam is controlled by section 1621 (a) (8) (B) of the Internal Revenue Code. This section excepts from "wages" subject to such withholding remuneration paid for services for an employer (other than the United States or any agency thereof) performed within a possession of the United States if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services. Private employers should apply the 80 percent test stated in section 1621(a)(8)(B) and, where such test is not met, should withhold and pay to the United States income tax upon the wages paid citizens of the United States for employee services performed on Guam. Where that test is met, income tax is not required to be withheld for the United States.

7. Federal tax forms, bearing a Government of Guam overstamp or otherwise suitably identified, are presently prescribed by the Government of Guam for use by individual taxpayers in the reporting and paying of Guamanian income tax and by employers in the reporting and paying of Guamanian income tax withheld. Any tax withheld and paid or payable to the Government of Guam is, under section

35 of the Code with respect to tax withheld at the source, allowable as a credit only against the Guamanian tax liability, and is not allowable as a credit on page 1 of the Federal income tax return.

8. It should be particularly noted that the requirements and exceptions as to withholding are not conclusive as to the includibility of remuneration in the gross income to be reported by a citizen of the United States on a return of income filed with the United States or with Guam.

9. Guamanian income tax liability, and the crediting or refunding of income tax withheld and paid or payable to Guam, are matters within the jurisdiction of the Commissioner of Taxes, Government of Guam, Agana, Guam, from whom taxpayers concerned may obtain information.

10. Correspondence in regard to paragraphs 3, 4, and 5 of this Revenue Ruling should refer to the symbols T: R: I. . Correspondence in regard to paragraph 6 should refer to T: R: E.

SECTION 252.—CITIZENS OF POSSESSIONS OF UNITED STATES

SECTION 29.252-1: Status of citizens of United States possession. Rev. Rul. 56

INTERNAL REVENUE CODE

The taxpayer, a citizen of Guam, who is a citizen of the United States only by virtue of collective naturalization under the Organic Act of Guam, 64 Stat. 384, C. B. 1950-2, 214, is a citizen of a possession of the United States for the purposes of section 252 of the Internal Revenue Code and is subject to Federal income tax only upon income derived from sources within the United States. Such taxpayer is also subject to income tax imposed by the government of Guam by reason of the dual system of taxation created by the Organic Act of Guam. (See I. T. 4046, C. B. 1951-1, 57.)

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SECTION 275.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

SECTION 29.275-1: Period of limitation upon assessment of tax. T. D. 5971
(Also Section 42, Section 29.42-1.)

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 section 611 of the Revenue Act of 1951, relating to income pursuant to award of Interstate Commerce Commission.

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

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

On November 15, 1952, a notice of proposed rule making was published in the Federal Register [17 F. R. 10464] to conform Regulations 111 [26 CFR, part 29] to section 611 of the Revenue Act of 1951, approved October 20, 1951. No objections to the rules proposed having been received within the 30 days following such publication, the amendments set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.42–1 [26 CFR 29.42–1] the following:

SEC. 611. INCOME PURSUANT TO AWARD OF INTERSTATE COMMERCE COMMISSION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) Notwithstanding section 42 of the Internal Revenue Code, amounts received, pursuant to an award under the order issued under the Railway Mail Pay Act of 1916 by the Interstate Commerce Commission on December 4, 1950, as compensation for the transportation of mail during 1950 and prior years shall be deemed to be income which accrued in the taxable years in which the services to which such compensation relates were rendered. Notwithstanding section 292 of such Code, no interest shall be assessed or collected for any period prior to July 1, 1951, with respect to that part of any deficiency which the Secretary determines to be attributable to the inclusion of income in a taxable year by reason of the application of this section. Any deficiency attributable to the inclusion of income in any taxable year by reason of the application of this section may be assessed at any time prior to the expiration of the period for assessment with respect to the taxable year of the taxpayer which includes December 4, 1950, notwithstanding the provisions of section 275 of the Internal Revenue Code or any other provision of law or rule of law which would otherwise prevent such assessment.

* * * * * * *

PAR. 2. Section 29.42–1(a), as amended by Treasury Decision 5405 [C. B. 1944, 154], approved September 22, 1944 [26 CFR 29.42–1(a)], is further amended by adding at the end thereof the following new sentence:

As to amounts received, pursuant to an award under the order issued on December 4, 1950, under the Railway Mail Pay Act of 1916 by the Interstate Commerce Commission, as compensation for the transportation of mail during 1950 and prior years, see section 611(a) of the Revenue Act of 1951.

PAR. 3. Section 29.275–1, as amended by Treasury Decision 5942 [C. B. 1946–1, 159], approved October 24, 1952 [26 CFR 29.275–1], is further amended by inserting immediately preceding the last paragraph thereof the following:

(13) Any deficiency attributable to the inclusion of income in any taxable year by reason of the application of section 611(a) of the Revenue Act of 1951 (which qualifies section 42 with respect to the taxable year in which amounts received, pursuant to an award under the order issued on December 4, 1950, under the Railway Mail Pay Act of 1916 by the Interstate Commerce Commission, as compensation for the transportation of mail during 1950 and prior years are to be included in income) may be assessed at any time prior to the expiration of the period for assessment with respect to the taxable year of the taxpayer which includes December 4, 1950, notwithstanding the provisions of section 275 or of any other provision of law or rule of law, such as the provisions of section 3760 or the doctrine of *res judicata*, which would otherwise prevent such assessment.

PAR. 4. There is inserted immediately preceding section 293 the following:

SEC. 611. INCOME PURSUANT TO AWARD OF INTERSTATE COMMERCE COMMISSION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) Section 292 (relating to interest on deficiencies) is hereby amended by adding at the end thereof the following new subsection:

"(d) With respect to any corporation entitled to receive payment for the transportation of United States mail, if an award is retroactively received for the transportation of United States mail, and if such award is required to be treated as income in the year or years in which the mail was carried, then, notwithstanding the provisions of subsection (a) of this section, no interest shall be due, with respect to any period prior to thirty days after such award is granted, for tax deficiencies resulting from the inclusion of such additional mail payments retroactively."

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 8, 1953.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 12, 1953, 8:48 a. m.)

SECTION 29.275–1: Period of limitation upon assessment of tax.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5968, page 206.)

SECTION 29.275–1: Period of limitation upon assessment of tax.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5991, page 146.)

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX

SECTION 292.—INTEREST ON DEFICIENCIES

Rev. Rul. 47

INTERNAL REVENUE CODE

A Waiver of Restriction on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, Form 870, was filed by a taxpayer pursuant to the provisions of section 272(d) of the Internal Revenue Code. The waiver provides for the immediate assessment of additional tax in the amount of $3x$ dollars. Subsequent to the filing of such waiver, and prior to assessment of the additional tax, the taxpayer filed a second waiver providing for the immediate assess-

ment of additional tax in the amount of $5x$ dollars. The second waiver bore the notation that it superseded the waiver previously filed in the net amount of $3x$ dollars. The deficiency was not assessed prior to expiration of the thirtieth day after the filing of the second waiver. *Held*, for the purposes of section 292(a) of the Code, relating to interest on deficiencies, interest should be assessed on $3x$ dollars to the thirtieth day after the filing of the first waiver and on $2x$ dollars to the thirtieth day after the filing of the second waiver.

SUPPLEMENT O.—OVERPAYMENTS

SECTION 322.—REFUNDS AND CREDITS

SECTION 29.322-3: Claims for refund by taxpayers. Rev. Rul. 110

INTERNAL REVENUE CODE

Where claims for refund of Federal income tax were mailed in ample time to have been received in the offices of collectors of internal revenue in the ordinary course of the mails on or before March 15, 1952, but such claims were not received on that date because of outstanding instructions to the Post Office Department to the effect that collectors' offices would not be open to receive mail on Saturday, March 15, 1952, such claims will be considered to have been received on March 15, 1952, if they were in fact received by March 17, 1952.

Advice is requested whether claims for refund which were mailed in ample time to have been received in the offices of collectors of internal revenue in the ordinary course of the mails on March 15, 1952, but due to unusual circumstances were not received until March 17, 1952, may be considered to be timely filed.

The claims for refund of income tax in question were mailed during March 1952 in time to have been delivered to the offices of the collectors (now directors of internal revenue) in the ordinary course of the mails on Saturday, March 15, 1952. However, due to outstanding instructions to the Post Office Department to the effect that the collectors' offices would not be open to receive mail on Saturday, these claims were not delivered to the collectors' offices until Monday, March 17, 1952, at which time the claims were stamped as received. The collectors' offices were in fact open on March 15, 1952, and wide publicity was given to the fact that their offices would be open for the purpose of the taxpayer assistance program. Income tax returns, payments, and claims for refund which were physically presented were stamped as received on March 15, 1952. Had the Post Office Department been so instructed, the claims in question would also have been delivered and stamped as received on that date.

Ordinarily it is the position of the Bureau that a claim must be actually received prior to the expiration of the statute of limitations under section 322(b) of the Internal Revenue Code and that the fact that it was placed in the mails in ample time to reach the office of the collector or the Commissioner by the expiration of the statutory period is not sufficient to constitute a "filing" within the meaning of section 322(b). (Cf. I. T. 1921, C. B. III-1, 345 (1924); Pleasant Valley Wine Co., 14 T. C. 519; Frank A. Gray, 16 T. C. 262, 266.) However, here it appears that taxpayers may have been misled into believing that mail would be delivered to the offices of the collectors on Saturday, March 15, 1952, by the above-mentioned publicity.

Accordingly, it is held that where claims for refund of Federal income tax were mailed in ample time to have been received in the offices of collectors of internal revenue in the ordinary course of the mails on or before March 15, 1952, but such claims were not received on that date because of outstanding instructions to the Post Office Department to the effect that collectors' offices would not be open to receive mail on Saturday, March 15, 1952, such claims will be considered to have been received on March 15, 1952, if they were in fact received on March 17, 1952.

SECTION 29.322-7: Limitation upon the crediting and refunding of taxes paid.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5968, page 206.)

SUPPLEMENT Q.—REGULATED INVESTMENT COMPANIES

SECTION 361.—DEFINITION

SECTION 29.361-1: Definition of a regulated investment company. T. D. 6000

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 section 337 of the Revenue Act of 1951.

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

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

On December 4, 1952, notice of proposed rulemaking with respect to section 337 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 10972). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments to Regulations 111 [26 CFR, part 29] set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 29.361-1 [26 CFR 29.361-1] the following:

SEC. 337. TAX TREATMENT OF CERTAIN INVESTMENT COMPANIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) INCLUSION OF CERTAIN REGISTERED MANAGEMENT COMPANIES IN THE DEFINITION OF REGULATED INVESTMENT COMPANY.—Section 361 (relating to definition of regulated investment companies) is hereby amended by adding at the end thereof the following new subsection:

"(c) CERTAIN INVESTMENT COMPANIES.—If the Securities and Exchange Commission determines in accordance with regulations issued by it, and certifies to the Secretary not more than 60 days prior to the close of the taxable year of a registered management investment company,

that such investment company is principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, such investment company may, in the computation of 50 per centum of the value of its assets under subparagraph (A) of subsection (b)(3) for any quarter of such taxable year, include the value of any securities of an issuer, notwithstanding the fact that such investment company holds more than 10 per centum of the outstanding voting securities of such issuer, but only if the investment company has not continuously held any security of such issuer (or of any predecessor company of such issuer as determined under regulations prescribed by the Secretary) for 10 or more years preceding such quarter of such taxable year. The provisions of this subsection shall not apply at the close of any quarter of a taxable year to an investment company if at the close of such quarter more than 25 per centum of the value of its total assets is represented by securities of issuers with respect to each of which the investment company holds more than 10 per centum of the outstanding voting securities of such issuer and in respect of each of which or any predecessor thereof the investment company has continuously held any security for 10 or more years preceding such quarter unless the value of its total assets so represented is reduced to 25 per centum or less within 30 days after the close of such quarter. The terms used in this subsection shall have the same meaning as in subsection (b)(3) of this section. For the purposes of this subsection, unless the Securities and Exchange Commission determines otherwise, a corporation shall be considered to be principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, for at least 10 years after the date of the first acquisition of any security in such corporation or any predecessor thereof by such investment company if at the date of such acquisition the corporation or its predecessor was principally so engaged, and an investment company shall be considered at any date to be furnishing capital to any company whose securities it holds if within 10 years prior to such date it has acquired any of such securities, or any securities surrendered in exchange therefor, from such other company or predecessor thereof. For the purposes of the certification hereunder, the Securities and Exchange Commission shall have authority to issue such rules, regulations and orders, and to conduct such investigations and hearings, either public or private, as it may deem appropriate."

(b) TECHNICAL AMENDMENT.—Section 361(b)(3)(A) is hereby amended by inserting after "the total assets of the taxpayer and" the following: ", except and to the extent provided in subsection (c),".

(c) EFFECTIVE DATE.—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950.

PAR. 2. Section 29.361–1 [26 CFR 29.361–1] is amended as follows:

(A) By striking out the period and dash in the heading of (*b*) of the section and inserting in lieu thereof the following: "—(1). *In general.*"

(B) By inserting in the second sentence of (*b*) of the section, immediately after "5 percent of the value of the total assets of the corporation and", the following:

, except and to the extent provided in section 361(c) in the case of certain venture capital registered management investment companies qualifying thereunder,

(C) By adding at the end of (*b*) of the section the following:

(2) *Venture capital registered management investment companies.*—Section 361(c) provides, for taxable years beginning after December 31, 1950, that under certain conditions set forth below a registered management investment company which has been certified by the Securities and Exchange Commission for the taxable year may, in the computation of 50 percent of the value of its assets

under clause (A) of section 361(b)(3) for any quarter of such taxable year, include, with respect to securities other than Government securities or securities of other regulated investment companies, the value of any securities of an issuer, notwithstanding the fact that such registered management investment company holds more than 10 percent of the outstanding voting securities of such issuer, but only if the investment company has not continuously held any security of such issuer or of any predecessor company of such issuer for 10 or more years preceding such quarter of such taxable year. All other provisions and requirements of section 361 and the regulations thereunder are applicable in determining whether such registered management investment company qualifies as a regulated investment company within the meaning of such section.

The provisions of section 361(c) are applicable only to a registered management investment company which the Securities and Exchange Commission has determined, in accordance with regulations issued by it, and has certified to the Secretary, not more than 60 days prior to the close of the taxable year of such investment company, to be principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available. For the purpose of the aforementioned determination and certification, unless the Securities and Exchange Commission determines otherwise, a corporation shall be considered to be principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, for at least 10 years after the date of the first acquisition of any security in such corporation or any predecessor thereof by such investment company if at the date of such acquisition the corporation or its predecessor was principally so engaged, and an investment company shall be considered at any date to be furnishing capital to any company whose securities it holds if within 10 years prior to such date it has acquired any of such securities, or any securities surrendered in exchange therefor, from such other company or its predecessor.

Section 361(c) does not apply in the quarterly computation of 50 percent of the value of the assets of an investment company under clause (A) of section 361(b)(3) for any taxable year if at the close of any quarter of such taxable year more than 25 percent of the value of its total assets (including the 50 percent or more mentioned in such clause (A)) is represented by securities (other than Government securities or the securities of other regulated investment companies) of issuers as to each of which (i) such investment company holds more than 10 percent of the outstanding voting securities of such issuer and (ii) such investment company has continuously held any security of such issuer (or any security of a predecessor of such issuer) for 10 or more years preceding such quarter, unless the value of its total assets so represented is reduced to 25 percent or less within 30 days after the close of such quarter.

As used in section 361(c) and this paragraph (b)(2), the term "predecessor company" means any corporation the basis of whose securities in the hands of the investment company was, under the provisions of section 113, the same in whole or in part as the basis of any of the securities of the issuer, and any corporation with respect to whose securities any of the securities of the issuer were received directly or indirectly by the investment company in a transaction or series of transactions involving nonrecognition of gain or loss, in whole or in part. The other terms used in this paragraph (b)(2) have the same meaning as when used in section 361(b)(3) (see paragraph (b)(1), above).

(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).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved March 26, 1953.

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

(Filed with the Division of the Federal Register April 1, 1953, 8:52 a. m.)

SUPPLEMENT R.—EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

SECTION 373.—DEFINITIONS

SECTION 29.373-1: Definitions. T. D. 5985

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS AFFECTED BY AN EXCHANGE OR DISTRIBUTION MADE AFTER DECEMBER 31, 1941

Regulations 111 amended to conform to section 338 of the Revenue Act of 1951.

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

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

On November 11, 1952, notice of proposed rule making with respect to exchanges or distributions in obedience to orders of the Securities and Exchange Commission was published in the Federal Register (17 F. R. 10263). No objections to the proposed rules having been received, Regulations 111 [26 CFR, part 29] are amended as follows:

PARAGRAPH 1. There is inserted immediately preceding section 29.373-1 [26 CFR 29.373-1] the following:

SEC. 338. EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) DEFINITION OF SYSTEM GROUP.—Section 373(d)(1) (relating to the definition of the term "system group") is hereby amended to read as follows:

"(1) At least 90 per centum of each class of the stock (other than (A) stock which is preferred as to both dividends and assets, and (B) stock which is limited and preferred as to dividends but which is not preferred as to assets but only if the total value of such stock is less than 1 per centum of the aggregate value of all classes of stock which are not preferred as to both dividends and assets) of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall be applicable with respect to taxable years affected by an exchange or distribution made after December 31, 1947.

PAR. 2. Section 29.373-1(d) [26 CFR 29.373-1(d)] is amended as follows:

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

"System Group"—(1) Taxable years affected by an exchange or distribution made before January 1, 1948.

(B) By striking from the first sentence thereof "The term 'system group' is defined" and inserting in lieu thereof the following:

For taxable years affected by an exchange or distribution made before January 1, 1948, the term "system group" is defined

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

(2) *Taxable years affected by an exchange or distribution made after December 31, 1947.*—For taxable years affected by an exchange or distribution

made after December 31, 1947, the term "system group" is defined in section 373(d) to mean one or more chains of corporations connected through stock ownership with a common parent corporation, if at least 90 percent of each class of stock (other than (A) stock which is preferred as to both dividends and assets, and (B) stock which is limited and preferred as to dividends but which is not preferred as to assets but only if the total value of such stock is less than 1 percent of the aggregate value of all classes of stock which are not preferred as to both dividends and assets) of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations, and if the common parent corporation owns directly at least 90 percent of each class of stock (other than stock preferred as to both dividends and assets) of at least one of the other corporations; but no corporation is a member of a system group unless it is either a registered holding company or a majority-owned subsidiary company. While the type of stock which must, for the purpose of this definition, be at least 90 percent owned may be different from the voting stock which must be more than 50 percent owned for the purpose of the definition of a majority-owned subsidiary company under section 373(c), as a general rule both types of ownership tests must be met under section 373(d), since a corporation, in order to be a member of a system group, must also be a registered holding company or a majority-owned subsidiary company.

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 10, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 13, 1953, 8:53 a. m.)

SUPPLEMENT T.—INDIVIDUALS WITH ADJUSTED GROSS INCOME OF LESS THAN $5,000

SECTION 402.—MANNER AND EFFECT OF ELECTION

SECTION 29.402-1: Manner of election to compute tax under supplement T.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5965, page 60.)

SECTION 29.402-1: Manner of election to compute tax under supplement T.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5993, page 9.)

SUBCHAPTER D.—EXCESS PROFITS TAX

PART I.—RATE AND COMPUTATION OF TAX

SECTION 430.—IMPOSITION OF TAX

SECTION 40.430-2, REGULATIONS 130: Rate of tax. T. D. 5997

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to conform to section 501 of the Revenue Act of 1951, relating to maximum tax for new corporations.

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

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

On December 13, 1952, a notice of proposed rule making was published in the Federal Register [17 F. R. 11343] to conform Regulations 130 [26 CFR, part 40] to section 501 of the Revenue Act of 1951, approved October 20, 1951. After consideration of such relevant suggestions as were presented regarding the proposals, the amendments set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 40.430-1 [26 CFR 40.430-1] the following:

SEC. 501. MAXIMUM TAX FOR NEW CORPORATIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 430 (relating to imposition of tax) is hereby amended as follows:

(1) By adding at the end of subsection (a) thereof, as amended by section 121 of this Act, the following:

"(3) in the case of a corporation for which an amount is determined for the taxable year under subsection (e), the amount determined under such subsection."

(2) By redesignating subsection (e) as subsection (f); and

(3) By inserting after subsection (d) the following new subsection:

"(e) NEW CORPORATIONS.—

"(1) ALTERNATIVE AMOUNT.—In the case of a taxpayer which commenced business after July 1, 1945, and whose fifth taxable year ends after June 30, 1950, the amount referred to in subsection (a)(3) shall be—

"(A) If the taxable year is the first or second taxable year of the taxpayer, an amount equal to 5 per centum of the excess profits net income for the taxable year, except that if the excess profits net income exceeds $300,000, the amount shall be the sum of $15,000 plus the amount determined under subparagraph (E) of this paragraph.

"(B) If the taxable year is the third taxable year of the taxpayer, an amount equal to 8 per centum of the excess profits net income for the taxable year, except that if the excess profits net income exceeds $300,000, the amount shall be the sum of $24,000 plus the amount determined under subparagraph (E) of this paragraph.

"(C) If the taxable year is the fourth taxable year of the taxpayer, an amount equal to 11 per centum of the excess profits net income for the taxable year, except that if the excess

profits net income exceeds $300,000, the amount shall be the sum of $33,000 plus the amount determined under subparagraph (E) of this paragraph.

"(D) If the taxable year is the fifth taxable year of the taxpayer, an amount equal to 14 per centum of the excess profits net income for the taxable year, except that if the excess profits net income exceeds $300,000, the amount shall be the sum of $42,000 plus the amount determined under subparagraph (E) of this paragraph.

"(E) The amount determined under this subparagraph shall be—

"(i) if the taxable year ends before April 1, 1951, an amount equal to 15 per centum of the excess of the excess profits net income for the taxable year over $300,000.

"(ii) if the taxable year begins on January 1, 1951, and ends on December 31, 1951, an amount equal to 17¼ per centum of the excess of the excess profits net income for the taxable year over $300,000.

"(iii) if the taxable year (other than a taxable year described in clause (ii)) ends after March 31, 1951, an amount equal to 18 per centum of the excess of the excess profits net income for the taxable year over $300,000.

"(2) FIRST FIVE TAXABLE YEARS.—For the purpose of this subsection—

"(A) The taxable year in which the taxpayer commenced business and the first, second, third, and fourth succeeding taxable years shall be considered its first, second, third, fourth, and fifth taxable years, respectively.

"(B) The taxpayer shall be considered to have been in existence and to have had taxable years for any period during which it or any corporation described in any clause of this subparagraph was in existence, and the taxpayer shall be considered to have commenced business on the earliest date on which it or any such corporation commenced business:

"(i) Any corporation which during or prior to the taxable year was a party with the taxpayer to a transaction described in section 445(g)(2) (A), (B), or (C), determined as if the date 'July 1, 1945' were substituted for the date 'December 1, 1950' in section 445(g)(2)(C).

"(ii) Any corporation if a group of not more than four persons who control the taxpayer at any time during the taxable year also controlled such corporation at any time during the period beginning twelve months preceding their acquisition of control of the taxpayer and ending with the close of the taxable year; but only if at any time during such period (and while such persons controlled such corporation) such corporation was engaged in a trade or business substantially similar to the trade or business of the taxpayer during the taxable year. For the purpose of this clause, the term 'control' means the ownership of more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock. A person shall not be considered a member of the group referred to in this clause unless during the period referred to in this clause he owns stock in such corporation at a time when the members of the group control such corporation and he owns stock in the taxpayer at a time when the members of the group control the taxpayer. For the purpose of this clause, the ownership of stock shall be determined in accordance with the provisions of section 503, except that constructive ownership under section 503(a)(2) shall be determined only with respect to the individual's spouse and minor children.

"(iii) In case the taxpayer during or prior to the taxable year was a purchasing corporation (as defined in part IV),

the selling corporation (as defined in such part) whose properties were acquired in the part IV transaction; but this clause shall not apply unless for the taxable year or for any preceding taxable year the conditions of paragraphs (1), (2), and (3) of section 474(c) were satisfied with respect to such transaction.

"(iv) Any corporation which, under regulations prescribed by the Secretary, is determined by one or more additional applications of clauses (i) to (iii) to stand indirectly in the same relation to the taxpayer as though such corporation were described in any such clause.

If as of the beginning of December 1, 1950, the adjusted basis for determining gain upon sale or exchange of the aggregate assets theretofore acquired by the taxpayer in transactions described in clauses (i) and (iii) (or acquired in the ordinary course of business in replacement of such assets) and held by it at such time constituted less than 20 per centum of the adjusted basis for determining gain upon sale or exchange of its total assets held at such time, then transactions described in such clauses occurring prior to such date shall be disregarded in determining the date as of which the taxpayer shall be considered to have commenced business.

"(3) LIMITATION.—The provisions of paragraph (1) of this subsection shall not apply to a taxpayer which derives more than 50 per centum of its gross income (determined without regard to dividends and without regard to gains from sales or exchanges of capital assets) for the taxable year from contracts and subcontracts to which the provisions of title I of the Renegotiation Act of 1951 (or the provisions of any prior renegotiation act) are applicable."

SEC. 523. EFFECTIVE DATE OF TITLE V[REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [including sec. 501] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 2. Section 40.430–2, as amended by Treasury Decision 5969 [page 122, this Bulletin], approved December 29, 1952 [26 CFR 40.430–2], is further amended as follows:

(A) By striking the period at the end of clause (iv) of (a)(1) of the section and inserting in lieu thereof ", or", and by adding after such clause (iv) the following new clause:

(v) in the case of a new corporation for which an amount is determined for the taxable year under section 430(e), the amount determined under such section and under (e) of this section.

(B) By redesignating the present (e) of the section as (f) of the section.

(C) By inserting immediately following (d) of the section the following:

(e) *New corporations.*—(1) Section 430(e), together with section 430(a)(3), provides, in the case of any corporation which commenced business after July 1, 1945, for a maximum excess profits tax for any of its first five taxable years which ends after June 30, 1950. The determination of such maximum excess profits tax, which is the amount referred to in section 430(a)(3) and in (a)(1)(v) of this section, depends upon the amount of the excess profits net income and upon whether the taxable year is the first, second, third, fourth, or fifth taxable year of the taxpayer. If the excess profits net income for the taxable year does not exceed $300,000, the maximum excess profits tax will be an amount equal to 5 percent of the excess profits net income for the taxable year if such taxable year is the first or second taxable year of the taxpayer; an amount equal to 8 percent of the excess profits net income if the taxable year is the third taxable year of the taxpayer; an amount equal to 11 percent of the excess profits net income if the taxable year is the fourth taxable year of the tax-

payer; and an amount equal to 14 percent of the excess profits net income if the taxable year is the fifth taxable year of the taxpayer. If the excess profits net income for the taxable year exceeds $300,000, the maximum excess profits tax will be an amount equal to the sum of $15,000, if the taxable year is the first or second taxable year of the taxpayer, $24,000, if the taxable year is the third taxable year of the taxpayer, $33,000, if the taxable year is the fourth taxable year of the taxpayer, and $42,000, if the taxable year is the fifth taxable year of the taxpayer, plus, in each case, an amount equal to (i) 15 percent of the amount by which the excess profits net income for such taxable year exceeds $300,000 if the taxable year ends before April 1, 1951, or (ii) 17¼ percent of such excess if the taxable year begins on January 1, 1951, and ends on December 31, 1951 (the calendar year 1951), or (iii) 18 percent of such excess if the taxable year ends after March 31, 1951, but is not the calendar year 1951.

(2) The determination of the maximum excess profits tax, as described in (1) above, is shown in the following chart:

A	B	C	D
If the excess profits tax taxable year of the taxpayer is—	If excess profits net income for the taxable year does not exceed $300,000, the maximum excess profits tax is—	If excess profits net income for the taxable year exceeds $300,000, the maximum excess profits tax is—	Amount to be added to column C where excess profits net income exceeds $300,000—
The first or second taxable year.	5 percent of excess profits net income.	$15,000 plus the amount specified in column D.	(i) If the taxable year ends before April 1, 1951, 15 percent of the amount by which the excess profits net income for such taxable year exceeds $300,000; or (ii) If the taxable year begins on January 1, 1951, and ends on December 31, 1951 (the calendar year 1951), 17¼ percent of such excess; or (iii) If the taxable year ends after March 31, 1951 (except the calendar year 1951), 18 percent of such excess.
The third taxable year.	8 percent of excess profits net income.	$24,000 plus the amount specified in column D.	
The fourth taxable year.	11 percent of excess profits net income.	$33,000 plus the amount specified in column D.	
The fifth taxable year.	14 percent of excess profits net income.	$42,000 plus the amount specified in column D.	

(3) The date the corporation commenced business shall be determined for purposes of section 430(e) and of (e) of this section under the rules provided in the regulations promulgated under section 445, relating to the computation of average base period net income in the case of new corporations. See section 40.445-1(a)(2). The taxable year in which the taxpayer commenced business, unless the taxpayer is considered to have had an earlier constructive existence, shall be considered its first taxable year and the next 4 succeeding taxable years shall be considered its second, third, fourth, and fifth taxable years, respectively. The taxpayer, however, shall be considered to have been in existence and to have had taxable years for any period during which any corporation described in section 430(e)(2)(B) (i), (ii), (iii), or (iv), and in (5) through (8) below, was in existence, and the taxpayer shall be considered to have commenced business on the earliest date on which it or any such corporation commenced business. See (4) below for the determination of constructive taxable years of the taxpayer where such other corporation came into existence prior to the date the taxpayer came into existence.

(4) If the taxpayer is deemed under the provisions of section 430(e)(2)(B) and of (e) of this section to have been in existence prior to the date on which it in fact came into existence and to have had taxable years prior to such date, its first 5 taxable years for purposes of section 430(e) and of (e) of this section shall be determined by reference to the annual accounting period first established by the taxpayer. Any 12-month period ending with the day on which such annual accounting period first established by the taxpayer ends and during all or part of which the taxpayer or any corporation described in section 430(e)(2)(B) (i)-(iv) and in (5) through (8) below was in existence shall be considered a taxable year of the taxpayer for the purpose of determining its first 5 taxable years. If both the taxpayer and any other such corporation were in existence during all or part of any such 12-month period, such period shall nevertheless be considered to be only 1 taxable year of the taxpayer. Any such 12-month period, however, shall be considered a taxable year of the taxpayer if any such other

corporation was in existence during all or part of such period, even though such period, or the part thereof in which such other corporation was in existence, did not constitute a taxable year of such other corporation. The rule set forth above may be illustrated by the following examples:

Example (1). Corporation A came into existence and commenced business on April 1, 1947. It adopted the calendar year as its annual accounting period and filed income tax returns for the period April 1, 1947, through December 31, 1947, and for the calendar year 1948. Corporation A was dissolved on June 30, 1949, and an income tax return was filed for the period January 1, 1949, through June 30, 1949. Corporation B came into existence and commenced business on July 1, 1949. Corporation B likewise adopted the calendar year as its annual accounting period and filed income tax returns for the period July 1, 1949, through December 31, 1949, and also for the calendar year 1950 and subsequent calendar years. By reason of a transaction described in section 430(e)(2)(B), Corporation B is deemed for purposes of section 430(e) and of (e) of this section to have commenced business on April 1, 1947, the date Corporation A commenced business, and to have been in existence and to have had taxable years since that date. Since Corporation B first adopted the calendar year as its annual accounting period, any 12-month period ending on December 31 during which either Corporation B or Corporation A was in existence will constitute a taxable year of Corporation B. Since Corporation A came into existence on April 1, 1947, it was in existence during part of the 12-month period January 1, 1947, through December 31, 1947, and such 12-month period will be deemed to be the first taxable year of Corporation B for purposes of section 430(e) and of (e) of this section. Corporation A was in existence during the whole 12-month period January 1, 1948, through December 31, 1948, and such period will be deemed to be the second taxable year of Corporation B. Corporation A was in existence during part of the 12-month period January 1, 1949, through December 31, 1949, and Corporation B also was in existence during part of such period. The 12-month period January 1, 1949, through December 31, 1949, accordingly will be considered to be a taxable year of Corporation B and will be its third taxable year for purposes of section 430(e) and of (e) of this section. The calendar years 1950 and 1951 will be the fourth and fifth taxable years, respectively, of Corporation B. It is to be noted that the 12-month period January 1, 1949, through December 31, 1949, is deemed to be 1 taxable year of Corporation B even though both Corporation A and Corporation B were in existence during part of such period and even though Corporation A filed an income tax return for the period January 1, 1949, through June 30, 1949, and Corporation B filed an income tax return for the period July 1, 1949, through December 31, 1949. It is to be further noted that in this example the 12-month period January 1, 1949, through December 31, 1949, would constitute 1 taxable year of Corporation B even though Corporation A had not been dissolved on June 30, 1949, but had continued in existence until after December 31, 1949.

Example (2). Assume in the above example that when Corporation A came into existence and commenced business on April 1, 1947, it adopted the fiscal year ending March 31 as its annual accounting period and filed income tax returns for the fiscal years April 1, 1947, through March 31, 1948, and April 1, 1948, through March 31, 1949, and also an income tax return for the period April 1, 1949, through June 30, 1949. Since Corporation B first adopted the calendar year as its annual accounting period, Corporation B's first 5 taxable years must be determined by reference to the 12-month periods ending on December 31. Corporation A came into existence on April 1, 1947, and accordingly was in existence during part of the 12-month period January 1, 1947, through December 31, 1947. Such 12-month period January 1, 1947, through December 31, 1947, accordingly will be deemed to be the first taxable year of Corporation B for purposes of section 430(e) and of (e) of this section even though the period April 1, 1947, through December 31, 1947, did not constitute a taxable year of Corporation A. Similarly, the 12-month period January 1, 1948, through December 31, 1948, will be deemed to be the second taxable year of Corporation B even though such 12-month period did not constitute a taxable year of Corporation A. The 12-month periods January 1, 1949, through December 31, 1949, January 1, 1950, through December 31, 1950, and January 1, 1951, through December 31, 1951, will be deemed to be Corporation B's third, fourth, and fifth taxable years, respectively.

(5) (i) If any corporation during or prior to the taxable year for which the excess profits tax is being determined was a party with the taxpayer to a trans-

action described in section 445(g)(2) (A), (B), or (C), determined as if the date "July 1, 1945" were substituted for the date "December 1, 1950" in section 445(g)(2)(C), and if such other corporation had commenced business prior to the date on which the taxpayer commenced business, then the taxpayer, under the provisions of section 430(e)(2)(B)(i), shall be deemed to have commenced business on the date such other corporation commenced business. The taxpayer shall also be considered to have been in existence during the whole period such other corporation was in existence and to have had taxable years during such period as determined under the provisions of (4) above. For limitation on the application of section 430(e)(2)(B)(i) in certain cases, see (9) below.

(ii) The provisions of section 430(e)(2)(B)(i) and of (5)(i) above are applicable only if the party to the transaction with the taxpayer was a corporation. They do not apply, for example, where such party was an individual or a partnership. Thus, if an individual who has been operating a certain business as a sole proprietorship incorporates such business and transfers all the assets of the business to a newly formed corporation in a transaction which qualifies as a section 112(b)(5) transaction, the newly formed corporation will not be deemed to have been in existence during the prior period when the individual was conducting the business as a sole proprietorship nor will the corporation be deemed to have had taxable years during such prior period.

(6) (i) If a group of not more than four persons control the taxpayer at any time during the taxable year for which the excess profits tax is being determined and if this same group of not more than four persons at any time during the period beginning 12 months prior to its acquisition of control of the taxpayer and ending with the close of such taxable year also controlled a second corporation which at some time during such period (and while the group controlled such second corporation) was engaged in a trade or business substantially similar to the trade or business carried on by the taxpayer during such taxable year, then under the provisions of section 430(e)(2)(B)(ii) the taxpayer will be deemed to have commenced business on the date on which it itself commenced business or on the date on which such second corporation commenced business, whichever is the earlier. If the second corporation commenced business on a date prior to that on which the taxpayer commenced business, the taxpayer for purposes of section 430(e) and of (e) of this section will also be deemed to have been in existence for the entire period during which such second corporation was in existence and to have had taxable years during such period as determined under the provisions of (4) above.

(ii) For purposes of section 430(e)(2)(B)(ii) and of (6)(i) above a group of not more than four persons will be deemed to control the taxpayer or any other corporation if, and only if, the total stock ownership of such persons in the taxpayer or such other corporation represents more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of the shares of all classes of stock. For purposes of section 430(e)(2)(B)(ii) and of this provision the ownership of stock shall be determined in accordance with the provisions of section 503, except that constructive ownership under section 503(a)(2) shall be determined only with respect to the individual's spouse and minor children. A person will not be considered to be a member of the group of not more than four persons which controls the taxpayer at some time during the taxable year and which also controlled a second corporation at some time during the period referred to in section 430(e)(2)(B)(ii) and in (6)(i) above unless such person owned stock in the taxpayer at the time the group controlled the taxpayer during the taxable year and also owned stock in the second corporation at the time the group controlled such second corporation during the prescribed period. The individual does not have to own the same percentage of stock in the taxpayer as in the second corporation, but the individual must own some stock in the corporation at the time the group controls such corporation. It is not necessary for the group to control the taxpayer and second corporation at the same time. If the group controlled the taxpayer at any time during the taxable year for which the excess profits tax is being determined and if the same group also controlled the second corporation at some time during the prescribed period, then the requirements of control provided in section 430(e)(2)(B)(ii) will be met without regard to whether the group controlled the two corporations at the same time or at different times.

(iii) Whether or not the second corporation, at the time it was controlled by the group, was engaged in a trade or business substantially similar to the

trade or business carried on by the taxpayer during the taxable year is a question of fact which must be determined in each particular case in the light of all the circumstances of that case.

(7) (i) If during or prior to the taxable year for which the excess profits tax is being determined the taxpayer was a purchasing corporation in a part IV transaction and if the selling corporation in such part IV transaction had commenced business on a date prior to that on which the taxpayer commenced business, then the taxpayer, under the provisions of section 430(e)(2)(B)(iii), shall be deemed to have commenced business on the date such selling corporation commenced business. The taxpayer shall also be considered to have been in existence during the whole period such selling corporation was in existence and to have had taxable years during such period as determined under the provisions of (4) above. Section 430(e)(2)(B)(iii) and this provision shall not be applicable, however, unless for the taxable year or any preceding taxable year the conditions of paragraphs (1), (2), and (3) of section 474(c) were satisfied with respect to the part IV transaction. For limitation on the application of section 430(e)(2)(B)(iii) in certain cases, see (9) below.

(ii) The terms "purchasing corporation" and "selling corporation" have the same meaning for purposes of section 430(e)(2)(B)(iii) as for purposes of part IV. Since an individual operating a business as a sole proprietorship or a partnership, under certain circumstances, can be a selling corporation under part IV, such an individual or partnership, unlike the situation with respect to a transaction described in section 430(e)(2)(B)(i), can likewise be considered to be a corporation for purposes of section 430(e)(2)(B)(iii). If the taxpayer acquires assets from a sole proprietorship or from a partnership in a part IV transaction and if the sole proprietorship or the partnership constitutes a selling corporation under part IV, then the taxpayer will be deemed to have commenced business on the date the sole proprietorship or partnership commenced business, provided such date is prior to that on which the taxpayer itself commenced business, and to have been in existence and to have had taxable years, as determined under (4) above, during all such prior period.

(8) Section 430(e)(2)(B)(iv) provides that the three clauses in section 430(e)(2)(B) (i), (ii), and (iii) may be applied several times to determine when the taxpayer commenced business and what are its first 5 taxable years. Thus, if the taxpayer under section 430(e)(2)(B)(iii), for example, is deemed to have commenced business on the date Corporation A commenced business and to have been in existence and to have had taxable years during the period Corporation A was in existence, and if Corporation A under section 430(e)(2)(B)(i) in turn would be deemed to have commenced business on the date Corporation B had commenced business and to have been in existence and to have had taxable years during the period Corporation B was in existence, then the taxpayer, for purposes of section 430(e) and of (e) of this section, shall be deemed to have commenced business on the date Corporation B commenced business and to have been in existence and to have had taxable years during the entire period beginning with the date Corporation B came into existence. The taxpayer's first 5 taxable years accordingly will be determined, under the provisions of (4) above, by reference to the date on which Corporation B came into existence. It is immaterial that the taxpayer had no direct relationship with Corporation B. It is sufficient that Corporation B stands indirectly in the same relationship to the taxpayer as if it were a corporation described in one of the three clauses in section 430(e)(2)(B) (i), (ii), or (iii). It is immaterial which of the clauses in section 430(e)(2)(B) (i), (ii), and (iii) are to be applied, or how many times they are to be applied, or in what order. The taxpayer shall be considered to have commenced business and its first 5 taxable years will be determined by reference to that corporation which first came into existence and commenced business and with which the taxpayer directly or indirectly stands in a relationship described in any of the three clauses in section 430(e)(2)(B) (i), (ii), or (iii).

(9) If as of the beginning of December 1, 1950, the adjusted basis for determining gain upon the sale or exchange of the aggregate assets which had been acquired prior to that date by the taxpayer in 1 or more transactions described in section 430(e)(2)(B)(i) or in section 430(e)(2)(B)(iii) (or acquired in the ordinary course of business in replacement of such assets) and which were held by it at such time constituted less than 20 percent of the adjusted basis for determining gain upon sale or exchange of all the assets held by the taxpayer at such time, then such transactions shall be disregarded in determin-

ing the date as of which the taxpayer shall be considered to have commenced business and also in determining the first 5 taxable years of the taxpayer. The provisions of the preceding sentence are applicable only to transactions which occurred prior to December 1, 1950, but have no application to any transaction which occurred on or after December 1, 1950.

(10) The maximum excess profits tax provided in section 430(e)(1) and in (e) of this section shall not be available to a taxpayer which derives more than 50 percent of its gross income (determined without regard to dividends and without regard to gains from sales or exchanges of capital assets) for the taxable year for which the excess profits tax is being determined from contracts or subcontracts to which the provisions of title I of the Renegotiation Act of 1951 (or the provisions of any prior renegotiation act) are applicable. In determining whether the taxpayer has derived more than 50 percent of its gross income in any taxable year from contracts or subcontracts which are subject to renegotiation, all income from contracts or subcontracts which are subject to renegotiation under the applicable renegotiation act and the regulations promulgated thereunder with respect to such year must be taken into account without regard to whether a particular contract or subcontract is in fact renegotiated. The determination whether a taxpayer has derived more than 50 percent of its gross income in any taxable year from contracts and subcontracts which are subject to renegotiation, however, shall be made without regard to the provisions of the Renegotiation Act of 1951 which provide that receipts and accruals of $250,000 or less in any taxable year shall not be renegotiated. If a taxpayer, for example, had gross income for the taxable year of $200,000 of which $150,000 was derived from a contract of a type which is subject to renegotiation under title I of the Renegotiation Act of 1951 (assuming that the receipts and accruals in respect of which such $150,000 was derived were $250,000 or less), such taxpayer would not be eligible for such taxable year for the benefits of the maximum excess profits tax provided in section 430(e)(1) since 75 percent of its gross income for such taxable year was derived from a contract of a type that is subject to renegotiation under title I of the Renegotiation Act of 1951 even though the receipts and accruals from such contract in fact are not renegotiated under the provisions of such Act. In determining whether the taxpayer has derived more than 50 percent of its gross income in any taxable year from contracts or subcontracts which are subject to renegotiation, the taxpayer's total gross income for the taxable year and also its income from contracts or subcontracts which are subject to renegotiation shall each be computed after taking into account the effect of any renegotiation previously effected with respect to such year. In filing its return, however, the taxpayer shall make such determination without regard to any renegotiation not previously effected with respect to such year. If a subsequent renegotiation with respect to such year makes the taxpayer eligible for the benefits of the maximum excess profits tax provided in section 430(e)(1), it may within the applicable period of limitations file a claim for credit or refund of the overpayment, if any, resulting from the application of such maximum excess profits tax provisions.

(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).)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved March 16, 1953.

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

(Filed with the Division of the Federal Register March 19, 1953, 8:51 a. m.)

Section 40.430–2, Regulations 130: Rate of tax.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5969, page 122.)

SECTION 433.—EXCESS PROFITS NET INCOME

SECTION 40.433(a)-2, REGULATIONS 130: Computation of excess profits net income for the taxable year. T. D. 5958

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAXES; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Section 40.433(a)-2(j)(3) of Regulations 130 amended

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

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

On October 1, 1952, a notice of proposed rule making was published in the Federal Register (17 F. R. 8691) to conform Regulations 130 [26 CFR, part 40] to section 122(b) of the Internal Revenue Code, as amended by section 330(b) of the Revenue Act of 1951, approved October 20, 1951. No objections to the rules proposed having been received within the 30 days following publication, section 40.433(a)-2(j)(3) of such regulations is amended by striking "1950 and 1951" from the third sentence from the end, and by inserting in lieu thereof "1950, 1951, and 1952", and by inserting "and any subsequent taxable year" immediately after "for 1950" in the second sentence from the end, so that such sentences as so amended will read as follows:

If the excess profits credit for 1950 is determined under section 435 or under section 436(a) by the use of section 458, the $85,000 so computed may, at the election of the taxpayer made on its return for 1950, be treated as a net operating loss carry-over from 1949, and the $85,000 carry-over will, subject to the provisions of section 122(b)(2), be a carry-over to the years 1950, 1951, and 1952. The net operating loss deduction for 1950 and any subsequent taxable year is determined without regard to any other carry-over from a taxable year ending before June 30, 1950, for example the loss for 1948, if such loss exceeded the net income for 1949, and the net operating loss deduction for any subsequent taxable year for which the excess profits credit is computed under neither section 435 nor section 458 is determined without regard to the $85,000 carry-over from the base period.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 16, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 19, 1952, 8:56 a. m.)

SECTION 40.433(a)-2, REGULATIONS 130: Computation of excess profits net income for the taxable year. T. D. 5973

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Amendment of part I of Regulations 130 to conform to sections 325, 502 through 504(a), 505 through 512, 520, 522, and 602 of the Revenue Act of 1951.

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

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

On October 18, 1952, notice of proposed rule making, regarding amendments to Regulations 130 (26 CFR, part 40) made necessary by sections 325, 502 through 504(a), 505 through 512, 520, 522, and 602 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 9259). No objection to the rules proposed having been received, the amendments set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 40.433(a)-1 [26 CFR 40.433(a)-1] the following:

SEC. 502. PAYMENTS FROM FOREIGN SOURCES FOR TECHNICAL ASSISTANCE, ETC. [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 433(a)(1).—Section 433(a)(1) (relating to excess profits net income for taxable years ending after June 30, 1950) is hereby amended by adding at the end thereof the following new subparagraph:

"(R) Payments From Foreign Sources for Technical Assistance, Etc.—In the case of a domestic corporation which renders to a related foreign corporation technical assistance, engineering services, scientific assistance, or similar services (such services or assistance being related to the production or improvement of products of the type manufactured by such domestic corporation), there shall be excluded the remuneration for such services or assistance if such remuneration constitutes income derived from sources without the United States. Any deductions in connection with or properly allocable to the rendering of such services or assistance shall not be allowed. For the purpose of this subparagraph, a foreign corporation shall be considered to be a 'related foreign corporation' if the domestic corporation at the time it renders such services or assistance owns 10 per centum or more of the outstanding stock of such foreign corporation."

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SEC. 503. ELECTION WITH RESPECT TO CERTAIN INADMISSIBLE ASSETS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

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(b) AMENDMENT OF SECTION 433(a)(1).—Section 433(a) (relating to adjustments in excess profits net income for the taxable year) is hereby amended by adding the following new subparagraph at the end thereof:

"(S) Interest on Certain Government Obligations.—For adjustment in the case of a taxpayer making an election provided in section 440(c), relating to dealers in certain Government obligations, see section 440(c)."

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SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including sections 502 and 508] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 2. Section 40.433(a)-2, as amended by Treasury Decision 5958 [page 320, this Bulletin], approved December 16, 1952 [26 CFR 40.433(a)-2], is further amended by adding at the end thereof the following:

(r) (1) Section 433(a)(1)(R) provides that there shall be excluded, in computing excess profits net income, any income accrued or received by a domestic corporation which constitutes remuneration to such domestic corporation for the rendering of technical assistance, engineering services, scientific assistance, or similar services to a related foreign corporation. The services or assistance rendered by the domestic corporation must be related to the production or improvement of products of the type manufactured by the domestic corporation. The remuneration, in addition, must constitute income from sources without the United States. Any deductions which are connected with or properly allocable to the rendering of such services or assistance shall not be allowed in computing excess profits net income.

(2) Any remuneration accrued or received by a domestic corporation shall not be excluded, however, in the case of a domestic corporation whose principal business consists of the furnishing of technical assistance or services. The term "related foreign corporation", for the purpose of section 433(a)(1)(R) and of (1), above, means a foreign corporation 10 percent or more in value of the outstanding stock of which is owned by the domestic corporation at the time the domestic corporation renders such services or assistance. The determination whether any remuneration constitutes income derived from sources without the United States shall be made in accordance with the provisions and principles of section 119 and the regulations thereunder.

(3) There shall not be excluded under section 433(a)(1)(R) and (1), above, any income which in substance represents payments for the use of assets, royalties for the use of patents, fees for the use of copyrights or other licenses, or other similar payments. The income to be excluded shall be the income derived from imparting technical or management knowledge or skill for the production or improvement of certain products, but shall not include any income derived from the license or sale of the right to produce a product or to use a certain method of production. Thus, there may be excluded remuneration received by the domestic corporation for the services of an engineer to instruct the personnel of the related foreign corporation or to establish or improve production techniques, and for the equipment used by such engineer in connection with the rendering of such services, but there shall not be excluded any income received for the use of equipment to produce the products of the related foreign corporation. If the remuneration of the domestic corporation consists of elements of more than one type of income, only that part of the remuneration which is clearly identified as being attributable to the activities described in section 433(a)(1)(R) shall be excluded in computing excess profits net income.

(s) For adjustment in the case of a taxpayer making the election provided in section 440(c), relating to dealers in certain Government obligations, see section 440(c) and section 40.440-1(g)(2).

PAR. 3. There is inserted immediately preceding section 40.433(b)-1 [26 CFR 40.433(b)-1] the following:

SEC. 325. TAX TREATMENT OF COAL ROYALTIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(e) CONFORMING AMENDMENTS.—

(1) Section 433 (relating to computation of excess profits net income) is hereby amended by inserting at the end thereof the following new subsection:

"(d" GAIN OR LOSS UPON CERTAIN DISPOSALS OF COAL IN BASE PERIOD.—For the purpose of subsection (b), the excess profits net income shall be computed as if the provisions of section 117 (j) and (k)(2) which relate to disposals of coal were a part of the law applicable to the taxable year for which excess profits net income is computed."

* * * * * * *

(3) The amendments made by this subsection shall be applicable in computing the tax under subchapter D of chapter 1 for taxable years ending after December 31, 1950.

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SEC. 502. PAYMENTS FROM FOREIGN SOURCES FOR TECHNICAL ASSISTANCE, ETC. [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) AMENDMENT OF SECTION 433(b).—Section 433(b) (relating to taxable years in base period) is hereby amended by adding at the end thereof the following new paragraph:

"(16) PAYMENTS FROM FOREIGN SOURCES FOR TECHNICAL ASSISTANCE, ETC.—In the case of a domestic corporation which rendered to a related foreign corporation technical assistance, engineering services, scientific assistance, or similar services (such services or assistance being related to the production or improvement of products of the type manufactured by such domestic corporation), there shall be excluded the remuneration for such services or assistance if such remuneration constituted income derived from sources without the United States. Any deductions in connection with or properly allocable to the rendering of such services or assistance shall not be allowed. For the purpose of this paragraph, a foreign corporation shall be considered to be a 'related foreign corporation' if the domestic corporation at the time it rendered such services or assistance owned 10 per centum or more of the outstanding stock of such foreign corporation."

SEC. 508. ELECTION WITH RESPECT TO CERTAIN INADMISSIBLE ASSETS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(c) AMENDMENT OF SECTION 433(b).—Section 433(b) (relating to adjustments in excess profits net income for taxable years in base period) is hereby amended by adding at the end thereof the following new paragraph:

"(17) INTEREST ON CERTAIN GOVERNMENT OBLIGATIONS.—For adjustment in the case of a taxpayer making an election provided in section 440(c), relating to dealers in certain Government obligations, see section 440(c)."

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including sections 502 and 508] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 4. Section 40.433(b)-2 [26 CFR 40.433(b)-2] is amended by striking from the second sentence of (a) of such section "and (8) the adjustment to income in the case of life insurance companies." and by inserting in lieu thereof the following:

(8) the adjustment to income in the case of life insurance companies, (9) the adjustment for payments from foreign sources for technical assistance, etc., and (10) the adjustment for interest on certain Government obligations (see section 40.440-1(g)(2)). For the purpose of computing the tax for taxable years ending after December 31, 1950, excess profits net income shall be computed as if the provisions of section 117 (j) and (k)(2) which relate to disposals of coal were a part of the law applicable to the taxable year for which the excess profits net income is being computed.

PAR. 5. There is inserted immediately preceding section 40.435-1 [26 CFR 40.435-1] the following:

SEC. 503. AVERAGE BASE PERIOD NET INCOME IN CASE OF CERTAIN FISCAL YEAR TAXPAYERS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 435(d) (relating to the general average method for the computation of average base period net income) is hereby amended by adding at the end thereof the following: "For the purpose of the computations under this subsection in the case of a taxpayer whose first taxable year under this subchapter is a taxable year which either began before January 1, 1950, or was preceded by a taxable year beginning before January 1, 1950, and ending after March 31, 1950, there shall be substituted for the base period of the taxpayer the period of 48 consecutive months ending March 31, 1950, if such substitution produces a lesser tax under this subchapter for the taxable year for which the tax is being computed. In computing the average base period net income for such substituted period, the excess profits net income for January, February, and March of 1950 shall be computed by use of the 'weighted excess profits net income', as defined in section 435(e)(2)(E), for the taxable year in which such months fall."

SEC. 504. AVERAGE BASE PERIOD NET INCOME—ALTERNATIVE BASED ON GROWTH IN CASE OF NEW CORPORATIONS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) GENERAL RULE.—Section 435(e)(1) (relating to the alternative based on growth) is hereby amended by striking out the phrase "the beginning of its base period" and inserting in lieu thereof the following: "the end of its base period."

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SEC. 505. AVERAGE BASE PERIOD NET INCOME—ALTERNATIVE BASED ON GROWTH [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 435(e)(2)(G) (relating to the alternative based on growth) is hereby amended by striking out the word "only".

SEC. 506. ADJUSTMENTS FOR CHANGES IN INADMISSIBLE ASSETS IN CASE OF BANKS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 435(g).—Section 435(g) (relating to net capital addition or reduction) is hereby amended by redesignating paragraph (8) as paragraph (11) and by adding after paragraph (7) the following new paragraph:

"(8) ADJUSTMENTS FOR CHANGES IN INADMISSIBLE ASSETS IN CASE OF BANKS.—In the case of a bank (as defined in section 104)—

"(A) If the increase in total assets for the taxable year exceeds the net capital addition computed without regard to the adjustment under paragraph (1) for an increase in inadmissible assets, then the net capital addition for the taxable year shall not be less than the excess of—

"(i) the amount determined under the first sentence of paragraph (1) over

"(ii) an amount which bears the same ratio to the increase in inadmissible assets for the taxable year, determined under paragraph (5), as the amount computed under such first sentence bears to the increase in total assets for the taxable year.

"(B) If the decrease in total assets for the taxable year exceeds the net capital reduction computed without regard to the adjustment under paragraph (2) for a decrease in inadmissible assets, then the net capital reduction for the taxable year shall not be less than the excess of—

"(i) the amount determined under the first sentence of paragraph (2) over

"(ii) an amount which bears the same ratio to the decrease in inadmissible assets for the taxable year, determined under paragraph (5), as the amount computed under such first sentence bears to the decrease in total assets for the taxable year.

For the purpose of this paragraph, the increase or decrease in total assets for the taxable year shall be computed in the same manner as the increase or decrease in inadmissible assets for the taxable year is computed under paragraph (5), except that such computations shall be made with respect to all assets, whether admissible or inadmissible assets as defined in section 440."

* * * * * * *

(c) AMENDMENT OF SECTION 435(f).—Section 435(f) (relating to capital additions in base period) is hereby amended as follows:

(1) By inserting immediately after the word "reduced" in paragraph (1) thereof the following: "(but not below zero)".

(2) By adding at the end of paragraph (1) thereof the following:

"For special rule in the case of banks, see paragraph (6)."

(3) By renumbering paragraph (6) as paragraph (7), and by adding immediately after paragraph (5) the following new paragraph:

"(6) YEARLY BASE PERIOD CAPITAL OF BANKS.—In the case of a bank (as defined in section 104), the yearly base period capital for any taxable year shall be determined as follows:

"(A) A tentative yearly base period capital shall be computed under paragraph (1) without regard to paragraph (1)(A).

"(B) The tentative yearly base period capital so determined shall be reduced by the amount determined under section 440(b) (relating to inadmissible assets). For the purpose of this subparagraph, the computation under section 440(b) shall include only the daily amounts (described in such section) for the first day of such taxable year."

(d) EFFECTIVE DATE OF SUBSECTION (c)(3).—The amendment made by subsection (c)(3) (adding a new paragraph (6) to section 435(f)) shall be applicable with respect to taxable years beginning on or after the date of the enactment of this Act, and, at the election of the taxpayer made in accordance with regulations prescribed by the Secretary, shall be applicable to all taxable years ending after June 30, 1950.

SEC. 507. DECREASE IN INADMISSIBLE ASSETS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 435(g) (relating to net capital addition or reduction) is hereby amended as follows:

(a) By adding at the end of paragraph (1) thereof the following:

"For further adjustment with respect to the amount determined under the preceding provisions of this paragraph, see paragraph (9)."

(b) By adding immediately after paragraph (8), as added by section 506 of this Act, the following new paragraphs:

"(9) DECREASE IN INADMISSIBLE ASSETS.—

"(A) Except as otherwise provided in subparagraph (B) (relating to banks), the excess of the amount computed under paragraph (2) (A) or (B), whichever is applicable to the taxpayer (whether or not any amount is determined under the first sentence of paragraph (2)), over the amount, if any, computed under the first sentence of paragraph (2) shall be considered the net capital addition for the taxable year or shall be added to the net capital addition otherwise determined under paragraph (1), as the case may be. The amount of the excess so determined shall be subject to the exceptions and limitations provided in paragraph (10).

"(B) In the case of a bank (as defined in section 104), the computation under subparagraph (A) shall be made by substituting for the amount computed under paragraph (2) (A) or (B) whichever of the following amounts is the lesser:

"(i) An amount which bears the same ratio to the decrease in inadmissible assets as the sum of the equity capital (as defined in section 437(c)) and the daily borrowed capital (as defined in section 439(b)), each determined as of the first day of the first taxable year ending after June 30, 1950, bears to the total assets as of the beginning of such day;

"(ii) If paragraph (8)(B) is applicable, the amount computed under paragraph (8)(B)(ii).

"(10) EXCEPTIONS AND LIMITATIONS FOR THE PURPOSE OF PARAGRAPH (9).—For the purpose of paragraph (9)—

"(A) The adjustment to the decrease in inadmissible assets required under subparagraph (B) of paragraph (2) shall not be greater than 25 per centum of the excess of the net capital reduction computed under the first sentence of paragraph (2) (and computed without regard to the percentage limitations in paragraph (4) (C) and (E)) over the net capital reduction computed under such sentence without regard to paragraph (4) (C) and (E).

"(B) The amount determined under paragraph (9) shall not be greater than the excess of the increase in operating assets for the taxable year over the net capital addition (determined without regard to paragraph (9) and determined without regard to the limitation to 75 per centum provided in paragraph (3)(C) and paragraph (4) (C) and (E)). For the purpose of the preceding sentence, the increase in operating assets for the taxable year shall be determined in the same manner as the increase in inadmissible assets for the taxable year is determined under paragraph (5). For the purpose of such determination, the term 'operating assets' means—

"(i) property used in the taxpayer's trade or business within the meaning of section 117(j)(1) except that such property need not be held more than six months, and

"(ii) stock in trade or other property of a kind which would properly be includible in the inventory of the taxpayer if owned at the close of the taxable year, and property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business,

except any such assets which constitute inadmissible assets, stock, securities, or intangible property (such intangible property not being limited to the property described in section 441(i)).

"(C) The amount determined under paragraph (9) shall be subject to reduction to the extent that the Secretary determines that the increase in operating assets is a result, directly or indirectly, of an increase in indebtedness of the taxpayer (other than indebtedness which constitutes borrowed capital)."

SEC. 509. ALTERNATIVE AVERAGE BASE PERIOD NET INCOME [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

(1) Section 435(f)(3) (relating to capital addition in the base period) is hereby amended by inserting immediately after the words "under section 442(c)(1)", wherever appearing therein, the following: "or under section 442(h)".

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SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [sections 501 through 523] shall be applicable only with respect to taxable years ending after June 30, 1950.

SEC. 602. EXCESS PROFITS CREDIT BASED ON INCOME [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) PERCENTAGE OF AVERAGE BASE PERIOD NET INCOME TAKEN INTO ACCOUNT.—

(1) IN GENERAL.—Paragraph (1) (A), and paragraph (2), of section 435(a) (relating to excess profits credit based on income) are each amended by striking out "85 per centum" and inserting in lieu thereof "83 per centum."

(2) TAXABLE YEARS BEGINNING BEFORE JULY 1, 1951, AND ENDING AFTER JUNE 30, 1951.—Section 435(a) is hereby amended by adding at the end thereof the following new paragraphs:

"(4) CALENDAR YEAR 1951.—In the case of a taxable year beginning on January 1, 1951, and ending on December 31, 1951, there shall be used, for the purposes of paragraph (1)(A) and paragraph (2), in lieu of 85 per centum of the average base period net income, an amount equal to 84 per centum of the average base period net income.

"(5) TAXABLE YEARS (OTHER THAN CALENDAR YEAR 1951) BEGINNING BEFORE JULY 1, 1951, AND ENDING AFTER JUNE 30, 1951.—In the case of any taxable year (other than a taxable year described in paragraph (4)) beginning before July 1, 1951, and ending after June 30, 1951, there shall be used, for the purposes of paragraph (1)(A) and paragraph (2), in lieu of 85 per centum of the average base period net income, an amount equal to the sum of—

"(A) that portion of an amount equal to 85 per centum of the average base period net income which the number of days in such taxable year prior to July 1, 1951, bears to the total number of days in such taxable year, plus

"(B) that portion of an amount equal to 83 per centum of the average base period net income which the number of days in such taxable year after June 30, 1951, bears to the total number of days in such taxable year."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall be applicable only with respect to taxable years ending after June 30, 1951.

PAR. 6. Section 40.435-1 [26 CFR 40.435-1] is amended as follows: (A) By changing (a) of such section to read as follows:

(a) *Introductory.*—(1) In order for a corporation to determine for any particular taxable year the amount of its excess profits credit based on income, it is necessary first to compute the amount of the average base period net income. The first item in determining the excess profits credit based on income is an amount equal to a percentage of such average base period net income. See (2), below, and section 435(a) for the percentage applicable to the taxable year for

which the credit is being computed. Two methods are provided in section 435 for determining the average base period net income: (i) the general average method set forth in section 435(d) and in (d) of this section, and (ii) the alternative method set forth in section 435(e) applicable to certain taxpayers whose growth entitles them to the benefits of a method provided in such section, if such method results in a lesser excess profits tax.

(2) With respect to the particular taxable years indicated, the following percentages of average base period net income shall be taken into account as the first item in determining the amount of the excess profits credit based on income:

(i) 85 percent in the case of a taxable year ending after June 30, 1950, and not ending after June 30, 1951.

(ii) 84 percent in the case of a taxable year which is the calendar year 1951.

(iii) 83 percent in the case of a taxable year beginning after June 30, 1951.

(iv) In the case of any taxable year (other than a taxable year which is the calendar year 1951) beginning before July 1, 1951, and ending after June 30, 1951, there shall be used an amount equal to the sum of—

(A) that portion of an amount equal to 85 percent of the average base period net income which the number of days in such taxable year prior to July 1, 1951, bears to the total number of days in such taxable year, plus

(B) that portion of an amount equal to 83 percent of the average base period net income which the number of days in such taxable year after June 30, 1951, bears to the total number of days in such taxable year.

(B) By changing (d) of such section to read as follows:

(d) *Computation under general average method.*—(1) The following steps are required for the computation of the average base period net income under the general average method:

(i) The excess profits net income is determined for each month during which the taxpayer was in existence during the base period. This amount is determined for any month during any part of which the taxpayer was in existence by dividing the excess profits net income (computed in accordance with the provisions of section 433(b)) for the taxable year in which such month falls by the number of full calendar months in such taxable year. In no case shall the excess profits net income for any month be less than zero. The excess profits net income for any month during no part of which the taxpayer was in existence shall be zero.

(ii) The 36 months which produce the highest aggregate excess profits net income are selected under either of two methods: (A) the 12 consecutive months having the lowest aggregate excess profits net income may be eliminated; or (B) the 36 consecutive months having the highest aggregate excess profits net income may be retained.

(iii) The excess profits net income for each of the 36 months selected under (ii) is aggregated.

(iv) The aggregate amount computed under (iii) is divided by 3.

(2) A taxpayer which had a taxable year beginning in 1949 and ending after March 31, 1950, may compute an average base period net income under the general average method described in (1), above, either for its base period as defined in section 435(b) and in (b) of this section or for a substituted period consisting of 48 consecutive months ending March 31, 1950, whichever period produces the lesser excess profits tax for the taxable year. In computing the average base period net income for such substituted period, the excess profits net income for January, February, and March of 1950 shall be a "weighted excess profits net income", as defined in section 435(e)(2)(E) and in section 40.435-5(b), for the taxable year in which such months fall.

(3) A taxpayer having a taxable year beginning in 1949 and ending after March 31, 1950, shall indicate on Schedule EP-2 (Form 1120) which period is used in the computation of its average base period net income. A taxpayer may use the substituted 48-month period for the purpose of determining its unused excess profits credit adjustment as defined in section 432(b) but shall use the base period as defined in section 435(b) and in (b) of this section for the purpose of any other computation under subchapter D of chapter 1. For example, the base period and not the substituted 48-month period shall be used for the purpose of any reference in section 442 to 435(d).

PAR. 7. Section 40.435-4 [26 CFR 40.435-4] is amended as follows:

(A) By striking out the phrase "the beginning of its base period" wherever appearing therein (such phrase appearing in the first sentence of (a), (b), and (c) of such section) and inserting in lieu thereof the following: "the end of its base period".

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

(d) *Corporations commencing business during base period.*—In the case of a corporation which commenced business during its base period, total payroll, gross receipts, net sales, and excess profits net income, for any portion of its base period during which it was not in existence, will be taken into account under section 435(e) at zero. A corporation not in existence on the first day of its base period would, unless it is a member of an affiliated group for its first taxable year ending after June 30, 1950, automatically satisfy the total assets requirement of section 435(e)(1)(A)(i) and of (b) of this section since its total assets as of the 1st day of its base period would be zero.

PAR. 8. Section 40.435-5 [26 CFR 40.435-5] is amended by striking from (a)(7) thereof the phrase "and does not qualify under the general requirements for the alternative based on growth (see section 40.435-4(b))".

PAR. 9. Section 40.435-6 [26 CFR 40.435-6] is amended as follows:

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

(5) For special rules applicable in the case of a bank, see (e) of this section and section 435(f)(6).

(B) By inserting in the third sentence of (b)(1) of such section immediately after the words "Such sum shall be reduced" the following: "(but not below zero)".

(C) By inserting at the end of (d) of such section the following:

(3) If the taxpayer computes an average base period net income by reference to section 442(h), the rules stated in (i) through (iii) of (2), above, without regard to the 110 percent qualification therein, shall be applicable in determining the base period capital addition.

(e) *Yearly base period capital of banks.*—(1) For the purpose of computing the tax for taxable years beginning on or after October 20, 1951, the adjustment to the yearly base period capital for inadmissible assets in the case of a bank, as defined in section 104, must be made under section 435(f)(6) which provides a proportionate adjustment with respect to such assets. The yearly base period capital shall be determined under such section as follows:

(i) A tentative yearly base period capital shall be computed under section 435(f)(1), without any reduction under section 435(f)(1)(A) for inadmissible assets.

(ii) The amount determined under (i) shall be reduced by an amount which bears the same ratio to the amount determined under (i) as the ratio which the total of the inadmissible assets bears to the total of admissible and inadmissible assets, each such total being determined only by reference to the daily amounts of admissible and inadmissible assets for the first day of the taxable year for which yearly base period capital is determined. See section 440(b) and section 40.440-1.

(2) A taxpayer using the adjustment for inadmissible assets provided in section 435(f)(6) shall so indicate on Schedule EP-2(A) (Form 1120) and shall file with, and as a part of, its return a schedule showing the computation of its base period capital addition pursuant to such section. In the case of a taxpayer making the election described in (3), below, such schedule shall be filed for all taxable years beginning before October 20, 1951, and shall be filed with the election.

(3) If the taxpayer elects by a statement attached to its return for a taxable year beginning before October 20, 1951, the adjustment for inadmissible assets under section 435(f)(6) shall be applicable in the computation of its excess profits tax for all taxable years beginning before October 20, 1951. In the case of a taxpayer electing to use such adjustment for a taxable year beginning before October 20, 1951, for which a return has been filed, such election shall be

made in writing and shall be filed with and as a part of an amended return, or, if made in connection with a claim for credit or refund, with and as a part of such claim. An election once made shall be irrevocable and shall apply to the computation of the tax for all taxable years beginning before October 20, 1951. In such case, section 435(f)(6) is applicable in computing the yearly base period capital of each taxable year involved in determining the base period capital addition.

PAR. 10. Section 40.435-7 [26 CFR 40.435-7] is amended as follows:

(A) By redesignating "(5)" in (a) of such section as "(6)" and by adding after (4) thereof the following:

(5) For special rules for changes in inadmissible assets in the case of banks, see section 435(g)(8) and (f) of this section.

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

(4) For further adjustment with respect to the amount of the net capital addition, as determined above, by reason of a decrease in inadmissible assets, see section 435(g)(9) and (g) of this section.

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

(f) *Adjustment for changes in inadmissible assets in the case of banks.*—(1) In the case of a bank, as defined in section 104, a limitation on the adjustment to the net capital addition for an increase in inadmissible assets is required under section 435(g)(8)(A). This limitation shall be applicable where the increase in total assets for the taxable year (as determined under (3), below) exceeds the net capital addition computed without regard to any adjustments for an increase in inadmissible assets. In such a case, the amount of the adjustment for inadmissible assets shall not be greater than an amount which bears the same ratio to the increase in inadmissible assets for the taxable year as the amount of the net capital addition, computed without adjustment for such increase, bears to the increase in total assets for the taxable year.

(2) In the case of a bank, a limitation on the net capital reduction for a decrease in inadmissible assets is required under section 435(g)(8)(B). This limitation shall be applicable where the decrease in total assets for the taxable year (as determined under (3), below) exceeds the net capital reduction for such year computed without regard to any adjustments for a decrease in inadmissible assets. In such a case, the amount of the adjustment for inadmissible assets shall not be greater than an amount which bears the same ratio to the decrease in inadmissible assets for the taxable year as the amount of the net capital reduction, computed without adjustment for such decrease, bears to the decrease in total assets for the taxable year.

(3) For the purpose of (1) and (2), above, total assets shall include all assets, whether admissible or inadmissible assets as defined in section 440, and total assets as of any time shall be determined in accordance with the rules for determining assets set forth in section 40.437-5(b). An increase or decrease in inadmissible assets for the taxable year shall be determined under section 435(g)(5). See (d) and (e) of this section. An increase or decrease in total assets shall also be determined under section 435(g)(5) as if that section had reference to all assets held by the taxpayer, whether admissible or inadmissible assets as defined in section 440.

(4) A taxpayer required to apply the limitation on the adjustment for changes in inadmissible assets provided in section 435(g)(8) shall so indicate on Schedule EP-2(B) (Form 1120) and shall attach thereto a separate schedule showing the computations under such section.

(g) *Decrease in inadmissible assets.*—(1) *In general.*—A net capital addition for the taxable year may be allowed, or the amount otherwise determined under section 435(g)(1) and under (d) of this section may be increased, in certain cases described in section 435(g)(9) where a decrease in inadmissible assets (in excess of the net capital reduction, if any) is accompanied by a corresponding increase in operating assets. For this purpose, an increase in operating assets is taken into account only to the extent that it exceeds the net capital addition as adjusted under section 435(g)(10)(B). The term "operating assets" means (i) property used in the taxpayer's trade or business within the meaning of section 117(j)(1) determined without regard to any holding period specified in such section, and (ii) stock in trade or other property of a kind which would

property be includible in the inventory of the taxpayer if owned at the close of the taxable year, and property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. Such term does not include cash, inadmissible assets, stock, securities, or intangible property, whether or not such intangible property is described in section 441(i). Section 435(g)(9) sets forth two rules for the computation of the addition to the income credit under such section, one of which is applicable in the case of a taxpayer other than a bank, as defined in section 104, and the other of which is applicable in the case of such a bank.

(2) *Taxpayers other than banks.*—In the case of a taxpayer other than a bank (as defined in section 104), the following steps are required under section 435(g)(9) and (10) in order to determine the amount of the net capital addition for the taxable year, or the amount to be added to the net capital addition determined under section 435(g)(1), as the case may be:

(i) There is determined the excess of the total of the inadmissible assets, as defined in section 440(b), for the first day of the taxpayer's first taxable year ending after June 30, 1950, over the total of the daily amounts attributable to the inadmissible assets for the taxable year, divided by the number of days in such year.

(ii) There is determined the excess, if any, divided by the number of days in the taxable year, of the aggregate of the daily capital reduction for each day of the taxable year over the aggregate of the daily capital addition for each day of the taxable year. See (b) and (c) of this section.

(iii) The excess of the amount computed under (i) over the amount, if any, computed under (ii) is determined. Where the amount computed under (i) exceeds the amount, if any, computed under (ii) without regard to section 435(g)(4) (C) and (E), relating to a decrease in borrowed capital and to an increase in loans to members of a controlled group of corporations of which the taxpayer is a member, the amount computed under (i) may be reduced. In such a case the amount computed under (i) shall be reduced by 25 percent of the excess, if any, of—

(A) an amount computed under (ii) by using 100 percent, in lieu of 75 percent, of the amounts determined under section 435(g)(4) (C) and (E), over

(B) an amount computed under (ii) without regard to section 435(g)(4) (C) or (E).

(iv) There is determined the excess of the total of the daily amounts attributable to operating assets for the taxable year, divided by the number of days in such year, over the total amount of such assets for the first day of the taxpayer's first taxable year ending after June 30, 1950. For this purpose the adjusted basis of such assets for determining gain upon sale or exchange shall be used.

(v) The net capital addition, if any, under section 435(g)(1) is recomputed without regard to the percentage limitations under section 435(g)(3)(C), relating to an increase in borrowed capital, and under section 435(g)(4) (C) and (E), relating to a decrease in borrowed capital and to an increase in loans to members of a controlled group of corporations of which the taxpayer is a member.

(vi) The amount to be added to the net capital addition, or the amount which shall be considered the net capital addition, as the case may be, is whichever of the following amounts is the lesser—

(A) the amount determined under (iii), or

(B) the excess of the amount determined under (iv) over the amount determined under (v).

(3) *Special rule in the case of a bank.*—In the case of a bank (as defined in section 104), the adjustment for a decrease in inadmissible assets shall be determined as provided in (2), above, except that in lieu of the amount computed under (2)(i) there shall be substituted whichever of the following amounts is the lesser (and such amounts shall not be adjusted under the second and third sentences of (2)(iii), above):

(i) An amount which bears the same ratio to the amount determined under (2)(i), above, as the sum of the equity capital, as defined in section 437(c), and the daily borrowed capital, as defined in section 439(b), each determined as of the 1st day of the first taxable year ending after June 30, 1950, bears to the total assets (determined as provided in section 435(g)(8)) as of the beginning of such day, or

(ii) If the decrease in total assets for the taxable year exceeds the net capital reduction, computed without regard to adjustments for a decrease in inadmissible assets, the amount computed under section 435(g)(8)(B)(ii). See (f)(2) of this section.

(4) *Special rules applicable to the section 435(g)(9) adjustment.*—The adjustment to the net capital addition for a decrease in inadmissible assets provided in section 435(g)(9) shall be subject to reduction in any case in which the Commissioner determines that the increase in operating assets is the direct or indirect result of an increase in indebtedness of the taxpayer, other than indebtedness which constitutes borrowed capital as defined in section 439(b). This limitation may be applied, for example, in a case where the addition to operating assets is accompanied by increased open account indebtedness to a member of a controlled group, as defined in section 435(g)(6). A taxpayer computing a net capital addition by reference to section 435(g)(9) shall attach to Schedule EP-2(B) (Form 1120) a schedule showing the computation under such section and shall include a statement of its operating assets.

PAR. 11. There is inserted immediately preceding section 40.438-1 [26 CFR 40.438-1] the following:

SEC. 506. ADJUSTMENTS FOR CHANGES IN INADMISSIBLE ASSETS IN CASE OF BANKS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) AMENDMENT OF SECTION 438.—Section 438 (relating to new capital credit changes) is hereby amended by adding after subsection (f) the following new subsection:

"(g) ADJUSTMENTS FOR INADMISSIBLE ASSETS IN CASE OF BANKS.—In the case of a bank (as defined in section 104), if the increase in total assets for the taxable year (determined in the manner provided in the last sentence of section 435(g)(8)) exceeds the net new capital addition computed without regard to the adjustment under subsection (b) for an increase in inadmissible assets, then the net new capital addition for the taxable year shall not be less than the excess of the amount determined under the first sentence of subsection (b) over an amount which bears the same ratio to the increase in inadmissible assets for the taxable year, determined under section 435(g)(5), as the amount computed under such first sentence bears to such increase in total assets for the taxable year."

* * * * * * *

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including section 506(b)] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 12. Section 40.438-4 [26 CFR 40.438-4] is amended as follows:

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

For special rules for changes in inadmissible assets in the case of banks, see section 438(g) and (c) of this section.

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

(c) *Adjustments for inadmissible assets in the case of banks.*—(1) In the case of a bank, as defined in section 104, a limitation on the adjustment to the net new capital addition for an increase in inadmissible assets is required under section 438(g). This limitation shall be applicable where the increase in total assets (as determined under (2), below) for the taxable year exceeds the net new capital addition for such year computed without regard to adjustments for an increase in inadmissible assets. In such a case, the amount of the adjustment for inadmissible assets shall not be greater than an amount which bears the same ratio to the increase in inadmissible assets for the taxable year as the amount of the net new capital addition, computed without regard to any adjustment for inadmissible assets, bears to the increase in total assets for the taxable year.

(2) For the purpose of (1), above, total assets shall include all assets, whether admissible or inadmissible assets as defined in section 440, and total assets as of any time shall be determined in accordance with the rules for determining assets set forth in section 40.437–5(b). An increase or decrease in inadmissible assets for the taxable year shall be determined under section 435(g)(5). See (d) and (e) of section 40.435–7. An increase or decrease in total assets shall also be determined under section 435(g)(5) as if that section had reference to all assets held by the taxpayer, whether admissible or inadmissible assets as defined in section 440.

(3) A taxpayer required to apply the limitation on the adjustment for changes in inadmissible assets provided in section 438(g) shall so indicate on Schedule EP–4 (Form 1120) and shall attach thereto a separate schedule showing the computations under such section.

PAR. 13. There is inserted immediately preceding section 40.440–1 [26 CFR 40.440–1] the following:

SEC. 325. TAX TREATMENT OF COAL ROYALTIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(e) CONFORMING AMENDMENTS.—

* * * * * * *

(2) Section 440(a)(1) (relating to definition of "inadmissible assets") is hereby amended by striking out "and" at the end of subparagraph (A); by striking out the period at the end of subparagraph (B) and inserting in lieu thereof "; and"; and by adding at the end thereof the following new subparagraph:

"(C) The economic interest referred to in the provisions of section 117(k)(2) relating to coal if the taxpayer is subject to such provisions with respect to the income from such coal."

(3) The amendments made by this subsection shall be applicable in computing the tax under subchapter D of chapter 1 for taxable years ending after December 31, 1950.

* * * * * * *

SEC. 508. ELECTION WITH RESPECT TO CERTAIN INADMISSIBLE ASSETS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 440.—Section 440 (relating to admissible and inadmissible assets) is hereby amended by adding at the end thereof the following new subsection:

"(c) TREATMENT OF GOVERNMENT OBLIGATIONS AS ADMISSIBLE ASSETS.—If the taxpayer elects for any taxable year, in accordance with regulations prescribed by the Secretary, to increase its excess profits net income by an amount equal to the amount by which the interest received or accrued during the taxable year on Government obligations exceeds the sum of—

"(1) the amount of interest paid or accrued during such year which is not allowed as a deduction under section 23(b), and

"(2) the amount of the adjustments required for the taxable year under section 22(o) (relating to adjustment for certain bond premiums), but not in excess of the amount of interest received or accrued during the taxable year on Government obligations to which such section is applicable,

then for the taxable year for which the election is made the term 'admissible assets' shall include Government obligations, and the term 'inadmissible assets' shall not include Government obligations. For the purpose of applying section 435 to the taxable year for which the election is made, Government obligations shall not be considered 'inadmissible assets' in determining original inadmissible assets or yearly base period capital. As used in this subsection the term 'Government obligations' means obligations described in section 22(b)(4) any part of the interest from which is excludible from gross income or allowable as a credit against net income; but such term shall include only such obli-

gations as in the hands of the taxpayer are property described in section 117(a)(1)(A). For the purpose of determining the excess profits credit for a taxable year for which the election is made, the excess profits net income under section 433(b) for any taxable year shall include the amount by which the interest received or accrued during such taxable year on Government obligations exceeds the amount of interest paid or accrued during such year which is not allowed as a deduction under section 23(b) and, if the taxable year ends after June 30, 1950, the amount with respect to such year described in paragraph (2)."

* * * * * * *

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including section 508] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 14. Section 40.440–1 [26 CFR 40.440–1] is amended as follows:

(A) By inserting at the end of (a) of such section the following:

For the election in certain cases to treat Government obligations as admissible assets, see section 440(c) and (g) of this section.

(B) By striking the first sentence from (b) of such section and by inserting in lieu thereof the following:

The term "inadmissible assets" means (1) stock in all corporations, domestic or foreign, except stock in a foreign personal holding company, and except stock which is not a capital asset (such as stock held primarily for sale to customers by a dealer in securities), (2) all obligations described in section 22(b)(4), any part of the interest from which is excludable from gross income or allowable as a credit against net income, and (3) for the purpose of computing the tax for taxable years ending after December 31, 1950, the economic interest referred to in section 117(k)(2), relating to coal, if the taxpayer is subject to the provisions of such section with respect to the income from such coal.

(C) By striking from (c) of such section "section 436(a)(1) and section 448(b)(3)" and by inserting in lieu thereof the following: "section 435(f)(6), section 436(a)(1), and section 448(b)(3)".

(D) By striking the last sentence of (f) of such section and inserting in lieu thereof the following:

The amount so determined is the amount of the reduction referred to in section 436(a)(1) or section 448(b)(3), as the case may be. Section 440(b) similarly applies in determining the amount of the reduction referred to in section 435(f)(6), except that for such purpose only the daily amounts of admissible and inadmissible assets for the first day of the taxable year are used.

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

(g) (1) Section 440(c) provides that, if the taxpayer makes the election described in that section, its Government obligations described in section 22(b)(4) to which the election is applicable, any part of the interest from which is excludable from gross income or allowable as a credit against net income, shall be treated as admissible assets. The election under section 440(c) is applicable to such Government obligations as are not capital assets in the taxpayer's hands and as are stock in trade or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. In the case of such election, the term "admissible assets" shall include such Government obligations and the term "inadmissible assets" shall not include such obligations. For this purpose, the term "obligations described in section 22(b)(4)" includes obligations, the discount on which, if issued at a discount, would be treated as interest described in section 22(b)(4). An election under section 440(c) shall be made in the manner described in (4), below.

(2) In the case of a taxpayer making the election under section 440(c) for any taxable year, the excess profits net income shall be increased by an amount

equal to the amount by which the interest received or accrued during the taxable year on the Government obligations to which the election is applicable (see (1), above) exceeds the sum of—

(i) the amount of interest paid or accrued during such year which is not allowed as a deduction under section 23(b) and which is properly allocable to the Government obligations to which the election is applicable, and

(ii) the amount of the adjustments required for the taxable year under section 22(o) (relating to adjustment for certain bond premiums) with respect to the Government obligations to which the election is applicable, but not in excess of the amount of interest received or accrued during the taxable year on such Government obligations.

(3) For the purpose of applying section 435 to the taxable year for which the election is made, the Government obligations to which such election is applicable shall not be considered inadmissible assets in determining yearly base period capital under section 435(f)(1) or in determining original inadmissible assets under section 435(g)(5). See sections 40.435–6 and 40.435–7. For the purpose of determining the excess profits credit for a taxable year for which the election under section 440(c) is made, the excess profits net income computed under section 433(b) for any taxable year shall be increased by the excess of the amount of interest received or accrued on such obligations during such taxable year reduced (but not below zero) by the amount of interest paid or accrued during such taxable year which is not allowed as a deduction under section 23(b) and which is properly allocable to such obligations. In the case of a taxable year ending after June 30, 1950, such interest shall further be reduced by the amount of the adjustment required under section 22(o) (relating to the adjustment for certain bond premiums with respect to such obligations), but not by an amount greater than the amount of interest received or accrued during the taxable year on such obligations. For the purpose of determining the amount of interest received or accrued with respect to any taxable year, the term "interest" includes, in the case of obligations issued at a discount, so much of such discount as (for the purpose of determining gain upon sale or disposition) is treated as interest in the hands of the taxpayer for the taxable year.

(4) The election pursuant to section 440(c) shall be made in a statement attached to Schedule EP (Form 1120) accompanying the income tax return for such year or by the use of figures on such schedule which clearly reflect the election. Such election must be made for each taxable year for which the benefits of section 440(c) are claimed. If the taxpayer has failed so to elect or desires to change its election, such election or change in election may, subject to the approval of the Commissioner, be made by the taxpayer filing with the Commissioner of Internal Revenue, Washington 25, D. C., within the period of limitations for the filing of claims for credit or refund with respect to the year or years involved, a notice of its election or change in election accompanied by a recomputation of its excess profits tax for such year. If the recomputation results in an overpayment for such year, the taxpayer should file a claim for credit or refund on Form 843 in accordance with the provisions of section 322.

PAR. 15. There is inserted immediately preceding section 40.442–1 [26 CFR 40.442–1] the following:

SEC. 509. ALTERNATIVE AVERAGE BASE PERIOD NET INCOME [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 442.—Section 442 (relating to abnormalities during the base period) is hereby amended as follows:

(1) By inserting at the end of subsection (a) thereof the following:

"If such taxpayer is also entitled to the benefits of subsection (h), the taxpayer's average base period net income determined under this section shall be the amount computed under subsection (c) or (d), whichever is applicable to the taxpayer, or the amount computed under subsection (h), whichever results in the lesser tax under this subchapter for the taxable year. In the case of any other taxpayer entitled to the benefits of subsection (h), the taxpayer's average base period net income determined under this section shall be the amount computed under subsection (h)."

(2) By striking out "determined under this section" in subsections (c) and (d) thereof each place it occurs and inserting in lieu thereof the following: "computed under this subsection".

(3) By inserting after "subsection (c)(2)" in subsection (e)(1) thereof the following: "and subsection (h)".

(4) By redesignating subsections (h) and (i) thereof as (i) and (j), respectively, and by inserting after subsection (g) thereof the following new subsection:

"(h) ALTERNATIVE AVERAGE BASE PERIOD NET INCOME.—

"(1) ELIGIBILITY REQUIREMENTS.—A taxpayer which commenced business on or before the first day of its base period shall be entitled to the benefits of this subsection if—

"(A) the aggregate excess profits net income (if any) for the 12 months selected under paragraph (2)(B) is less than 35 per centum of one-half of the aggregate excess profits net income for the 24 months remaining under such paragraph; and

"(B) normal production, output, or operation was interrupted or diminished because of the occurrence, within 12 months preceding (i) the first day of the 12-month period selected under paragraph (2)(B)(i), or (ii) the first day of any period of six or more consecutive months selected under paragraph (2)(B)(ii), of events unusual or peculiar in the experience of such taxpayer.

This subsection shall have no application unless the taxpayer has an aggregate excess profits net income for the 24 months remaining under paragraph (2)(B).

"(2) COMPUTATION.—If the taxpayer is entitled to the benefits of this subsection, its average base period net income computed under this subsection shall be computed as follows:

"(A) By determining under subsection (b) the period subject to adjustment under this section. For the purposes of subparagraph (B) but not for the purposes of paragraph (1)(B) such period shall be considered a period of 36 consecutive months.

"(B) By selecting from such period whichever of the following 12 months results in the higher remaining aggregate excess profits net income—

"(i) the 12 consecutive months the elimination of which produces the highest remaining aggregate excess profits net income, or

"(ii) the 12 months which remain after retaining the 24 consecutive months which produce the highest remaining aggregate excess profits net income.

"(C) By computing for each of the 12 months selected under subparagraph (B) a substitute excess profits net income computed under subsection (e).

"(D) By computing the sum of—

"(i) the aggregate of the substitute excess profits net income, as determined under subparagraph (C), for the 12 months selected under subparagraph (B), but the amount computed under this clause shall not exceed one-half of the aggregate excess profits net income for the 24 months remaining under subparagraph (B), and

"(ii) the aggregate of the excess profits net income for each of the 24 months remaining under subparagraph (B), computed in the manner provided by the second sentence of section 435(d)(1).

"(E) By dividing by three the amount ascertained under subparagraph (D).

"(3) AGGREGATE EXCESS PROFITS NET INCOME.—The 'aggregate excess profits net income' for any period shall be computed for the purposes of this subsection in the same manner as under subsection (b)."

* * * * * * *

SEC. 510. DEFINITION OF TOTAL ASSETS FOR PURPOSES OF SECTIONS 442-446 [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

The first sentence of section 442(f) (relating to definition of total assets) is hereby amended to read as follows: "For the purposes of this section, the taxpayer's total assets for any day shall be determined as of the end of such day and shall be an amount equal to the excess of—

"(1) the sum of the cash and the property (other than cash, inadmissible assets, and loans to members of a controlled group as defined in section 435(f)(4)) held by the taxpayer in good faith for the purposes of the business, over

"(2) the amount of any indebtedness (other than borrowed capital as defined in section 439(b)(1)) to a member of a controlled group (as defined in section 435(g)(6)) which includes the taxpayer."

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including sections 509 and 510] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 16. Section 40.442-1 [26 CFR 40.442-1] is amended to read as follows:

SEC. 40.442-1. GENERAL RULE.—If a taxpayer which commenced business on or before the first day of its base period establishes that it experienced certain abnormalities (described in section 40.442-2, below), then such taxpayer may be entitled to use the average base period net income computed under section 442(c) or section 442(d), whichever is applicable. If the taxpayer is also entitled to the benefits of section 442(h), the taxpayer's average base period net income determined under section 442 shall be the amount computed under subsection (c) or (d) of such section, whichever is applicable to the taxpayer, or the amount computed under subsection (h) of such section, whichever results in the lowest excess profits tax for the taxable year. In the case of any other taxpayer entitled to the benefits of section 442(h), the taxpayer's average base period net income determined under section 442 shall be the amount computed under subsection (h) of such section. See sections 40.442-3 and 40.442-4, below, for methods of computation. Section 442 is applicable only if the taxpayer makes application therefor in accordance with section 447(e). For rules governing the application of section 442 in the case of an acquiring corporation, see section 462(d), and in the case of a component corporation, see section 461(c).

PAR. 17. Section 40.442-3 [26 CFR 40.442-3] is amended by changing the first sentence of (d)(1) thereof to read as follows:

(1) The term "total assets" for any day means the excess, determined as of the end of such day, of—

(i) the sum of the cash and other property (other than inadmissible assets, as defined in section 440(a)(1), and other than loans to members of a controlled group, as defined in section 435(f)(4)) held by the taxpayer in good faith for purposes of the business, over

(ii) the amount of any indebtedness (other than borrowed capital, as defined in section 439(b)(1)) to a member of a controlled group, as defined in section 435 (g)(6), which includes the taxpayer.

PAR. 18. There is inserted immediately after section 40.442-3 [26 CFR 40.442-3] the following:

SEC. 40.442-4. ALTERNATIVE AVERAGE BASE PERIOD NET INCOME.—(a) *In general.*—Section 442(h) provides that a taxpayer which commenced business on or before the first day of its base period may use a substitute excess profits net income for 12 months (as selected under (1), below) of the period subject to adjustment determined under section 40.442-3, that is, the 36 months in the base period selected as having the highest aggregate excess profits net income

or the lowest aggregate deficit in excess profits net income. In order to determine its eligibility for the benefits of section 442(h), a taxpayer must first select a period of 12 months, as shown in (1), below, and then ascertain whether the requirements set forth in (2), (3), and (4), below, are met.

(1) After determining under section 442(b) and section 40.442-3(a) the 36-month period subject to adjustment, the 12-month period is selected by determining either (i) the 12 consecutive months the elimination of which produces the highest aggregate excess profits net income or the lowest aggregate deficit in excess profits net income for the remaining 24 months, or (ii) the 12 months which remain after eliminating the 24 consecutive months which produce the highest aggregate excess profits net income or the lowest aggregate deficit in excess profits net income. For the purpose of making this selection, the 36 months previously determined under section 442(b) and section 40.442-3(a) shall be considered a period of 36 consecutive months.

(2) The aggregate excess profits net income, if any, computed as provided in section 40.442-3(a)(1) for the 12 months selected under (1), must be less than 35 percent of one-half of the aggregate excess profits net income so computed for the 24 months remaining after such selection.

(3) There must not be an aggregate deficit in excess profits net income for the 24 months remaining in (1).

(4) The taxpayer must show that normal production, output, or operation was interrupted or diminished because of the occurrence of events unusual or peculiar in the experience of the taxpayer (see section 40.442-2(a)), within 12 months preceding either—

(i) the first day of the 12-month period selected under (1), if 12 consecutive months are selected under (1), or

(ii) if the 12 months selected under (1) are not consecutive, the first day of any period of six or more consecutive months in such 12 months.

(b) *Computation.*—If the taxpayer is entitled to the benefits of section 442(h) under the rules of (a), above, its average base period net income under section 442(h) shall be computed as follows:

(1) A substitute excess profits net income is determined for each of the 12 months selected under (a)(1), above. Such substitute excess profits net income is computed under section 442(e) for each such month by determining the taxpayer's total assets (determined under section 442(f) and under section 40.442-3(d)) for the last day of the taxable year in which such month falls, or for the last day of the taxpayer's last taxable year ending before July 1, 1950, whichever day is earlier, and by multiplying such total assets by the appropriate industry base period yearly rate of return determined under section 447 for the base period year in which such month falls. See section 442(e)(2) for special rules in case of fiscal years. Under section 442(g), the appropriate industry classification under section 447 is the classification to which is attributable the largest amount of the taxpayer's gross receipts for the taxable year within which falls the last month for which a substitute excess profits net income is determined.

(2) The amount determined under (1) is reduced by the total interest paid or incurred by the taxpayer for the 12 months beginning with the first day of the taxable year within which such month falls.

(3) The amount determined under (1) and reduced under (2) is divided by 12. The amount so computed is the substitute excess profits net income for the month.

(4) The sum of the following amounts is computed—

(i) the aggregate of the amounts determined under (3), but such aggregate shall not exceed one-half of the aggregate excess profits net income computed in the manner provided in section 40.442-3(a)(1) for the 24 months remaining in (a)(1), above, and

(ii) the aggregate of the excess profits net income for each of the 24 months remaining in (a)(1), above, but computed by dividing the excess profits net income for the taxable year in which each such month falls by the number of full calendar months in such taxable year, and raising any deficits in excess profits net income to zero.

(5) The amount determined under (4) is divided by 3.

(c) For special rules applicable to section 442(h) and to this section, see section 40.442-3 (d) and (e).

PAR. 19. There is inserted immediately preceding section 40.443-1 [26 CFR 40.443-1] the following:

SEC. 511. AVERAGE BASE PERIOD NET INCOME—CHANGE IN PRODUCTS OR SERVICES [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 443(f) (relating to change in products or services) is hereby amended to read as follows:

"(f) RULES FOR APPLICATION OF SECTION.—

"(1) The benefits of this section shall not be allowed unless the taxpayer makes application therefor in accordance with section 447(e).

"(2) If after the end of the base period of the taxpayer there was a substantial change in the products produced by the taxpayer, such change shall, for the purpose of subsection (a)(1), be considered to have occurred on the last day of its base period if the taxpayer prior to July 1, 1950, commenced the construction of the facilities for the production of such new products, and if such construction and the production of such new product is in furtherance of a course of action to which the taxpayer (or a corporation with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter) was committed prior to the close of the base period by contract with another person, which contract granted a license, franchise, or similar right essential for the production of such new product."

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including section 511] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 20. Section 40.443-2 [26 CFR 40.443-2] is amended by adding at the end thereof the following:

(d) *Commitment rule.*—(1) If after the base period of the taxpayer there was a substantial change in the products produced by the taxpayer, such change shall, for the purpose of section 443(a)(1) and section 40.443-1(a)(1), be considered to have occurred on the last day of its base period if—

(i) the taxpayer prior to July 1, 1950, commenced construction of the facilities for the production of such new product, and

(ii) such construction and the production of such new product is in furtherance of a course of action to which the taxpayer (or a corporation with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year ending after June 30, 1950) was committed prior to the close of the base period by contract with another person, which contract granted a license, franchise, or similar right essential for the production of such new product.

(2) The contract referred to in (1)(ii), above, must be in writing. It must have been executed prior to the end of the base period of the corporation to which the license, franchise, or similar right essential for the production of the new product were by its terms granted. The corporation granted such license, franchise, or similar right to produce the new product may have been either the taxpayer or any corporation with which the taxpayer has the privilege of filing a consolidated return for the taxpayer's first taxable year ending after June 30, 1950.

PAR. 21. There is inserted immediately preceding section 40.444-1 [26 CFR 40.444-1] the following:

SEC. 520. INCREASE IN CAPACITY FOR PRODUCTION OR OPERATION [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 444(f) (relating to increase in capacity for production or operation) is hereby amended to read as follows:

"(f) RULES FOR APPLICATION OF SECTION.—

"(1) The benefits of this section shall not be allowed unless the the taxpayer makes application therefor in accordance with section 447(e).

"(2) If, during its first taxable year ending after June 30, 1950, the taxpayer completed construction of (including the installation of the machinery or equipment for use in) a factory building or other manufacturing establishment, such factory building or other manufacturing establishment and such machinery or equipment shall, for the purpose of determining whether there is an increase in capacity under the provisions of subsection (b), be considered to have been added to its total facilities on the last day of its base period if—

"(A) the taxpayer, prior to the end of its base period, had completed construction work representing more than 40 per centum of the total cost of construction of such factory building or other manufacturing establishment, and

"(B) the completion of such factory building or other manufacturing establishment was in pursuance of a plan to which the taxpayer was committed prior to the end of its base period.

This paragraph shall not apply in determining the amount of the taxpayer's total assets for the purpose of subsection (c)."

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including section 520] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 22. Section 40.444–2 [26 CFR 40.444–2] is amended by adding at the end thereof the following:

(c) *Commitment rule.*—(1) If during its first taxable year ending after June 30, 1950, the taxpayer completed construction of (including installation of the machinery or equipment for use in) a factory building or other manufacturing establishment, then section 444(b)(2) provides that such factory building or other manufacturing establishment and such machinery or equipment shall, for the purpose of determining whether there is an increase in capacity under the provisions of section 444(b) and this section be considered to have been added to its total facilities on the last day of its base period if—

(i) the taxpayer, prior to the end of its base period, had completed construction work representing more than 40 percent of the total cost of construction of such factory building or other manufacturing establishment, and

(ii) the completion of such factory building or other manufacturing establishment was in pursuance of a plan to which the taxpayer was committed prior to the end of its base period.

(2) Section 444(f)(2) does not apply in determining the amount of the taxpayer's total assets for the purpose of section 444(c) and section 40.444–3.

(3) Section 444(f)(2) is applicable only in the case of a separate manufacturing plant, the construction of which (including installation of machinery and equipment for use therein) is completed by the taxpayer during its first taxable year ending after June 30, 1950. The section is not applicable, for example, to: additions made to plants in existence at the end of the taxpayer's base period; a factory or other manufacturing establishment acquired other than through construction, such as through purchase; machinery and equipment installed in a factory building or manufacturing establishment existing at the end of the taxpayer's base period.

(4) A legally binding form of commitment is not required; any substantial change in position prior to the end of the taxpayer's base period unequivocally establishing the intent of the taxpayer to complete the construction of such factory building or other manufacturing establishment after the end of its base period, will be taken as sufficient proof that the actual completion of the construction of such factory or other manufacturing establishment during the taxpayer's first taxable year ending after June 30, 1950, was in pursuance of a plan to which the taxpayer was committed prior to the end of its base period.

(5) For the purpose of section 444(f)(2), the term "other manufacturing establishment" means a production structure, other than a factory building, such as an oil refinery.

PAR. 23. There is inserted immediately preceding section 40.445–1 [26 CFR 40.445–1] the following:

SEC. 512. AVERAGE BASE PERIOD NET INCOME—NEW CORPORATION [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 445(c) (relating to total assets for first three years of new corporation) is hereby amended by adding at the end thereof the following new sentence: "For the purpose of this subsection, the net capital addition or reduction shall be computed without regard to the limitation to 75 per centum provided in section 435(g)(3)(C) and section 435(g)(4)(C) and (E)."

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including section 512] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 24. Section 40.445–2 [26 CFR 40.445–2] is amended by inserting at the end of (d)(1) thereof the following:

For the purpose of this paragraph, the net capital addition or reduction shall be computed without regard to the limitation to 75 percent provided in section 435(g)(3)(C), relating to an increase in borrowed capital, and section 435(g)(4)(C) and (E), relating to a decrease in borrowed capital and an increase in loans to members of a controlled group of corporations of which the taxpayer is a member.

PAR. 25. There is inserted immediately preceding section 40.450–1 [26 CFR 40.450–1] the following:

SEC. 522. STRATEGIC MINERALS [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 450(b)(1) (relating to corporations engaged in mining of strategic minerals) is hereby amended by inserting after "chromite," the following: "bauxite,".

SEC. 523. EFFECTIVE DATE OF TITLE V [TITLE V, REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including section 522] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 26. Section 40.453–2, as amended by Treasury Decision 5953 [C. B. 1952–2, 204], approved December 2, 1952 [26 CFR 40.453–2], is further amended as follows:

(A) By striking the second sentence from (c)(5) of such section and by inserting in lieu thereof the following:

The mineral units or timber units of a lessor for the taxable year shall be computed in the same manner as in the case of a producer, except that—

(i) in the case of a lessor of a timber block, and

(ii) in computing nontaxable income from exempt excess output for taxable years ending after December 31, 1950, in the case of a lessor of a coal property,

there shall not be included in the timber or coal units for such year any timber or coal which has been disposed of by the lessor and which is considered to have been sold under the provisions of section 117(k)(2).

(B) By adding at the end of (k)(1) of such section the following:

In computing nontaxable income from exempt excess output for taxable years ending after December 31, 1950, in the case of a lessor of a coal property the estimated recoverable units shall be determined without regard to coal which has been disposed of by the lessor and which is considered to have been sold under the provisions of section 117(k)(2).

(C) By adding at the end of (m)(14) of such section the following:

In the case of a lessor of a timber block, and for taxable years ending after December 31, 1950, in the case of a lessor of a coal mining property, there shall not be included in the timber units or coal units to be used in the computation of unit net income any timber or coal which has been disposed of by the lessor and which is considered to have been sold under the provisions of section 117(k)(2).

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 16, 1953.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 21, 1953, 8:54 a. m.)

SECTION 40.433(a)-2, REGULATIONS 130: Computation of excess profits net income for the taxable year. T. D. 5986

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130, section 40.433(a)-2(m) (relating to exclusion from excess profits net income of certain income derived from foreign sources) amended.

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

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

On December 16, 1952, notice of proposed rule making with respect to amendments of Regulations 130, section 40.433(a)-2(m), relating to the exclusion from excess profits net income of certain income derived from foreign sources, was published in the Federal Register (17 F. R. 11366). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, the amendments to Regulations 130 [26 CFR, part 40] set forth below are hereby adopted:

PARAGRAPH 1. Section 40.433(a)-2, as amended by Treasury Decision 5973 [page 321, this Bulletin], approved January 16, 1953, is further amended by striking out all of paragraph (m) and substituting in lieu thereof the following:

(m) (1) Under section 433(a)(1)(M) there shall be excluded income derived from sources within any foreign country to the extent that such income,—

(i) but for monetary, exchange, or other restrictions imposed by such foreign country, or

(ii) but for the taxpayer's election to defer the reporting of such income under a method of accounting, approved by the Commissioner, applicable to income which could not be readily converted into United States dollars or into other money or property readily convertible into United States dollars,

would have been includible in the gross income of the taxpayer for any taxable year which preceded its first taxable year ended after June 30, 1950. If such income is includible in the gross income of the taxpayer for a taxable year succeeding the first taxable year ended after June 30, 1950, and, but for such restrictions or such election, would have been includible in the gross income of the taxpayer for its first taxable year ended after June 30, 1950, and if such first taxable year began prior to July 1, 1950, such income shall be excluded in an amount which is the same proportion of such income as the number of days prior to July 1, 1950, in such first taxable year is of the total number of days in such first taxable year. Deductions properly chargeable and allocable to the income excluded under section 433(a)(1)(M) shall not be allowed.

(2) For the purpose of this paragraph—

(i) The term "blocked foreign income" means income derived from sources within any foreign country during any taxable year which would, but for the restrictions or the election described in (1) above, have been includible in the gross income of the taxpayer for such taxable year.

(ii) The term "unblocked foreign income" means income which was "blocked foreign income" during the taxable year in which it was derived from sources within any foreign country, but which becomes includible in the gross income of the taxpayer for any subsequent taxable year, whether as a result of the removal of such restrictions, or of such income becoming readily convertible into United States dollars or into other money or property readily convertible into United States dollars, or for other reasons.

(3) In cases where unblocked foreign income cannot be specifically identified as the blocked foreign income or portion thereof of a particular taxable year, the determination whether unblocked foreign income from sources within any foreign country has become includible in the gross income of the taxpayer for a taxable year ending after June 30, 1950, and the determination of the taxable year in which any such unblocked foreign income would have been includible but for the restrictions or the election, shall be made in accordance with the following rules:

(i) The aggregate amount includible in gross income for the taxable year in respect to income derived from sources within such foreign country shall first be deemed attributable to the income derived from sources within such foreign country during such taxable year. To the extent that such unblocked foreign income is attributable to income so derived during the taxable year, such unblocked foreign income shall not be excluded under section 433(a)(1)(M).

(ii) The amount of such unblocked foreign income in excess of the portion thereof attributable to income derived from sources within such foreign country during such taxable year under the rule stated in (i) above shall be deemed to be attributable to the earliest blocked foreign income derived from sources within such foreign country, which blocked foreign income has not been previously deemed unblocked in a prior taxable year. Such excess shall be excluded under section 433(a)(1)(M) only to the extent of the aggregate of the blocked foreign income derived from sources within such foreign country in all taxable years beginning prior to July 1, 1950, but such aggregate shall be reduced by the proportion of the blocked foreign income derived from sources within such foreign country during the taxpayer's first taxable year ending after June 30, 1950, if such taxable year began prior to July 1, 1950, as the number of days after June 30, 1950, in such first taxable year is of the total number of days in such first taxable year.

In determining whether unblocked foreign income which becomes includible in the gross income of the taxpayer for a taxable year ending after June 30, 1950, can be specifically identified as attributable to the blocked foreign income or portion thereof derived from sources within such foreign country in a particular taxable year, effect shall be given to the previous application of the rules in (i) and (ii) above to unblocked foreign income derived from sources within such foreign country which became includible in gross income of the taxpayer for a prior taxable year ending after June 30, 1950.

(This Treasury Decision is issued under the authority contained in sections 62, 433(a) (1) (M), and 3791 of the Internal Revenue Code (53 Stat. 32, 64 Stat. 1142, 53 Stat. 467; 26 U. S. C. 62, 433(a) (1) (M), 3791).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 10, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 13, 1953, 8:54 a. m.)

SECTION 40.433(a)-2, REGULATIONS 130: Computation of excess profits net income for the taxable year.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5992, page 297.)

SECTION 40.433(a)-2, REGULATIONS 130: Computation of excess profits net income for the taxable year.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 6006, page 30.)

SECTION 40.433(b)-2, REGULATIONS 130: Computation of excess profits net income. T. D. 5982

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Section 40.433(b)-2(a) of Regulations 130 amended

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

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

On November 15, 1952, a notice of proposed rule making was published in the Federal Register [17 F. R. 10468] to amend Regulations 130 [26 CFR, part 40]. No objections to the rules proposed having been received within the 30 days following such publication, such regulations are hereby amended by adding at the end of section 40.433(b)-2(a), as amended by Treasury Decision 5973 [page 321, this Bulletin], approved January 16, 1953, the following new sentence:

In making the adjustment required by section 433(b) (6) for dividends received, the limitation provided in section 26(b) with respect to dividends in kind shall be applicable only if the dividend was received after August 31, 1950.

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 9, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 12, 1953, 8:48 a. m.)

SECTION 435.—EXCESS PROFITS CREDIT—BASED ON INCOME

SECTION 40.435–1, REGULATIONS 130: Excess profits credit based on income—Determination of average base period net income. (Also Section 459, Section 40.459(a)–1.) T. D. 5987

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to conform to section 516 of the Revenue Act of 1951, relating to transition from war production and increase in peacetime capacity.

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

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

On November 15, 1952, a notice of proposed rule making was published in the Federal Register [17 F. R. 10468] to conform Regulations 130 [26 CFR, part 40] to section 516 of the Revenue Act of 1951, approved October 20, 1951. No objections to the rules proposed having been received within the 30 days following such publication, the amendments set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately after section 509(b) of the Revenue Act of 1951, which precedes section 40.435–1 [26 CFR 40.435–1], the following:

> SEC. 516. TRANSITION FROM WAR PRODUCTION AND INCREASE IN PEACETIME CAPACITY [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].
>
> * * * * * * *
>
> (b) TECHNICAL AMENDMENTS.—Section 435(c) (relating to determination of average base period net income) is hereby amended as follows:
>
> (1) By inserting immediately after "445 or 446," the following: "or any subsection of section 459,".
>
> (2) By inserting immediately after "or under such section" the following: "or subsection".

PAR. 2. Section 40.435–1(c) [26 CFR 40.435–1(c)] is amended by inserting "or any subsection of section 459," immediately after "or 446," and by inserting "or subsection" immediately after "under whichever section" in such section, so that such section 40.435–1(c) as so amended will read as follows:

(c) *Average base period net income—Determination.*—The average base period net income is the amount determined under section 435(d) (for computation, see (d) of this section), unless the taxpayer is entitled to the benefits of section 435(e), 442, 443, 444, 445, or 446, or any subsection of section 459, in which case the average base period net income shall be the amount determined under whichever section or subsection, applicable to the taxpayer, results in the lowest excess profits tax for the taxable year.

PAR. 3. There is inserted immediately after section 40.458–8 [26 CFR 40.458–8] the following:

SEC. 516. TRANSITION FROM WAR PRODUCTION AND INCREASE IN PEACETIME CAPACITY [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) IN GENERAL.—Part I of subchapter D of chapter 1 is hereby amended by adding at the end thereof a new section to read as follows:

"SEC. 459. MISCELLANEOUS PROVISIONS.

"(a) AVERAGE BASE PERIOD NET INCOME—TRANSITION FROM WAR PRODUCTION AND INCREASE IN PEACETIME CAPACITY.—In the case of a taxpayer which commenced business before January 1, 1940, and since such date has engaged primarily in manufacturing, the taxpayer's average base period net income determined under this subsection shall be the amount computed under section 435(e)(2)(G) (i) and (ii) if—

"(1) The adjusted basis of the taxpayer's total facilities (as defined in section 444(d)) as of the beginning of its base period (when added to the total facilities at such time of all corporations with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter) did not exceed $10,000,000;

"(2) The basis (unadjusted) of the taxpayer's total facilities (as defined in section 444(d)) at the close of its base period was 250 per centum or more of the basis (unadjusted) of its total facilities at the beginning of its base period;

"(3) The percentage of the taxpayer's aggregate gross income which was from contracts with the United States and related subcontracts was (A) at least 70 per centum for the period comprising all taxable years beginning after December 31, 1941, and ending before January 1, 1946, (B) less than 20 per centum for the period comprising all taxable years ending after December 31, 1945, and before January 1, 1950, and (C) less than 20 per centum for the period comprising all taxable years ending after December 31, 1949, and beginning before July 1, 1950; and

"(4) The average monthly excess profits net income of the taxpayer (computed in the manner provided in section 443(e)) for—

"(A) the period comprising all taxable years ending with or within the last 24 months of its base period, and

"(B) the last taxable year ending before the first day of its base period,

are each 300 per centum or more of the average monthly excess profits net income (so computed) of the taxpayer for the period comprising all taxable years ending with or within the first 24 months of its base period."

* * * * * * *

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [including sec. 516] shall be applicable only with respect to taxable years ending after June 30, 1950.

SEC. 40.459(a)–1. TRANSITION FROM WAR PRODUCTION AND INCREASE IN PEACETIME CAPACITY.—(a) A corporation which commenced business before January 1, 1940, which has been engaged primarily in manufacturing since January 1, 1940, and which satisfies all the requirements provided in paragraphs (1) through (4) of section 459(a) may compute its average base period net income under section 459(a), for the purpose of computing its excess profits tax for any taxable year ending after June 30, 1950, instead of under any

other applicable provision of the Code. The average base period net income computed under section 459(a) shall be the amount computed under section 435(e)(2)(G) (i) and (ii) and under sections 40.435–5(a)(7) (i) and (ii) and 40.435–5(b). If the taxpayer computes its average base period net income under section 459(a), the base period capital addition provided in section 435(f) shall not be allowed in computing its excess profits credit.

(b) The date the corporation commenced business shall be determined for the purpose of section 459(a) under the rules provided in the regulations promulgated under section 445, relating to the computation of average base period net income in the case of new corporations. See section 40.445–1(a)(2).

(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).)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved February 12, 1953.

Elbert P. Tuttle,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 16, 1953, 8:52 a. m.)

Section 40.435–1, Regulations 130: Excess profits credit based on income—Determination of average base period net income.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

Section 40.435–6, Regulations 130: Capital additions in base period. (Also Section 442, Section 40.442–3, Regulations 130.) T. D. 6010

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS-PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to clarify effect on the excess-profits credit of loans to a foreign subsidiary corporation.

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington 25, D. C.

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

On July 10, 1952, notice of proposed rulemaking, regarding amendments to Regulations 130 [26 CFR, part 40] with respect to the effect on the excess-profits credit based on income of loans by a member of a controlled group of corporations to another member of the same group, was published in the Federal Register (17 F. R. 6201). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments to Regulations 130 set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding the last sentence of section 40.435–6(b)(5) [26 CFR 40.435–6(b)(5)] the following:

The reduction under section 435(f)(1)(B) is required whether or not such other member of the controlled group is subject to the excess profits tax, for example, in a case in which such other member is a foreign corporation not engaged in trade or business within the United States.

PAR. 2. There is inserted at the end of section 40.435–7(c)(5) [26 CFR 40.435–7(c)(5)] the following:

The adjustment under section 435(g)(7) is required whether or not such other corporation is subject to the excess profits tax, for example, in a case in which such other corporation is a foreign corporation not engaged in trade or business within the United States.

PAR. 3. Section 40.442–3(d)(1), as amended by Treasury Decision 5973 [page 321, this Bulletin], approved January 16, 1953 [26 CFR 40.422–3(d)(1)], is further amended by inserting after the third sentence thereof the following:

The exclusion from total assets of loans to a member of a controlled group of corporations of which the taxpayer is a member is required whether or not such other member of the controlled group is subject to the excess profits tax, for example, in a case in which such other member is a foreign corporation not engaged in trade or business within the United States.

(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).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved May 7, 1953.

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

(Filed with the Division of the Federal Register May 12, 1953, 8:54 a. m.)

SECTION 438.—NEW CAPITAL CREDIT CHANGES

SECTION 40.438–4, REGULATIONS 130: Computation of net new capital addition.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

SECTION 439.—BORROWED CAPITAL

SECTION 40.439–1, REGULATIONS 130: Borrowed capital. Rev. Rul. 14

INTERNAL REVENUE CODE

In determining the daily borrowed capital of an insurance company (except a mutual insurance company other than life or marine) as of January 1, 1950, the first day of the taxpayer's first taxable year for excess profits tax purposes, section 439(b)(2) of the Internal Revenue Code requires that the amount of its unearned premiums for such day shall be the mean of the amount of such premiums determined at the beginning and end of 1950.

Advice is requested relative to the interpretation of section 439(b)(2) of the Internal Revenue Code with respect to the manner of computing the amount of the unearned premiums of an insurance company (except a mutual insurance company other than life or marine) to be used in determining the daily borrowed capital for January 1, 1950, the first day of its first taxable year for excess profits tax purposes.

Section 439(b) of the Internal Revenue Code provides in part as follows:

(b) DAILY BORROWED CAPITAL.—For the purposes of this subchapter [subchapter D, chapter 1, of the Code], the daily borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

* * * * * * *

(2) In the case of an insurance company, an amount equal to 66 2/3 per centum of the mean of the amount of the pro rata unearned premiums determined at the beginning and end of the taxable year * * *

The reference to "any day" in section 439(b) of the Code is applicable to the first day of any taxable year as well as to any other day during the year. It is clear from the literal language of the statute that an averaging method was intended to be used in the determination of borrowed capital for insurance companies.

Accordingly, it is held that in determining the daily borrowed capital of an insurance company (except a mutual insurance company other than life or marine) as of January 1, 1950, the first day of the taxpayer's first taxable year for excess profits tax purposes, section 439(b)(2) of the Internal Revenue Code requires that the amount of its unearned premiums for such day shall be the mean of the amount of such premiums determined at the beginning and end of 1950.

SECTION 440.—ADMISSIBLE AND INADMISSIBLE ASSETS

SECTION 40.440-1, REGULATIONS 130: Admissible and inadmissible assets.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

SECTION 442.—AVERAGE BASE PERIOD NET INCOME—ABNORMALITIES DURING BASE PERIOD

SECTION 40.442-1, REGULATIONS 130: General rule.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

SECTION 40.442-3, REGULATIONS 130: Computation of average base period net income.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 6010, page 347.)

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SECTION 443.—AVERAGE BASE PERIOD NET INCOME—CHANGE IN PRODUCTS OR SERVICES

SECTION 40.443-2, REGULATIONS 130: Requirements as to change in products or services.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

SECTION 444.—AVERAGE BASE PERIOD NET INCOME—INCREASE IN CAPACITY FOR PRODUCTION OR OPERATION

SECTION 40.444-2, REGULATIONS 130: Requirements as to increase in capacity for production or operation. Rev. Rul. 34

INTERNAL REVENUE CODE

For the purposes of section 444(b)(2)(A) of the Internal Revenue Code, facilities held under lease by the parent company of an affiliated group as of the day prior to the beginning of the last 36 months of the consolidated base period constitute facilities held by the taxpayer, within the meaning of section 444(d) of the Code, and no increase in capacity for production, under the provisions of section 444(b)(2)(A) of the Code, results to the affiliated group upon the acquisition, by purchase, of such facilities by a subsidiary company prior to the close of the consolidated base period.

Advice is requested whether, for the purposes of section 444(b)(2)(A) of the Internal Revenue Code, facilities held under lease by the parent company of an affiliated group as of the day prior to the beginning of the last 36 months of the consolidated base period constitute facilities held by the taxpayer, within the meaning of section 444(d) of the Internal Revenue Code, or if an increase in capacity for production, for the purposes of section 444(b)(2)(A) of the Code, results to the affiliated group upon the acquisition, by purchase, of such facilities by a subsidiary company prior to the close of the consolidated base period.

In the instant case the P Company, the common parent of an affiliated group, leased and operated certain plant facilities for a period beginning prior to the beginning of the last 36 months of the consolidated base period. The leasing arrangement continued in effect until the leased facilities were purchased from the owner thereof by C Company, a subsidiary of the affiliated group. The acquisition by purchase of these facilities by C Company occurred during the last 36 months of the consolidated base period. To meet the requirements for an increase in capacity for production or operation under section 444(b)(2)(A) of the Code, it would be necessary for the affiliated group to *exclude* from capacity for production of the group the capacity attributable to the plant facilities held under lease by the P Company as of the day prior to the beginning of the last 36 months of the consolidated

base period, and to *include*, as of the last day of the base period, the capacity attributable to the same facilities which in the meantime were acquired by C Company.

Section 444 of the Internal Revenue Code provides in part as follows:

(a) IN GENERAL.—If a taxpayer which commenced business on or before the first day of its base period establishes that, during the 36-month period ending on the last day of its base period, there was an increase, as defined in subsection (b), in its capacity for production or operation, the taxpayer's average base period net income determined under this section shall be the amount computed under subsection (c).

(b) INCREASE IN CAPACITY.—An increase in capacity for production or operation shall be deemed to have occurred, for the purposes of this section, if the taxpayer establishes that it made an addition or additions to its facilities (as defined in subsection (d)) or replaced all or a part of its existing facilities, and that:

* * * * * * *

(2) (A) as a result of such additions or replacements, its capacity for production or operation on the last day of its base period was 150 per centum or more of its capacity for production or operation on the day prior to the beginning of such 36-month period, and (B) the adjusted basis for determining gain upon sale or exchange of its total facilities on the last day of its base period was 150 per centum or more of the adjusted basis for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of such 36-month period * * *

* * * * * * *

(d) FACILITIES.—For the purposes of this section, the term "facilities" means real property and depreciable tangible property, held by the taxpayer in good faith for the purposes of the business.

The term "capacity for production or operation", as defined in section 40.444–2 of Regulations 130, means the capacity to produce or to operate rather than the level of production or operation actually achieved. Thus, the continued or additional utilization of existing facilities does not constitute an increase in capacity. In the instant case the leased facilities were utilized by the affiliated group during the base period and should be included in the measurement of capacity for production as of the day prior to the beginning of the last 36 months of the base period.

In view of the foregoing, it is held that for the purposes of section 444(b)(2)(A) facilities held under lease by the parent company of an affiliated group as of the day prior to the beginning of the last 36 months of the consolidated base period constitute facilities held by the taxpayer, within the meaning of section 444(d) of the Internal Revenue Code, and no increase in capacity for production under the provisions of section 441(b)(2) of the Code, results to the affiliated group upon the acquisition, by purchase, of such facilities by a subsidiary company prior to the close of the consolidated base period.

SECTION 40.444–2, REGULATIONS 130: Requirements as to increase in capacity for production or operation.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

SECTION 445.—AVERAGE BASE PERIOD NET INCOME—NEW CORPORATION

SECTION 40.445–2. REGULATIONS 130: Computations.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

SECTION 448.—EXCESS PROFITS CREDIT—REGULATED PUBLIC UTILITIES

SECTION 40.448–1: Excess profits credit of regulated public utilities entitled to benefits of section 448. (Also Sections 40.448–2, 40.448–3.) T. D. 5983

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Excess profits credit of regulated public utilities entitled to benefits of section 448 of the Internal Revenue Code.

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

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

On June 27, 1952, a notice of proposed rule making was published in the Federal Register (17 F. R. 5772) to conform Regulations 130 [26 CFR, part 40] to sections 513 and 514 of the Revenue Act of 1951, approved October 20, 1951, and to express in greater detail the regulations under section 448 of the Internal Revenue Code, relating to the excess profits credit of regulated public utilities. After consideration of all relevant matter presented by interested persons regarding the rules proposed, the amendments to Regulations 130 set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 40.448–1 [26 CFR 40.448–1] the following:

SEC. 513. EXCESS PROFITS CREDIT—REGULATED PUBLIC UTILITIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 448(c)(3) (relating to regulated public utilities) is hereby amended to read as follows:

"(3) 6 per centum in the case of a corporation engaged as a common carrier (A) in the furnishing or sale of transportation by railroad, if subject to the jurisdiction of the Interstate Commerce Commission, or (B) in the furnishing or sale of transportation of oil or other petroleum products (including shale oil) by pipe line, if subject to the jurisdiction of the Interstate Commerce Commission or if the rates for such furnishing or sale are subject to the jurisdiction of a public service or public utility commission or other similar body of the District of Columbia or of any State."

SEC. 514. CONSOLIDATED RETURNS OF REGULATED PUBLIC UTILITIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 448(e) (relating to consolidated returns of regulated public utilities) is hereby amended by adding at the end thereof the following new sentence:

"For purposes of filing a consolidated return with its railroad lessee corporation, a railroad lessor corporation described in section 434(d) (without regard to the requirement of payment of the lessor's taxes by the lessee) shall be considered a corporation described in subsection (c)(3)."

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * the amendments made by this title [including sections 513 and 514] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 2. Section 40.488-1 [26 CFR 40.488-1] is amended by adding at the end thereof the following:

For rules applicable to consolidated returns of affiliated corporations which include regulated public utilities, see section 29.141-1 of Regulations 111 and see Regulations 129.

PAR. 3. Section 40.448-2 [26 CFR 40.448-2] is amended as follows:

(A) By striking paragraph (a)(3) and inserting in lieu thereof the following:

(3) A corporation engaged as a common carrier (i) in the furnishing or sale of transportation by railroad, if subject to the jurisdiction of the Interstate Commerce Commission, or (ii) in the furnishing or sale of transportation of oil or other petroleum products (including shale oil) by pipeline, if subject to the jurisdiction of the Interstate Commerce Commission or if the rates for such furnishing or sale are subject to the jurisdiction of a public service or public utility commission or other similar body of the District of Columbia or of any State.

(B) By redesignating (b), (c), and (d) thereof as (d), (e), and (f), respectively.

(C) By striking the last sentence of (a) and inserting in lieu thereof the following:

For the purpose of this section the term "a corporation engaged in the furnishing or sale" includes a corporation (i) whose operations are an integral part of "the furnishing or sale" of a product or service described in section 448(c) and this section by an interconnected and coordinated public utility system or systems and (ii) whose rates for furnishing products or services to the system or systems are established or approved by a regulatory body described in this paragraph under the same type of regulation applicable to the system or systems for the products or services described in section 448(c) and this section.

(b) *Rates.* (1) If a schedule of rates has been filed with any regulatory body described in (a) of this section having the power to disapprove such rates, then such rates shall be considered as established or approved rates for the purpose of (a) of this section even though such body has taken no action on the filed schedule.

(2) Rates fixed by contract between the public utility and the purchaser, except where the purchaser is the United States, a State, the District of Columbia, or an agency or political subdivision of the United States, a State, or the District of Columbia, shall not be considered as established or approved rates for the purpose of (a) of this section in those cases where they are not subject to direct control, or where no maximum rate for such contract rates has been established, by the United States, a State, the District of Columbia, or by any agency or political division thereof. But see paragraph (3).

(3) If the taxpayer establishes to the satisfaction of the Commissioner that its revenue from regulated rates described in paragraph (1) or (4) of (a) of this section and from unregulated rates are derived from its operation of a single interconnected and coordinated system or from its operation of more than one such system, and that an unregulated rate applicable in the operation of such system or systems has been and is substantially as favorable to users and consumers as a comparable regulated rate applicable in the operation of such system or systems, the revenue from such unregulated rate shall be considered, for the purpose of (a) of this section, as income derived from sources described in paragraph (1) or (4) of (a) of this section. For the purpose of determining whether or not an unregulated rate has been and is substantially as favorable to users and consumers as a comparable regulated rate, due consideration shall be given to the factors recognized by the regulatory body described in (a) of this section under whose jurisdiction the comparable regulated rate is established or approved.

(c) *Byproducts and residual products.*—If byproducts or residual products are a direct and necessary incident to the furnishing of products or services described in section 448(c), and if the revenue from such byproducts or residual products is applied in reduction of the cost of furnishing the products or services described in section 448(c) or is otherwise reflected in the rates established or approved by the regulatory body for such products or services, then the revenue from such byproducts or residual products shall be considered as derived from sources described in section 448(c).

(D) By striking subparagraph (2) of (e) thereof (as redesignated by subparagraph (B) above), and by substituting therefor the following:

(2) In the case of a corporation described in (a)(1) (i) or (ii), (2) or (4) of this section, if the corporate books of account are maintained in accordance with systems of accounts prescribed by an appropriate regulatory body (or, if not so prescribed, are maintained in accordance with the uniform systems of accounts prescribed by the Federal Power Commission or the National Association of Railway and Utility Commissioners), the adjusted invested capital for such taxable year shall be the sum of the average outstanding common and preferred capital stock accounts for the taxable year and the average capital and earned surplus accounts for the taxable year, as properly recorded on the corporate books of account. The following rules shall apply for the purpose of this paragraph:

(i) The determination of the adjusted invested capital for any taxable year shall be made without regard to the profits or loss for such taxable year computed in accordance with such system of accounts and without regard to distributions out of the profits for such taxable year so computed. In determining whether a distribution is out of the profits for the taxable year, such profits shall be computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the income and excess profits tax for such taxable year and the determination shall be made without regard to the amount of the profits at the time the distribution was made.

(ii) The term "an appropriate regulatory body" as used in this section means a regulatory body described in section 448(c)(1) and in (a)(1) of this section, under whose jurisdiction the corporation operates.

(iii) The average of any account (such as the common stock account or the capital surplus account) shall be the sum, divided by the number of days in the taxable year, of the amount of such account as of the beginning of each day of the taxable year.

(iv) If the adjusted invested capital for any taxable year is computed by the method prescribed by this paragraph, the taxpayer must attach a statement to its return for such taxable year setting forth all the facts which require the use of such method.

PAR. 4. Section 40.448-3 [26 CFR 40.448-3] is amended as follows:

(A) By changing the cross reference in (a) thereof from "section 40.448-2(c)" to "section 40.448-2(e)", by changing the cross reference in (c) thereof from "section 40.448-2(d)" to "section 40.448-2(f)",

and by changing the cross reference in (d) thereof from "section 40.448-2(b)" to "section 40.448-2(d)".

(B) By adding at the end of (a) thereof the following:

In case the corporation is described in section 40.448-2(a) (1), (2), (3), or (6), and is also described in section 40.448-2(a) (4) or (5), the computation under the preceding sentence shall be as follows:

(1) A first amount shall be computed by applying a 6 percent rate to the sum of the items specified in the preceding sentence;

(2) A second amount shall be computed by applying a 1 percent rate to the sum of the items specified in the preceding sentence;

(3) There shall be added to the first amount so much of the second amount as the ratio of the gross income from the operations described in section 40.448-2(a) (4) and (5) bears to the total gross income from the operations described in section 40.448-2(a).

For the purpose of this paragraph gross income shall be computed without regard to dividends and capital gains and losses.

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 10, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 13, 1953, at 8:53 a. m.)

SECTION 40.448-2(e): Adjusted invested capital. Rev. Rul. 63

INTERNAL REVENUE CODE

In connection with the computation of the excess profits credit for regulated public utilities, the phrase "as properly recorded on the corporate books of account", as it is used in section 40.448-2(e)(2) of Regulations 130, refers to entries in the corporate books of account, including all adjustments thereto, which have been made in conformity with the rules and system of accounts prescribed by the appropriate regulatory body, and subject to the limitations set forth in section 40.448-2(e)(2)(i) of the regulations.

Advice is requested relative to the correct interpretation of the phrase "as properly recorded" as it is used in section 40.448-2(e)(2) of Regulations 130 with respect to the computation of adjusted invested capital of a regulated public utility for purposes of determining the excess profits credit under section 448(b) of the Internal Revenue Code in a case where such regulated public utility maintains its books of account in accordance with a system of accounts prescribed by an appropriate regulatory body, or if not so prescribed, are maintained in accordance with the uniform system of accounts prescribed by the Federal Power Commission or the National Association of Railway and Utility Commissioners.

Section 448 of the Internal Revenue Code provides a special alternative method for the computation of excess profits credit to certain corporations which qualify as regulated public utilities.

Section 40.448-2(e)(2) of Regulations 130, promulgated pursuant to section 448 of the Code, provides in part as follows:

(2) In the case of a corporation described in (a)(1) (i) or (ii), (2) or (4) of this section, if the corporate books of account are maintained in accordance

with systems of accounts prescribed by an appropriate regulatory body * * *, the adjusted invested capital for such taxable year shall be the sum of the average outstanding common and preferred capital stock accounts for the taxable year and the average capital and earned surplus accounts for the taxable year, *as properly recorded on the corporate books of account.* * * *. [Italics supplied.]

In the Senate Finance Committee Report on the Excess Profits Tax Act of 1950, C. B. 1951–1, 260, 261, it is stated that in the case of certain regulated industries receiving the benefits of this provision where the corporate books of account are maintained in accordance with the uniform systems prescribed by a regulatory body, the equity capital and retained earnings are the sum of the average outstanding common and preferred stock accounts and the capital surplus and earned surplus accounts as shown on the corporation's books. It is further stated therein that such regulated utilities may compute their equity capital and retained earnings in the manner provided by their regulating bodies rather than by the means provided for ordinary corporations using the invested capital basis. This method was permitted to allow these regulated public utilities to compute the elements of their adjusted invested capital by use of the same elements that are employed in the determination of the base upon which their rate of return is computed for regulatory purposes of other governmental bodies.

It is accordingly held, in connection with the computation of the excess profits credit for regulated public utilities, that the phrase "as properly recorded on the corporate books of account", as it is used in section 40.448–2(e) (2) of Regulations 130, refers to entries in the corporate books of account, including all adjustments thereto, which have been made in conformity with the rules and system of accounts prescribed by the appropriate regulatory body, and subject to the limitations set forth in section 40.448–2(e) (2) (i) of the regulations.

SECTION 449.—PERSONAL SERVICE CORPORATIONS

SECTION 40.449–1, REGULATIONS 130: Taxation of personal service corporations. Rev. Rul. 64

(Also Section 52, Section 29.52–1.)

INTERNAL REVENUE CODE

Taxpayers desiring to use Schedule PS (Form 1120), Computation of United States Personal Service Corporation Income, in filing returns for the calendar year 1952 or for a fiscal year ending in 1953 should utilize Schedule PS (Form 1120) for 1951 and should make the appropriate changes in the dates printed on such form.

SECTION 40.449–3, REGULATIONS 130: Election as to taxability. T. D. 5961

(Also Section 454, Section 40.454–1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to make technical corrections and to provide rule for determining the excess profits tax in the case of certain

corporations not subject to the excess profits tax for all taxable years ending after June 30, 1950.

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

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

On September 13, 1952, notice of proposed rule making with respect to determining excess profits tax of certain corporations not subject to the excess profits tax for all taxable years ending after June 30, 1950, was published in the Federal Register [17 F. R. 8276]. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments to Regulations 130, set forth below are hereby adopted.

PARAGRAPH 1. Section 40.449–3 [26 CFR 40.449–3], which section relates to election as to taxability under subchapter D of chapter 1 in the case of a personal service corporation, is amended as follows:

(A) By correcting in the second sentence of such section the typographical error "be be" to read as follows: "to be"; and

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

For the purpose of determining the excess profits tax for any taxable year for which the corporation does not make an election under section 449, the first taxable year of the corporation ending after June 30, 1950, is considered its first taxable year under subchapter D of chapter 1, whether or not it made an election under section 449 for such taxable year. Similarly, the second and subsequent taxable years under subchapter D of chapter 1 are determined without regard to any election under section 449.

PAR. 2. Section 40.454–1 [26 CFR 40.454–1], which section relates to exempt corporations, is amended as follows:

(A) By striking from (b) of such section the word "paragraph" and by inserting in lieu thereof the following: "subsection"; and

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

(f) For the purpose of determining the excess profits tax for any taxable year for which the corporation is not exempt under section 454, the first taxable year of the corporation ending after June 30, 1950, is considered its first taxable year under subchapter D of chapter 1, whether or not it was exempt under section 454 for such taxable year. Similarly, the second and subsequent taxable years under subchapter D of chapter 1 are determined without regard to any exemption under section 454.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 16, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 19, 1952, 8:57 a. m.)

SECTION 453.—NONTAXABLE INCOME FROM CERTAIN MINING AND TIMBER OPERATIONS, AND FROM NATURAL GAS PROPERTIES

SECTION 40.453-2, REGULATIONS 130: Definitions.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5973, page 321.)

SECTION 40.453-2, REGULATIONS 130: Definitions.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 6004, page 45.)

SECTION 454.—EXEMPT CORPORATIONS

SECTION 40.454-1, REGULATIONS 130: Exempt corporations.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5961, page 356.)

SECTION 455.—RELIEF FOR INSTALLMENT BASIS TAXPAYERS AND TAXPAYERS WITH INCOME FROM LONG-TERM CONTRACTS

SECTION 40.455-2, REGULATIONS 130: Computation of income on accrual method. T. D. 5972

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Section 40.455-2(b) of Regulations 130 amended

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

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

On November 25, 1952, a notice of proposed rule making was published in the Federal Register (17 F. R. 10706) to amend Regulations 130 [26 CFR, part 40]. No objections to the rules published having been received within the 30 days following publication, such regulations are hereby amended by striking from section 40.455-2(b) thereof the second, third, fourth, and fifth sentences, which read as follows:

The deduction for bad debts under section 23(k) shall be allowed only with respect to debts which become worthless within the taxable year. No reserve for bad debts arising from installment accounts receivable may be set up for excess profits tax purposes only, and no bad debt deduction shall be allowed for any additions to such a reserve. Only those debts which have become worthless within the taxable year and which are allowed as a deduction in the computation of net income for the purposes of the normal tax and surtax for the taxable year shall be allowed in the determination of the bad debt deduction for

excess profits tax purposes under section 455(a). If a debt reflected in installment accounts receivable was created in a prior taxable year, and if the total amount of the profit represented by such installment accounts receivable is includible in gross income for such year under the accrual method of accounting, the amount of the deduction for the bad debt shall be computed upon the accrual method and shall not be limited to the unrecovered cost of the goods or articles sold in consideration of such debt.

and inserting in lieu thereof the following sentences:

No reserve for bad debts arising from accounts receivable from installment sales or installment sales obligations may be set up for excess profits tax purposes unless a reserve has been established for income tax purposes. If a debt reflected in installment accounts receivable was created in a prior taxable year, and if the total amount of the profit represented by such installment accounts receivable is includible in gross income for such year under the accrual method of accounting, the amount of the deduction for bad debts, in the case of a taxpayer which bases its deduction for bad debts on the debts which become worthless within the taxable year, shall be computed upon the accrual method and shall not be limited to the unrecovered cost of the goods or articles sold in consideration of such debt. The same principle shall be applicable in determining the amount which may be deducted as a reasonable addition to a reserve for bad debts in the case of a taxpayer properly on the reserve method.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 16, 1953.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 21, 1953, 8:54 a. m.)

SECTION 459.—MISCELLANEOUS PROVISIONS

SECTION 40.459(a)-1, REGULATIONS 130: Transition from war production and increase in peacetime capacity.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5987, page 345.)

SECTION 40.459(b)-1, REGULATIONS 130: Base period catastrophe. T. D. 5966

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to conform to section 517 of the Revenue Act of 1951, relating to base period catastrophe.

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

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

On November 6, 1952, a notice of proposed rule making was published in the Federal Register (17 F. R. 9988) to conform Regulations

130 [26 CFR, part 40] to section 517 of the Revenue Act of 1951, approved October 20, 1951. No objections to the rules proposed having been received within the 30 days following such publication, such regulations are amended by inserting immediately after section 40.458-8 [26 CFR 40.458-8] the following:

SEC. 517. BASE PERIOD CATASTROPHE [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 459, as added by section 516 of this Act, is hereby amended by adding after subsection (a) thereof the following new subsection:

"(b) BASE PERIOD CATASTROPHE.—

"(1) ELIGIBILITY REQUIREMENTS.—A taxpayer shall be entitled to the benefits of this subsection only if it was engaged throughout its base period primarily in manufacturing and if—

"(A) the taxpayer suffered during the last thirty-six months of its base period a catastrophe by fire, storm, explosion, or other casualty which destroyed or rendered inoperative a production facility constituting a complete plant or plants having in the hands of the taxpayer immediately prior to the catastrophe an adjusted basis equal to 15 per centum or more of the adjusted basis of all the taxpayer's production facilities at such time;

"(B) as a result of such catastrophe the taxpayer's normal production or operation was substantially interrupted for a period of more than twelve consecutive months; and

"(C) the taxpayer, prior to the end of its base period, replaced such production facility with a production facility which at the end of its base period had in its hands an adjusted basis not less than the adjusted basis immediately prior to the catastrophe of the production facility destroyed or rendered inoperative.

"(2) COMPUTATION.—The taxpayer's base period net income determined under this subsection shall be the amount computed under subparagraph (A) or the amount computed under subparagraph (B), whichever results in the lesser tax under this subchapter for the taxable year for which the tax is being computed:

"(A) The amount computed under section 435(d) by substituting for the excess profits net income for each month in the taxable year in which the catastrophe described in paragraph (1) occurred an amount equal to the aggregate, divided by the number of months in the base period preceding such taxable year, of the excess profits net income for each month (computed under section 435(d)(1)) in the base period preceding such taxable year. The average base period net income computed under this subparagraph shall, for the purpose of section 435(a)(1)(B), be considered an average base period net income determined under section 435(d).

"(B) The amount computed under section 435(e)(2)(G) (i) and (ii)."

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [including sec. 517] shall be applicable only with respect to taxable years ending after June 30, 1950.

SEC. 40.459(b)-1. BASE PERIOD CATASTROPHE.—(a) *In general.*—A corporation which was engaged throughout its base period primarily in manufacturing, which suffered a catastrophe by fire, storm, explosion, or other casualty during the last 36 months of its base period, and which satisfies all the requirements provided in subparagraphs (A), (B), and (C) of section 459(b)(1) may compute its average base period net income, for the purpose of computing its excess profits tax for any taxable year ending after June 30, 1950, under the provisions of section 459(b)(2) and of paragraph (b) of this section instead of under any other applicable provisions of the Code and regulations.

(b) *Computation of average base period net income under section 459(b).*—If a taxpayer may compute its average base period net income under section 459(b),

its average base period net income as computed under section 459(b)(2) shall be whichever of the following two amounts results in the lesser excess profits tax for the taxable year for which such tax is being computed:

(1) The amount computed under section 435(d) and section 40.435-1(d) determined by substituting for the excess profits net income for each month in the taxable year in which the catastrophe described in section 459(b)(1) occurred an amount equal to the aggregate of the excess profits net income for each month (computed under section 435(d)(1) and section 40.435-1(d)(1)) in the base period preceding such taxable year divided by the number of months in the base period preceding such taxable year.

(2) The amount computed under section 435(e)(2)(G) (i) and (ii) and under sections 40.435-5(a)(7) (i) and (ii) and 40.435-5(b).

An average base period net income computed under section 459(b)(2)(A) and under subparagraph (1) of this paragraph shall be considered, for the purpose of section 435(a)(1)(B), to be an average base period net income determined under section 435(d). If the average base period net income is computed under section 459(b)(2)(A) and under subparagraph (1) of this paragraph for the purpose of determining the excess profits tax for any taxable year, the base period capital addition, provided in section 435(f), will be allowed in computing the excess profits tax for such taxable year. If, in determining the excess profits tax for any taxable year, the average base period net income is computed under section 459(b)(2)(B) and under subparagraph (2) of this paragraph, however, the base period capital addition will not be allowed in computing the excess profits tax for such taxable year since such average base period net income is not considered to be an average base period net income computed under either section 435(d) or under section 442. The amount computed under section 459(b)(2)(A) and subparagraph (1) of this paragraph or the amount computed under section 459(b)(2)(B) and subparagraph (2) of this paragraph, depending on which results in the lesser excess profits tax for the taxable year, is to be the average base period net income computed under section 459(b).

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 22, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 29, 1952, 8:52 a. m.)

SECTION 40.459(c)-1, REGULATIONS 130: Consolidation of newspapers. T. D. 5978

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to conform to section 518 of the Revenue Act of 1951, relating to consolidation of newspapers.

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

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

On December 4, 1952, a notice of proposed rule making was published in the Federal Register (17 F. R. 10973) to amend Regulations 130 [26 CFR, part 40]. No objections to the rules proposed having been received within the 30 days following publication, such regula-

tions are hereby amended by inserting immediately after section 40.459(b)-1(b) [26 CFR 40.459(b)-1(b)] the following:

SEC. 518. CONSOLIDATION OF NEWSPAPERS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 459, as added by sections 516 and 517 of this Act, is hereby amended by adding after subsection (b) thereof the following new subsection:

"(c) CONSOLIDATION OF NEWSPAPER OPERATIONS.—In the case of a taxpayer engaged primarily in the newspaper publishing business in its last taxable year ending before July 1, 1950, if—

"(1) After the close of the first half of the base period of the taxpayer and prior to July 1, 1950, the taxpayer consolidated its mechanical, circulation, advertising, and accounting operations in connection with its newspaper publishing business with such operations of another corporation engaged in the newspaper publishing business in the same area; and

"(2) The taxpayer establishes to the satisfaction of the Secretary that, during the period beginning with the consolidation and ending with the close of the first taxable year beginning after the consolidation, such consolidation resulted in substantial reductions in the amounts which would otherwise have been paid or incurred as expenses in the conduct of the operations described in paragraph (1); and either

"(3) The total deductions of the taxpayer under section 23, computed without regard to section 23 (s) and (bb), for the first taxable year beginning after such consolidation were not in excess of 80 per centum of the average of such deductions for the two taxable years of the taxpayer next preceding the taxable year in which such operations were consolidated; or

"(4) The excess profits net income of the taxpayer, computed as provided in section 433(b), for the first taxable year of the taxpayer beginning after such consolidation was 125 per centum or more of the amount determined under section 435(d)(4);

the taxpayer's average base period net income determined under this subsection shall be an amount computed under section 435(d) plus an amount equal to the excess of the average of the amounts paid or incurred as expenses in the conduct of the operations described in paragraph (1) during the two taxable years of the taxpayer next preceding the taxable year in which such operations were consolidated over such amounts paid or incurred during the first taxable year of the taxpayer beginning after such consolidation. In determining such excess amount proper adjustment shall be made for increase in labor costs and newsprint following such consolidation. Proper adjustment shall also be made for any case in which a taxable year referred to in this subsection is a period of less than twelve months. This subsection shall not be applicable to any taxable year of the taxpayer unless the consolidation described in paragraph (1) was continued throughout such taxable year."

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [including sec. 518] shall be applicable only with respect to taxable years ending after June 30, 1950.

SEC. 40.459(c)-1. CONSOLIDATION OF NEWSPAPERS.—(a) A taxpayer which was engaged primarily in the newspaper publishing business in its last taxable year ending before July 1, 1950, which after the close of the first half of its base period and before July 1, 1950, consolidated certain of its operations with those of another corporation engaged in the same business in the same area, and which satisfies all the requirements set forth in paragraphs (1) and (2) and in either paragraph (3) or paragraph (4) of section 459(c) may compute its average base period net income, for the purpose of computing its excess profits tax for any taxable year ending after June 30, 1950, under the provisions of section 459(c) instead of under any other applicable provision of the Code. The average

base period net income may be computed under section 459(c) in determining the excess profits tax for any taxable year, however, only if the consolidation described in paragraph (1) of section 459(c) was continued throughout such taxable year. The average base period net income computed under section 459(c) shall be used in computing the taxpayer's excess profits tax for any taxable year if, and only if, the use of such average base period net income computed under section 459(c) results in a lesser excess profits tax than would result from any other allowable computation of such tax.

(b) If the taxpayer is to compute its average base period net income under section 459(c), it must establish to the satisfaction of the Commissioner, under the provisions of paragraph (2) of section 459(c), that the consolidation referred to in paragraph (1) of section 459(c) resulted in substantial reductions in the amounts which otherwise would have been paid or incurred as expenses (within the meaning of section 23(a)(1)(A)) in the conduct of the operations described in paragraph (1) of section 459(c) during the period beginning with such consolidation and ending with the close of the first taxable year beginning after such consolidation. If the taxpayer first claims the benefits of section 459(c) on its return or on an amended return or in a claim for refund, it must attach a statement to such return or amended return or claim for refund containing sufficient information to enable the Commissioner to determine whether the requisite substantial reductions in expenses occurred.

(c) The taxpayer must satisfy the conditions of either paragraph (3) or paragraph (4) of section 459(c) in order to be allowed to compute its average base period net income under section 459(c). Under the provisions of paragraph (4), the excess profits net income of the taxpayer, computed as provided in section 433(b), for its first taxable year beginning after the consolidation described in paragraph (1) of section 459(c) must be 125 percent or more of the amount determined under section 435(d)(4), which relates to the computation of the average base period net income under the general average method. Section 433(b) provides for the computation of excess profits net income for taxable years in the base period for the purpose of computing average base period net income. For the purpose of the test set forth in paragraph (4) of section 459(c), however, the excess profits net income for the first taxable year of the taxpayer beginning after the consolidation shall be computed in the manner provided in section 433(b) without regard to whether or not such first taxable year is a taxable year in the base period.

(d) (1) The average base period net income computed under section 459(c) shall be the sum of the following two amounts:

(i) The amount computed under section 435(d) (relating to the computation of average base period net income under the general average method); and

(ii) An amount equal to the amount by which the average of the amounts paid or incurred as expenses in the conduct of the operations described in paragraph (1) of section 459(c) during the two taxable years of the taxpayer immediately preceding the taxable year in which the consolidation described in paragraph (1) of section 459(c) occurred exceeded such amounts paid or incurred during the first taxable year of the taxpayer beginning after such consolidation.

(2) In determining the excess amount described in (ii) of subparagraph (1) of this paragraph, proper adjustment shall be made for any increase in the cost per unit of labor or newsprint, due to wage or price increases, following such consolidation. If the taxpayer can show by relevant data and under generally accepted principles of accounting that its average unit costs of labor or newsprint in its first taxable year beginning after the consolidation were higher, due to wage or price increases, than its average unit costs of labor or newsprint in its two taxable years immediately preceding the taxable year in which the consolidation took place, then the amount specified in (ii) of subparagraph (1) of this paragraph shall be determined by substituting for the costs of labor or newsprint in such first taxable year amounts determined on the basis of its average unit costs of labor or newsprint in such two taxable years immediately preceding the taxable year in which the consolidation occurred.

(3) If the first taxable year beginning after the consolidation described in section 459(c)(1) or if either of the two taxable years immediately preceding the taxable year in which such consolidation occurred is a taxable year of less than 12 months, then, in determining the amount specified in (ii) of subparagraph (1) of this paragraph, the amounts paid or incurred as expenses in such

taxable year in the conduct of the operations described in paragraph (1) of section 459(c) shall be such amounts as would be reflected in a computation on an annualized basis under the method set forth in section 433(a)(2)(A). Similarly, if the first taxable year beginning after the consolidation or either of the two taxable years immediately preceding the taxable year in which the consolidation occurred was a taxable year of less than 12 months, then in determining whether the taxpayer meets the requirement set forth in paragraph (3) of section 459(c) the total deductions of the taxpayer referred to in such paragraph (3) for such short taxable year shall be the amount which would be reflected in a computation on an annualized basis under the method set forth in section 433(a)(2)(A). If the first taxable year beginning after the consolidation was a taxable year of less than 12 months, the excess profits net income for such short taxable year shall also be annualized under the method set forth in section 433(a)(2)(A). In each case proper adjustment shall be made to prevent distortion with respect to nonrecurring items.

(4) If the average base period net income is computed under section 459(c) and this section for the purpose of determining the excess profits tax for any taxable year, the base period capital addition provided in section 435(f) shall not be allowed in determining such tax for such year.

(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).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 29, 1953.

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

(Filed with the Division of the Federal Register February 3, 1953, 8:53 a. m.)

PART II.—EXCESS-PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN EXCHANGES

SECTION 461.—DEFINITIONS

SECTION 40.461-7, REGULATIONS 130: Provisions generally applicable under Part II. (Also Sections 40.461-6, 40.461-8; Section 462, Sections 40.462-2, 40.462-4, 40.462-9, 40.462-15; Section 463, Section 40.463-1; Section 464, Section 40.464-1.) T. D. 6017

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Excess-profits credit based on income in connection with part II transactions.

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

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

On November 26, 1952, notice of proposed rulemaking, regarding amendments to part II of Regulations 130 [26 CFR, part 40], relating to the excess-profits credit based on income in connection with certain exchanges, to conform such part to title V of the Revenue Act of 1951 (other than section 521 of that act), approved October 20, 1951,

was published in the Federal Register (17 F. R. 10743). After consideration of all such relevant matter as was presented by interested persons relating to the rules proposed, the amendments to Regulations 130 set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 521(b)(2) of the Revenue Act of 1951, which precedes section 40.461-1 [26 CFR 40.461–1], the following:

SEC. 509. ALTERNATIVE AVERAGE BASE PERIOD NET INCOME [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(2) Section 461 (relating to definitions for purposes of part II) is hereby amended by inserting at the end thereof the following new subsection:

"(g) APPLICATION OF SECTION 442(h).—For the purpose of this part, the reference to section 442(c) in any section in this part shall be deemed a reference to section 442 (c) or (h)."

SEC. 519. TELEVISION BROADCASTING COMPANIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 459, as added by sections 516 to 518 of this Act, is hereby amended by adding after subsection (c) thereof the following new subsections:

"(d) TELEVISION BROADCASTING COMPANIES.—

* * * * * * *

"(6) APPLICATION OF PART II.—The Secretary shall prescribe regulations for the application of Part II for the purpose of this subsection in the case of an acquiring corporation or a component corporation in a transaction described in section 461 (a) which occurred prior to January 1, 1951.

* * * * * * *

PAR. 2. Section 40.461–6, as added by Treasury Decision 5865 [C. B. 1951–2, 97], approved November 13, 1951 [26 CFR 40.461–6], is amended by changing the phrase "section 442(c)" in (b)(1) thereof to read as follows: "section 442 (c) or (h)".

PAR. 3. Section 40.461–7, as added by Treasury Decision 5865 [26 CFR 40.461–7], is hereby amended by adding at the end thereof the following:

(d) *Average base period net income determined with partial reference to section 435(d).*—The last two sentences of section 435(d) as added by section 503 of the Revenue Act of 1951 (relating to a substitute 48 month period in lieu of the base period) are inapplicable for the purpose of any computations other than the determination of the average base period net income under the general average method of section 435(d). Thus, in determining an alternative average base period net income under section 442(c), 442(h), or 459(d), with respect to a part II transaction, the base period of the taxpayer and not the substitute 48-month period shall be used in computing the excess-profits net income of such taxpayer.

(e) *Nonavailability of part II in the case of an alternative average base period net income computed under any subsection of section 459 other than subsection (d) of such section.*—An acquiring corporation which is qualified to compute its average base period net income under any subsection of section 459 other than subsection (d) of such section, and which was a party to a part II transaction at any time during or after its base period, shall be entitled to determine its excess-profits credit for any taxable year ending after the date of the part II transaction, under part II or under the applicable subsection of section 459, whichever produces the lesser excess-profits tax for the taxable year, but shall not be entitled to apply the provisions of both part II and the applicable sub-

section of section 459. The same rule is applicable to a component corporation in a part II transaction, except that the provisions of section 461(c) must be applied whether or not the excess-profits credit is determined with reference to section 459.

(f) *Application of part II in the case of an alternative average base period net income computed under section 459(d).*—A corporation which is qualified to compute its average base period net income under section 459(d) and which was a party to a part II transaction shall determine such average base period net income with reference to part II if the part II transaction occurred prior to January 1, 1951. For computations under section 459(d) with reference to part II, see section 40.461–8. In the case of a part II transaction occurring on or after January 1, 1951, the rules stated in (e), above, are applicable (except that the provisions of this paragraph shall continue applicable with respect to any previous part II transaction occurring before January 1, 1951).

PAR. 4. There is added immediately after section 40.461–7, as amended by paragraph 3 of this Treasury Decision [26 CFR 40.461–7], the following:

SEC. 40.461–8. RULES FOR APPLICATION OF SECTION 459(d) UNDER PART II.—Every corporation engaged in the business of television broadcasting throughout a period beginning before January 1, 1951, and ending with the close of the taxable year, which is a party to a part II transaction occurring before January 1, 1951, whether as an acquiring corporation or as a component corporation, may compute its excess-profits credit based on income with reference to section 459(d) and to section 40.462–15. The provisions of the regulations under part II applicable in the case of a taxpayer computing its excess-profits credit with reference to section 435(d) (the general average method for determining average base period net income) shall also be applicable to a taxpayer computing its excess-profits credit under part II with reference to section 459(d), except as otherwise specifically provided in section 40.462–15, section 40.463–1(g), and section 40.464–1(f).

PAR. 5. There is inserted immediately preceding section 521(b) (3) and (4) of the Revenue Act of 1951, which precedes section 40.462–1 [26 CFR 40.462–1], the following:

SEC. 504. AVERAGE BASE PERIOD NET INCOME—ALTERNATIVE BASED ON GROWTH IN CASE OF NEW CORPORATIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) AMENDMENT OF PART II.—Section 462(c) (relating to the use by an acquiring corporation in a part II transaction of an alternative average base period net income based on growth) is hereby amended as follows:

(1) By amending paragraph (1) thereof to read as follows:

"(1) In the case of a transaction described in section 461(a), other than a transaction described in section 461(a)(1)(E),—

"(A) The acquiring corporation shall not be denied the right to determine whether it is eligible for the benefits of section 435(e) without reference to the recomputation of its excess profits net income provided for in section 462(b) where the transaction occurred on or after July 1, 1950, but it shall be denied such right where the transaction occurred prior to July 1, 1950.

"(B) Where, immediately prior to the date of the transaction, the acquiring corporation and all the component corporations (other than a corporation created incident to such transaction) met the requirements of section 435(e)(1)(A)(i) and, in case the transaction occurred on or after July 1, 1950, had commenced business prior to the beginning of its base period (determined without reference to section 461(d)), the acquiring corporation shall be entitled to compute its average base period net income under section 435(e) with reference to the recomputation of its excess profits net income provided for in section 462(b) if the tests of section 435(e) are satisfied. For

that purpose, the acquiring corporation shall combine with its total payroll and its total gross receipts for that portion of its base period which preceded such transaction the total payroll and total gross receipts of such component corporations for that portion of such period and it shall combine with its net sales for that portion of the period prior to January 1, 1951, which preceded such transaction the net sales of such component corporations for that portion of such period. The allocation of payroll and gross receipts amounts of a component corporation to any such portion of such period shall be made in accordance with the rules provided in section 435(e)(4) and (5). For purposes of qualifying under section 435(e)(1)-(A)(i) (relating to total assets of the taxpayer), such acquiring corporation shall combine its total assets on the date specified in section 435(e)(1)(A)(i) with the total assets of each component corporation on such date. The Secretary shall prescribe by regulations such rules as may be necessary to insure that such combined total gross receipts do not reflect a duplication for purposes of this section.

"(C) Where, immediately prior to the date of the transaction, either the acquiring corporation or one or more component corporations (other than a corporation created incident to such transaction) did not meet the requirements of section 435(e)(1)(A)(i), or, in case the transaction occurred on or after July 1, 1950, had not commenced business prior to the beginning of its base period (determined without reference to section 461(d)), the acquiring corporation shall not be entitled to compute its average base period net income under section 435(e) with reference to the recomputation of its excess profits net income provided for in section 462(b). In any such case, where the transaction occurred on or after July 1, 1950, the monthly excess profits net income of the corporation entitled to the benefits of section 435(e) for any month of the acquiring corporation's base period shall be, for purposes of the recomputation provided for in section 462(b), one-twelfth of the average base period net income to which such corporation was entitled under section 435(e), and such monthly excess profits net income shall be in lieu of the monthly excess profits net income determined under paragraphs (1) and (2) of section 462(b)."

(2) By striking from the second sentence of paragraph (2) thereof the words: "had commenced business prior to the beginning of its base period (determined without reference to section 461(d)) and".

(3) By striking from paragraph (3) thereof the words "which had commenced business prior to the beginning of its base period" and by inserting in lieu thereof the following: "which had commenced business prior to the end of its base period".

PAR. 6. Section 40.462–1, as amended by Treasury Decision 5998 [page 372, this Bulletin], approved March 24, 1953 [26 CFR 40.462–1], is further amended as follows:

(A) By changing the third sentence of (a)(1) to read as follows:

If computed with reference to section 462(b), the excess-profits net income of the acquiring corporation shall be the excess-profits net income or deficit in excess-profits net income for each month of the acquiring corporation's base period as defined in section 435(b) (or the 48-month period prescribed in section 435(d), if such period is available to the acquiring corporation), increased or decreased, as the case may be, by the addition or reduction resulting from including the excess-profits net income or deficit in excess-profits net income for that month of all component corporations in the manner provided in section 462(b).

(B) By changing the phrase "computed under section 442 (c) and (d)" in (a)(3) thereof to read as follows: "computed under section 442 (c), (d), or (h)".

(C) By inserting in the first sentence of (b) (1) (i) after the words "in the base period of the acquiring corporation" the following: "(or the 48-month period prescribed in section 435(d), if applicable)".

(D) By inserting in the first sentence of (b) (1) (iii) after the words "the acquiring corporation's base-period" the following: "(or the 48-month period prescribed in section 435(d), if applicable)".

PAR. 7. Section 40.462-2, as added by Treasury Decision 5865 [26 CFR 40.462-2], is amended as follows:

(A) By amending (b) (1) (i) (B) thereof to read as follows:

(B) (aa) If the part II transaction occurs before July 1, 1950, if the acquiring corporation recomputes its excess-profits net income under section 462(b), and if the acquiring corporation qualifies under the rules of section 435(e) (1) (A) after applying the rules set forth in (ii), below; or

(bb) If the part II transaction occurs after June 30, 1950, if the acquiring corporation (other than a corporation created incident to such transaction) and all the component corporations actually commenced business prior to the beginning of the acquiring corporation's base period, if the acquiring corporation recomputes its excess-profits net income under section 462(b), and if the acquiring corporation qualifies under the rules of section 435(e) (1) (A) after applying the rules set forth in (ii), below.

(B) By amending (b) (2) (i) (B) and (C) thereof by striking from the phrase "and all component corporations actually commenced business prior to the beginning of the acquiring corporation's base period" the word "beginning" and substituting in lieu thereof the word "end".

(C) By amending (c) (1) (i) (B) thereof by striking therefrom the following: "if the component corporation actually commenced business prior to the beginning of its base period,".

(D) By amending (c) (2) (i) (B) thereof by striking therefrom the following: "if the component corporation actually commenced business prior to the beginning of its base period,".

PAR. 8. Section 40.462-4, as added by Treasury Decision 5865 [26 CFR 40.462-4], is amended as follows:

(A) By amending (a) (1) by changing the phrase "under section 442 (c) or (d)" in the introductory portion thereof preceding clause (i) to read as follows: "under section 442 (c), (d), or (h)", and by striking from such portion the word "either".

(B) By amending (a) (1) (i) thereof by changing the phrase "for the purpose of section 442 (c) or (d)" to read as follows: "for the purpose of section 442 (c), (d), or (h)".

(C) By amending (a) (1) (ii) thereof by changing the phrase "under section 442 (a) or (h)".

(D) By amending (a) (2) by changing the phrase "under section 442(c) or under section 442(d)" in the introductory portion thereof preceding clause (i) to read as follows: "under section 442 (c) or (h) or under section 442(d)".

(E) By amending (a) (2) (i) thereof by inserting therein the phrase "or under section 442(h) (2) (B) (to the extent made available under section 442(h) (2) (D))" and the phrase "or (h), respectively," so that as amended such provision will read as follows:

(i) The substitute excess-profits net income for any month identified under section 442(c) (1) and (3) or under section 442(h) (2) (B) (to the extent made available under section 442(h) (2) (D)) of any corporation entitled to the benefits of section 442 (c) or (h), respectively, immediately prior to the transaction shall be considered the excess-profits net income of that corporation for such month;

(F) By amending (b)(1) thereof by changing the phrase "under section 442 (c) or (d)" in the first sentence thereof to read as follows: "under section 442 (c), (d), or (h)", and by striking therefrom the word "either".

(G) By amending (b)(2) thereof by changing the phrase "under section 442(c) or under section 442(d)" to read as follows: "under section 442 (c) or (h) or under section 442(d)".

PAR. 9. Section 40.462–9(a)(1), as added by Treasury Decision 5865 [26 CFR 40.462–9(a)(1)], is amended by changing the phrase "or substitute excess-profits net income if computed under section 442(c)" in the second sentence thereof to read as follows: "or substitute excess-profits net income if computed under section 442 (c) or (h)".

PAR. 10. There is added immediately after section 40.462–14, as added by Treasury Decision 5865 [26 CFR 40.462–14], the following:

SEC. 40.462–15. ALTERNATIVE AVERAGE BASE PERIOD NET INCOME UNDER SECTION 459(d).—(a) *Part II transactions other than a transaction described in section 461(a)(1)(E).*—In the case of a part II transaction occurring before January 1, 1951, other than a transaction described in section 461(a)(1)(E), the acquiring corporation shall be entitled to determine its average base period net income under section 459(d) in the manner provided therein, after the application of the rules provided below, if the requirements of section 459(d) are satisfied after the application of such rules. The rules referred to above are as follows:

(1) For this purpose, the base period experience of the component corporation prior to the date of the transaction shall be attributed to the acquiring corporation as if the business, or businesses, the assets, and the other items of the component corporation during the period prior to the transaction were those of the acquiring corporation.

(2) In applying the foregoing rule, proper adjustment as to each item shall be made to prevent duplication, including the elimination of such portion of any item with respect to the component corporation or the acquiring corporation as is attributable to transactions between either such component corporation and the acquiring corporation or such component corporation and another component corporation.

(3) In determining under the foregoing rules the total assets for any day prior to the date of the part II transaction, the provisions of section 47) shall be applicable with respect to the assets of the component corporation if such section is applicable to the part II transaction.

(4) The principles of section 40.461–3(c) shall be applicable not only with respect to excess-profits net income but also with respect to all other factors involved in the computation.

(b) *Part II transactions described in section 461(a)(1)(E).*—In the case of a part II transaction described in section 461(a)(1)(E) which occurred prior to January 1, 1951, the provisions of (a) of this section shall be applicable subject to the following rules:

(1) For the purpose of section 459(d)(2)(A), there shall be available to the acquiring corporation only such portion of each item of the component corporation's base period experience prior to the transaction as is allocable to the properties of such component corporation transferred to the acquiring corporation, determined under section 462(i) without regard to any items attributable to the television properties.

(2) For the purpose of section 459(d)(2)(B), the base period experience or the portion of the average base period net income, as the case may be, attributable to the television properties shall be allocated on the basis of such properties transferred or retained.

(3) The special rules of section 40.461–7(b) are applicable in the case of a transfer to an acquiring corporation not created incident to the part II transaction or in the case of a transfer by more than one component corporation to an acquiring corporation.

(c) *Other applicable rules.*—(1) If the stock in the component corporation is acquired by the acquiring corporation under circumstances requiring an adjustment under the principles of section 462(j)(1) and section 40.462–10, the following rules shall apply subject to the principles of such sections:

(i) The base period experience of the component corporation shall, for the purpose of the determination under section 459(d)(2)(A), be excluded to the extent attributable to such stock.

(ii) For the purpose of the determination of the individual rate of return under section 459(d)(4), the base period experience of the component corporation attributable to the business of radio broadcasting (including total assets so attributable) shall be excluded for the period prior to the acquisition of such stock to the extent attributable to such stock.

(iii) If the acquisition of the stock occurs after the date as of which the ratio specified in section 459(d)(5) is determined, then, such ratio shall, to the extent the assets used in the television broadcasting business are attributable to such stock, be determined and be applied as of the date of the acquisition of the stock. See also (2), below.

(2) For the purpose of the determination under section 459(d)(2)(A), the provisions of section 459(d)(5) shall (subject to the rule of (1)(iii) above, if applicable) be applied to the combined base period experience of the acquiring corporation and the component corporation, that is, the ratio under section 459(d)(5) shall be determined (whether for a date prior to or after the part II transaction) on the basis of the total assets of both corporations, and the ratio shall be applied to the excess-profits net income of the acquiring corporation as determined under this section with reference to the component corporation. See (a)(1) and (3), above.

(3) If the part II transaction occurred in a taxable year of the acquiring corporation ending after June 30, 1950, proper adjustment shall be made, under the principles of section 40.462–11, in determining the excess-profits credit for such taxable year so that the benefit to the acquiring corporation from the application of section 459(d) with respect to the component corporation shall be reduced to an amount which is such portion thereof as the number of days in the taxable year after the transaction is of the total number of days in such taxable year.

(4) For other applicable rules, see, in general, section 40.461–8.

PAR. 11. Section 40.463–1, as added by Treasury Decision 5865 [26 CFR 40.463–1], is amended as follows:

(A) By adding after paragraph (b)(8) the following:

(9) For the purpose of section 435(g)(8) (relating to adjustments for changes in inadmissible assets in case of banks), the original total assets, the average total assets, and the increase or decrease in total assets of the taxpayer shall be determined under the rules provided in this section for the determination of original inadmissible assets, average inadmissible assets, and the increase or decrease in inadmissible assets, as if the rules had reference to all assets, whether admissible or inadmissible assets as defined in section 440.

(10) For the purpose of section 435(g)(10), the determination of an increase in operating assets shall be made under the rules provided in this section for the determination of an increase in inadmissible assets.

(B) By adding after the second sentence of (d)(2) the following: In the computation for this purpose, section 445(c) provides that the net capital addition or reduction shall be computed without regard to the limitation to 75 percent provided in section 435(g)(3)(C) and section 435(g)(4)(C) and (E);

(C) By striking the words "and (8)" in paragraph (f)(1)(iii) and inserting in lieu thereof the following: "(8), (9), and (10)".

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

(g) *Application of section 459(d).*—If the average base period net income is computed with reference to section 459(d), the net capital addition or reduction computed under this section shall be adjusted in the manner required by section 459(d) and the regulations thereunder. For the purpose of such adjustment, the principles of section 40.462–15(a)(1) shall be applicable.

PAR. 12. Section 40.464–1, as added by Treasury Decision 5865 [26 CFR 40.464–1], is amended as follows:

(A) By amending the phrase appearing in the second sentence of (a)(1) thereof and reading "under section 442(c) with reference to

section 462(d)" to read as follows: "under section 442 (c) or (h) with reference to section 462(d)".

(B) By adding immediately after the third sentence of (a)(1) thereof the following:

No base period capital addition shall be allowed the acquiring corporation with respect to any corporation a party to the part II transaction (whether the acquiring or component corporation) the monthly excess-profits net income of which is computed under section 435(e) and section 462(c)(1)(C) (see section 40.462-2(b)(1)(iii) and section 40.462-2(b)(2)(iii)); or, except to the extent provided by section 435(f)(3), if the monthly excess-profits net income of the corporation is computed under section 442 (c), (d), or (h) and section 462(d)(2)(B) (see section 40.462-4(a)(2) and section 40.462-4(b)(2)).

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

(f) *Application of section 459(d).*—If the average base period net income is computed with reference to section 459(d), the base period capital addition computed under this section shall be adjusted in the manner required by section 459(d) and the regulations thereunder. For the purpose of such adjustment, the principles of section 40.462-15(a)(1) shall be applicable.

(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).)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved May 29, 1953.

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

(Filed with the Division of the Federal Register June 3, 1953, 8:49 a. m.)

SECTION 462.—AVERAGE BASE PERIOD NET INCOME—DETERMINATION

Section 40.462-1, Regulations 130: General rules for determining average base period net income of an acquiring corporation.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5998, page 372.)

Section 40.462-15, Regulations 130: Alternative average base period net income under section 459(d).

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 6017, page 364.)

SECTION 463.—CAPITAL CHANGES

Section 40.463-1, Regulations 130: Net capital addition or reduction under Part II.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 6017, page 364.)

SECTION 40.463–3, REGULATIONS 130: Capital changes in case of part II transaction following part IV transaction.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 5998, below.)

SECTION 464.—CAPITAL CHANGES DURING BASE PERIOD

SECTION 40.464–1, REGULATIONS 130: Base period capital additions under Part II.

INTERNAL REVENUE CODE

Regulations 130 amended. (See T. D. 6017, page 364.)

SECTION 40.464–3, REGULATIONS 130: Base period capital addition in case of part II transaction following part IV transaction.

INTERNAL REVENUE CODE

Regulation 130 amended. (See T. D. below.)

PART IV.—EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS OCCURRING PRIOR TO DECEMBER 1, 1950

SECTION 474.—EXCESS PROFITS CREDIT BASED ON INCOME—CERTAIN TAXABLE ACQUISITIONS

SECTION 40.474–1, REGULATIONS 130: Purpose and scope of part IV. T. D. 5998

(Also Sections 40.474–2, 40.474–3, 40.474–4, 40.474–5, 40.474–6; Section 462, Sections 40.462–1, 40.462–9; Section 463, Section 40.463–3; Section 464, Section 40.464–3, Regulations 130.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to conform to section 521 of the Revenue Act of 1951, relating to excess profits credit based on income in connection with certain taxable acquisitions (part IV).

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

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

On December 2, 1952, notice of proposed rulemaking with respect to amendments to conform Regulations 130 to section 521 of the Revenue Act of 1951 (Public Law 183, 82d Cong., 1st sess.), approved October 20, 1951, relating to excess profits credit based on income in connection with certain taxable acquisitions (part IV), was published in the Federal Register (17 F. R. 10878). After consideration

of such relevant suggestions as were presented by interested persons regarding the proposals, the amendments to Regulations 130 [26 CFR, part 40] set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 523 of the Revenue Act of 1951, which precedes section 40.435-1 [26 CFR 40.435-1], the following:

SEC. 521. EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

(1) Section 435(a)(3) (relating to amount of excess profits credit) is hereby amended by inserting before the period at the end thereof the following: ", and in the case of certain taxable acquisitions, see part IV of this subchapter".

* * * * * * *

PAR. 2. There is inserted immediately preceding section 40.461-1, as added by Treasury Decision 5865 [C. B. 1951-2, 97], approved November 13, 1951 [26 CFR 40.461-1], the following:

SEC. 521. EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(2) Section 461 (relating to definitions under part II) is amended by inserting at the end thereof the following new subsections:

"(g) COMPONENT CORPORATION WHICH WAS A PURCHASING CORPORATION IN A PREVIOUS TRANSACTION.—See section 462(b)(4) for rules applicable if the component corporation was a purchasing corporation (as defined in part IV) in a previous part IV transaction, or if (as an acquiring corporation in a previous part II transaction) it was subject to the provisions of section 462(b)(4).

"(h) DEFINITION OF PART II TRANSACTION.—For the purpose of this subchapter, the term 'part II transaction' means a transaction described in section 461(a)."

* * * * * * *

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [sections 501 through 523] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 3. There is inserted immediately preceding section 40.462-1, as added by Treasury Decision 5865 [26 CFR 40.462-1], the following:

SEC. 521. EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(3) Section 462(b) (relating to the method of recomputing the excess profits net income of an acquiring corporation under part II) is hereby amended by adding at the end thereof the following new paragraph:

"(4) If the average base period net income of the acquiring corporation is determined under section 435(d) with reference to this subsection, and if the provisions of section 474(b) (relating to the

computation of excess profits net income in the case of certain purchasing corporations) were applicable to the component corporation immediately prior to the part II transaction (or would have been applicable, if such part II transaction had occurred in a taxable year of the component corporation ending after June 30, 1950), then the excess profits net income (or deficit therein) of the component corporation shall, for the purpose of this subsection, be determined with the application of the provisions of section 474(b). For the purpose of this paragraph, if a component corporation was an acquiring corporation in a previous part II transaction and, immediately prior to the later part II transaction, the provisions of this paragraph were applicable to such component corporation, its excess profits net income (or deficit therein) shall be determined with the application of the provisions of the preceding sentence. This paragraph shall be applicable to an acquiring corporation only if—

"(A) the properties acquired by the acquiring corporation from the component corporation include substantially all of the properties (other than cash), or properties acquired in the ordinary course of business in the replacement of properties, which the component corporation acquired either from the selling corporation in the part IV transaction or from a previous component corporation subject (immediately prior to such acquisition) to the provisions of this paragraph;

"(B) the business or businesses acquired by the acquiring corporation were operated by the acquiring corporation from the date of such transaction to the end of the taxable year or were transferred during the taxable year by the acquiring corporation in a part II transaction to which the provisions of this paragraph are applicable; and

"(C) in the event that the part II transaction is one described in section 461(a)(1)(E), the provisions of section 462(i)(6) are satisfied."

(4) SECTION 462(i)(6) (relating to allocation rules in the case of transactions described in section 461(a)(1)(E)) is hereby amended by adding at the end thereof the following: "Notwithstanding the provisions of paragraph (1), if an acquiring corporation in a transaction described in section 461(a)(1)(E) determines its average base period net income under section 435(d) by recomputing its excess profits net income under the provisions of section 462(b)(4), the amount of the component corporation's excess profits net income for any month which shall be taken into account by the acquiring corporation shall be such portion of the component corporation's excess profits net income for such month as is determined on the basis of the earnings experience of the assets transferred and the assets retained by the component corporation."

* * * * * * *

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [sections 501 through 523] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 4. Section 40.462–1, as added by Treasury Decision 5865 [26 CFR 40.462–1], is amended by adding at the end thereof the following:

(d) *Recomputation of excess profits net income of acquiring corporation with reference to that of a component corporation which was a purchasing corporation in a part IV transaction.*—(1) This paragraph is applicable where a purchasing corporation in a part IV transaction becomes a component corporation in a later part II transaction and immediately prior to the part II transaction the provisions of section 474(b) were applicable in computing the average base period net income of the component corporation (or such provisions would have been applicable to the component if the part II transaction

had occurred in a taxable year of the component corporation ending after June 30, 1950). In such case if the average base period net income of the acquiring corporation in the part II transaction is determined under the general average method of section 435(d) by recomputing the excess profits net income with reference to section 462(b), in applying paragraphs (b) and (c) of this section to the acquiring corporation the excess profits net income (or deficit therein) of the component corporation must be determined with the application of the provisions of section 474(b), whether or not the component corporation computed its average base period net income with the application of section 474(b). For the application of the provisions of section 474(b) to a purchasing corporation in a part IV transaction, see sections 40.474-1 and 40.474-2. This paragraph shall not be applicable to the acquiring corporation unless each of the following conditions is met:

(i) The properties acquired by the acquiring corporation from the component corporation must include substantially all the properties (other than cash), or properties acquired in the ordinary course of business in the replacement of properties, which such component corporation acquired from the selling corporation in the part IV transaction or from a previous component corporation to which the provisions of section 462(b)(4) and of this paragraph were applicable;

(ii) The business or businesses acquired by the acquiring corporation must have been operated by the acquiring corporation from the date of the part II transaction to the end of the taxable year, unless such business or businesses were transferred during the taxable year by the acquiring corporation in a subsequent part II transaction to which the provisions of section 462(b)(4) and of this paragraph are applicable; and

(iii) In the event the part II transaction is a transaction described in section 461(a)(1)(E) the provisions of section 462(i)(6), relating to the allocation of base period experience, must be satisfied. See section 40.462-9(c).

(2) Similarly, in the case of successive part II transactions, (1) above is also applicable if a purchasing corporation in a part IV transaction becomes a component corporation in a part II transaction and thereafter its acquiring corporation becomes a component corporation in a later part II transaction, and if immediately prior to the later part II transaction the provisions of section 462(b)(4) and of (d) of this section were applicable in computing the average base period net income of the previous acquiring corporation (or such provisions would have been applicable to the previous acquiring corporation if the later part II transaction had occurred in a taxable year of the previous acquiring corporation ending after June 30, 1950). In such case, if the later acquiring corporation determines its average base period net income under the general average method of section 435(d) by recomputing the excess profits net income with reference to section 462(b), in applying paragraphs (b) and (c) of this section to such later acquiring corporation the excess profits net income (or deficit therein) of its component corporation (that is, the previous acquiring corporation) shall be determined with the application of the provisions of section 474, whether or not the component corporation determined its average base period net income by recomputing its excess profits net income with reference to section 462(b). As in the case of the first acquiring corporation, this paragraph is applicable to the second acquiring corporation only if the conditions set forth in subparagraph (1) (i), (ii), and (iii) above are met in the case of the second acquiring corporation.

PAR. 5. Section 40.462-9, as added by Treasury Decision 5865 [26 CFR 40.462-9], is amended by adding at the end thereof the following:

(c) *Part II transaction following part IV transaction.*—If an acquiring corporation in a transaction described in section 461(a)(1)(E) determines its average base period net income under the general average method of section 435(d), if the component corporation in such transaction was a purchasing corporation in a previous part IV transaction (or was an acquiring corporation from such a purchasing corporation), and if the acquiring corporation recomputes its excess profits net income with the application of the provisions of section 462(b)(4), the allocation of the base period experience of the component corporation shall be made on the basis of the special rule provided in section

462(i)(6) in lieu of the allocation provided in paragraph (a) or (b) of this section. The special rule provided in section 462(i)(6) requires that the allocation be made as follows:

(1) For the period prior to the date of the part IV transaction, the excess profits net income or deficit (or portion thereof) properly attributable to the business or businesses involved in the part IV transaction and acquired by the acquiring corporation in the part II transaction shall be the amounts which, with respect to such business or businesses, were available under part IV to the purchasing corporation in the part IV transaction (or would have been available if the part IV transaction had occurred in a taxable year of the purchasing corporation ending after June 30, 1950).

(2) For the period after the date of the part IV transaction, the excess profits net income or deficit (or portion thereof) properly attributable to such business or businesses shall be determined under the principles of (b) of this section but without regard to the requirement of a written agreement for the application of such principles.

(3) If the acquiring corporation acquires, in the part II transaction, properties of the component corporation not used in such business or businesses, the excess profits net income or deficit properly attributable to such properties shall be determined under (b) of this section without regard to the requirement for a written agreement as to such allocation.

PAR. 6. There is inserted immediately preceding section 40.463–1, as added by Treasury Decision 5865 [26 CFR 40.463–1], the following:

SEC. 521. EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(5) SECTION 463 (relating to capital changes) is amended by inserting at the end thereof the following new subsection:

"(c) COMPONENT CORPORATION WHICH WAS A PURCHASING CORPORATION IN A PREVIOUS TRANSACTION.—The Secretary shall provide by regulations for the application of this section in cases to which section 462(b)(4) is applicable."

* * * * * * *

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [incl. sec. 521] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 7. There is inserted immediately after section 40.463–2, as added by Treasury Decision 5865 [26 CFR 40.463–2], the following:

SEC. 40.463–3. CAPITAL CHANGES IN CASE OF PART II TRANSACTION FOLLOWING PART IV TRANSACTION.—In the case of an acquiring corporation in a part II transaction to which the provisions of section 462(b)(4) (relating to the determination of the excess profits net income or deficit with the application of the provisions of section 474(b) in the case of a component corporation which was a purchasing corporation in a previous part IV transaction) are applicable, the net capital addition or reduction of the acquiring corporation shall be determined under section 40.463–1 by recomputing the items of transferred capital addition and reduction of the component corporation with the application of the provisions of section 40.474–5. Such adjustment shall be made whether or not the component corporation computed its excess profits credit with the application of the provisions of part IV. The adjustment provided in this section shall also be made in the case of a component corporation which was an acquiring corporation in a previous part II transaction to which the provisions of section 462(b)(4) were applicable or would have been applicable if such previous part II transaction had occurred in a taxable year of the component corporation ending after June 30, 1950. In such case the adjustment shall be made with respect to the later acquiring corporation whether or not the previous acquiring corporation computed its excess profits credit by application of part II.

PAR. 8. There is inserted immediately preceding section 40.464–1, as added by Treasury Decision 5865 [26 CFR 40.464–1], the following:

SEC. 521. EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) TECHNICAL AMENDMENTS.—

* * * * * * *

(6) SECTION 464 (relating to capital changes during the base period) is amended by inserting at the end thereof the following new subsection:

"(c) The Secretary shall provide by regulations for the application of this section in cases to which section 462(b)(4) is applicable."

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [incl. sec. 521] shall be applicable only with respect to taxable years ending after June 30, 1950.

PAR. 9. There is inserted immediately after section 40.464–2, as added by Treasury Decision 5865 [26 CFR 40.464–2], the following:

SEC. 40.464–3. BASE PERIOD CAPITAL ADDITION IN CASE OF PART II TRANSACTION FOLLOWING PART IV TRANSACTION.—In the case of an acquiring corporation in a part II transaction to which the provisions of section 462(b)(4) (relating to the determination of the excess profits net income or deficit with the application of the provisions of section 474(b) in the case of a component corporation which was a purchasing corporation in a previous part IV transaction) are applicable, the base period capital addition of the acquiring corporation shall be determined under section 40.464–1 by computing the component corporation's yearly base period capital and its base period capital addition (whichever is available to the acquiring corporation) with the application of the provisions of section 40.474–6. Such adjustment shall be made whether or not the component corporation computed its excess profits credit with the application of the provisions of part IV. The adjustment provided in this section shall also be made in the case of a component corporation which was an acquiring corporation in a previous part II transaction to which the provisions of section 462(b)(4) were applicable (or would have been applicable if the previous part II transaction had occurred in a taxable year of the component corporation ending after June 30, 1950). In such case the adjustment shall be made with respect to the later acquiring corporation whether or not the previous acquiring corporation computed its excess profits credit by application of part II.

PAR. 10. There is added immediately after section 40.472–8 [26 CFR 40.472–8] the following:

SEC. 521. EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS [REVENUE ACT of 1951, APPROVED OCTOBER 20, 1951].

(a) GENERAL RULE.—Subchapter D (relating to the excess profits tax) of chapter 1 is hereby amended by inserting immediately following section 472 the following new part:

"PART IV—EXCESS PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS OCCURRING PRIOR TO DECEMBER 1, 1950

"SEC. 474. EXCESS PROFITS CREDIT BASED ON INCOME—CERTAIN TAXABLE ACQUISITIONS.

"(a) DEFINITIONS.—For the purpose of this part—

"(1) PURCHASING CORPORATION.—The term 'purchasing corporation' means a corporation which, before December 1, 1950, acquired—

"(A) In a transaction other than a transaction described in section 461(a), substantially all of the properties (other than cash) of another corporation, of a partnership, or of a business owned by a sole proprietorship; or

"(B) Properties of another corporation or of a partnership if (i) such properties constituted, immediately prior to the acquisition, substantially all of the properties (other than cash) of one or more separate businesses of such other corporation or such partnership, (ii) such other corporation or such partnership was engaged in one or more separate businesses other than those described in clause (i), and (iii) substantially all of the properties (other than cash) of such other corporation or such partnership were acquired, in furtherance of a single plan of complete liquidation for such other corporation or such partnership, by the purchasing corporation, and by one or more other persons, in transactions other than transactions described in section 461(a).

"(2) SELLING CORPORATION.—The term 'selling corporation' means a corporation, a partnership, or a business owned by a sole proprietorship, as the case may be, properties of which were acquired by a purchasing corporation in a transaction described in paragraph (1).

"(3) PART IV TRANSACTION.—The term 'part IV transaction' means a transaction described in paragraph (1).

"(b) AVERAGE BASE PERIOD NET INCOME OF PURCHASING CORPORATION.—The average base period net income of a purchasing corporation, if computed with reference to this part, shall be determined under section 435(d). The average base period net income under section 435(d) of a purchasing corporation shall be determined by computing its excess profits net income either with or without reference to this part, whichever produces the lesser tax under this subchapter for the taxable year for which the tax is being computed. If computed with reference to this part, the excess profits net income of a purchasing corporation for any month of its base period shall be its excess profits net income (or deficit therein), computed without reference to this part, and increased or decreased, as the case may be, by the addition or reduction resulting from including—

"(1) In the case of a transaction described in subsection (a)(1)(A), the excess profits net income (or deficit therein) for such month of the selling corporation, or

"(2) In the case of a transaction described in subsection (a)(1)(B), the excess profits net income (or deficit therein) for such month of the selling corporation properly attributable to the business or businesses acquired by the purchasing corporation and properly allocable to such purchasing corporation.

The excess profits net income of a purchasing corporation for any month, recomputed as provided in the previous sentence, shall not be less than zero.

"(c) LIMITATIONS.—This part shall apply only if each of the following conditions is satisfied:

"(1) The selling corporation (A) did not, after the part IV transaction (or the last transaction described in subsection (a)(1)(B)), continue any business activities other than those incident to its complete liquidation, and (B) within a reasonable time after ceasing business activities, completely liquidated in a transaction other than a transaction described in section 461(a), and ceased existence.

"(2) During so much of the base period of the purchasing corporation and of the period thereafter as preceded the part IV transaction, the properties acquired in the part IV transaction were substantially all of the properties (other than cash) which were used, or which in the ordinary course of business replaced properties used, by the selling corporation (or by a component corporation, as defined in section 461(b), of such selling corporation) in the production of the excess profits net income (or deficit therein)

which under subsection (b) increases or decreases the excess profits net income of the purchasing corporation. For the purpose of this paragraph, if a business in the hands of both the selling corporation and the purchasing corporation was operated under a substantially identical franchise or license, granted by the same person, such franchise or license shall be deemed acquired by the purchasing corporation from the selling corporation.

"(3) The business or businesses acquired in the part IV transaction (including the properties so acquired or properties in replacement thereof) were operated by the purchasing corporation from the date of such transaction to the end of the taxable year or were transferred during the taxable year by the purchasing corporation in a part II transaction to which the provisions of section 462(b)(4) are applicable.

(d) SPECIAL RULES.—

"(1) For the purpose of subsection (a)(1), the properties of a selling corporation shall be considered to have been acquired by a purchasing corporation only if acquired from—

"(A) such selling corporation, or

"(B) persons who received the properties upon the liquidation of such selling corporation and who forthwith transferred such properties to the purchasing corporation in a transaction other than a transaction described in section 461(a).

"(2) The computations required by this part in the case of a selling corporation which is a partnership or a business owned by a sole proprietorship shall be made, under regulations prescribed by the Secretary, as if such partnership or such business owned by a sole proprietorship had been a corporation.

"(3) In no case shall more than 100 per centum of the excess profits net income (or deficit therein) for any month of a selling corporation be allocated to the purchasing corporation or, in the case of transactions described in subsection (a)(1)(B), to the several persons (or to any one or more of such persons) receiving the properties of such selling corporation in such transactions.

"(e) SUCCESSIVE TRANSACTIONS.—

"(1) PART IV TRANSACTION FOLLOWING PART IV TRANSACTION.—In the case of a selling corporation which was a purchasing corporation in a previous part IV transaction, or which acquired properties of a purchasing corporation in a transaction to which section 462(b)(4) is applicable, the computations under this part with respect to the selling corporation shall be made without regard to the previous part IV transaction.

"(2) PART IV TRANSACTION FOLLOWING PART II TRANSACTION.—Subject to the provisions of paragraph (1), in the case of a selling corporation which was an acquiring corporation as defined in section 461(a) in a previous transaction, its excess profits net income (or deficit therein) which increases or decreases the excess profits net income (or deficit therein) of the purchasing corporation under subsection (b) (1) or (2), and its capital changes which are taken into account under this part in determining the capital changes of the purchasing corporation, shall be determined with the application of the rules of part II to such selling corporation with respect to the part II transaction.

"(3) PART II TRANSACTION FOLLOWING PART IV TRANSACTION.—For rules applicable in the case of a part II transaction following a part IV transaction, see sections 462(b)(4), 463(c), and 464(c).

"(f) REGULATIONS.—The Secretary shall by regulations prescribe rules for the application of this part. Such regulations shall include the following rules:

"(1) BASE PERIOD CAPITAL ADDITION.—Rules (consistent with the principles of section 464) for the determination of the base period capital addition of the purchasing corporation by reference to the capital changes of the selling corporation and of the purchasing corporation.

"(2) NET CAPITAL ADDITION OR REDUCTION.—Rules (consistent with the principles of section 463) for the determination of the net capital

addition or reduction of the purchasing corporation by reference to the capital changes of the selling corporation and of the purchasing corporation.

"(3) EXCESS PROFITS NET INCOME.—Rules (consistent with the principles of section 462(i)) for the determination of the amount of excess profits net income (or deficit therein) of the selling corporation attributable to the business or businesses acquired by a purchasing corporation in a transaction described in subsection (a)(1)(B) and properly allocable to such purchasing corporation.

"(4) DUPLICATION.—Rules for the application under this part of the principles of section 462(j)(1) and the other provisions of part II relating to the prevention of duplication.

"(5) EXCESS PROFITS CREDIT.—In the event that the part IV transaction occurred in a taxable year of the purchasing corporation which ended after June 30, 1950, rules (consistent with the principles of section 462(j)(2)) for the determination of the excess profits credit of such corporation for the year in which the transaction occurred.

Such rules shall not include the principles of section 461(c) (relating to the excess profits credit of the component corporation), of section 462(b)(2) (relating to constructive excess profits net income for months during which a corporation was not in existence), of section 462(1) (relating to minimum average base period net income in the case of certain acquiring corporations), or of such other provisions of part II as relate to sections 435(e), 442, 443, 444, 445, or 446."

* * * * * * *

SEC. 523. EFFECTIVE DATE OF TITLE V [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Except as otherwise provided in section 506(d), the amendments made by this title [incl. sec. 521] shall be applicable only with respect to taxable years ending after June 30, 1950.

SEC. 40.474-1. PURPOSE AND SCOPE OF PART IV.—(a) *General purpose.*—The term "part IV" when used in these regulations means section 474. Part IV provides rules under which a "purchasing corporation", subject to the conditions and limitations contained therein, may utilize the earnings experience of a "selling corporation" in computing the purchasing corporation's excess profits credit based on income. The term "purchasing corporation" means a corporation which, before December 1, 1950, acquired properties from a "selling corporation" in a transaction meeting the requirements set forth in section 474. See paragraph (b) below. A "selling corporation" may be a corporation, a partnership, or a business owned by a sole proprietorship. The excess profits credit of the selling corporation is not determined under part IV. A foreign corporation cannot be a purchasing corporation and neither a foreign corporation, a foreign partnership, nor a foreign sole proprietorship can be a selling corporation. The average base period net income of a purchasing corporation may be determined by computing its excess profits net income either with or without reference to part IV, whichever produces the lesser tax. However, if the average base period net income of the purchasing corporation is computed with reference to part IV, such average base period net income must be determined under the general average method of section 435(d). If the average base period net income of the purchasing corporation is computed under the growth alternative of section 435(e) or under an alternative method provided in section 442, 443, 444, 445, 446, or any subsection of section 459, the excess profits net income of the purchasing corporation may not be computed with reference to part IV.

(b) *Part IV transactions.* The term "part IV transaction" means one of the transactions described in section 474(a)(1). Such transactions do not include any acquisition of property in a transaction described in section 461(a). The following transactions are part IV transactions:

(1) The acquisition, before December 1, 1950, by a purchasing corporation, in a transaction other than a transaction described in section 461(a), of substantially all the properties (other than cash) of another corporation, of a partnership, or of a business owned by a sole proprietorship; or

(2) The acquisition, before December 1, 1950, by a purchasing corporation, in a transaction other than a transaction described in section 461(a), of

part, as distinguished from substantially all, of the properties of another corporation or of a partnership, if the following conditions are met:

(i) Such properties constituted immediately prior to such acquisition substantially all the properties (other than cash) of one or more separate businesses of the other corporation or the partnership;

(ii) The other corporation or the partnership was engaged in one or more separate businesses other than those described in (i) above; and

(iii) Substantially all the properties (other than cash) of the other corporation or the partnership, including the properties acquired by the purchasing corporation, were acquired, in furtherance of a single plan of complete liquidation of the other corporation or the partnership, by the purchasing corporation and by one or more other persons, whether or not the acquisition by any of such other persons constituted a part IV transaction but only if the acquisition by any of such other persons was not a transaction described in section 461(a).

In determining whether the properties acquired by the purchasing corporation in a part IV transaction constituted substantially all the properties of the transferor, or of a separate business of the transferor, as the case may be, proper regard must be had to any previous dispositions of property by the selling corporation. Properties will be considered to have been acquired in a part IV transaction only if such properties were acquired from the selling corporation or from shareholders of the selling corporation who received such properties upon the complete liquidation of such corporation and who forthwith transferred them to the purchasing corporation in a transaction other than a transaction described in section 461(a). In determining whether the transaction is a transaction described in (2), above, the properties acquired by the purchasing corporation shall be considered to have constituted the properties of a separate business of the selling corporation only if such business was a going business unit for which adequate and separate records were maintained. Similarly, in the case of a transaction described in (1), above, a business owned by a sole proprietorship means a going business unit for which adequate and separate records were maintained.

(c) *Limitations on application of part IV.* A purchasing corporation may compute its average base period net income under section 435(d) with reference to part IV only if each of the following conditions is satisfied:

(1) After the part IV transaction described in paragraph (b)(1) above, or the last transaction described in paragraph (b)(2) above, the selling corporation did not engage in any business activities other than those incident to its complete liquidation and, within a reasonable time after ceasing business activities, the selling corporation was completely liquidated in a transaction other than a transaction described in section 461(a), and its existence terminated.

(2) During so much of the base period of the purchasing corporation and of the period thereafter as preceded the part IV transaction, the properties acquired by the purchasing corporation in such transaction were substantially all the properties (other than cash) which were used (or which in the ordinary course of business replaced properties used) by the selling corporation (or by a component corporation of such selling corporation in case the latter was an acquiring corporation in a previous part II transaction) in the production of the excess profits net income or deficit therein which under section 474(b) increases or decreases the excess profits net income of the purchasing corporation. See section 40.474–2. Thus, for example, if the selling corporation during the base period of the purchasing corporation and prior to the part IV transaction disposed of properties used in the business acquired by the purchasing corporation, so that the purchasing corporation did not acquire substantially all the properties used in such business, part IV is not applicable. Similarly, in the case of a transaction described in section 474(a)(1)(A), if the selling corporation during the base period of the purchasing corporation disposed of the properties used in one business and acquired properties for another business, the properties used in the latter business being acquired by the purchasing corporation, part IV is not applicable. If the selling corporation described in the preceding sentence had also owned throughout the base period prior to the part IV transaction a second business, and if the acquisition by the purchasing corporation of the business referred to in

the preceding sentence was a transaction described in section 474(a)(1)(B), part IV is not applicable if the excess profits net income of the selling corporation available to the purchasing corporation under section 474(b)(2) includes excess profits net income for months prior to the date the business acquired by the purchasing corporation was owned by the selling corporation. If a business was operated by the selling corporation prior to the part IV transaction under a franchise or license granted by any person, for example, a franchise or license not transferable by the selling corporation, and if after such transaction the purchasing corporation operated the same business under a substantially identical franchise or license granted by the same person, such franchise or license will be considered to have been acquired by the purchasing corporation from the selling corporation.

(3) The business or businesses transferred to the purchasing corporation in the part IV transaction (including the properties actually transferred or properties acquired in replacement thereof) were operated by the purchasing corporation from the date of such transaction to the end of the taxable year of the purchasing corporation for which the excess profits credit is computed, unless during the taxable year such business or businesses were transferred by the purchasing corporation in a part II transaction to which the provisions of section 462(b)(4) are applicable. See section 40.462–1(d).

SEC. 40.474–2. RULES FOR DETERMINING AVERAGE BASE PERIOD NET INCOME OF A PURCHASING CORPORATION.—(a) *In general.*—The average base period net income of a purchasing corporation, for the purpose of the excess profits credit based on income and computed under the general average method (section 435(d)), may be determined by computing its excess profits net income with or without reference to part IV, whichever results in the lesser excess profits tax. If computed without reference to part IV, the excess profits net income of the purchasing corporation is computed with reference to its base period experience, but without reference to the base period experience of the selling corporation. The excess profits net income of the purchasing corporation, if computed with reference to part IV, shall be its excess profits net income or deficit in excess profits net income for each month of its base period (as defined in section 435(b)) or each month of the substitute period provided in section 435(d), whichever is applicable, increased or decreased by the addition or reduction resulting from including the excess profits net income or deficit for that month of the selling corporation to the extent provided in section 474(b). In applying the provisions of section 474(b) to a purchasing corporation which acquired properties in two or more part IV transactions, all selling corporations in such transactions must be taken into account. The excess profits net income of the purchasing corporation for any month recomputed with the application of the provisions of section 474(b) shall in no event be less than zero. As used in the regulations under part IV the term "base period experience" refers to the excess profits net income or deficit in excess profits net income. See section 40.474–3 for rules applicable in recomputing the excess profits net income (or deficit therein) in the case of successive transactions under parts II and IV.

(b) *Method of recomputation of excess profits net income of a purchasing corporation with reference to that of the selling corporation.*—The following steps are required for the recomputation of the excess profits net income of a purchasing corporation with reference to the base period experience of the selling corporation:

(1) The excess profits net income or deficit in excess profits net income for each month in the base period of the purchasing corporation and, for the purpose of the substitute period provided in section 435(d), for each month in the additional period ending March 31, 1950, must be determined for the purchasing corporation and for each selling corporation. Except as provided below with respect to the selling corporation for its taxable year in which the part IV transaction occurred, the excess profits net income or deficit in excess profits net income of any corporation for any month during any part of which such corporation was in existence is determined by dividing the excess profits net income computed under section 433(b) (or) deficit in excess profits net income computed under section 433(c)) for the taxable year in which such month falls by the number of full calendar months in such taxable year. In the case of a transaction described in section 474(a)(1)(B),

there is taken into account the portion of the excess profits net income or deficit properly attributable to the business or businesses acquired by the purchasing corporation and properly allocable to such purchasing corporation. In determining the excess profits net income or deficit of the selling corporation for any month during the taxable year in which the part IV transaction occurred, the excess profits net income or deficit for such taxable year shall be determined without regard to any items arising after the date of the transaction and the number of months in the taxable year shall be determined without regard to the period after the date of the transaction. The excess profits net income of any corporation for any month during no part of which such corporation was in existence shall be zero. For the purpose of the substitute period provided in section 435(d), the excess profits net income for January, February, or March 1950, is subject to the percentages specified in section 435(e)(2)(E).

(2) For each month of the purchasing corporation's base period (or, if applicable, the substitute period provided in section 435(d)) preceding the date of the part IV transaction, the excess profits net income or deficit in excess profits net income of the purchasing corporation for that month as determined under subparagraph (1) shall be increased or decreased, as the case may be, by the excess profits net income or deficit in excess profits net income of each selling corporation for that month so determined; except that, if the purchasing corporation acquires only a part of the selling corporation's properties in a transaction described in section 474(a)(1)(B), then the increase or decrease shall be made for only that portion of such selling corporation's excess profits net income or deficit in excess profits net income properly attributable to the business or businesses acquired by the purchasing corporation and properly allocable to the purchasing corporation under paragraph (c) of this section.

(c) *Allocation of excess profits net income of selling corporation to purchasing corporation.*—In the case of a part IV transaction described in section 474(a)(1)(B), that is, a transaction in which a part as distinguished from all or substantially all the properties of a selling corporation is transferred to a purchasing corporation, the portion of the base period experience of the selling corporation allocated to the purchasing corporation shall be determined under the rules provided in section 40.462-9(b) for the allocation of the excess profits net income or deficit of a component corporation to an acquiring corporation, subject to the following exceptions:

(1) The agreement referred to in section 40.462-9(b) shall not be required.

(2) The Commissioner may, for good cause shown, permit the allocation to reflect, as to certain items, an allocation, under the principle of section 40.462-9(a), based upon the fair market value of the properties (other than cash).

(3) Cash shall not be taken into account in making the allocation.

(4) The provisions of section 40.462-9(b)(2) which permit allocation of more than 100 percent of the excess profits net income of a partnership shall not be applicable.

(d) *Special rules for partnerships and sole proprietors.*—In the case of a business owned by a sole proprietorship or a partnership its excess profits net income or deficit in excess profits net income for each month falling within the purchasing corporation's base period (or the substitute period provided in section 435(d) if applicable) prior to the date of the part IV transaction shall be determined as if such partnership or such business owned by a sole proprietorship had been a corporation. See section 474(d)(2). Among the adjustments which are necessary in such a case are the following:

(1) A reasonable deduction for salary or compensation to each partner or to the sole proprietor for personal services actually rendered shall be allowed.

(2) The credit for dividends received shall be that applicable to corporations.

(3) The treatment of capital gains and losses and of taxes (whether State, local, or other) shall be that applicable to corporations.

(4) The deduction for charitable contributions shall be that allowed by section 23(q).

(e) *Limitation in case of part IV transaction occurring in a taxable year ending after June 30, 1950.*—In the case of a part IV transaction occurring in a

taxable year of the purchasing corporation ending after June 30, 1950, for the purpose of computing the purchasing corporation's excess profits credit for such taxable year, there is available to the purchasing corporation only a proportionate part of the amount of the monthly excess profits net income (or deficit) of the selling corporation which is otherwise available to the purchasing corporation. Such proportionate part shall be determined by the ratio which the number of days in the taxable year of the purchasing corporation after the day of the transaction bears to the total number of days in such taxable year. In computing the excess profits credit of the purchasing corporation for subsequent taxable years the limitation stated in this paragraph is not applicable.

(f) *Examples.*—The computation of the average base period net income of the purchasing corporation determined under the general average method of section 435(d) by computing the excess profits net income with reference to section 474(b) may be illustrated by the following example:

Example. The P Corporation was in existence and commenced business prior to January 1, 1946. The S_1 Corporation and the S_2 Corporation each came into existence on January 1, 1947. The P Corporation, the S_1 Corporation, and the S_2 Corporation each makes its income tax returns on the calendar year basis. On January 1, 1949, the P Corporation purchased for cash all the properties of the S_1 Corporation, and on January 5, 1949, it purchased for cash all the properties of the S_2 Corporation in part IV transactions. The excess profits net income for each of the corporations for the base period taxable years is as follows:

Excess profits net income for taxable year

	1946	1947	1948	1949
P Corporation	−$18,000	$24,000	$42,000	$96,000
S_1 Corporation	0	18,000	30,000	
S_2 Corporation	0	12,000	18,000	

The excess profits net income for each month in such taxable years is as follows:

Excess profits net income for each month in calendar year

	1946	1947	1948	1949
P Corporation	−$1,500	$2,000	$3,500	$8,000
S_1 Corporation	0	1,500	2,500	
S_2 Corporation	0	1,000	1,500	
Total	−1,500	4,500	7,500	8,000

The excess profits net income of the P Corporation for each month as recomputed under section 474(b) is the total excess profits net income for that month as shown in the above table, except that for each month in 1946 the recomputed excess profits net income is increased to zero. Since the 36 consecutive months in the years 1947, 1948, and 1949 have the highest aggregate excess profits net income, the average base period net income is such aggregate excess profits net income divided by 3. The average base period net income of the P Corporation recomputed under section 474(b) is $80,000, determined as follows:

Aggregate for months in 1947 (12×$4,500)	$54,000
Aggregate for months in 1948 (12×$7,500)	90,000
Aggregate for months in 1949 (12×$8,000)	96,000
Aggregate for 36 months	240,000
Aggregate divided by 3	80,000

This figure, subject to the percentage prescribed in section 435(a), may be used by the P Corporation in computing its excess profits credit based on income for the purpose of determining its excess profits tax for 1950 and future excess profits tax taxable years, provided all the conditions and limitations applicable under section 474, for example, the provisions of section 40.474-4, are met.

SEC. 40.474–3. SUCCESSIVE TRANSACTIONS.—(a) *Part IV transaction following part IV transaction.*—In the case of a purchasing corporation which acquired properties of a selling corporation, if such selling corporation was itself a purchasing corporation in a previous part IV transaction, the computations under section 474 for the purpose of computing the excess profits credit of the purchasing corporation in the later part IV transaction shall be made with respect to the selling corporation without regard to the previous part IV transaction. For example, the P Corporation acquires the property of the S Corporation in a part IV transaction on January 1, 1950. The S Corporation came into existence on January 1, 1949, and on the same date acquired all the properties of the Y Corporation in a part IV transaction. In computing the P Corporation's excess profits credit with reference to section 474, any computation required with respect to the S Corporation shall be made without regard to the excess profits net income (or deficit therein) of the Y Corporation.

(b) *Part IV transaction following part II transaction.*—(1) *Component corporation not a purchasing corporation.*—If a purchasing corporation acquired properties of a selling corporation in a part IV transaction, if the selling corporation previously had acquired properties of a component corporation in a part II transaction to which section 462(b)(4) was not applicable, and if the excess profits net income of the purchasing corporation is recomputed with the application of the provisions of section 474(b), the excess profits net income or deficit in excess profits net income of the selling corporation which increases or decreases the excess profits net income or deficit in excess profits net income of the purchasing corporation under section 474(b), shall be determined with the application of the rules of part II to such selling corporation with respect to the previous part II transaction. See sections 461 through 465, and the regulations thereunder. This rule must be followed whether or not the selling corporation determined its average base period net income by recomputing its excess profits net income with the application of part II.

(2) *Component corporation a purchasing corporation.*—If a purchasing corporation acquired properties of a selling corporation in a part IV transaction, and if the selling corporation previously had acquired properties of another corporation in a part II transaction to which section 462(b)(4) and the regulations thereunder are applicable, that is, a transaction in which the component corporation was a purchasing corporation in a part IV transaction preceding the part II transaction, the computations under section 474 for the purpose of computing the excess profits credit of the purchasing corporation in the later part IV transaction shall be made with respect to the selling corporation in such transaction without regard to the previous part IV transaction in which the component of the selling corporation had been a purchasing corporation. For example, the P Corporation acquired the properties of the S Corporation in a part IV transaction on January 1, 1950. The S Corporation previously had acquired all the properties of the C Corporation in a part II transaction on January 1, 1948. The C Corporation came into existence on January 1, 1947, and on the same date purchased all the properties of the D Corporation in a part IV transaction. Any computations required under section 474 with respect to the P Corporation's excess profits credit shall be made without regard to the excess profits net income (or deficit therein) of the D Corporation.

(c) *A purchasing corporation as an acquiring corporation under part II.*—Both part II and part IV may be applied in the case of a corporation which is qualified both as a purchasing corporation and as an acquiring corporation and which computes its average base period net income under the general average method of section 435(d).

(d) *Part II transaction following part IV transaction.*—For rules applicable in the case of a purchasing corporation which becomes a component corporation in a part II transaction, see sections 462(b)(4), 463(c), and 464(c) and the regulations thereunder.

SEC. 40.474–4. RULES FOR THE PREVENTION OF DUPLICATION.—(a) *In general.*—(1) The purpose of the rules prescribed in this section is to prevent certain duplications in base period income in cases where after December 31, 1945, and before December 1, 1950, assets of a purchasing corporation are used to purchase properties of a selling corporation in a part IV transaction. See section 474(f)(4). In such cases the excess profits net income of the selling corporation, or portion thereof attributable to the properties acquired by the purchasing corporation, shall be excluded in determining the purchasing corporation's excess profits net income or deficit and its average base period net income with reference

to the recomputations provided under part IV. The adjustment required under this section shall be made in the cases described in this section and in all other cases in which a similar adjustment may be required to prevent duplication, in a manner consistent with principles underlying such described cases.

(2) Except to the extent that duplication of experience occurs, no adjustment is necessary under this section—

(i) Where stock of the purchasing corporation is issued directly to the selling corporation in exchange for properties of the selling corporation; or

(ii) Where properties of the selling corporation are acquired through a bona fide long-term increase in the capital structure of the purchasing corporation made in conjunction with and for the purpose of such acquisition. A bona fide long-term increase in the capital structure within the meaning of this subparagraph (whether an increase in equity capital or in borrowed capital as defined in section 439(b)) shall be deemed to have occurred only to the extent that such increase is reflected in the capital structure throughout the period beginning with the time such increase is originally made and ending with the close of the taxable year of the purchasing corporation for which the tax is computed. For the purpose of determining whether such increase is reflected in the capital structure, proper adjustment shall be made to eliminate the effect of any loss occurring after the original increase is made, and, in the case of such determination as of any time during the taxable year, the determination shall be made without regard to the earnings and profits of such taxable year. If the increase in capital structure is the result of a part II transaction, this subparagraph and section 40.474–2(c) shall be applied in the light of the facts applicable both to the taxpayer and to the component corporation in such transaction. For the purpose of this subparagraph, an increase in the capital structure does not result from the conversion of inadmissible assets into admissible assets, or from the accumulation of earnings and profits prior to the beginning of the first taxable year which begins after the date of the acquisition.

(3) If properties of the selling corporation are acquired partly in the manner described in subparagraph (2) and partly in another manner, the adjustment required under this section shall be made to the extent the acquisition is made in such other manner. See paragraph (c) below. As to adjustment under regulations pursuant to section 474(f)(4) of the net capital addition or reduction see section 40.474–5, and as to adjustment under regulations pursuant to section 474(f)(4) of the base period capital addition, see section 40.474–6.

(b) *Examples.*—The application of this section may be illustrated by the following examples:

Example (1). The P Corporation and the S Corporation commenced business before January 1, 1946, and make their income tax returns on the calendar year basis. The P Corporation sold certain assets for cash and on July 1, 1950, it used such cash to purchase properties of the S Corporation in a part IV transaction. In applying section 474(b) in determining the average base period net income of the P Corporation, the rule provided in paragraph (a)(1) of this section requires the exclusion of the S Corporation's entire experience for the base period. The S Corporation's base period capital addition and its net capital addition or reduction for 1950 are also required to be excluded. See sections 40.474–5 and 40.474–6.

Example (2). The S Corporation commenced business before January 1, 1946, and makes its income tax returns on the calendar year basis. The P Corporation was organized on December 10, 1948. On January 1, 1949, the P Corporation issued its stock for cash and on the same day used such cash to acquire all the properties of the S Corporation in a part IV transaction. In determining the P Corporation's average base period net income under section 435(d), based on a recomputation of its excess profits net income under section 474(b), this section does not require the elimination of any part of the excess profits net income (or deficit) of the S Corporation. See paragraph (a)(2) of this section. Under regulations pursuant to section 474(f)(1), however, the P Corporation will not be allowed any base period capital addition for the cash paid in for its stock which was used in acquiring the properties of the S Corporation. See section 40.474–6.

Example (3). The P Corporation and the S Corporation both commenced business before January 1, 1946, and make their income tax returns on the cal-

endar year basis. Before January 1, 1946, the P Corporation became the owner of one-half the stock of the S Corporation. On July 1, 1950, the S Corporation was liquidated and the P Corporation received all of the properties which had been used in the operation of one of two separate businesses operated by the S Corporation. The acquisition of such properties qualifies as a part IV transaction. In applying section 474(b) in determining the average base period net income of the P Corporation the rule provided in paragraph (a)(1) of this section requires the exclusion of the base period experience of the business operated by the S Corporation. The S Corporation's base period capital addition and its net capital addition or reduction for 1950 are also required to be excluded. See sections 40.474–5 and 40.474–6.

(c) *Acquisition resulting in partial duplication.*—If a purchasing corporation acquires properties of a selling corporation in a part IV transaction, and only a part of the total consideration transferred by the purchasing corporation consists of stock issued directly by the purchasing corporation or of cash or other assets acquired by the purchasing corporation through a bona fide long-term increase in its capital structure, only that part of the selling corporation's base period experience before the acquisition which is not attributable to such stock so issued or to such cash or assets so acquired is to be excluded in computing the purchasing corporation's average base period net income under section 435(d), based on a recomputation of excess profits net income under section 474(b). The portion of the selling corporation's experience not to be excluded under this section with respect to any part of the base period (and of the additional period through March 31, 1950, for the purpose of the substitute period provided in section 435(d)) prior to the day of the transaction is an amount which bears the same ratio to the whole of the selling corporation's experience for such part of such period (or, in the case of a transaction described in section 474(a)(1)(B), the part of the selling corporation's experience properly attributable to the properties acquired by the purchasing corporation) as the sum of the fair market value of the stock of the purchasing corporation issued directly to the selling corporation, plus the fair market value of the other assets or cash acquired in the manner described in paragraph (a)(2) of this section, bears to the fair market value of the total consideration received by the selling corporation for such properties. The adjustment under this section in cases described in this paragraph may be illustrated by the following example:

Example. The P Corporation and the S Corporation each commenced business before January 1, 1946, and makes its income tax returns on the basis of the calendar year. On January 1, 1948, the P Corporation in a part IV transaction purchased all the properties of the S Corporation for $100,000 in cash, of which $60,000 was derived by the P Corporation from the sale of certain assets and $40,000 was derived from the issuance and sale of new shares of its stock, such new stock constituting a bona fide long-term increase in its capital structure. For the purpose of computing the P Corporation's average base period net income under section 435(d), based on a recomputation of the excess profits net income under section 474(b), 60 percent of the S Corporation's monthly excess profits net income (or deficit) for 1946 and 1947 is to be excluded under this section.

SEC. 40.474–5. NET CAPITAL ADDITION OR REDUCTION UNDER PART IV.—(a) *In General.*—If the purchasing corporation acquires properties of a selling corporation in a part IV transaction occurring in a taxable year ending after June 30, 1950, and if the purchasing corporation's average base period net income for the purpose of the excess profits credit for any taxable year ending after the date of the transaction is computed with the application of part IV, the net capital addition or net capital reduction of the purchasing corporation for such taxable year shall be computed under section 435(g) with the application of the following rules:

(1) If the part IV transaction involved a transaction described in section 40.474–4(a)(2) (i) or (ii), that is, a transaction in which there is no duplication of base period experience, the net capital addition or net capital reduction of the purchasing corporation shall be computed after making proper adjustment by decreasing the daily capital addition or increasing the daily capital reduction, as the case may be, for each day after the date of the part IV transaction, to the extent necessary so that such amount shall not reflect the transaction

described in section 40.474–4(a)(2). Thus, in the example in section 40.474–4(c), if the part IV transaction had occurred in a taxable year ending after June 30, 1950, the $40,000 derived from the issuance and sale of new shares of stock shall not be included in determining the amount paid in for stock under section 435(g)(3)(A) for such taxable year, and the equity capital as of the beginning of any taxable year beginning after the part IV transaction would be reduced by $40,000 for the purpose of applying section 435(g)(3)(B) or section 435(g)(4)(B) to such taxable year.

(2) Under principles corresponding to those set forth in section 462(j)(1) and section 40.463–1(e), the net capital addition or net capital reduction of the purchasing corporation is computed without regard to any capital changes of the selling corporation in any case subject to the provisions of section 40.474–4 unless the case involves a transaction described in section 40.474–4(a)(2)(i) in which no gain or loss is recognized upon the exchange of the stock for the properties.

(3) If the part IV transaction is subject to the provisions of section 40.474–4 by reason of an exchange described in section 40.474–4(a)(2)(i) in which no gain or loss was recognized, the purchasing corporation shall compute its net capital addition or net capital reduction under the rules provided in section 40.463–1 as if the purchasing corporation were an acquiring corporation and the selling corporation were a component corporation. If in such case the selling corporation was a party to a part II transaction occurring before the part IV transaction, the rules set forth in section 40.463–2 shall also be applicable as if the purchasing corporation were an acquiring corporation and the selling corporation were a component corporation.

(b) *Example.*—The rules prescribed by paragraph (a) of this section may be illustrated by the following example:

Example. The P Corporation and the S Corporation each makes its income tax returns on the basis of the calendar year. The P Corporation issued its stock on June 1, 1950, for $1,000,000 in cash, such new stock constituting a bona fide long-term increase in its capital structure, and on July 1, 1950, used such cash to acquire all the properties of the S Corporation in a part IV transaction. The P Corporation computes its excess profits credit under part IV. In computing the daily capital addition of the P Corporation for each day of 1950 after July 1, 1950, the $1,000,000 paid in for stock on June 1, 1950, shall be disregarded. In computing the equity capital of the P Corporation on January 1, 1951, for the purpose of comparing such amount with its equity capital on January 1, 1950, such equity capital on January 1, 1951, shall be reduced by $1,000,000, the amount paid in for the stock. The same adjustment (a decrease of $1,000,000) shall be made for such purpose in computing equity capital for the first day of each subsequent taxable year. Under principles corresponding to those set forth in section 40.463–1(e), the net capital addition or net capital reduction of the P Corporation is computed without regard to any capital changes of the S Corporation.

SEC. 40.474–6. BASE PERIOD CAPITAL ADDITION UNDER PART IV.—(a) *In general.*—If the purchasing corporation acquires properties of the selling corporation in a part IV transaction occurring after the beginning of the second taxable year of the purchasing corporation preceding its first taxable year ending after June 30, 1950, and if the purchasing corporation's average base period net income for the purpose of the excess profits credit for any taxable year ending after the date of the transaction is computed with the application of part IV, the base period capital addition of the purchasing corporation for such taxable year shall be computed under section 435(f) with the application of the following rules:

(1) If the part IV transaction involved a transaction described in section 40.474(a)(2)(i) or (ii), that is, a transaction in which there is no duplication of base period experience, the base period capital addition of the purchasing corporation shall be computed after making proper adjustment by decreasing the yearly base period capital for any day specified in section 435(f) after the date of the part IV transaction to the extent necessary so that such amount shall not reflect the transaction described in section 40.474–4(a)(2). Thus, in the example in section 40.474–4(c), if the part IV transaction had occurred after the beginning of the second taxable year of the purchasing corporation preceding its first taxable year ending after June 30, 1950, the yearly base period capital for each day specified in section 435(f) after the date of the part IV transaction shall be reduced by the $40,000 derived from the issuance and sale of new shares of stock.

(2) Under principles corresponding to those set forth in section 462(j)(1) and section 40.464–1(d), the base period capital addition of the purchasing corporation is computed without regard to the base period capital addition or yearly base period capital of the selling corporation in any case subject to the provisions of section 40.474–4, unless the case involves a transaction described in section 40.474–4(a)(2)(i) in which no gain or loss is recognized upon the exchange of the stock for the properties.

(3) If the part IV transaction is subject to the provisions of section 40.474–4 by reason of an exchange described in section 40.474–4(a)(2)(i) in which no gain or loss was recognized, the purchasing corporation shall compute its yearly base period capital or base period capital addition with reference to the yearly base period capital or base period capital addition of the selling corporation under the rules provided in section 40.464–1 as if the purchasing corporation were an acquiring corporation and the selling corporation were a component corporation. If, in such case, the selling corporation was a party to a part II transaction occurring before the part IV transaction, the rules set forth in section 40.464–2 shall also be applicable as if the purchasing corporation were an acquiring corporation and the selling corporation were a component corporation.

(*b*) *Example.*—The rules prescribed by paragraph (a) of this section may be illustrated by the following example:

Example. The P Corporation and the S Corporation each makes its income tax returns on the basis of the calendar year. The P Corporation issued its stock on June 1, 1949, for $1,000,000 in cash, such new stock constituting a bona fide long-term increase in its capital structure, and on July 1, 1949, used such cash to acquire all the properties of the S Corporation in a part IV transaction. The P Corporation computes its excess profits credit under part IV. In computing the base period capital addition of the P Corporation, its yearly base period capital for 1950 shall be reduced by $1,000,000, the amount paid in for the stock. Under principles corresponding to those set forth in section 40.464–1(d), the base period capital addition of the P Corporation is computed without regard to any capital changes of the S Corporation.

(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) and in section 521 of the Revenue Act of 1951 (65 Stat. 557).)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved March 24, 1953.

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

(Filed with the Division of the Federal Register March 27, 1953, 8:49 a. m.)

SUBCHAPTER E.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 481.—DEFINITIONS

Section 29.481–2: Self-employment income.

INTERNAL REVENUE CODE

Computation of self-employment income and the tax applicable thereto where a Federal income tax return has been filed for a period of less than 12 months. (See Rev. Rul. 94, page 84.)

SECTION 29.481-3: Trade or business. Rev. Rul. 111

INTERNAL REVENUE CODE

Amounts paid by a paper manufacturing company to its woodsmen employees for the use of chain saws owned and operated by such employees in cutting pulpwood for the company, less their operating expenses, do not constitute "self-employment income" under section 481 of the Internal Revenue Code.

Advice is requested whether the amounts paid by a paper manufacturing company to its woodsmen employees for the use of chain saws owned and operated by such employees in cutting pulpwood for the company, less operating expenses, constitute "self-employment income" under section 481 of the Internal Revenue Code.

In the instant case a paper manufacturing company hires woodsmen to cut pulpwood and pays them at a rate per cord. Eighty percent of the amount paid is considered taxable wages for the purposes of sections 1400, 1600, and 1621 of the Internal Revenue Code with respect to the Federal employment taxes and the withholding of income tax at the source on wages, and 20 percent is considered payment for the use of the chain saws owned by the woodsmen.

Section 481(c) of the Internal Revenue Code provides in part as follows:

TRADE OR BUSINESS.—The term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 23, except that such term shall not include—

* * * * * * *

(2) The performance of service by an individual as an employee * * *;

Inasmuch as the woodsmen in the instant case perform services as employees of the company, they come within the above exclusion of section 481(c) of the Code. It is immaterial, since the furnishing of the saw is an incident of the employee-employer arrangement, that the amounts paid to them for the use of the saws do not constitute wages for purposes of the Federal employment taxes and the withholding of income tax at the source on wages.

Accordingly, it is held that amounts paid by a paper manufacturing company to its woodsmen employees for the use of chain saws owned and operated by such employees in cutting pulpwood for the company, less their operating expenses, do not constitute "self-employment income" under section 481 of the Internal Revenue Code.

SECTION 482.—MISCELLANEOUS PROVISIONS

SECTION 29.482-1: Returns.

INTERNAL REVENUE CODE

Refund of self-employment tax in accordance with section 154 of the Internal Revenue Code does not eliminate the income on which such tax is based. (See Rev. Rul. 55, page 259.)

CHAPTER 3.—ESTATE TAX

SUBCHAPTER A.—BASIC ESTATE TAX

PART II.—ESTATES OF CITIZENS OR RESIDENTS OF THE UNITED STATES

SUBPART I.—COMPUTATION OF TAX

SECTION 811(a).—GROSS ESTATE: DECEDENT'S INTEREST

SECTION 81.13, REGULATIONS 105: Property of decedent at time of death. — Rev. Rul. 65

INTERNAL REVENUE CODE

Canadian timber licenses, renewable from year to year upon payment of prescribed annual license fees and performance by the licensee of other conditions of the license, constitute personal property of a decedent rather than real property situated outside the United States for purposes of section 811 of the Internal Revenue Code and the value of such licenses, determined under the law of the United States, is includible in determining the gross estate of a decedent, a resident citizen of the United States, under the provisions of section 811(a) of the Code.

SECTION 811(c).—GROSS ESTATE: TRANSFERS IN CONTEMPLATION OF, OR TAKING EFFECT AT, DEATH

SECTION 81.15, REGULATIONS 105: Transfers during life. — T. D. 6016

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 81.—ESTATE TAX UNDER CHAPTER 3 OF THE INTERNAL REVENUE CODE, AS AMENDED

Section 81.15 of Regulations 105, to the extent that it relates to estate tax consequences of transfers of community property in the case of decedents dying after October 21, 1942, and before January 1, 1948, amended.

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

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

Section 81.15 of Regulations 105 [26 CFR, part 81], as amended by Treasury Decision 5834 [C. B. 1951-1, 72], approved March 8, 1951, is further amended by striking therefrom the second and third sentences of the second paragraph which sentences commence "The same statutory provisions" and "If in the case of a decedent", respectively.

Because the purpose of this Treasury Decision is merely to eliminate from the regulations the provisions which state that a division of community property between the decedent and his spouse may cause the value of such property to be included in the gross estate of the decedent under section 811 (*c*) or (*d*), 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 authority contained in section 3791 of the Internal Revenue Code (53 Stat. 467; 26 U. S. C. 3791).)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved May 29, 1953.

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

(Filed with the Division of the Federal Register June 3, 1953, 8:49 a. m.)

SECTION 811(d).—GROSS ESTATE: REVOCABLE TRANSFERS

Section 81.20, Regulations 105: Transfers with power to change the enjoyment.

INTERNAL REVENUE CODE

One-half the cash surrender value of an insurance policy on the life of a married man domiciled in Louisiana or Texas is includible in the wife's gross estate in the event she predeceases him. (See Rev. Rul. 48, below.)

SECTION 811(g).—GROSS ESTATE: PROCEEDS OF LIFE INSURANCE

Section 81.27, Regulations 105: Insurance receivable by other beneficiaries. (Also Section 81.20; Section 1000, Section 86.2, Regulations 108.) Rev. Rul. 48

INTERNAL REVENUE CODE

A married man domiciled in Louisiana or Texas who purchases an insurance policy on his life in favor of a beneficiary other than his estate, possesses incidents of ownership in the policy, a community asset, in his own right as to one-half of the policy proceeds and as agent of the wife as to the remaining one-half. Upon the death of the husband, one-half of the proceeds of the policy is includible in his gross estate for estate tax purposes under section 811(g)(2) of the Internal Revenue Code, and the remaining one-half of the proceeds, in which he had incidents of ownership as the agent for his wife, becomes an absolute gift by the wife for Federal gift tax purposes. In the event the wife predeceases the husband, one-half

the value of the policy is includible in her gross estate as her interest in a community asset or as a revocable transfer under section 811(d) of the Code.

Advice is requested whether a married man domiciled in Louisiana or Texas, who purchases an insurance policy on his life in favor of a beneficiary other than his estate, pays the premiums thereon with community funds and reserves the incidents of ownership in the policy, possesses incidents of ownership as agent for the community, or, possesses incidents of ownership as to the entire policy in his own right, and, if upon the death of the husband only one-half of the policy proceeds are includible in his gross estate under section 811(g)(2) of the Internal Revenue Code, a gift by the wife to a third party beneficiary of the remaining one-half of the policy proceeds becomes absolute for Federal gift tax purposes.

Under the laws of the State of Louisiana, the husband has the power of management and administration over the one-half interest in the community property which is an absolute ownership vested in the wife at the time the property is acquired. He derives his management power from article 2404 of the Louisiana Civil Code which provides as follows:

The husband is the head and master of the partnership or community of gains; he administers its effects, disposes of the revenues which they produce, and may alienate them by an onerous title, without the consent and permission of his wife.

He can make no conveyance inter vivos, by a gratuitous title, of the immovables of the community, nor of the whole, or of a quota of the movables, unless it be for the establishment of the children of the marriage. A gratuitous title within the contemplation of this article embraces all titles wherein there is no direct, material advantage to the donor.

Nevertheless he may dispose of the movable effects by a gratuitous and particular title, to the benefit of all persons.

But if it should be proved that the husband has sold the common property, or otherwise disposed of the same by fraud, to injure his wife, she may have her action against the heirs of her husband, in support of her claim in one-half of the property, on her satisfactorily proving the fraud.

The laws of the State of Texas are similar in this respect to those of Louisiana in that the wife has a vested interest in community assets and the husband has management power over such assets. His powers of management are derived from article 4619, Vernon's Revised Civil Statutes, Texas, which provides in part as follows:

SECTION 1. All property acquired by either the husband or wife during marriage, except that which is the separate property of either, shall be deemed the common property of the husband and wife; and all the effects which the husband and wife possess at the time the marriage may be dissolved shall be regarded as common effects or gains, unless the contrary be satisfactorily proved. During coverture the common property of the husband and wife may be disposed of by the husband only * * *.

In both States, a life insurance policy taken out on the life of the husband during coverture with community funds, the right to surrender the policy being retained, is a community asset in which the wife has a vested interest and the husband has power of management over her interest, and the wife's transfer of her one-half interest in the policy is not considered absolute prior to the death of the husband.

Section 811 of the Internal Revenue Code provides that the value of the gross estate of the decedent shall be determined by including the

value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside the United States. With respect to life insurance proceeds section 811(g) of the Code provides in part as follows:

> (2) RECEIVABLE BY OTHER BENEFICIARIES.—To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. * * *

Section 81.27 of Regulations 105 provides that 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 State or other applicable law upon the terms of the policy. If a 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, and, under 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, the power of surrender possessed by the decedent as agent for his wife with respect to one-half of the policy is not considered an incident of ownership, and the decedent is, therefore, deemed to possess an incident of ownership in only one-half of the policy.

It is the position of the Bureau that, under the laws of Louisiana and Texas, a gift by the wife of one-half of the policy proceeds becomes absolute, for Federal gift tax purposes, upon the death of the husband, unless he purchased the policy with intent to defraud the wife, since at that time the community is dissolved, the authority of the husband as statutory manager of the community is ended, the policy matures, and the wife's interest therein is terminated; whereas, during the existence of the marital community any revocable transfer of rights is necessarily incomplete since the husband, acting for himself and as agent of his wife, may change the beneficiary, surrender the policy for cash, or exercise other legal incidents of ownership in accordance with the terms of the policy or the laws of the State.

In view of the foregoing, it is held that a married man domiciled in Louisiana or Texas who purchases an insurance policy on his life in favor of a beneficiary other than his estate, possesses incidents of ownership in the policy, a community asset, in his own right as to one-half of the policy proceeds and as agent of the wife as to the remaining one-half. Upon the death of the husband, one-half of the proceeds of the policy is includible in his gross estate for estate tax purposes under section 811(g)(2) of the Internal Revenue Code, and the remaining one-half of the proceeds, in which he had incidents of ownership as the agent for his wife, becomes an absolute gift by the wife for Federal gift tax purposes. In the event the wife predeceases the husband, one-half the cash surrender value of the policy is includible in her gross estate as her interest in a community asset or as a revocable transfer under section 811(d) of the Code.

SECTION 812(e).—NET ESTATE: BEQUESTS, ETC., TO SURVIVING SPOUSE

SECTION 81.47(a), REGULATIONS 105: Bequests, etc., to surviving spouse. Rev. Rul. 83

INTERNAL REVENUE CODE

The interest in an estate which passes to a surviving spouse pursuant to State law in the form of an allowance for support during the period of settlement of the deceased spouse's estate must constitute a vested right of property in order to qualify under section 812(e)(1)(A) of the Internal Revenue Code for the estate tax marital deduction.

Advice is requested whether amounts allowed and paid pursuant to State law for the support of a surviving spouse during the period of settlement of the estate of the deceased spouse qualifies as a marital deduction for estate tax purposes under section 812(e)(1)(A) of the Internal Revenue Code.

Under the general rule of subparagraph (A) of section 812(e)(1) of the Code, the marital deduction will be allowed with respect to any interest in property included in the gross estate which passes from a decedent to his surviving spouse as absolute owner. In order to qualify under this subparagraph, any right of a widow to an allowance in her husband's estate must be a vested right of property which is not terminated by her death or other contingency. Therefore, if a widow's allowance for the full period of settlement of the estate is such that the allowance, or any unpaid balance thereof, will survive as an asset of her estate in case she dies at any time following the decedent's death, the interest thus taken by the widow would clearly constitute a deductible interest under section 812(e)(1)(A) of the Code. Whether any interest thus taken by a widow satisfies the statutory requirements in this respect is to be determined in the light of the applicable provisions of the State statutes, as interpreted by the local courts.

There are cases, however, where it appears that the provisions of State statutes providing for allowances for support during the period of settlement of an estate do not confer upon the surviving spouse of a decedent any vested indefeasible right of property which would constitute a deductible interest under section 812(e) of the Code. In many States local courts have held that such allowances, or any rights thereto, terminate *ipso facto* upon remarriage and that death also terminates any rights to subsequent allowances. Under such circumstances, the interests passing to the surviving spouses of decedents in the forms of allowances made for their support, pursuant to local law, amount to no more than annuities payable out of the assets of the estates during the periods of settlement or until prior death or remarriage of the surviving spouses and, as such, constitute terminable interests within the meaning of section 812(e)(1)(B) of the Code, no portion of the values of which qualify for the marital deduction.

In view of the foregoing, it is held that the interest in an estate which passes to a surviving spouse pursuant to State law in the form of an allowance for support during the period of settlement of the deceased spouse's estate must constitute a vested right of property such as will, in the event of her death as of any moment or time following

the decedent's death, survive as an asset of her estate, in order to qualify under section 812(e)(1)(A) of the Internal Revenue Code for the estate tax marital deduction.

SUBPART II.—RETURNS AND PAYMENT OF TAX

SECTION 821.—RETURNS

SECTION 81.65, REGULATIONS 105: Preparation of return. (Also Section 81.66.) — Rev. Rul. 49

INTERNAL REVENUE CODE

Bureau regulations, promulgated pursuant to section 821 of the Internal Revenue Code, provide for the filing of supplemental documents with the filing, in duplicate, of a Federal estate tax return, Form 706. These regulations provide that supplemental documents, other than a will where a decedent dies testate, may be filed in duplicate where an executor desires to submit such documents with the return in explanation thereof. However, there is no specific requirement in the regulations for the filing of duplicate copies of Life Insurance Statement, Form 712. *Held*, the Bureau will impose no requirement that Form 712 be filed in duplicate.

CHAPTER 4.—GIFT TAX

SECTION 1000.—IMPOSITION OF TAX

SECTION 86.2, REGULATIONS 108: Transfers reached.

INTERNAL REVENUE CODE

A gift by the wife of one-half the proceeds of an insurance policy on the life of the husband becomes absolute in Louisiana and Texas upon the death of the husband. (See Rev. Rul. 48, page 392.)

SECTION 86.2(c), REGULATIONS 108: Transfers of community property after 1942 and on or before April 2, 1948. — T. D. 6015

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 86.—GIFT TAX UNDER CHAPTER 4 OF THE INTERNAL REVENUE CODE, AS AMENDED

Section 86.2(c) of Regulations 108 relating to gift tax consequences of transfers of community property after 1942 and on or before April 2, 1948, amended.

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

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

Section 86.2(*c*) of Regulations 108 [26 CFR, part 86], as amended by Treasury Decision 5698 [C. B. 1949-1, 226], approved May 13, 1949, is further amended as follows:

(A) By adding at the end of the first paragraph thereof the following:

No gift tax results from a transfer after December 31, 1942, and on or before April 2, 1948, of separate property of either spouse into community property.

(B) By striking therefrom the second paragraph thereof.

Because the purpose of this Treasury Decision is merely to eliminate from the regulations the provisions which state that a division of community property after 1942 and on or before April 2, 1948, constitutes a gift, 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 authority contained in section 1029 of the Internal Revenue Code (53 Stat. 157; 26 U. S. C. 1029).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved May 29, 1953.

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

(Filed with the Division of the Federal Register June 3, 1953, 8:49 a. m.)

SECTION 1004.—DEDUCTIONS

SECTION 86.13, REGULATIONS 108: Charitable etc., gifts. (Also Section 86.14.) T. D. 5964

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 certain provisions of parts I, II, and III of title III of the Revenue Act of 1950.

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

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

On October 9, 1952, notice of proposed rule making regarding certain gift tax provisions of the Revenue Act of 1950, approved September 23, 1950, was published in the Federal Register (17 F. R. 9017).

No objections to such rules having been received, the amendments set forth below necessary to conform Regulations 108 to such provisions are hereby adopted:

PARAGRAPH 1. There is inserted immediately preceding section 86.12 [26 CFR 86.12] the following:

SEC. 302. EXEMPTION OF CERTAIN ORGANIZATIONS FOR PAST YEARS [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

(a) TRADE OR BUSINESS NOT UNRELATED.—For any taxable year beginning prior to January 1, 1951, no organization shall be denied exemption under paragraph (1), (6), or (7) of section 101 of the Internal Revenue Code on the grounds that it is carrying on a trade or business for profit if the income from such trade or business would not be taxable as unrelated business income under the provisions of Supplement U of the Internal Revenue Code, as amended by this Act, or if such trade or business is the rental by such organization of its real property (including personal property leased with the real property).

(b) PERIOD OF LIMITATIONS.—In the case of an organization which would otherwise be exempt under section 101 of the Internal Revenue Code were it not carrying on a trade or business for profit, the filing of the information return required by section 54(f) of the Internal Revenue Code (relating to returns by tax-exempt organizations) for any taxable year beginning prior to January 1, 1951, shall be deemed to be the filing of a return for the purposes of section 275 of the Internal Revenue Code (relating to period of limitation upon assessment and collection). In the case of such an organization which was, by the provisions of section 54(f) of the Internal Revenue Code, specifically not required to file such information return, for the purposes of the preceding sentence a return shall be deemed to have been filed at the time when such return should have been filed had it been so required. The provisions of this subsection shall not apply to a taxable year of such an organization with respect to which, prior to September 20, 1950, (1) any amount of tax was assessed or paid, or (2) a notice of deficiency under section 272 of the Internal Revenue Code was sent to the taxpayer.

(c) DENIAL OF DEDUCTIONS.—A gift or bequest to an organization prior to January 1, 1951, for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals) otherwise allowable as a deduction under section * * * 1004(a)(2)(B), or 1004(b) (2) or (3) of the Internal Revenue Code, may not be denied under such sections if a denial of exemption to such organization for the taxable year of the organization in which such gift or bequest was made is prevented by the provisions of subsections (a) or (b) of this section.

SEC. 162. NET INCOME [INTERNAL REVENUE CODE AS AMENDED BY SECTION 321, REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) Subject to the provisions of subsection (g), there shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. Where any amount of the

income so paid or set aside is attributable to gain from the sale or exchange of capital assets held for more than six months, proper adjustment of the deduction otherwise allowable under this subsection shall be made for any deduction allowable to the trust under section 23(ee);

* * * * * * *

(g) RULES FOR APPLICATION OF SUBSECTION (a) IN THE CASE OF TRUSTS.—

* * * * * * *

(2) OPERATIONS OF TRUSTS.—

(A) Limitation on Charitable, Etc., Deduction.—The amount otherwise allowable under subsection (a) as a deduction shall not exceed 15 per centum of the net income of the trust (computed without the benefit of subsection (a)) if the trust has engaged in a prohibited transaction, as defined in subparagraph (B) of this paragraph.

(B) Prohibited Transactions.—For the purposes of this paragraph the term "prohibited transaction" means any transaction after July 1, 1950, in which any trust while holding income or corpus which has been permanently set aside or is to be used exclusively for charitable or other purposes described in subsection (a)—

(i) lends any part of such income or corpus, without receipt of adequate security and a reasonable rate of interest, to;

(ii) pays any compensation from such income or corpus, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

(iii) makes any part of its services available on a preferential basis to;

(iv) uses such income or corpus to make any substantial purchase of securities or any other property, for more than an adequate consideration in money or money's worth, from;

(v) sells any substantial part of the securities or other property comprising such income or corpus, for less than an adequate consideration in money or money's worth, to; or

(vi) engages in any other transaction which results in a substantial diversion of such income or corpus to;

the creator of such trust; any person who has made a substantial contribution to such trust; a member of the family (as defined in section 24(b)(2)(D)) of an individual who is the creator of the trust or who has made a substantial contribution to the trust; or a corporation controlled by any such creator or person through the ownership, directly or indirectly, of 50 per centum or more of the total combined voting power of all classes of stock entitled to vote or 50 per centum or more of the total value of shares of all classes of stock of the corporation.

(C) Taxable Years Affected.—The amount otherwise allowable under subsection (a) as a deduction shall be limited as provided in subparagraph (A) only for taxable years subsequent to the taxable year during which the trust is notified by the Secretary that it has engaged in such transaction, unless such trust entered into such prohibited transaction with the purpose of diverting such corpus or income from the purposes described in subsection (a), and such transaction involved a substantial part of such corpus or income.

(D) Future Charitable, Etc., Deductions of Trusts Denied Deduction Under Subparagraph (C).—If the deduction of any trust under subsection (a) has been limited as provided in

this paragraph, such trust, with respect to any taxable year following the taxable year in which notice is received of limitation of deduction under subsection (a), may, under regulations prescribed by the Secretary, file claim for the allowance of the unlimited deduction under subsection (a), and if the Secretary, pursuant to such regulations, is satisfied that such trust will not knowingly again engage in a prohibited transaction, the limitation provided in subparagraph (A) shall not be applicable with respect to taxable years subsequent to the year in which such claim is filed.

(E) Disallowance of Certain Charitable, Etc., Deductions.—No gift or bequest for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), otherwise allowable as a deduction under section * * * 1004(a)(2)(B), or 1004(b)(2) or (3), shall be allowed as a deduction if made in trust and, in the taxable year of the trust in which the gift or bequest is made, the deduction allowed the trust under subsection (a) is limited by subparagraph (A). With respect to any taxable year of a trust in which such deduction has been so limited by reason of entering into a prohibited transaction with the purpose of diverting such corpus or income from the purposes described in subsection (a), and such transaction involved a substantial part of such income or corpus and which taxable year is the same, or prior to the, taxable year of the trust in which such prohibited transaction occurred, such deduction shall be disallowed the donor only if such donor or (if such donor is an individual) any member of his family (as defined in section 24(b)(2)(D)) was a party to such prohibited transaction.

(F) Definition.—For the purposes of this paragraph the term "gift or bequest" means any gift, contribution, bequest, devise, legacy, or transfer.

(3) CROSS REFERENCE.—For disallowance of certain charitable, etc., deductions otherwise allowable under subsection (a), see section 3813.

* * * * * * *

SEC. 322. EFFECTIVE DATE OF PART II [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

The amendments made by this part [section 321, inserting subsection (g) in section 162 of the Internal Revenue Code] shall be applicable only with respect to taxable years beginning after December 31, 1950, except that subsection (g)(2)(E) of section 162 of the Internal Revenue Code, added by section 321(a) of this Act, shall apply only with respect to gifts or bequests (as defined in section 162(g)(2)(F) of the Internal Revenue Code) made on or after January 1, 1951.

* * * * * * *

SEC. 331. EXEMPTION OF CERTAIN ORGANIZATIONS UNDER SECTION 101(6) AND DEDUCTIBILITY OF CONTRIBUTIONS MADE TO SUCH ORGANIZATIONS [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

Chapter 38 is hereby amended by inserting at the end thereof the following new sections:

"SEC. 3813. REQUIREMENTS FOR EXEMPTION OF CERTAIN ORGANIZATIONS UNDER SECTION 101(6) AND FOR DEDUCTIBILITY OF CONTRIBUTIONS MADE TO SUCH ORGANIZATIONS.

"(a) ORGANIZATIONS TO WHICH SECTION APPLIES.—This section shall apply to any organization described in section 101(6) except—

"(1) a religious organization (other than a trust);

"(2) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;

"(3) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101(6)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public;

"(4) an organization which is operated, supervised, controlled, or principally supported by a religious organization (other than a trust) which is itself not subject to the provisions of this section; and

"(5) an organization the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research.

"(b) PROHIBITED TRANSACTIONS.—For the purposes of this section, the term 'prohibited transaction' means any transaction in which an organization subject to the provisions of this section—

"(1) lends any part of its income or corpus without the receipt of adequate security and a reasonable rate of interest, to;

"(2) pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

"(3) makes any part of its services available on a preferential basis to;

"(4) makes any substantial purchase of securities or any other property, for more than adequate consideration in money or money's worth, from;

"(5) sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or

"(6) engages in any other transaction which results in a substantial diversion of its income or corpus to;

the creator of such organization (if a trust); a person who has made a substantial contribution to such organization; a member of the family (as defined in section 24(b)(2)(D)) of an individual who is the creator of such trust or who has made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 per centum or more of the total combined voting power of all classes of stock entitled to vote or 50 per centum or more of the total value of shares of all classes of stock of the corporation.

"(c) DENIAL OF EXEMPTION TO ORGANIZATIONS ENGAGED IN PROHIBITED TRANSACTIONS.—

"(1) GENERAL RULE.—No organization subject to the provisions of this section which has engaged in a prohibited transaction after July 1, 1950, shall be exempt from taxation under section 101(6).

"(2) TAXABLE YEARS AFFECTED.—An organization shall be denied exemption from taxation under section 101(6) by reason of paragraph (1) only for taxable years subsequent to the taxable year during which it is notified by the Secretary that it has engaged in a prohibited transaction, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.

"(d) FUTURE STATUS OF ORGANIZATION DENIED EXEMPTION.—Any organization denied exemption under section 101(6) by reason of the provisions of subsection (c), with respect to any taxable year following the taxable year in which notice of denial of exemption was received, may, under regulations prescribed by the Secretary, file claim for

exemption, and if the Secretary, pursuant to such regulations, is satisfied that such organization will not knowingly again engage in a prohibited transaction, such organization shall be exempt with respect to taxable years subsequent to the year in which such claim is filed.

"(e) DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS.—No gift or bequest for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), otherwise allowable as a deduction under section * * * 1004(a)(2)(B), or 1004(b)(2) or (3), shall be allowed as a deduction if made to an organization which, in the taxable year of the organization in which the gift or bequest is made, is not exempt under section 101(6) by reason of the provisions of this section. With respect to any taxable year of the organization for which the organization is not exempt pursuant to the provisions of subsection (c) by reason of having engaged in a prohibited transaction with the purpose of diverting the corpus or income of such organization from its exempt purposes and such transaction involved a substantial part of such corpus or income, and which taxable year is the same, or prior to the, taxable year of the organization in which such transaction occurred, such deduction shall be disallowed the donor only if such donor or (if such donor is an individual) any member of his family (as defined in section 24(b)(2)(D)) was a party to such prohibited transaction.

"(f) DEFINITION.—For the purposes of this section, the term 'gift or bequest' means any gift, contribution, bequest, devise, legacy, or transfer.

* * * * * * *

SEC. 332. TECHNICAL AMENDMENTS [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

* * * * * * *

(g) AMENDMENT OF SECTION 1004(a).—Section 1004(a)(2)(B) is hereby amended by striking out "legislation;" and inserting in lieu thereof the following: "legislation. For disallowance of certain charitable, etc., deductions otherwise allowable under this subparagraph, see sections 3813 and 162(g)(2);".

(h) AMENDMENT OF SECTION 1004(b).—Section 1004(b) is hereby amended by adding at the end thereof the following new paragraph:

"For disallowance of certain charitable, etc., deductions otherwise allowable under paragraphs (2) and (3), see sections 3813 and 162(g)(2)."

SEC. 333. EFFECTIVE DATES [REVENUE ACT OF 1950, APPROVED SEPTEMBER 23, 1950].

Subsections (c) and (d) of section 3813 * * * of the Internal Revenue Code, added by section 331 of this Act, shall apply with respect to taxable years beginning after December 31, 1950, and subsection (e) of section 3813 of the Internal Revenue Code shall apply only with respect to gifts or bequests (as defined in section 3813 of the Internal Revenue Code) made on or after January 1, 1951.

PAR. 2. Section 86.13, as amended by Treasury Decision 5902 [C. B. 1952–1, 167], approved May 27, 1952 [26 CFR 86.13], is further amended as follows:

(A) By changing the heading thereof to read as follows: "CHARITABLE, ETC., GIFTS.—(*a*) *In general.*";

(B) By inserting immediately following the period at the end of paragraph (*a*) the following: "For disallowance of certain charitable gifts otherwise allowable as deductions hereunder see paragraph (*b*) of this section."; and

(C) By adding immediately succeeding paragraph (*a*) the following new paragraph:

(*b*) *Disallowance of certain charitable, etc., deductions.*—No deduction with respect to a gift made on or after January 1, 1951, to any trust or organization

described in (B) of paragraph (*a*) of this section which would otherwise be allowable under such paragraph shall be allowed if (1) the gift is made in trust and, for income tax purposes for the taxable year of the trust in which the gift is made, the deduction otherwise allowable to such trust under section 162(a) is limited by section 162(g)(2)(A) by reason of the trust having engaged in a prohibited transaction described in section 162(g)(2)(B); or (2) the gift is made to any such organization subject to section 3813 which, for its taxable year in which the gift is made, is not exempt from income tax under section 101(6) by reason of having engaged in a prohibited transaction described in section 3813(b).

For the purpose of section 162(g)(2)(E) and section 3813(e), the term "gift" includes any gift, contribution, or other disposition.

Regulations 111, relating to the income tax, contain the rules for the determination of the taxable year of the trust for which the deduction under section 162(a) is limited by section 162(g)(2) and for the determination of the taxable year of the organization for which an exemption is denied under section 3813(c). See sections 29.162-3(b) and 29.3813-1 of Regulations 111. Such taxable year must begin after December 31, 1950. Generally, such taxable year is a taxable year subsequent to the taxable year during which the trust or organization has been notified by the Commissioner that it has engaged in a prohibited transaction. However, if the trust or organization after December 31, 1950, and during or prior to the taxable year entered into the prohibited transaction for the purpose of diverting its corpus or income from the purposes described in section 162(a) or from its exempt purposes, as the case may be, and such transaction involves a substantial part of such income or corpus, then the deduction of the trust under section 162(a) for such taxable year is limited by section 162(g)(2), or the exemption of the organization for such taxable year is denied under section 3813(c), whether or not the organization has previously received notification by the Commissioner that it is engaged in a prohibited transaction. In certain cases, the limitation of section 162(g) may be removed or the exemption may be reinstated for certain subsequent taxable years under the rules set forth in sections 29.162-3(b) and 29.3813-2 of Regulations 111.

In cases in which prior notification by the Commissioner is not required in order to limit the deduction of the trust under section 162(g)(2) or to deny exemption of the organization under section 3813, the deduction otherwise allowable under paragraph (*a*) of this section shall not be disallowed in respect to gifts made during the same taxable year of the trust or organization in which such prohibited transaction occurred or in a prior taxable year unless the donor or a member of his family was a party to the prohibited transaction. For the purpose of the preceding sentence, the members of the donor's family include only his brothers and sisters, whether by whole or half blood, spouse, ancestors, and lineal descendants.

PAR. 3. Section 86.14 [26 CFR 86.14] is amended by adding at the end thereof the following:

For further limitations in the case of gifts made on or after January 1, 1951, see section 86.13(*b*), relating to gifts to certain trusts and organizations engaged in a prohibited transaction described in sections 162(g)(2)(B) or 3813(b).

(This Treasury Decision is issued under the authority contained in sections 1029 and 3791 of the Internal Revenue Code (53 Stat. 157, 467; 26 U. S. C. 1029, 3791).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 16, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 19, 1952, 8:58 a. m.)

CHAPTER 9.—EMPLOYMENT TAXES

SUBCHAPTER A.—EMPLOYMENT BY OTHERS THAN CARRIERS

PART III.—GENERAL PROVISIONS

SECTION 1426.—DEFINITIONS

SECTION 408.204, REGULATIONS 128: Who are employees.

INTERNAL REVENUE CODE

Services performed by physicians for a company as part-time services. S. S. T. 291 revoked. (See Rev. Rul. 84, below.)

SUBCHAPTER C.—TAX ON EMPLOYERS OF EIGHT OR MORE

SECTION 1607.—DEFINITIONS

SECTION 403.204, REGULATIONS 107: Who are employees. Rev. Rul. 84

(Also Section 1426, Section 408.204, Regulations 128.)

INTERNAL REVENUE CODE

A physician engaged in the private practice of medicine who in connection therewith examines and treats company employees as a part-time service for the company, is not an employee of the company within the meaning of sections 1426(d) and 1607(i) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively.

S. S. T. 291, C. B. 1938-1, 416, revoked.

Reconsideration has been given to S. S. T. 291, C. B. 1938-1, 416, in the light of the decision in *Willard Storage Battery Co.* v. *Carey*, 103 Fed. Supp. 7.

In S. S. T. 291, *supra*, it is held that a physician engaged by the O Company, who is required to report each morning at a fixed hour, to remain on duty as long as his services are needed, and who, in addition to treating employees of the company, is required to examine all individuals applying for work, is an employee of the O Company within the applicable provisions of titles VIII and IX of the Social Security Act, 49 Stat. 639, approved August 14, 1935.

In the Willard Storage Battery Co. case, the contracts between the physicians and the company indicated that direct control and supervision was not contemplated by the company as to the details and means by which the physicians accomplished their work. The evidence shows that the physicians performed only part-time service for the company and that they maintained private practices to which most of their time was devoted. The physicians were free to leave the company's premises during working hours if an emergency case in their private practice required their presence. The court held that the physicians were not employees of the company within the meaning of

the Social Security Act. In view of the facts found by the court and supported by the evidence, it was decided that no appeal would be taken in that case.

Titles VIII and IX of the Social Security Act were incorporated in the Internal Revenue Code, effective April 1, 1939, and subsequent to that date are cited as the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively. Inasmuch as the facts and circumstances set forth in S. S. T. 291, C. B. 1938-1, 416, do not differ materially from those in the Willard Storage Battery Co. case, S. S. T. 291, *supra*, is hereby revoked. It is the position of the Bureau that, generally, a physician engaged in the private practice of medicine who in connection therewith examines and treats company employees as a part-time service for the company, is not an employee of the company within the meaning of sections 1426(d) and 1607(i) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively. However, there may be compelling factual reasons for an inference of direct control and supervision upon which an employer-employee classification may be based, thereby distinguishing such cases from the Willard Storage Battery Co. case.

SUBCHAPTER D.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 1621.—DEFINITIONS

SECTION 405.102, REGULATIONS 116: Exclusions from wages.

INTERNAL REVENUE CODE

Withholding of income tax at source on compensation received by United States citizens for services performed on Guam. (See Rev. Rul. 8, page 300.)

CHAPTER 9A.—WAR TAXES AND WAR TAX RATES

SECTION 1650.—WAR TAX RATES OF CERTAIN MISCELLANEOUS TAXES

SECTION 130.0, REGULATIONS 42 (1942): Scope of Regulations. T. D. 5994

(Also Sections 130.30, 130.33; Section 3466, Sections 130.44, 130.46, 130.47; Section 3469, Sections 130.51, 130.53, 130.54, 130.60(a), 130.64, Regulations 42 (1942).)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 130.—TAXES ON SAFE DEPOSIT BOXES AND ON CERTAIN TRANSPORTATION AND COMMUNICATIONS SERVICES

Regulations 42 (1942 edition) amended to conform to the Revenue Act of 1951.

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

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

On October 29, 1952, notice of proposed rule making was published in the Federal Register [17 F. R. 9747], in order to conform Regulations 42 (1942 edition) [26 CFR, part 130] to sections 491, 492, 493, and 494 of the Revenue Act of 1951 (Public Law 183, 82d Cong., 1st sess.), approved October 20, 1951. After consideration of all relevant matter presented by interested persons regarding the rules proposed, the amendments to Regulations 42 (1942 edition) set forth below are hereby adopted.

PARAGRAPH 1. The first paragraph of section 130.0, as amended by Treasury Decision 5559 [C. B. 1947-1, 160], approved April 18, 1947 [26 CFR 130.0], is further amended as follows:

(A) By striking in paragraph (*c*) the words "and sections 2, 3, and 4 of the Excise Tax Act of 1947," and inserting in lieu thereof the following: ", sections 2, 3, and 4 of the Excise Tax Act of 1947, and sections 491 and 492 of the Revenue Act of 1951,".

(B) By striking in paragraph (*d*) the words "and sections 2, 3, and 4 of the Excise Tax Act of 1947," and inserting in lieu thereof the following: ", sections 2, 3, and 4 of the Excise Tax Act of 1947, section 607 of the Revenue Act of 1950, and sections 493 and 494 of the Revenue Act of 1951,".

PAR. 2. Immediately preceding section 130.30 [26 CFR 130.30], there is inserted the following:

SEC. 491. REDUCTION OF TAX ON TELEGRAPH DISPATCHES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) REDUCTION OF TAX.—The table contained in section 1650 (relating to the war tax rates of certain miscellaneous taxes) is hereby amended by striking out the following:

3465(a)(1)(B) (insofar as it relates to domestic telegraph, cable, and radio dispatches).	Domestic telegraph, cable, or radio dispatches.	15 per centum.	25 per centum.

(b) EFFECTIVE DATE.—Subject to the provisions of subsection (c), the amendments made by this section shall apply with respect to amounts paid on or after the rate reduction date (as defined in subsection (d)) for services rendered on or after such date.

(c) AMOUNTS PAID PURSUANT TO BILLS RENDERED.—The amendments made by this section shall not apply with respect to amounts paid pursuant to bills rendered prior to the rate reduction date. In the case of amounts paid pursuant to bills rendered on or after the rate reduction date for services for which no previous bill was rendered, the amendments made by this section shall apply except with respect to such services as were rendered more than 2 months before such date. In the case of services rendered more than 2 months before such date the provisions of sections 1650 and 3465 of the Internal Revenue Code in effect at the time such services were rendered shall be applicable to the amounts paid for such services.

(d) RATE REDUCTION DATE.—For the purposes of this section the term "rate reduction date" means the first day of the first month which begins more than 10 days after the date of the enactment of this Act.

PAR. 3. The second paragraph of section 130.30, as amended by Treasury Decision 5559 [26 CFR 130.30], is further amended by adding at the end thereof the following new sentences:

The provisions of section 1650 were further amended by section 491 of the Revenue Act of 1951, effective November 1, 1951, and as so amended, the rate of tax on amounts paid on and after that date for domestic services specified in section 3465(a)(1)(B) rendered on and after that date was reduced. The amendments as it relates to this tax applies to amounts paid pursuant to bills rendered on and after November 1, 1951, for services furnished on or after September 1, 1951, for which no previous bill was rendered.

PAR. 4. Section 130.33, as amended by Treasury Decision 5559 [26 CFR 130.33], is further amended by revising the first paragraph of (*b*) thereof to read as follows:

(*b*) *Telegraph, cable, and radio dispatches and messages.*—(1) *International messages.*—The amount paid for each international telegraph, cable, or radio dispatch or message is subject to tax at the rate of 10 percent.

(2) *Domestic messages.*—The amount paid for each domestic telegraph, cable, or radio dispatch or message is subject to tax at the specified rates for the following periods:

(i) On and after November 1, 1951, 15 percent;
(ii) April 1, 1944 through October 31, 1951, 25 percent;
(iii) November 1, 1942 through March 31, 1944, 15 percent;
(iv) Prior to November 1, 1942, 10 percent.

PAR. 5. Immediately preceding section 130.44 [26 CFR 130.44], there is inserted the following:

SEC. 492. EXEMPTION OF CERTAIN OVERSEAS TELEPHONE CALLS FROM THE TAX ON TELEPHONE FACILITIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) TELEPHONE CALLS FROM MEMBERS OF ARMED FORCES IN COMBAT ZONES.—Section 3466 is amended by redesignating subsection (c) thereof as subsection "(d)" and by inserting after subsection (b) the following new subsection:

"(c) No tax shall be imposed under section 3465(a)(1)(A) upon any payment received for any telephone or radio telephone message which originates within a combat zone, as defined in section 22(b)(13), from a member of the Armed Forces of the United States performing service in such combat zone, as determined under such section, provided a certificate, setting forth such facts as the Secretary may by regulations prescribe, is furnished to the person receiving such payment."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of enactment of this Act for telephone or radio telephone messages made on or after such date.

PAR. 6. Section 130.44, as amended by Treasury Decision 5521 [C. B. 1946–2, 171], approved June 14, 1946 [26 CFR 130.44], is further amended by striking "(see also section 130.46)" in the second sentence of the fifth paragraph, and by inserting in lieu thereof "(see also section 130.47)".

PAR. 7. Section 130.46 [26 CFR 130.46] is renumbered section 130.47 and a new section 130.46 is inserted to read as follows:

SEC. 130.46. TELEPHONE CALLS FROM MEMBERS OF ARMED FORCES IN COMBAT ZONES.—The exemption provided by section 3466(c) is applicable to any payment received on or after November 1, 1951, for any telephone or radio telephone message or call which orginates, on or after such date, within a combat zone as defined in section 22(b)(13), from a member of the Armed Forces of the United States performing service in such combat zone, if a properly executed certificate of exemption substantially in the form shown below is furnished the person receiving such payment. (See also section 130.47.)

Service is performed in a combat zone only if it is performed in an area which the President of the United States has designated by Executive order, for the purpose of section 22(b)(13), as an area in which Armed Forces of the United States are or have (after June 24, 1950) engaged in combat, and only if it is performed on or after the date designated by the President by Executive order

as the date of the commencing of combatant activities in such zone and on or before the date designated by the President by Executive order as the date of the termination of combatant activities in such zone.

EXEMPTION CERTIFICATE

(Overseas telephone calls)

_____, 19____.
(Date)

I certify that the toll charges of $_____ are for telephone or radio telephone messages originating at _____ within a combat
(Point of origin)
zone from _____ a member of the Armed Forces of the
(Name)
United States performing service in such combat zone, that the transmission facilities were furnished by _____; that the charges are exempt
(Name of carrier)
from tax under section 3466(c) of the Internal Revenue Code.

_____
(Signature of subscriber)

_____
(Address)

NOTE.—Penalty for fraudulent use, $10,000 or imprisonment or both. (See section 1718 of the Internal Revenue Code.)

PAR. 8. There is inserted immediately preceding section 130.50 [26 CFR 130.50] the following:

SEC. 493. EXEMPTION OF FISHING TRIPS FROM TAX ON TRANSPORTATION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) EXEMPTION.—Section 3469(b) (relating to exemption of certain trips from the tax of transportation of persons) is hereby amended by striking out "or to amounts" and inserting in lieu thereof "to amounts", and by inserting after the words "one month or less" the following ", or to amounts paid for transportation by boat for the purpose of fishing from such boat".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act for transportation on or after such first day.

PAR. 9. Section 130.51, as amended by Treasury Decision 5929 [C. B. 1952–2, 261], approved September 2, 1952 [26 CFR 130.51], is further amended by revising the second sentence of the eighth paragraph thereof to read as follows:

For other payments not subject to tax, see sections 130.54 and 130.60 to 130.64.

PAR. 10. Section 130.53, as amended by Treasury Decision 5929 [26 CFR 130.53], is further amended by adding at the end of the first paragraph of (i) thereof the following:

(For information with respect to the exemption of amounts paid on or after November 1, 1951, for transportation, on or after that date, of persons on boats chartered for fishing purposes, see section 130.60a.)

PAR. 11. Section 130.54, as amended by Treasury Decision 5929 [26 CFR 130.54], is further amended by deleting the words "see sections 130.60 to 130.63" appearing in the first sentence thereof and inserting in lieu thereof the words "see sections 130.60 to 130.64".

PAR. 12. Immediately preceding section 130.59 [26 CFR 130.59] there is inserted the following:

SEC. 493. EXEMPTION OF FISHING TRIPS FROM TAX ON TRANSPORTATION [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) EXEMPTION.—Section 3469(b) (relating to exemption of certain trips from the tax of transportation of persons) is hereby amended by striking out "or to amounts" and inserting in lieu thereof "to amounts", and by inserting after the words "one month or less" the following ", or to amounts paid for transportation by boat for the purpose of fishing from such boat".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act for transportation on or after such first day.

PAR. 13. Immediately following section 130.60 [26 CFR 130.60], there is inserted the following:

SEC. 130.60a. FISHING TRIPS.—No tax is imposed upon an amount paid on or after November 1, 1951, for transportation by boat, on or after that date, where the transportation is for the purpose of fishing from such boat.

PAR. 14. Immediately preceding section 130.64 [26 CFR 130.64], there is inserted the following:

SEC. 494. TAX ON TRANSPORTATION OF PERSONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) EXEMPTION OF CERTAIN FOREIGN TRAVEL.—Section 3469(a) of the Internal Revenue Code (relating to tax on transportation of persons) is hereby amended by striking out the third sentence and inserting in lieu of such sentence the following: "In the case of transportation by water on a vessel which makes one or more intermediate stops at ports within the United States, Canada, or Mexico on a voyage which begins or ends in the United States and ends or begins outside the northern portion of the Western Hemisphere, no part of such transportation shall be considered for the purposes of the preceding sentence to be from any port within the United States, Canada, or Mexico to any other such port if the vessel in stopping at any such intermediate port is not authorized both to discharge and to take on passengers. A port or station within Newfoundland shall not, for the purposes of the preceding two sentences, be considered as a port or station within Canada."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than ten days after the date of the enactment of this Act for transportation on or after such first day.

PAR. 15. Section 130.64, as amended by Treasury Decision 5929 [26 CFR 130.64], is further amended as follows:

(A) By striking the third sentence in the first paragraph thereof.

(B) By inserting immediately following the first paragraph the the following new paragraphs:

The tax does not attach to any part of a payment made on or after November 1, 1951, for transportation by water, on or after that date, on a vessel which makes one or more intermediate stops at ports within the United States, Canada, or Mexico, on a voyage between the United States and a port outside the northern portion of the Western Hemisphere, provided the vessel in stopping at any such intermediate port is not authorized both to discharge and to take on passengers.

In any case where the vessel in stopping at any such intermediate port is authorized or is permitted both to discharge and to take on passengers, the rules set forth in the first paragraph of this section apply. A vessel is authorized both to discharge and to take on passengers at the intermediate port unless there is a legal or other authoritative prohibition of such traffic. For the purposes of the preceding sentence, an order issued by the owner or operator of a vessel prohibiting such vessel from either discharging or taking on passengers at the intermediate port is not a legal or other authoritative prohibition of such traffic.

A port or station within Newfoundland shall not, for the purposes of the preceding paragraphs, be considered as a port or station within Canada.

(C) By inserting immediately following example 6 thereof two new examples as follows:

Example 7. H purchases a steamship ticket in New York City for transportation from New York City to Southampton, England. The vessel on which H sails makes an intermediate stop during the course of such voyage at Boston, Mass., to take on passengers. The vessel is not, however, authorized to discharge passengers at such port. No tax applies to the portion of the transportation between New York City and Boston, since H's voyage involved transportation between a port within the United States and a port outside the northern portion of the Western Hemisphere and the vessel on which H traveled was not authorized both to discharge and to take on passengers at the intermediate port at which it stopped.

Example 8. I purchases a steamship ticket in San Francisco for a voyage from San Francisco to Manila. The vessel on which he travels makes a stop at Honolulu to discharge passengers. The vessel is, however, permitted also to take on passengers at Honolulu. The tax applies to that portion of the transportation between San Francisco and Honolulu, since the vessel on which I traveled was permitted to both discharge and to take on passengers at Honolulu, the intermediate port at which it stopped.

(This Treasury Decision is issued pursuant to the authority contained in sections 3472 and 3791 of the Internal Revenue Code (53 Stat. 423, 467, 55 Stat. 722; 26 U. S. C. 3472, 3791).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved February 24, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 27, 1953, 8:50 a. m.)

SECTION 1651.—RETAILERS' EXCISE TAX ON LUGGAGE, ETC.

SECTION 320.60, REGULATIONS 51: Scope of tax. Rev. Rul. 85

INTERNAL REVENUE CODE

A completely insulated bag, which has no outside pockets to indicate it could be used as a purse, handbag, or other receptacle named in section 1651 of the Internal Revenue Code, and which is so constructed as to indicate that it is intended solely for use in carrying or keeping food or liquids hot or cold, is not subject to tax on luggage, etc. However, where such a bag is advertised or recommended for use in carrying articles of wearing apparel, or for use as any other receptacle named in section 1651 of the Code, as well as for use in carrying or keeping food or liquids hot or cold, it is subject to such tax when sold at retail.

SECTION 320.60, REGULATIONS 51: Scope of tax.

INTERNAL REVENUE CODE

Application of tax to saddle bags. (See Rev. Rul. 59, page 464.)

CHAPTER 10.—ADMISSIONS AND DUES

SUBCHAPTER A.—ADMISSIONS

SECTION 1700.—TAX

SECTION 101.2, REGULATIONS 43: Meaning of "admission." Rev. Rul. 112

INTERNAL REVENUE CODE

A "donation" made in lieu of a payment of a fixed charge for admission to a motion picture theater is subject to the tax on admissions imposed by section 1700(a) of the Internal Revenue Code.

Advice is requested whether the tax on admissions imposed by section 1700(a) of the Internal Revenue Code is applicable with respect to a "donation" made in lieu of a payment of a fixed admission charge to a motion picture theater.

In the instant case, a theater operator discontinued his former practice of charging a fixed amount for admission to his motion picture theater. Instead, he permitted admission to certain theater performances on the basis of cash donations in amounts determined solely by the admittees.

It is recognized that motion picture theaters and other entertainment endeavors are operated on a basis of presenting to the public a performance to which spectators are willing and are accustomed or expected to pay an admission charge. As in most other businesses, these entertainment fields are guided by a profit motive. These performances are invariably presented in the type of public place where the admission of spectators may be controlled under conditions most favorable to the operator. Thus, it is presumed that the privilege of admission must be paid for. The fact that the amount so paid is called something other than an admission charge, such as a "donation," does not alter its identity as a condition to admission, and it is in fact an admission charge even though the amount thereof is left to the discretion of the admittee.

Under section 1700(a) of the Code as amended by section 401 of the Revenue Act of 1951, the tax due on admissions is computed on the basis of the amount actually paid for admission to any place, rather than on the basis of an established price as provided prior to such amendment. Therefore, where an alleged "donation" is a condition to admission, any amount so paid constitutes an amount paid for admission and is subject to the tax imposed with respect thereto.

In the instant case, admission is permitted upon the proposed and accepted condition that the admittees pay for such privilege in any amount of their own choosing. It is held that these alleged "donations" constitute amounts paid for admission to a place at regular or reduced rates and, as such, are paid in lieu of a fixed admission charge to gain entry to the theater. Therefore, the amounts paid as "donations" are subject to the tax on admissions imposed by section 1700(a) of the Code.

SECTION 101.2, REGULATIONS 43: Meaning of "admission." (Also Section 1701, Section 101.15, Regulations 43.) — Rev. Rul. 113

INTERNAL REVENUE CODE

Where an organization acquires the sole right to use a theater or the right to dispose of all of the admissions for a particular performance, except a block retained by the theater owner for what is usually referred to as "house seats" that are not for resale, the retention of such tickets by the owner does not disturb the organization's sole right to use the theater or the right to dispose of all the admissions within the meaning of section 101.2 of Regulations 43. Such an arrangement constitutes a rental and is, therefore, not subject to the tax on admissions imposed by section 1700 of the Internal Revenue Code. However, if the organization in turn sells admissions to the place the tax will apply to amounts paid for such admissions unless exempt under section 1701 of the Code.

SECTION 101.5, REGULATIONS 43: Free and reduced rate admissions. (Also Sections 101.0, 101.1, 101.14; Section 1701, Sections 101.15, 101.16, Regulations 43.) — T. D. 6007

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 101.—TAXES ON ADMISSIONS, DUES, AND INITIATION FEES

Regulations 43 (1941 edition) amended to conform to Public Law 124 (82d Cong.) and the Revenue Act of 1951.

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

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

On November 15, 1952, notice of proposed rulemaking was published in the Federal Register (17 F. R. 10469), in order to conform Regulations 43 (1941 edition) [26 CFR, part 101], relating to the taxes on admissions, dues, and initiation fees under the provisions of the Internal Revenue Code, to Public Law 124 (82d Cong., 1st sess.) [C. B. 1951-2, 351], approved August 24, 1951, and to sections 401, 402, 403, and 404 of the Revenue Act of 1951 (Public Law 183, 82d Cong., 1st sess.), approved October 20, 1951. After consideration of all such relevant matter as was presented by interested persons regarding the proposal the amendments to Regulations 43 [26 CFR, part 101] set forth below are hereby adopted.

PARAGRAPH 1. The words appearing in parentheses in the heading beginning "Part 101" immediately preceding "SUBPART A.—INTRODUCTORY," as amended by Treasury Decision 5562 [C. B. 1947-1, 165], approved May 16, 1947, are further amended to read as follows:

(CHAPTER 10 OF THE INTERNAL REVENUE CODE AS AMENDED BY THE REVENUE ACTS OF 1941, 1942, AND 1951; AND CHAPTER 9A OF THE INTERNAL REVENUE CODE AS AMENDED BY THE REVENUE ACT OF 1943, THE PUBLIC DEBT ACT OF 1944, AND THE EXCISE TAX ACT OF 1947).

PAR. 2. The first sentence of the first paragraph of section 101.0, as amended by Treasury Decision 5562 [26 CFR 101.0], is further amended by striking out the words "and section 622, title VI, of the Revenue Act of 1942," and inserting in lieu thereof the words "section 622, title VI, of the Revenue Act of 1942, and the Revenue Act of 1951."

PAR. 3. Immediately preceding section 101.1 [26 CFR 101.1], there is inserted the following:

SEC. 403. EFFECTIVE DATE OF AMENDMENTS RELATING TO ADMISSIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

The amendments made by sections 401 and 402 shall be applicable with respect to amounts paid on or after the first day of the first month which begins more than ten days after the date of the enactment of this Act for admissions on or after such date.

SEC. 404. TAX ON CABARETS, ROOFGARDENS, ETC. [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

* * * * * * *

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall be applicable only with respect to periods after 10 antemeridian on the first day of the first month which begins more than ten days after the date of the enactment of this Act.

PAR. 4. Section 101.1, as amended by Treasury Decision 5562 [26 CFR 101.1], is further amended by adding at the end thereof the following new paragraph:

The Revenue Act of 1951 made further amendments to the Code effective November 1, 1951. In the case of the cabaret tax, the amendment became effective at 10 a. m. on November 1, 1951.

PAR. 5. Immediately preceding section 101.2 [26 CFR 101.2], there is inserted the following:

PUBLIC LAW 124 82d CONG., 1st SESS.), APPROVED AUGUST 24, 1951

* * * That section 1700(a)(1) of the Internal Revenue Code is hereby amended by adding at the end thereof the following new sentence: "No tax shall be imposed in the case of admission free of charge of a member of the Armed Forces of the United States when in uniform."

SEC. 2. The amendment made by this Act shall be applicable to admissions on and after the first day of the first month which begins more than 10 days after the date of the enactment of this Act.

SEC. 401. REMOVAL OF TAX ON FREE ADMISSIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 1700(a)(1) (relating to tax on single or season tickets) is hereby amended by striking out the second, fourth, and fifth sentences thereof.

PAR. 6. Section 101.5, as amended by Treasury Decision 5682 [C. B. 1949-1, 245], approved December 30, 1948 [26 CFR 101.5], is further amended to read as follows:

SEC. 101.5. FREE AND REDUCED RATE ADMISSIONS.—(a) *Beginning November 1, 1951.*—The tax imposed by section 1700(a) applies to the amount actually paid for admission, and no tax is due in the case of a person admitted free of charge. Further, a child under 12 years of age admitted for less than 10 cents is not liable for tax.

(b) *Prior to November 1, 1951.*—(1) *General rule.*—A person admitted free or at a reduced rate to any place at a time when and under circumstances under which an admission charge is made to other persons, is liable to tax (except as

provided in paragraph (*b*)(2) of this section) in an amount equivalent to the tax on the amount paid by such other persons for the same or similar accommodations.

Where persons in a certain group or class, such as students 12 years of age or over, women, or members of a particular organization, are admitted at a price less than the established price of admission to the public generally, they are liable for tax based on the established price of admission to other persons for the same or similar accommodations. Women admitted free or at reduced rates to dances or any other place are liable for tax based on the established price of admission to other persons.

If tickets or cards of admission are issued the tax should be collected at the time of the issuance of such tickets or cards, while if no tickets or cards are used tax should be collected when the persons are admitted.

(2) *Exceptions.*—A bona fide employee of the management of the theater or other place, a municipal officer on official business, or a child under 12 years of age, is not liable to tax if admitted free but if admitted at a reduced rate is liable to tax on the reduced price, except that a child under 12 years of age admitted for less than 10 cents is not liable for tax. Bona fide employees are (i) those persons, including directors and officers, regularly employed by the proprietor of the place or attraction or regularly engaged in work or business transacted there, whether their duties require admission to the place or not, and whether on duty at the time admitted or not; and (ii) other persons whose admission to the place is required for the performance of some duty to, or work for, the proprietor.

Persons in the military or naval forces of the United States when in uniform, members of the military or naval forces of any of the United Nations when in uniform, and members of the Civilian Conservation Corps when in uniform are not liable for tax if admitted free, and if admitted at a reduced rate are liable for tax on the reduced price. Except as provided in the two paragraphs immediately succeeding, these exemptions do not apply to admissions after December 31, 1947.

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].)

Effective October 1, 1951, to and including October 31, 1951, the tax does not apply to the admission free of charge of a member of the Armed Forces of the United States when in uniform. This exemption applies to free admissions only.

Newspaper reporters, photographers, telegraphers, radio announcers, and persons of similar vocation who are admitted free to any place for the performance of special duties in connection with an event and whose special duties are the sole reason for their presence and free admission, are not liable for any tax on admissions. Free admissions, including free admissions to spoken plays, etc., granted to such persons who are not admitted solely for the purpose of performing their special duties in connection with the event are subject to tax equivalent to the tax on the admission charge paid by other persons for the same or similar accommodations.

PAR. 7. Immediately preceding section 101.13 there is inserted the following:

SEC. 404. TAX ON CABARETS, ROOFGARDENS, ETC. [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) BALLROOMS AND DANCEHALLS.—Section 1700(e)(1) (relating to tax on cabarets, roofgardens, etc.) is hereby amended by inserting after the second sentence thereof the following new sentence: "In no case shall such term include any ballroom, dancehall, or other similar place where the serving or selling of food, refreshment, or merchandise is merely incidental, unless such place would be considered, without the application of the preceding sentence, as a 'roofgarden, cabaret, or other similar place'."

* * * * * * *

PAR. 8. Section 101.14, as amended by Treasury Decision 5385 [C. B. 1944, 637], approved June 30, 1944 [26 CFR 101.14], is further amended as follows:

(A) By amending the first paragraph to read as follows:

The term "roofgarden, cabaret, or other similar place" includes 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, except that after 10 a. m. November 1, 1951, such term does not include any ballroom, dancehall, or other similar place where the serving or selling of food, refreshment, or merchandise is merely incidental, unless such place would otherwise be considered as a roofgarden, cabaret, or other similar place. The exception with respect to ballrooms, dancehalls, or other similar places, applies only to such of those establishments which are operated primarily to furnish music and dancing privileges and where the serving or selling of food, refreshment, or merchandise constitutes in fact an incidental or subsidiary service in relation to the furnishing of music and dancing privileges.

A public performance furnished at a roofgarden, cabaret, or other similar place 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.

(B) Example (1) is deleted, examples (2) and (3) are renumbered (1) and (2), respectively, and the following is inserted as example (3):

(3) A dancehall is operated from 9 p. m. until midnight every Friday and Saturday night. The charge for admission varies according to the character of the entertainment furnished, so that when a name band appears, the admission charge is higher than when the music is furnished by a local band. Refreshments consisting of sandwiches, potato chips, soft drinks, and coffee are served at tables, and the number of patrons who can be seated at any time is substantially less than the number of persons who can be accommodated for dancing. The serving of refreshments is limited to the period when the dancehall is open. Patrons are not required to purchase refreshments. In this case, the dancehall is operated primarily for the purpose of furnishing music and dancing privileges and the sale of refreshments constitutes an incidental service. Amounts paid by patrons of the dancehall are not subject to the cabaret tax; however, the charge for admission is subject to the admissions tax.

PAR. 9. Immediately preceding section 101.15 [26 CFR 101.15], there is inserted the following:

SEC. 402. EXEMPTIONS FROM ADMISSIONS TAX [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) REINSTATEMENT OF PREWAR EXEMPTIONS.—Notwithstanding section 541(b) of the Revenue Act of 1941, the provisions of section 1701 (relating to exemptions from the admissions tax) shall apply to amounts paid on or after the effective date specified in section 403 of this Act for admissions on or after such date.

(b) AMENDMENT OF SECTION 1701 (a) AND (b).—Subsections (a) and (b) of section 1701 (relating to exemptions from admissions tax) are hereby amended to read as follows:

"(a) CERTAIN RELIGIOUS, EDUCATIONAL, OR CHARITABLE ENTERTAINMENTS, ETC.—

"(1) IN GENERAL.—Except as provided in paragraph (2), any admissions all the proceeds of which inure—

"(A) exclusively to the benefit of—

"(i) a church or a convention or association of churches;

"(ii) an educational institution which is exempt under section 101(6) or which is an educational institution of a government or political subdivision thereof, if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on;

"(iii) a corporation or any community chest, fund, or foundation organized and operated exclusively for charitable purposes, exempt under section 101(6), if such corporation or organization is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or is primarily supported by contributions from the general public;

"(iv) a society or organization conducted for the sole purpose of maintaining symphony orchestras or operas and receiving substantial support from voluntary contributions;

"(v) an organization (organized prior to October 1, 1951) which is exempt under section 101(6) and which is operated for the purpose of conducting an annual chautauqua program of educational, cultural, and religious activities at a permanent location—

if no part of the net earnings thereof inures to the benefit of any private stockholder or individual;

"(B) exclusively to the benefit of National Guard organizations, Reserve officers' associations or organizations, posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private stockholder or individual; or

"(C) exclusively to the benefit of a police or fire department of any city, town, village, or any municipality or exclusively to a retirement, pension, or disability fund for the sole benefit of members of such a police or fire department or to a fund for the heirs of such members.

"(2) NONEXEMPT ADMISSIONS.—The exemption provided under paragraph (1) shall not apply in the case of admissions to (A) any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary or secondary school or unless in the case of an athletic game between two elementary or secondary schools, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children, (B) wrestling matches, prize fights, or boxing, sparring, or other pugilistic matches or exhibitions, (C) carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation, or (D) any motion picture exhibition.

"(b) AGRICULTURAL FAIRS.—Any admissions to agricultural fairs if no part of the net earnings thereof inures to the benefit of any stockholders or members of the association conducting the same—if the proceeds therefrom are used exclusively for the improvement, maintenance, and operation of such agricultural fairs; or".

(c) ADMISSIONS TO MUNICIPAL SWIMMING POOLS, ETC.—Section 1701 is hereby amended by striking out the period at the end of subsection (c) and inserting in lieu thereof "; or" and by adding at the end of such section the following new subsections:

"(d) MUNICIPAL SWIMMING POOLS, ETC.—Any admissions to swimming pools, bathing beaches, skating rinks, or other places providing facilities for physical exercise, operated by any State or political subdivision thereof or by the United States or any agency or instrumentality thereof—if the proceeds therefrom inure exclusively to the benefit of the State, political subdivision, United States, agency, or instrumentality. For the purposes of this subsection, the term 'State' includes Alaska, Hawaii, and the District of Columbia; or

"(e) (1) HOME AND GARDEN TOURS.—Any admission to a home or garden which is temporarily opened to the general public as part of a program conducted by a society or organization to permit the inspection of historical homes and gardens—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

"(2) HISTORIC SITES.—Any admissions to historic sites, houses, and shrines, and museums conducted in connection therewith, maintained and operated by a society or organization devoted to the preservation and maintenance of such historic sites, houses, shrines, and museums—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual."

SEC. 1701. INTERNAL REVENUE CODE.

* * * * * * *

(c) CERTAIN CONCERTS.—Any admissions to concerts conducted by a civic or community membership association if no part of the net earnings thereof inures to the benefit of any stockholders or members of such association.

* * * * * * *

PAR. 10. Section 101.15, as amended by Treasury Decision 5682 [26 CFR 101.15], and section 101.16, as amended by Treasury Decision 5170 [C. B. 1942–2, 246], approved September 25, 1942 [26 CFR 101.16], are stricken and the following is inserted in lieu thereof:

SEC. 101.15. EXEMPTIONS FROM TAX.—(*a*) *Scope of exemption, effective November 1, 1951.*—The admissions taxes imposed by section 1700 are of two classes: (1) taxes on admissions per se to be paid by the person paying for admission, and (2) taxes on charges in excess of the regular or established price of admission, which taxes are to be paid by the person selling or disposing of tickets or cards of admission at excess prices. Section 1701(a) confers exemption, under certain conditions and limitations, from taxes of one or both classes. Admissions, or excess charges, are not exempt merely because the proceeds are to be used for a religious, educational, or charitable purpose. The primary condition is that all the proceeds of the admissions or excess charges, as the case may be, inure to the benefit of the organizations enumerated in section 1701(a) and the event is not of a type described in section 1701(a)(2). (See paragraph (*c*) of this section.) It may happen that the proceeds of admission charges inure to the benefit of exempt organizations and the proceeds of excess charges go to the benefit of nonexempt organizations or persons. In that event, the tax exemption applies only to the admission charges. Conversely, the situation may be that the proceeds of the excess charges, but not of the admission charges, inure to the benefit of exempt organizations. In that situation, the excess charges only are exempt from tax.

The term "all the proceeds" means all the net proceeds of the regular admission charges or excess charges, as the case may be, after payment of actual and reasonable expenses incurred in presenting the event. Whether certain expenses are reasonable is to be determined on the basis of all the facts in the matter. If the expenses are in excess of what is reasonable and necessary under the circumstances, all the proceeds would not be deemed to inure exclusively to the benefit of the exempt organization. In any case where the amount to be received by a nonexempt person or organization for talent, services, or otherwise, is based on a percentage of the net or gross proceeds, the organization claiming exemption shall, before exemption may be allowed, establish that the maximum amount to be received on the percentage basis is a reasonable sum and not more than would ordinarily be received on a flat-rate basis for the same or similar talent or services, and that the contract actually operates to the benefit of the exempt organization.

(*b*) *Organizations exempt from admissions tax.*—(1) *General.*—Under the provisions of section 1701(a)(1)(A), exemption is granted with respect to admissions, other than those specified in section 1701(a)(2) (see paragraph (*c*) of this section), all the proceeds of which inure to the benefit of certain religious, educational, charitable, or other organizations operating on a nonprofit basis. The mere fact that an organization is so organized or operated does not afford a basis for exemption. To be entitled to such exemption the organization must comply with all of the statutory requirements. There is no requirement, expressed or implied, that an institution, society, or organization, to be included within these exemption provisions, must be organized or operating in the United States.

For an organization to be considered a religious, educational, or charitable institution, or society, or organization of the kind contemplated by section 1701(a), it must have a definite organization, with officers, directors, or trustees, and the usual essential features (incorporation not being essential) of an association of its class. The organization must also have a purpose which as put into practice is religious, educational, charitable, or of the nature specified by the statute. Furthermore, no part of the net earnings of such organization shall inure to the benefit of any private stockholder or individual.

Other requirements which must be met by organizations that may be exempt from the admissions tax are set forth in the following subparagraphs (2) through (8).

(2) *Churches or conventions or associations of churches.*—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of a church or a convention or association of churches are exempt from tax. (For exceptions to this exemption, see paragraph (*c*) of this section.)

The term "convention or association of churches" includes a union of churches of the same denomination organized on a regional or other basis, or a union of churches of different denominations which meet and act in concert to further a particular religious purpose.

Missions and missionary societies, Sunday school classes, choir groups, and other associations forming a functional part of the organization of a church fall within the exemption.

(3) *Educational institutions.*—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of an educational institution are exempt from the tax, provided (i) the educational institution is exempt under section 101(6), or is an educational institution of a government or political subdivision thereof, (ii) the institution normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on, and (iii) no part of the net earnings thereof inures to the benefit of any private stockholder or individual. (For exceptions to this exemption, see paragraph (*c*) of this section.) Generally, this exemption applies in the case of institutions engaged in the presentation of formal instruction, such as elementary and high schools, colleges and universities, through the medium of a regular faculty and curriculum with a regularly organized body of pupils or students in attendance. However, any educational institution exempt from income tax under section 101(6), such as a museum, art gallery, etc., may also qualify under section 1701(a) for an exemption from the tax on admissions but only if, as a substantial part of its activities, such institution maintains a regular faculty, curriculum, and student body.

Any organization sponsored and administered by an educational institution as a part of its educational program, and in which membership is open to any of the members thereof, is also entitled to exemption. Examples of such organizations are student governing bodies, athletic associations, dramatic clubs, language clubs, science clubs, and similar groups.

(4) *Charitable organizations.*—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of a corporation or any community chest, fund, or foundation organized and operated exclusively for charitable purposes, exempt under section 101(6), are exempt from tax provided such corporation or organization is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or is primarily supported by contributions from the general public, and if no part of the net earnings thereof inures to the benefit of any private stockholder or individual. (For exceptions to this exemption, see paragraph (*c*) of this section.)

Charitable organizations supported by funds contributed by the United States or any State or political subdivision thereof are entitled to exemption regardless of the extent of the support received and of the manner in which the funds are contributed, i. e., whether as payment for specific services rendered by the organization, by the allotment of any sum, or whatever other means may be used.

However, charitable organizations supported by contributions received from the general public, in order to show that they are primarily supported in such manner, must establish that more than 50 percent of all the income received by the organization, is derived from that source. Amounts paid for admission are not regarded as "contributions" for purposes of this exemption.

(5) *Symphony orchestra and opera organizations.*—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of a society or organization conducted for the sole purpose of maintaining symphony orchestras or operas and receiving substantial support from voluntary contributions, are exempt from tax, if no part of the net earnings thereof inures to the benefit of any private stockholder or individual. (For exceptions to this exemption, see paragraph (*c*) of this section.)

The name by which an organized group of musicians is called is not the test of whether or not such group is a symphony orchestra. It must have a personnel of sufficient size and ability to render symphonies capably and such symphonies must form a major part of its regular programs. Bands and ordinary orchestras are not included in the exemption.

(6) *Chautauquas and assemblies.*—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of a society or organization organized prior to October 1, 1951, exempt from income tax under section 101(6) and operated for the purpose of conducting an annual chautauqua program of educational, cultural, and religious activities at a permanent location are exempt from tax, if no part of the net earnings thereof inures to the benefit of any private stockholder or individual. (For exceptions to this exemption, see paragraph (*c*) of this section.)

The term "chautauqua program" means an operation designed to provide a series of meetings or assemblies of persons who are brought together for a common purpose, wherein a program of educational, cultural, and religious activities is carried on and during which courses of instruction in either educational, cultural, or religious activities are actually participated in by persons present for the program.

(7) *National Guard and Reserve officers' associations or organizations of war veterans.*—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of National Guard organizations, Reserve officers' associations or organizations, posts or organizations of war veterans, or auxiliary units or societies of any of the foregoing, are exempt from tax, if organized in the United States or any of its possessions and if no part of their net earnings inures to the benefit of any private stockholder or individual. (For exceptions to this exemption, see paragraph (*c*) of this section.)

(8) *Police or fire department.*—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of a police or fire department (including a volunteer fire department) of any city, town, village, or municipality or exclusively to a retirement, pension, or disability fund for the sole benefit of members of such a police or fire department or to a fund for the heirs of such members, are exempt from tax. (For exceptions to this exemption, see paragraph (*c*) of this section.)

(*c*) *Nonexempt admissions.*—The exemptions provided by section 1701(a)(1) in the case of events held for the benefit of the organizations specified therein (paragraph (*b*) (2) through (8) of this section) do not apply with respect to admissions to:

(1) Any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary or secondary school; or unless in the case of an athletic game between two elementary or secondary schools, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children. (See sec. 101.15(*d*)(6).)

(2) Wrestling matches, prize fights, or boxing, sparring, or other pugilistic matches or exhibitions, irrespective of the status of the participants, the character of the organization sponsoring the event, or to whom the admission proceeds are payable.

(3) Carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation. It is immaterial whether the

professional performer or operator is paid for his services from the admission proceeds or from some other source.

(4) Any motion picture exhibition.

(*d*) *Admissions to specific events exempt from tax.*—(1) *Agricultural fairs.*—Admissions to agricultural fairs the proceeds of which are used exclusively for the improvement, maintenance, and operation of such fairs are exempt from tax, if no part of the net earnings thereof inures to the benefit of any stockholder or member of the association conducting the fair.

The term "agricultural fairs" includes, in general, all exhibitions of farm produce, livestock, poultry, flowers, or the like held for the promotion or advancement of agriculture (including horticulture). It includes any exhibition of animals of a species whose chief utility is in connection with agriculture, held by an association organized to improve that species of animal and to disseminate knowledge concerning its breeding.

The exemption afforded with respect to agricultural fairs is limited to the general admission charge to the fair grounds or to any additional payment for seating accommodations offered in connection with any free event held in connection with the fair. The exemption does not extend to admissions to any exhibit, entertainment, or other event for which a separate additional admission charge is made.

The foregoing exemption applies only to admissions to agricultural fairs and does not extend to admissions to events which may be conducted at the fair grounds by the fair association when a fair is not in progress, even though the proceeds from such admissions may inure exclusively to the benefit of the fair association.

The following are examples of events regarded as agricultural fairs within the meaning of the statute:

(i) An exhibition of articles of garden produce to stimulate a "garden movement" in the community.

(ii) A poultry show held by a poultry fanciers' association for the purpose of teaching poultry farmers how to secure the greatest possible egg production.

(iii) A horse fair held by a society organized to improve the quality of farm animals, the animals exhibited being chiefly of that class.

Examples of events which do not qualify as agricultural fairs include the following:

(i) A dog show presented by a dog fanciers' association.

(ii) A horse show held primarily for the purpose of exhibiting fancy riding and driving horses.

(iii) A food show presented by a retail grocers' association for the purpose of exhibiting raw food products, the processes of manufacture, the finished food products, and the food prepared for the table.

(2) *Concerts.*—No tax is due with respect to payments for admission to concerts conducted by a civic or community association operating under a constitution, bylaws, or other rules or regulations providing for a definite class of membership, if no part of the net earnings inures to the benefit of any member or stockholder. This exemption applies only with respect to concerts and has no application to other entertainments given by any such association. This exemption applies regardless of the disposition made of the proceeds from the admissions.

(3) *Municipal swimming pools, etc.*—Admissions to swimming pools, bathing beaches, skating rinks, or other places providing facilities for physical exercise, which are operated by any State or political subdivision thereof or by the United States or any agency or instrumentality thereof, are exempt from tax provided the proceeds from the admission charges inure exclusively to the benefit of the State, political subdivision, United States, agency, or instrumentality. The term "State," for the purpose of this exemption, includes Alaska, Hawaii, and the District of Columbia.

The exemption applies where the payment for admission to the swimming pool, bathing beach, skating rink, or other place providing facilities for physical exercise entitles the person making such payment to swim, skate, or otherwise use the facility offered. The exemption does not apply, however, where the only privilege afforded the person paying for admission is the right of being a spectator at any event, exhibition, tournament, etc., conducted at the place providing such facilities.

(4) *Home and garden tours.*—Admissions to homes or gardens temporarily opened to the general public as part of a program conducted by a society or

organization to permit the inspection of historic homes and gardens are exempt from tax, if no part of the net earnings thereof inures to the benefit of any private stockholder or individual. This exemption applies regardless of the disposition made of the proceeds from the admissions.

(5) *Historic sites.*—Admissions to historic sites, houses, and shrines, and museums conducted in connection therewith, maintained and operated by a society or organization devoted to the preservation and maintenance of such historic sites, houses, shrines, and museums are exempt from tax, if no part of the net earnings thereof inures to the benefit of any private stockholder or individual. This exemption applies regardless of the disposition made of the proceeds from the admissions.

Historic museums not maintained in connection with historic sites, houses, or shrines are not entitled to exemption with respect to admissions thereto.

(6) *Athletic events.*—Admissions to any athletic game or exhibition the proceeds of which inure exclusively to the benefit of an elementary or secondary school are exempt from tax. Admissions to any athletic game or exhibition between two elementary or secondary schools are exempt from tax, provided the entire gross proceeds from such game inure to the benefit of a hospital for crippled children. For the purpose of this exemption, the term "secondary school" includes any high school, or the equivalent thereof, through grade 12.

(*e*) *Scope of exemption, prior to November 1, 1951.*—(1) *General rule.*—The several exemptions from the tax on admissions allowed by section 1701 of the Code and by the Interior Department Appropriation Acts prior to October 1, 1941, were terminated as of that date by section 541 (b) and (c) of the Revenue Act of 1941. Accordingly, *except as provided in subparagraph (2)*, all amounts paid on and after October 1, 1941, for admission to any place are subject to tax, regardless of the purpose of the entertainment or affair and regardless of the organization or person to whom the proceeds inure. A child under 12 years of age admitted for less than 10 cents is not liable for tax. (See section 101.4.)

(2) *Exceptions.*—(i) Amounts paid on and after October 1, 1941, for admission to theaters and other activities operated by or under the control of the War Department or the Navy Department within posts, camps, reservations, and other areas maintained by the Military or Naval Establishment shall be exempt from the tax imposed by this section, provided the net proceeds from said admission charges are used exclusively for the welfare of the military or naval forces of the United States. These exceptions are not applicable to amounts paid after December 31, 1947. (See sec. 11 of Public Law 384, 80th Cong.)

(ii) 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(*b*) (2) [26 CFR 101.5].)

(iii) Effective October 1, 1951, to and including October 31, 1951, the tax does not apply to the admission free of charge of a member of the Armed Forces of the United States when in uniform. This exemption applies to free admissions only.

(*f*) *Admissions by or for the benefit of Federal, State, or municipal Governments.*—The fact that the authority charging admissions or receiving the proceeds thereof is the United States or an agency thereof, or a State or Territory or political subdivision thereof, such as a county, city, town, or other municipality, does not make such admissions exempt, in the absence of specific statutory provision. The Code specifically provides that the taxes on admission shall be paid by the person paying for admission. It is not, therefore, a tax on the person or authority selling the admissions or receiving the proceeds thereof.

SEC. 101.16. APPLICATION FOR EXEMPTION.—A determination concerning the applicability of an exemption provided by section 1701 may be obtained by the timely filing of a properly executed application for exemption on Form 755. This form may be procured from any director of internal revenue. The application shall show the place and the occasion with respect to which exemption is requested. It shall be executed by an officer or duly authorized agent of the organization in control of the admissions or excess charges or, in the case of control by an individual, the application must be executed by him or his duly authorized agent. Where the proceeds of the admissions or excess charges will inure to the benefit of an organization not in control of such admissions or excess charges, the beneficiary shall join in executing the application for exemption.

The application shall be filed with the director of internal revenue for the district in which is located the place to which the admissions will be sold. It shall be filed as early as possible so that the organization may be advised in ample time prior to the date of the event of the action taken by the director. The application shall be accompanied by the necessary supporting data specified therein, so that action can be taken without the necessity of additional correspondence.

(This Treasury Decision is issued pursuant to the authority contained in section 3791 of the Internal Revenue Code (53 Stat. 467; 26 U. S. C. 3791).)

T. COLEMAN ANDREWS,
Comissioner of Internal Revenue.

Approved April 15, 1953.

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

(Filed with the Division of the Federal Register April 21, 1953, 8:51 a. m.)

SECTION 1701.—EXEMPTIONS FROM TAX

Rev. Rul. 66

INTERNAL REVENUE CODE

Application of the exemption provided by section 1701(a)(1)(A)(ii) of the Internal Revenue Code to admissions to games conducted by an association organized to promote and maintain the athletic activities of a high school.

Advice is requested whether the exemption provided by section 1701(a)(1)(A)(ii) of the Internal Revenue Code, with respect to admissions, the proceeds of which inure to an educational institution, is applicable to admissions to athletic games conducted by an association organized to promote and maintain the athletic activities of a high school. It is stated that membership in the association is open to any person in the community and that funds derived from membership dues, donations and the proceeds from the games are handled, administered and controlled by the association.

It is held that the exemption provided by section 1701(a)(1)(A)(ii) of the Code is limited to organizations engaged in the presentation of formal instruction through the medium of a regular faculty and curriculum and a regular body of pupils. The association described above, although in operation for the purpose of financially assisting the school's athletic program is not considered to constitute, or be a part of, a school within the scope of the exemption. Moreover, section 1701(a)(2) of the Code specifically provides, in part, that the exemption afforded under sub-paragraph (ii) above shall not apply in the case of admissions to any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary or secondary school or unless in the case of an athletic game between two elementary or secondary schools, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children.

Since the proceeds from games conducted by the association are handled, administered and controlled by the association, such proceeds do not, within the meaning of the statute, inure exclusively to the benefit of the high school. Accordingly, the association is not

entitled to exemption from the collection of tax with respect to admission charges to the games conducted by it.

Exemption from admissions tax may be allowable with respect to games conducted by the association only if the elementary or secondary school is specifically designated and becomes the beneficiary of the proceeds thereof, either by having the proceeds immediately turned over to the school or by appropriating such proceeds to the immediate use of the school.

Rev. Rul. 67

INTERNAL REVENUE CODE

The exemption provided by section 1701(a)(1)(B) of the Internal Revenue Code does not apply to admissions to baseball games played by teams sponsored by organizations of war veterans, where the proceeds inure to the benefit of such organizations.

Advice is requested whether the exemption provided by section 1701(a)(1)(B) of the Internal Revenue Code is applicable to admissions to baseball games played by teams sponsored by organizations of war veterans, where the proceeds inure to the benefit of such organizations.

Section 1701(a)(1)(B) of the Code provides generally that the tax does not apply to any admissions all the proceeds of which inure exclusively to the benefit of National Guard organizations, Reserve officers' associations or organizations, posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations. However, section 1701(a)(2)(A) of the Code specifically provides, that the above exemption shall not apply in the case of admissions to any *athletic game or exhibition* unless the proceeds inure exclusively to the benefit of an elementary or secondary school or unless in the case of an athletic game between two elementary or secondary schools, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children.

Since the admissions involved in the instant case are to athletic games and the proceeds from such games do not inure to the benefit of an elementary or secondary school, the exemption under section 1701(a)(1)(B), *supra*, does not apply. Accordingly, amounts collected as admissions to such games are subject to tax.

Section 101.15, Regulations 43: Exemptions from tax.

INTERNAL REVENUE CODE

Regulations 43 amended. (See T. D. 6007, page 412.)

Section 101.15, Regulations 43: Exemptions from tax.

INTERNAL REVENUE CODE

Sale of admissions by organization with sole right to dispose of all admissions. (See Rev. Rul. 113, page 412.)

CHAPTER 11.—DOCUMENTS, OTHER INSTRUMENTS, AND PLAYING CARDS [INCLUDING STAMP TAXES]

SUBCHAPTER A.—RATE AND PAYMENT OF TAX

SECTION 1807.—PLAYING CARDS

ARTICLE 8, REGULATIONS 66: Tax on playing cards. Rev. Rul. 97

INTERNAL REVENUE CODE

Playing card stamps, properly affixed to packs when removed from the place of manufacture, may not be redeemed once the cards have been removed from the premises of the manufacturer.

Advice is requested whether playing card stamps which were properly affixed to packs of cards when removed from the place of manufacture, may be redeemed by the Bureau where the cards were subsequently returned to the manufacturer by the purchaser and the stamps or wrappers to which they were affixed were in an unusable condition.

Section 1807 of the Internal Revenue Code imposes a tax of 13 cents upon every pack of playing cards containing not more than 54 cards, manufactured or imported, and sold, or removed for consumption or sale. Article 8 of Regulations 66, relating to the tax on playing cards, provides in part that the tax on playing cards accrues upon removal from the factory or place where made, or upon sale prior to such removal, and is to be paid by the manufacturer thereof by affixing of stamps before removal.

Liability for the tax is incurred by the manufacturer of playing cards upon removal of the cards from the place of manufacture and payment of the tax is evidenced by affixing stamps to the packs of cards. There is no provision of law under which playing card stamps, properly affixed to packs when removed from the place of manufacture, may be redeemed after the cards have been removed from the premises of the manufacturer.

Accordingly, it is held that the tax was properly paid upon removal of the playing cards from the premises of the manufacturer and the stamps may not be redeemed with respect to the packs returned to the manufacturer, regardless of the condition of the stamps or wrappers to which they were attached.

CHAPTER 19.—RETAILERS' EXCISE TAXES

SECTION 2400.—TAX ON JEWELRY, ETC.

SECTION 320.30, REGULATIONS 51: Scope of tax. (Also Section 2401, Section 320.40, Regulations 51.) Rev. Rul. 98

INTERNAL REVENUE CODE

Belts and belt buckles which are made of, or ornamented with precious metals, pearls, or precious or semiprecious stones are subject

to the 20 percent tax imposed by section 2400 of the Internal Revenue Code when sold at retail regardless of whether they are sold separately or in combination. However, belts and belt buckles which contain no precious metals, pearls, or precious or semiprecious stones, and to which are permanently attached "imitations" of pearls, or precious or semiprecious stones are in the nature of dress findings and are not considered taxable within the purview of section 2400 of the Code.

Belts made of fur on the hide or pelt are considered to constitute articles of fur and subject to the 20 percent tax imposed by section 2401 of the Code, regardless of the ornamentation thereon.

SECTION 2401.—TAX ON FURS

SECTION 320.40, REGULATIONS 51: Scope of tax.

INTERNAL REVENUE CODE

Belts made of fur on the hide or pelt subject to tax. (See Rev. Rul. 98, page 424.)

SECTION 2402.—TAX ON TOILET PREPARATIONS

SECTION 320.50, REGULATIONS 51: Scope of tax. Rev. Rul. 57

INTERNAL REVENUE CODE

Application of tax on toilet preparations, imposed by section 2402 of the Internal Revenue Code, as amended, to the sale of preparations or products intended for use solely as a remedy for dandruff. Mimeograph 5828, C. B. 1945, 438, modified.

Advice is requested concerning the application of the tax on toilet preparations, imposed by section 2402 of the Internal Revenue Code, as amended, to the sale of preparations or products intended for use as a remedy for dandruff or for the elimination of scales or flakes resulting from dandruff.

Section 2402 of the Code imposes upon the following articles sold at retail a tax of equivalent to 20 percent of the price for which so sold:

Perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, aromatic cachous, toilet powders, and any similar substance, article, or preparation, by whatsoever name known or distinguished; any of the above which are used or applied or intended to be used or applied for toilet purposes.

It is held that the tax imposed by section 2402 of the Code does not apply to the sale of preparations or products used or intended for use as a remedy for, or as an application for relief from, dandruff (including the incidental elimination of dandruff scales or flakes), provided the labels, leaflets, or other advertising relating thereto, are so limited as to exclude any reference to the use of preparations or products for toilet purposes (such as to improve one's personal appearance).

Mimeograph 5828, C. B. 1945, 438, is modified to the extent inconsistent herewith.

SECTION 320.50, REGULATIONS 51: Scope of tax. Rev. Rul. 114

INTERNAL REVENUE CODE

Perfume purchased in bulk and dispensed through a coin-operated vending machine is a sale at retail and subject to the tax on toilet preparations imposed by section 2402 of the Internal Revenue Code, computed in accordance with section 2403 of the Code.

Advice is requested whether the dispensing of perfume through a coin-operated machine by inserting a coin therein constitutes a sale at retail within the meaning of section 2402 of the Internal Revenue Code.

Section 320.50 of Regulations 51 provides in part that the tax attaches to the sale by the retailer of the articles enumerated in section 2402 of the Code and similar articles commonly or commercially known as toilet articles. Section 2402 of the Code, among other articles, imposes a tax upon perfume sold at retail.

It is held that the dispensing of perfume through a coin-operated machine by inserting a coin therein constitutes a sale at retail within the meaning of section 2402 of the Code. Accordingly, the owner of the machine from which the perfume is dispensed, is the person selling the perfume at retail and is liable for reporting and paying the tax with respect thereto which may be computed in accordance with section 2403 of the Code on the basis of the total returns from the machine during each month rather than on individual sales.

SECTION 320.50, REGULATIONS 51: Scope of tax. Rev. Rul. 115

INTERNAL REVENUE CODE

The sale of cold cream by a manufacturer to doctors or hospitals for use for toilet purposes in the same form as purchased is a sale at retail within the meaning of section 2402 of the Internal Revenue Code and therefore subject to the tax imposed thereunder; however, a sale of cold cream by a manufacturer, usually in bulk, to doctors, hospitals, or druggists for further manufacturing purposes, such as the use of the cold cream as a component material in the compounding of medicinal ointments, is not considered to be a sale at retail within the meaning of section 2402 of the Code and is not subject to the tax thereunder, *provided*, that the manufacturer has in his possession a statement from the purchaser showing that the cold cream was purchased for such use.

CHAPTER 26.—LIQUOR

SECTIONS 2800-3195.—LIQUOR

Rev. Rul. 20

INTERNAL REVENUE CODE

Criminal conviction under section 3116 of the Internal Revenue Code for the possession of goods intended for use in violating the provisions of the internal revenue laws affirmed in a case where evidence obtained as a result of search and seizure without a warrant was

ruled admissible since, under the circumstances, the seizing officers had probable cause to believe that a violation of the law was taking place.

Attention is called to the per curiam opinion of the United States Court of Appeals for the Fourth Circuit in the case of *Walter Alexander Godette* v. *United States* (199 Fed. (2d) 331), decided October 11, 1952 (No. 6436), affirming a criminal conviction, under section 3116, title 26, United States Code, for the possession of 12,000 pounds of sugar which was intended for use in violating the provisions of the internal revenue laws.

In the case of *United States* v. *Harvin et al.* (91 Fed. Supp. 249), the court said that section 3116 defines a criminal offense as well as a forfeiture. In the Godette case, *supra*, an appellate court has, for the first time, affirmed a conviction under this section. Hence, while the offense is punishable as a misdemeanor, this section may be used to advantage in the prosecution of persons possessing property which may be shown to have been intended for use in violating the internal revenue laws.

The Godette opinion is also important because the court ruled admissible in the criminal proceedings, under the circumstances in this case, evidence obtained as a result of the search and seizure, without a warrant, of the truck containing the 12,000 pounds of sugar. The illegal search and seizure issue was the principal point raised in the appellate court.

The opinion in the Godette case, *supra*, reads as follows:

Walter Alexander Godette was found guilty in a trial before the judge without a jury in the district court of violating 26 U. S. C. A. section 3116, of possessing property, to wit, 12,000 pounds of sugar contained in 120 bags, which was intended for use in violating the provisions of the internal revenue laws, and was sentenced to pay a fine of $500. During the trial the defendant moved the district judge to suppress the evidence which was secured by the seizure and search of the truck on the ground that the search was made in violation of the fourth amendment to the Federal Constitution; but the motion was denied and the main question on this appeal relates to the propriety of that action in view of the circumstances attending the seizure.

On October 25, 1951, certain Government officers raided a large illicit still located in the woods about three-quarters of a mile from Godette's residence, in the neighborhood of North Harlow, N. C. After destroying the still and arresting several persons, the officers proceeded by automobile to New Bern, N. C. En route they met the defendant driving a truck but did not at first recognize him. While passing the truck they observed that it was heavily laden and that the contents were covered with tarpaulin. They turned around and followed the truck for half a mile and were able to see that the truck was carrying some substance contained in bags. They then pulled up along side the truck and recognized the driver as Godette whom they had known as a man with a bad record and reputation for the illicit manufacture of whisky and financing others engaged in this occupation. They then signaled him to stop by using the siren. The defendant stopped his truck and upon being asked if he had sugar on his truck, replied that he did have sugar contained in 120 one hundred pound bags. He permitted the investigators to examine the sugar. He denied, however, that it was his sugar stating that he had gotten it for one John Carter who operated a small grocery store at North Harlow; and he exhibited a bill of sale made out to Carter from a baker in Greenville, N. C., in an amount of $1,086. At the trial Carter testified that the defendant had never hauled any sugar for him and that the sugar in question was not intended for him and that his gross business at his store was between $200 and $300 per week. The baker who sold the sugar testified that he had sold sugar to the defendant a number of times before the day of the seizure.

We think that the seizure of the truck and the sugar under these circumstances did not amount to an unreasonable search and seizure in violation of the amend-

ment. It has been firmly established since the decision in Carroll v. United States, 267 U. S. 132, 45 S. Ct. 280, 69 L. ed. 543, that the search of an automobile without warrant and the seizure therein of illicit liquor or material for the illicit manufacture of liquor, which is subject to seizure under the acts of Congress, does not violate the amendment, if made upon probable cause or the belief, reasonably arising out of circumstances known to the officers, that the vehicle contains such articles. In that case the court held that when the securing of a search warrant is reasonably practicable, it must be used, but when seizure is impossible, except without warrant as in the case of a moving vehicle on the highway, the seizing officer may proceed without warrant if he has reasonable cause for belief that the contents of the vehicle offend the law.[1]

There was probable cause in the pending case. The officers had just destroyed a large still in the general neighborhood of the defendant's residence; the sugar truck was proceeding to that section of the community; the driver of the truck was reputed to be a violator of the liquor laws and this fact was known to the officers; the truck was loaded with 6 tons of sugar and the only explanation was that the goods [were] intended for a small neighborhood grocery store. No force was used in the course of the transaction. The defendant stopped his truck, when requested to do so, and consented to the inspection of his load. These circumstances led the officers reasonably to believe that a violation of the law was taking place and they would have been recreant to their duty if they had not made the seizure and held the property until an exhaustive investigation could be made. See, Husty v. United States, 282 U. S. 694, 51 S. Ct. 240, 75 L. ed. 629; Brinegar v. United States, 338 U. S. 160, 69 S. Ct. 1302, 93 L. ed. 1879; Grice v. United States, 4 Cir., 146 Fed. (2d) 849; Robinson v. United States, 5 Cir., 164 Fed. (2d) 271; Pearson v. United States, 10 Cir., 150 Fed. (2d) 219; Ray v. United States, 5 Cir., 84 Fed. (2d) 654.

When the case came to trial the evidence not only showed the circumstances of the seizure, as above set out, but the neighborhood grocer, in whose name the sugar had been billed, testified that the sugar did not belong to him. Moreover, the baker, who sold the sugar to the defendant, testified that he had made similar sales of sugar to the defendant on prior occasions. Neither the defendant nor any one on his behalf testified as to the purpose for which this large amount of seized sugar had been acquired, or the use to which it would be put; and it was proved that sugar had been used for the illicit manufacture of liquor in the neighborhood. Taking all these circumstances into consideration, it is obvious that there was sufficient evidence before the court to justify the verdict of guilty.

Affirmed.

SECTION 182.630a, REGULATIONS 3: General. (Also Section 182.630b, Regulations 3; Sections 178.296, 178.298, Regulations 7; Section 185.815, Regulations 10; Section 176.11, Regulations 28; and Section 192.390, Regulations 18.) Rev. Rul. 36*

INTERNAL REVENUE CODE

1. *Purpose.*—Section 309 of the Tariff Act of 1930, as amended, 19 U. S. C. 1309, and sections 182.630a–182.630b of Regulations 3, "Industrial Alcohol," sections 178.296–178.298 of Regulations 7, "Wine,"

[1] In United States v. Rabinowitz, 339 U. S. 56, 70 S. Ct. 430, 94 L. ed. 653, the court relaxed the strict rule that requires a search warrant solely upon the basis of the practicability of procuring it rather than upon the reasonableness of the search after a lawful arrest. The court said, 339 U. S. at page 65, 70 S. Ct. at page 435: "A rule of thumb requiring that a search warrant always be procured whenever practicable may be appealing from the vantage point of easy administration. But we cannot agree that this requirement should be crystallized into a *sine qua non* to the reasonableness of a search. It is fallacious to judge events retrospectively and thus to determine, considering the time element alone, that there was time to procure a search warrant. Whether there was time may well be dependent upon considerations other than the ticking off of minutes or hours. The judgment of the officers as to when to close the trap on a criminal committing a crime in their presence or who they have reasonable cause to believe is committing a felony is not determined solely upon whether there was time to procure a search warrant. Some flexibility will be accorded law officers engaged in daily battle with criminals for whose restraint criminal laws are essential."

*Originally issued as IR-Mimeograph 126, dated February 6, 1953.

section 185.815 of Regulations 10, "Warehousing of Distilled Spirits," and section 176.11 of Regulations 28, "Drawback on Distilled Spirits and Wines," authorize the withdrawal of alcohol, wine, and distilled spirits, free of tax or with benefit of drawback, for use on certain vessels and aircraft, and section 192.390 of Regulations 18, "Fermented Malt Liquors," authorizes the withdrawal of fermented malt liquors, free of tax, for use on certain vessels and aircraft. The purpose of this ruling is to provide a current listing of those countries whose vessels of war, and aircraft engaged in foreign trade, may withdraw alcoholic liquors, free of tax or with benefit of drawback, pursuant to section 309 of the Tariff Act of 1930 as amended, in accordance with Treasury Decision 53046, approved July 16, 1952, 17 F. R. 6732.

2. *Supplies for vessels.*—Section 10.59 of Customs Regulations of 1943, as amended, and as further amended by Treasury Decision 53046, *supra*, provides, in part, as follows:

WITHDRAWAL OF SUPPLIES FOR VESSELS

10.59 *Exemption from customs duties and internal-revenue tax.*—(a) A vessel shall not be considered to be actually engaged in the foreign trade, or in trade between the Atlantic and Pacific ports of the United States, or between the United States and its possessions, as the case may be, for the purpose of withdrawing supplies from bonded warehouses free of duty and internal-revenue tax pursuant to section 309(a), Tariff Act of 1930, as amended, unless it is—

(1) Operating on a regular schedule in a class of trade which entitles it to the privilege;

(2) Actually transporting passengers or merchandise to or from a foreign port, a port on the opposite coast of the United States, or between a port in a possession of the United States and a port in the United States or in another of its possessions;

(3) Proceeding in ballast to another domestic port to lade passengers or cargo for a foreign port, and its last carriage of passengers or cargo prior to departure from the port of withdrawal was in foreign trade; or

(4) Departing in ballast from the port at which the withdrawal is made for a foreign port, a port on the opposite coast of the United States, a port in one of the possessions of the United States (or if the port of withdrawal is in a possession of the United States, for a foreign port, the United States, or another possession of the United States) for the purpose of lading passengers or cargo at the port of destination for transportation in a class of trade specified in section 309(a), Tariff Act of 1930, as amended, for which class of trade the vessel is suitable and seaworthy at the time of leaving the port of withdrawal and from which it is not diverted prior to such lading.

* * * * * * *

(d) The privilege shall be accorded to vessels of war of the following countries:

Argentina
Australia
Belgium
Brazil
Canada
Chile
Colombia
Cuba
Denmark
The Dominican Republic
Ethiopia
Finland
France
Great Britain
Greece
Haiti
India
Ireland
Mexico
The Netherlands
New Zealand
Nicaragua
Norway
Panama
The Philippines
El Salvador
Spain
Sweden
Thailand
Turkey
Union of South Africa
Uruguay
Venezuela

* * * * * * *

3. *Supplies and equipment for aircraft of foreign registry.*—In accordance with section 309(d) of the Tariff Act of 1930, as amended by the Customs Administration Act of 1938, the Secretary of Commerce has found and has advised the Secretary of the Treasury that the below listed countries extend to aircraft registered in the United States and engaged in foreign trade, privileges substantially reciprocal to those given aircraft registered in such foreign country and engaged in foreign trade by section 309(a) of such act:

Australia	France
Bahama Islands	Israel
Belgium	The Netherlands
Bermuda	Norway
Canada	Sweden
Denmark	Switzerland
Ecuador	United Kingdom

4. *For guidance of officials concerned.*—Assistant District Commissioners, Alcohol and Tobacco Tax, should be guided by the above in acting upon applications to withdraw alcohol, wines, and distilled spirits, free of tax or with benefit of drawback, for use on certain vessels and aircraft, and applications to withdraw fermented malt liquors, free of tax, for use on certain vessels and aircraft, pursuant to the provisions of law and regulations referred to above.

5. *Correspondence.*—Correspondence relating to this Revenue Ruling should refer to the number thereof and the symbols O:AT:PPt.

REGULATIONS No. 5 (ALCOHOL TAX ACT.) T. D. 5977

TITLE 27—INTOXICATING LIQUORS.—CHAPTER I. PART 5.—LABELING AND ADVERTISING OF DISTILLED SPIRITS

Requirements for labeling distilled spirits

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

District Commissioners, Assistant District Commissioners, Alcohol and Tobacco Tax, and Others Concerned:

1. Notice of public hearing to be held in Washington, D. C., on December 19, 1952, with respect to certain proposals to amend Regulations No. 5, Relating to Labeling and Advertising of Distilled Spirits, was published in the Federal Register on December 3, 1952 (17 F. R. 10908).

2. Upon the conclusion of the said hearing and after consideration of all relevant material submitted by interested persons in connection therewith regarding the proposals, the following amendments to section 35 (27 CFR 5.35) are hereby adopted:

(a) By deleting the present subsections (a) and (b) of section 35 (27 CFR 5.35), and inserting in lieu thereof the following new subsection (a):

(a) "*Bottled by*".—On labels of domestic distilled spirits, there shall be stated the phrase "bottled by", immediately followed by the name (or trade name) of the bottler and the place where such distilled spirits are bottled. If the bottler is the actual bona fide operator of more than one bottling plant engaged in bottling the same brand of distilled spirits, there may be stated immediately following the name (or trade name) of such bottler the addresses of the plants at which such product is bottled: *Provided*, That the State of distillation is stated as provided by subsection (e) of this section: *Provided further*,

(1) That, where distilled spirits are bottled by or for the distiller thereof, there may be stated, in lieu of the phrase "bottled by", followed by the bottler's name (or trade name) and address, the phrase "distilled by", followed by the name (or trade name) under which the particular spirits were distilled, and the address (or addresses) of the distiller;

(2) That, where distilled spirits are bottled by or for the rectifier thereof, there may be stated, in lieu of the phrase "bottled by", followed by the bottler's name (or trade name) and address, the phrases "blended by", "made by", "prepared by", "manufactured by", or "produced by" (whichever may be appropriate to the act of rectification involved), followed by the name (or trade name) under which the distilled spirits were rectified, and the address (or addresses) of the rectifier.

(b) By relettering the present subsection (c) as subsection (b) and by amending the phrase "by subsections (a) and (b)" in the first sentence of paragraph (4) of that subsection to read "by subsection (a)".

(c) By deleting the present subsections (d) and (e) and inserting in lieu thereof a new subsection (c) as follows:

(c) *"Bottled for".*—In addition to the requirements of (a) and (b) of this section, there may also be stated the name and address of the person for whom the distilled spirits are bottled, immediately preceded by the words "bottled for" or "distributed by", or other similar statement.

and by relettering the present subsections (f), (g), and (h) as subsections (d), (e), and (f), respectively.

3. These amendments relieve restrictions presently contained in the regulations and shall become effective on the date of publication in the Federal Register.

(This Treasury Decision is issued pursuant to and under the authority contained in section 5 of the Federal Alcohol Administration Act as amended (49 Stat. 981); Reorganization Plan No. III, paragraph 2 (54 Stat. 1222); 1950 Reorganization Plan No. 26 (64 Stat. 1280); section 3170 of the Internal Revenue Code (53 Stat. 373); and section 161 of the Revised Statutes (5 U. S. C. 22)).

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 28, 1953.

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

(Published in the Federal Register February 4, 1953)

SECTION 178.139, REGULATIONS 7: Neutralizing, sterilizing, and preserving agents. (Also Sections 178.204, 178.205, 178.206, Regulations 7.) — Rev. Rul. 25*

INTERNAL REVENUE CODE

Materials approved for use in manufacture of wines

1. The following materials have been approved for use by winemakers in filtering, clarifying, purifying, or other cellar treatment of wines, within the limitations and conditions set forth herein and in sections 178.139, 178.204, 178.205, and 178.206 of Regulations 7. The procedure stated in paragraph 2 of this Revenue Ruling must be observed, and the records referred to in paragraph 4 must be maintained.

*Originally issued as IR-Mimeograph 106, dated January 16, 1953.

Kind of material	*Purpose for which used*	*Limitations*
Activated carbon	To clarify and purify wine.	May be used in accordance with section 178.204, Regulations 7.
Activated carbon	To remove excess color in white wines.	May be used in accordance with section 178.206, Regulations 7. *Application must be filed.*
Antifoam "A" (Silicone compound).	To reduce the foam in fermenters.	May not affect the basic composition of the wine.
Asbestos, shredded	To clarify wine	May be used in accordance with section 178.204, Regulations 7.
Bentonite (Wyoming clay).	To clarify wine	May be used in accordance with section 178.204, Regulations 7.
Calcium carbonate	To reduce excessive natural acidity in wine.	May be used in accordance with section 178.139, Regulations 7.
Calcium hydroxide (hydrated lime).	To reduce excessive natural acidity in wine.	May be used in accordance with section 178.139, Regulations 7.
Calcium hydroxide (hydrated lime).	To facilitate pressing juice from pulp, peel and cull oranges in making distilling material.	Not to exceed 24 pounds per ton.
Calcium sulfate (gypsum).	Production of Spanish type or Flor sherry wine.	Finished wine, when marketed, must not contain more than 2 grams per liter of potassium sulfate, as wine containing in excess of this amount is considered injurious to health by the Food and Drug Administration. *Application must be filed.*
Carbon	To clarify and purify wine.	May be used in accordance with section 178.204, Regulations 7.
Charcoal (bone)	To purify wine	May be used in accordance with section 178.204, Regulations 7.
Citric acid	To stabilize grape wine	May be used in accordance with section 178.205, Regulations 7. *Application must be filed.*
Diatomaceous earth (Hi-flow; Siloid; Supercel; Solka Floc).	To clarify wine	May be used in accordance with section 178.204, Regulations 7.
Eggs (albumen or yolks).	In filtering and clarifying wine.	May be used in accordance with section 178.204, Regulations 7.
Gelatin	To clarify wine	May be used in accordance with section 178.204, Regulations 7.
Gypsum (same as calcium sulfate—see above).	----------	----------
Hydrated lime (same as calcium hydroxide—see above).	----------	----------
Hydrogen peroxide	To reduce the sulfur dioxide content of distilling material.	None of the material may be contained in the distillate.

Kind of material	*Purpose for which used*	*Limitations*
Isinglass	To clarify wine	May be used in accordance with section 178.204, Regulations 7.
Mineral oil	Used on surface of wine in storage tanks to prevent the access of air to the wine.	None of the oil may be contained in the finished wine when marketed.
Mineral oil	To remove objectionable taste and odor of wine.	May not affect basic composition of wine and none of the mineral oil may be contained in the finished wine.
Nitrogen gas	To maintain pressure during filtering and bottling of champagne. To prevent oxidation of wine.	May not be contained in champagne or still wine.
Oak chips (uncharred and untreated).	In aging and baking sherry wine in redwood cooperage.	Finished product must have the flavor and color usually developed by the storage and baking of sherry wine in oak cooperage. *Application must be filed.*
Oak chips (uncharred and untreated).	To treat wine	May not change the composition and character of the wine, other than that accomplished during the usual storage of wine in oak cooperage. *Application must be filed.*
Olygo (finely divided metallic silver).	Filtering, clarifying and purifying wine.	May be used in accordance with section 178.204, Regulations 7.
Oxygen	In baking sherry wine	May be used provided it does not cause changes in the wine other than those occurring during the usual storage in wooden cooperage over a period of time. *Application must be filed.*
Pectinol	To clarify wine	One pound per 100 gallons of wine, in accordance with section 178.204, Regulations 7.
Phosfates	To start secondary fermentation in manufacturing champagne and sparkling wines.	Small quantity only may be used. (The use of ammonium phosfate, ammonium sulfate, or potassium acid phosfate as yeast food in the production of still wine is not permitted.)
Potassium metabisulfite.	Sterilizing and preserving wine.	May be used in accordance with section 178.139, Regulations 7.
Protovac Casein PV-20 (Neutral Sodium Caseinate).	Clarification of wine	May be used in accordance with section 178.204, Regulations 7.
Sodium Metabisulfite.	Sterilizing and preserving wine.	May be used in accordance with section 178.139, Regulations 7.
Sparkolloid (powdered agar and filter aid).	Clarification of wine	Two pounds to 1,000 gallons of wine, in accordance with section 178.204, Regulations 7.

Kind of material	*Purpose for which used*	*Limitations*
Sulfuric acid	To effect a favorable yeast development in distilling material.	May not be contained in distillate.
Sulfur dioxide	Sterilizing and preserving wine.	May be used in accordance with section 178.139, Regulations 7.
Tannin	Clarifying grape wine	May be used in accordance with section 178.205, Regulations 7. *Application must be filed.*
Urea	To facilitate fermentation of wine.	Not exceeding 2 pounds per thousand gallons of must. May be used as a yeast food.
Zeolite (inert carbonaceous material).	For clarification and removal of metallic components of tartrates.	May be used in accordance with section 178.204, Regulations 7.

2. It is the responsibility of the winemaker to see that materials employed in the filtering, clarifying, purifying, or other treatment of wines are used within the limitations prescribed herein and in the regulations. Failure of the winemaker to observe such limitations in the use of the materials may incur liability for rectification tax or the imposition of penalties. The following procedure is prescribed to facilitate compliance with the requirements of the regulations:

a. Application not required.—If the winemaker desires to use a material specifically named in the above list, for one of the purposes authorized by section 178.139 or 178.204 of Regulations 7, he need not file an application for permission to use such material, provided the material is used within the prescribed limitations.

b. Application must be filed.—If the winemaker desires to use a material for a purpose authorized by section 178.139 or 178.204 of Regulations 7, and the material is named in the above list, but the winemaker is doubtful whether the quantity he desires to use will change the basic composition of the wine or eliminate characteristic elements of the wine, or if the winemaker desires to use a quantity in excess of that specifically stated in the list, an application, in triplicate, containing a full statement regarding the proposed use of the material should be submitted to the Assistant District Commissioner, A&TT. When deemed essential, samples of each kind of wine before and after filtering, clarifying, purifying, or other treatment, with some of the material should be submitted to the assistant district commissioner for examination by the district laboratory. After approval or disapproval by the assistant district commissioner, the original application will be returned to the winemaker, one copy will be retained for the assistant district commissioner's records and the remaining copy will be forwarded to the Head, Alcohol and Tobacco Tax Division, Washington, D. C., marked "Attention: O: AT: PPt".

c. Application must be filed.—If the winemaker desires to use tannin or citric acid under the provisions of section 178.205 of Regulations 7, or material to remove excess color in wines under the provisions of section 178.206 of Regulations 7, an application must be filed as required in such sections.

d. Application must be filed.—If the winemaker desires to use a material bearing the statement "Application must be filed" in the above list, an application must be filed, even though the material is used within the stated limitations.

e. Application must be filed.—Where the winemaker desires to use material other than that specifically named in Regulations 7, or in the above list (but excluding sulfur in its various forms), he must file application, in triplicate, with the assistant district commissioner, setting forth the name and description of the material, the purpose, the manner and extent to which it is to be used, together with any pertinent information in regard to its composition. A sample of the material should be submitted with the application. The application, in triplicate, with the sample of the material, will be forwarded to this office by the assistant district commissioner. Two copies of the application will be returned to the assistant district commissioner with advice whether the application is approved or disapproved and if approved, the limitations to be observed. The assistant district commissioner will retain one copy of the application and return one copy to the winemaker.

3. Where an application covers the use of materials in wines intended for use as distilling material, the application should be accompanied by a statement containing the information required by section 184.191 of Regulations 5.

4. A record of the purchase and receipt of materials intended for the cellar treatment of wines must be kept, as required by section 178.127 of Regulations 7, and in addition where materials are used under the provisions of section 178.139 or 178.205 the record of use required by such sections must be kept.

5. The following materials, not specifically described in Regulations 7, have been approved as ingredients for wine, within the stated limitations (it is not necessary for winemakers to file applications before using such materials, but the production record (Form 701) must clearly show the use):

Kind of material	*Purpose for which used*	*Limitations*
Brewers' chips	Fermentation and sweetening of nonstandard wine.	Brewers' chips are classed as "corn sugar." Wine must be labeled to show the use of "corn sugar."
Raw cane sugar	Used in sugar-water solution for fermentation of natural wine.	Approved provided the sugar does not contain sufficient molasses flavor or color to affect the flavor and color of the wine, and the sugar contains not less than 95 percent of actual sugar calculated on a dry basis. May not be used for sweetening wine after fermentation.
Dextrose	Fermenting and sweetening of wine.	May be used only where the law and regulations authorize the use of dextrose sugar.
Hops	Manufacture of honey wine to facilitate fermentation and the production of a marketable product.	May be used in quantities not exceeding 1 pound of hops for each 1,000 pounds of honey.

6. Correspondence in regard to this Revenue Ruling should refer to the number thereof and to the symbols O : AT : PPt.

SECTION 185.588, REGULATIONS 10: Determination of tare—Method of determination. (Also Sections 185.590, 185.600, 185.601, 185.695, Regulations 10.) T. D. 6002

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 185.—WAREHOUSING OF DISTILLED SPIRITS

Revised instructions for use of Form 1520 and Form 1619

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

District Commissioners, Assistant District Commissioners, Alcohol and Tobacco Tax, and Others Concerned:

1. Sections 185.588, 185.590, 185.600, 185.601, and 185.695 of Regulations 10, "Warehousing of Distilled Spirits" (26 CFR, part 185; 15 F. R. 5233), as amended, are hereby amended to read as follows:

SUBPART AA—WITHDRAWAL OF DISTILLED SPIRITS FROM WAREHOUSE

* * * * * * *

DETERMINATION OF TARE

SEC. 185.588. METHOD OF DETERMINATION.—When packages of spirits are to be individually gauged for withdrawal from the warehouse, the actual tare of the package will be determined: *Provided*, That the average increase in tare may be determined and used to establish the tare at the time of gauge for withdrawal where it is shown to the satisfaction of the assistant district commissioner[1] (1) that, due to shortage of critical materials, the proprietor has been unable to install bulk gauging tanks for gauging distilled spirits dumped from packages, as provided in subpart CC, (2) that the volume of taxpaid withdrawals is not sufficient to justify the installation and use of bulk gauging tanks, or (3) that, in the case of small lots, it is not feasible to dump the spirits into bulk gauging tanks of large capacities. Written application to use the average tare method of gauging distilled spirits for taxpayment will be made to the assistant district commissioner by the warehouseman. (53 Stat. 375; 26 U. S. C. 3176.)

SEC. 185.590. AVERAGE TARE METHOD.—This method of determining tare may be used only for lots of spirits of the same kind and cooperage warehoused within a period of 10 days of each other at proofs not differing more than 10 percent. Packages which have been changed in cooperage to prevent loss or to change the kind of cooperage may not be included as a part of a lot containing packages not so changed, even though all packages involved contain the same kind of spirits originally warehoused within the same 10 days at proofs not differing more than 10 percent. The average increase in tare for a lot of spirits will be established by finding the actual tare, as described in section 185.589, for not less than 20 percent of the packages to be gauged for withdrawal, and determining the actual increase in tare for such packages. Where the average tare method is used, however, no rinsing of packages will be permitted. The words "Average tare taken" will be entered conspicuously on Form 1520 by the proprietor and the number of packages to be used as a basis for the determination will be stated thereon as 20 percent, 25 percent, 33⅓ percent, or 50 percent, of those to be withdrawn. The packages to be used for the determination will be selected at random by the storekeeper-gauger. Where application of the percentage to the number of packages to be withdrawn results in a fraction, the fraction will be counted as an additional package. Not less than two packages may be weighed to determine the average increase in tare of any lot of five packages or less. The actual tare found will be entered by the storekeeper-gauger on Form 1520

[1] Denotes the Assistant District Commissioner, Alcohol and Tobacco Tax, pursuant to Reorganization Plan No. 1 of 1952 (17 F. R. 2243).

for those packages for which it was determined, and an asterisk (*) will be placed to the left of the serial number of such packages. The actual increase in tare of each such package will be noted in the proper column of Form 1520 by the storekeeper-gauger, who will add these increases together and divide by the number of packages weighed to determine the average increase in tare to be applied to the other packages of the lot to be withdrawn. If the average increase so found contains a fraction of a pound less than twenty-five hundredths (0.25), it will be dropped; if twenty-five hundredths (0.25) or any intermediate fraction to and including seventy-five hundredths (0.75), it will be called one-half pound; if above seventy-five hundredths (0.75), it will be called 1 pound. The average increase in tare thus ascertained will be regarded as the increase of each of the remaining packages enumerated in the application for withdrawal and will be added to the entry tare of each such package to determine the withdrawal tare. (53 Stat. 375; 26 U. S. C. 3176.)

Subpart BB—Taxpaid Withdrawals in Packages

Sec. 185.600. Application, Form 179.—Application for taxpayment and withdrawal of distilled spirits in packages from a bonded warehouse shall be made by the proprietor on Form 179, in quadruplicate. Unless the packages are to be withdrawn on the original gauge, the proprietor will indicate on the form the method of gauge desired, i. e., whether actual or average tare, or whether all packages of the lot will be dumped in a gauging tank for bulk gauge and subsequent removal by pipeline or in packages under the provisions of sections 185.620–185.636. If the proprietor elects an individual gauge of each package, he shall also indicate on the Form 179 whether he desires the packages to be rinsed before the spirits are gauged or whether he desires to taxpay without rinsing. If the packages are not rinsed before gauging, recovery of spirits by rinsing of the packages at the time of dumping for bottling or rectification will be precluded. The proprietor's elections as to method of gauge and whether the packages will be rinsed may not be changed once gauging of the spirits has begun. Where the spirits are to be drawn into packages from a storage tank, the proprietor shall state, in addition to other applicable data on the form, the estimated quantity to be withdrawn. Separate applications shall be filed for the withdrawal of spirits from storage tanks. Likewise a separate application shall be filed for each lot of spirits in packages dumped for bulk gauge in a gauging tank in accordance with section 185.620. All copies of the application will be delivered to the storekeeper-gauger at the warehouse. (53 Stat. 298 as amended, 335, 373 as amended, 375; 26 U. S. C. 2800, 2882, 3170, 3176.)

Sec. 185.601. Preparation of Form 1520.—Except where spirits are to be withdrawn in packages filled from warehouse storage tanks at the time of withdrawal, the proprietor will prepare Form 1520, in quintuplicate, covering the packages shown in the application, Form 179. The proprietor will enter in the heading of the Form 1520 all the information called for and will show as to each package the necessary details of the entry gauge in the columns headed "Serial Nos. of Packages or Tank Cars," "Kind of Spirits," "Original Taxable Gallons," "Last Gauge," "Date of Original Entry for Deposit" and, if the packages are to be gauged by the average tare method, "Tare on Entry Gauge." If the "Last Gauge" was established by a Form 1698, the serial number of the form will be entered in columns 11 and 12. In the event a regauge is to be made upon withdrawal of packages which have remained in the warehouse for a period not exceeding 30 days from the date of the original gauge the proprietor will note on Form 1520 the reason for requesting a regauge. All copies of the Form 1520 will be delivered to the storekeeper-gauger with the Form 179. (53 Stat. 335, 373 as amended, 375; 26 U. S. C. 2882, 3170, 3176.)

Subpart FF—Transfers in Bond Between Internal Revenue Bonded Warehouses

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TRANSFERS BETWEEN WAREHOUSES IN SAME DISTRICT

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SEC. 185.395. TRANSFERS IN PACKAGES.—When the proprietor of the shipping warehouse desires to make shipment of spirits in original packages, or in packages previously filled from warehouse storage tanks, or of blended brandies in packages filled in the brandy blending department, he will prepare an original and five copies of Form 1619 filling in the heading and giving details as to serial numbers of packages, date of original entry for deposit, original gauge and last gauge (if other than the original). In the case of blended brandies the proprietor shall also show on Form 1619 the date and serial number of the Form 1685 covering the blending of the brandies, the date of the original entry of the oldest brandy in the blend and the date of the original entry of the youngest brandy in the blend. The proprietor shall execute on the six copies of Form 236 a description of the packages to be transferred and will give all copies of Forms 236 and 1619 to the storekeeper-gauger. Upon receipt of the Forms 236 and 1619 the storekeeper-gauger will weigh and examine the packages and where it is determined that any package bears evidence of unusual loss that cannot be satisfactorily explained, or of tampering, such package will be detained pending further investigation in accordance with the applicable provisions of sections 185.480-185.496. The storekeeper-gauger will enter the shipping gross weights on Form 1619. The quantity to be transferred shall not exceed the maximum stated in the application. Upon withdrawal for transfer to noncontiguous premises, the word "Transferred" followed by the date of transfer, the number of the receiving warehouse, and the State in which such warehouse is located, will be plainly and durably stenciled on the Government head of the package in letters and figures not less than one-half inch in height. These marks may be abbreviated as follows:

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I. R. B. W. 4-N. Y.

Forms 236 and 1619 will be disposed of in accordance with the provisions of section 185.706. (53 Stat. 300 as amended, 332, 375; 26 U. S. C. 2801, 2875, 3176.)

2. The purposes of these amendments are (*a*) to amend the instructions contained in regulations relative to the recording of the original tare of packages of distilled spirits on Form 1520, "Report of Spirits Gauged," and Form 1619, "Report of Packages Transferred Between Bonded Warehouses," and (*b*) to clarify the intent of regulations with respect to packages which may be included in one lot when average tare is to be taken.

3. It is found that compliance with the notice and public rulemaking 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 amendments for the reason that the changes made impose no additional requirements on the industry, but relate merely to agency procedure or clarify existing requirements.

4. This Treasury Decision shall be effective upon its publication in the Federal Register. (This Treasury Decision is issued under the authority contained in 53 Stat. 298 as amended, 300 as amended, 332, 335, 373 as amended, 375; 26 U. S. C. 2800, 2801, 2875, 2882, 3170, 3176.)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved March 31, 1953.

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

(Published in the Federal Register April 7, 1953)

SECTION 185.1055, REGULATIONS 10: Storekeeper-gauger's report. (Also Section 185.1056, Regulations 10.) T. D. 5974

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 185.—WAREHOUSING OF DISTILLED SPIRITS

Requirements for semiannual report of spirits in warehouses prescribed.

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

To District Commissioners, Assistant District Commissioners, Alcohol and Tobacco Taxes, and Others Concerned:

1. Subpart XX of Regulations 10, "Warehousing of Distilled Spirits" (26 CFR, part 185, 15 F. R. 5233) is hereby amended as follows:

SUBPART XX—SEMIANNUAL REPORTS OF SPIRITS IN WAREHOUSES

SEC. 185.1055. STOREKEEPER-GAUGER'S REPORT.—The storekeeper-gauger shall prepare a report, in triplicate, on Form 332, by kinds, seasons, and years of production, of stocks of distilled spirits on deposit in the internal revenue bonded warehouse at the close of business on June 30 and December 31 of each year. Form 332 shall be prepared as indicated by the headings of the columns and lines and in accordance with the instructions printed on the form or issued in respect thereto and by this part. In the case of blended brandy the season and year of the oldest brandy in the blend shall be considered the season and year of the blended brandy. The original and one copy will be forwarded to the assistant district commissioner[1] on or before the tenth day of the month succeeding the date for which the report was prepared, and the remaining copy shall be retained in the office of the storekeeper-gauger at the warehouse. (53 Stat. 375; 26 U. S. C. 3176.)

SEC. 185.1056. ASSISTANT DISTRICT COMMISSIONER'S REPORT.—Each assistant district commissioner[1] shall prepare a summary report, in duplicate, on Form 332, by kinds, seasons, and years of production, of distilled spirits in internal revenue bonded warehouses at the close of business on June 30 and December 31 of each year, for each State within his district. Form 332 shall be prepared as indicated by the headings of the columns and lines and in accordance with the instructions printed on the form or issued in respect thereto and by this part. The original of the summary report on Form 332 with the originals of the Forms 332 submitted by storekeeper-gaugers for each internal revenue bonded warehouse within the State shall be forwarded to the Commissioner not later than the last day of the month succeeding the date for which the report was rendered. The duplicate copies of Form 332 shall be retained by the assistant district commissioner. (53 Stat. 375; 26 U. S. C. 3176.)

2. The purpose of the proposed amendment is to require storekeeper-gaugers and assistant district commissioners to report by kinds, seasons, and years of production, stocks of distilled spirits on deposit in internal revenue bonded warehouses at the close of business on December 31 of each year, in addition to the reporting of such stocks annually as of June 30.

3. 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

[1] Pursuant to Reorganization Plan No. 1 of 1952 (17 F. R. 2243) the office of District Supervisor has been abolished and the office of Assistant District Commissioner, Alcohol and Tobacco Tax, created in place thereof.

the issuance of these regulations for the reason that the change made is of an administrative nature and does not impose any requirement on the industry.

4. This Treasury Decision shall be effective upon the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in 53 Stat. 375; 26 U. S. C. 3176.)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved January 16, 1953.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register January 23, 1953)

SECTION 190.122, REGULATIONS 15: Receiving tanks. T. D. 5996

(Also Section 190.468a, Regulations 15.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 190.—RECTIFICATION OF SPIRITS AND WINES

Amendment of requirement for vodka receiving tanks at rectifying plants.

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

District Commissioners, Assistant District Commissioners, Alcohol and Tobacco Tax, and Others Concerned:

1. Sections 190.122 and 190.468a of Regulations 15 (26 CFR, part 190) are amended to read as follows:

SUBPART I—EQUIPMENT

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SEC. 190.122. RECEIVING TANKS.—Where rectified products are produced by redistillation, such as gin or cordials, or where spirits are redistilled, the rectifier must provide a requisite number of receiving tanks. Where vodka is produced, a receiving tank or tanks may be provided therefor, if desired. Each receiving tank shall be constructed of metal or other suitable material and equipped with a suitable device whereby the contents can be accurately determined. Manheads, inlets, and outlets of such tanks must be provided with facilities for locking with Government locks. Each tank shall have plainly and legibly painted thereon words indicating its use, as "Gin Receiving Tank," "Cordial Receiving Tank," "Heads and Tails Receiving Tank," "Vodke Receiving Tank," etc., followed by its serial number and capacity in gallons. Receiving tanks must be located in the rectifying room. (53 Stat. 300 as amended, 318, 375; 26 U. S. C. 2801, 2829, 3176.)

SUBPART Y—RECTIFICATION

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TAX-EXEMPT VODKA

SEC. 190.468a. PRODUCTION.—Vodka may be produced exempt from the rectification tax in accordance with the procedure prescribed by section 190.468b. Vodka so produced must be either (*a*) promptly drawn from the processing or receiving tank or tanks into metal, porcelain or glass containers or paraffin-

lined containers, gauged, stamped, and removed to the finished products room or (*b*) transferred from such tank or tanks to a bottling tank, gauged, and bottled and removed to the finished products room or conveyed by pipeline to a contiguous taxpaid bottling house or rectifying plant for bottling. (See sections 190.615 to 190.672.) (53 Stat. 298 as amended, 300 as amended, 375; 26 U. S. C. 2800, 2801, 3176.)

2. The purpose of these amendments is to eliminate the requirement that vodka produced at the rectifying plant must be run into a receiving tank prior to being drawn into prescribed containers or transferred to a bottling tank. Since vodka is produced at rectifying plants by the treatment of distilled spirits with charcoal in processing tanks, the deposit of the finished vodka in a receiving tank prior to packaging or transfer to a bottling tank is an unnecessary requirement. The use of such a tank will be optional.

3. It is found that compliance with the notice, public rulemaking 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.

4. This Treasury Decision shall be effective immediately upon the date of its publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in 53 Stat. 298 as amended, 300 as amended, 318, 375; 26 U. S. C. 2800, 2801, 2829, 3176.)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved February 26, 1953.

Elbert P. Tuttle,
Acting Secretary of the Treasury.

(Published in the Federal Register March 3, 1953)

Section 190.246, Regulations 15: Branding, labeling, etc. T. D. 5995

(Also Sections 190.252, 190.436, 190.900, 190.903. 190.904, Regulations 15.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 190.—RECTIFICATION OF SPIRITS AND WINES

Rectification under trade names

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington 25, D. C.

To District Commissioners, Assistant District Commissioners, Alcohol and Tobacco Tax, and Others Concerned:

1. Regulations 15, Rectification of Spirits and Wines (26 CFR, part 190; 15 F. R. 4790), as amended, are hereby further amended as follows:

(*a*) Sections 190.246, 190.252, 190.436, 190.900, 190.903, and 190.904 are amended; and

(*b*) Sections 190.900a and 190.900b are added.

SUBPART M—REQUIREMENTS GOVERNING CHANGES IN NAME, PROPRIETORSHIP, CONTROL, LOCATION, PREMISES, AND EQUIPMENT

SEC. 190.246. MARKING PACKAGES AND CASES.—Where there is a change in the individual, firm, or corporate name of the rectifier, he must, upon receipt of the assistant district commissioner's authorization, as provided in section 190.316, mark under such new name the spirits rectified or bottled thereunder, as provided in subpart II of this part, unless the spirits are rectified or bottled under a trade name or style other than the name in which the rectifying plant is qualified and operated, as provided in subpart NN. (53 Stat. 309, 318, 327 as amended, 329, 373 as amended, 375, 394; 26 U. S. C. 2812, 2831, 2857, 2861, 3170, 3176, 3270.)

TRADE NAMES

* * * * * * *

SEC. 190.252. MARKING CONTAINERS.—The packages and cases of spirits may be marked under the trade name in which they were rectified or bottled as provided in subpart NN of this part. (53 Stat. 329, 373 as amended, 375; 26 U. S. C. 2861, 3170, 3176.)

SUBPART X—GAUGING AND DUMPING SPIRITS FOR RECTIFICATION

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SEC. 190.436. MARKING PROCESSING TANKS.—In every case where spirits are dumped into processing tanks or receptacles, the number of the formula under which the spirits are to be rectified will be marked legibly upon such tanks or receptacles: *Provided*, That where spirits are not to be rectified in the processing tanks or receptacles in which originally dumped, such tanks will be labeled to show the kind of spirits and the serial number and date of the Form 122 pursuant to which the spirits were dumped, in lieu of the number of the formula: *And provided further*, That where packages of spirits are dumped under the circumstances described in section 190.438 the rectifier will not be required to mark the formula number on processing tanks or receptacles. (53 Stat. 375; 26 U. S. C. 3176.)

SUBPART NN—OPERATING UNDER A NEW NAME OR RECTIFYING AND BOTTLING UNDER DIFFERENT TRADE NAMES

SEC. 190.900. QUALIFICATION OF PROPRIETOR.—Whenever the proprietor of a rectifying plant desires to change the individual or corporate name, or the trade name or style, in which the rectifying plant is operated, he must, except as provided in sections 190.900a and 190.900b, secure approval of such change in the manner prescribed in sections 190.240–190.256 prior to the commencement of operations. (53 Stat. 375; 26 U. S. C. 3176.)

SEC. 190.900a. TRADE NAME RECTIFICATION.—Where the rectifier desires to rectify particular spirits under a trade name or style other than the name in which the rectifying plant is qualified and operated, and such trade name or style has been specified on an approved Form 27-B and on the rectifier's Federal Alcohol Administration Act permit, he may rectify such spirits under such approved trade name without filing an amended notice on Form 27-B or changing the name under which the rectifying plant is then qualified and operated. Form 122-Supplemental will be prepared, in duplicate, covering the particular spirits which the rectifier desires to rectify under such trade name. In the heading of the form will be shown the formula number and the trade name under which the spirits are to be rectified, and in the body of the form will be shown the quantities of each kind of spirits, which previously have been dumped for rectification pursuant to Form 122 and which it is desired to rectify under the formula and trade name specified. The rectifier will submit both copies of Form 122-Supplemental to the Government officer, who will inspect the spirits described on the form and verify the entries. If the officer is satisfied that the entries are correct, he will approve both copies of the form and return them to the proprietor who will retain one copy on file at the rectifying plant available for examination by Government officers. The original copy of Form 122-Supple-

mental will be attached to the processing tank in which the spirits are rectified, and shall remain attached to the tank until the rectified spirits are transferred to packages or to a bottling tank for bottling pursuant to Form 237, at which time the Form 122–Supplemental will be removed from the processing tank and attached to the Form 237. The rectifier shall state on Part 1 of Form 237 the trade name or style under which the spirits were rectified. The spirits so rectified may be labeled "blended by", "made by", "prepared by", "manufactured by", or "produced by" (whichever may be appropriate to the act of rectification involved), followed by the trade name or style under which the spirits were rectified, and the address (or addresses) of the rectifier, in accordance with Regulations 5 (27 CFR, part 5) issued under the Federal Alcohol Administration Act. (53 Stat. 375; 26 U. S. C. 3176.)

SEC. 190.900b. TRADE NAME BOTTLING.—Where the rectifier desires to bottle particular spirits under a trade name or style other than the name in which the rectifying plant is qualified and operated, or the name under which the spirits were rectified pursuant to Form 122–Supplemental, and such trade name or style has been specified on an approved Form 27–B and on the rectifier's Federal Alcohol Administration Act permit, and he has secured certificates of label approval (Form 1649) or certificates of exemption from label approval (Form 1650) for the labeling of spirits under such trade name or style, he shall specify on Form 230 or Form 237, as the case may be, his intent to bottle and label the particular spirits covered by the form under such name or style. Upon approval of the form in the usual manner, he may so bottle and label the particular spirits covered by Form 230 or Form 237, as the case may be, without filing an amended notice on Form 27–B or changing the name under which the rectifying plant is then qualified and operated. (53 Stat. 375; 26 U. S. C. 3176.)

SEC. 190.903. MARKING PACKAGES AND CASES.—The packages or cases will be marked under the individual or corporate name or trade name or style in which the rectifying plant is being operated: *Provided*, That where spirits are rectified pursuant to section 190.900a, or are bottled pursuant to section 190.900b, under a trade name other than that in which the rectifying plant is qualified and operated, such trade name may be marked on the packages or cases as the name of the rectifier or bottler, as the case may be, in lieu of the name in which the rectifying plant is being operated: *Provided further*, That where such spirits are bottled for a certain dealer they may be marked in accordance with section 190.798. The packages and cases shall be further marked in accordance with sections 190.797 and 190.798. (53 Stat. 375; 26 U. S. C. 3176.)

SEC. 190.904. RECORDS.—Separate records on Form 45 and Form 182, will not be required for operations under a new individual or corporate name or under each trade name or style. The rectifier shall, however, note on Form 45 the individual or corporate name or the trade names or styles under which operations were conducted during the month, and the dates of operation under each. The storekeeper-gauger will make a similar notation on Form 182. In the case of spirits rectified pursuant to the provisions of section 190.900a, or bottled pursuant to section 190.900b, the proprietor will show on Form 45 the trade name under which the particular spirits were rectified or bottled. (53 Stat. 375; 26 U. S. C. 3176.)

2. The purpose of these amendments is to authorize the rectification (concurrently with regular operations) of particular spirits under a trade name or names other than the name under which the rectifying plant is then qualified and operated, in lieu of filing an amended notice on Form 27–B, Notice by Rectifier, and changing the name under which the rectifying plant is qualified and operated.

3. It is found that compliance with the notice, public rulemaking 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.

4. This Treasury Decision shall be effective upon the date of its publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in 53 Stat. 309, 318, 327 as amended, 329, 373 as amended, 375, 394; 26 U. S. C. 2812, 2831, 2857, 2861, 3170, 3176, 3270.)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved February 26, 1953.

ELBERT P. TUTTLE,
Acting Secretary of the Treasury.

(Published in the Federal Register March 3, 1953)

SECTION 171.2, MISCELLANEOUS REGULATIONS RELATING TO LIQUOR: Basic permit procedure under Federal Alcohol Administration Act. Rev. Rul. 37*

INTERNAL REVENUE CODE

1. *Purpose.*—The purpose of this Revenue Ruling is to prescribe uniform procedure to be followed by holders of basic permits under the Federal Alcohol Administration Act and by district offices of the Bureau with respect to changes of location of permittees.

2. *Authority.*—Section 171.2 of the Miscellaneous Regulations Relating to Liquor, governing Basic permit procedure under Federal Alcohol Administration Act (as amended by T. D. 4982, C. B. 1940-2, 426, approved July 9, 1940, 5 F. R. 2549; T. D. 5039, C. B. 1941-1, 481, approved February 12, 1941, 6 F. R. 950; T. D. 5152, C. B. 1942-1, 344, approved June 3, 1942, 7 F. R. 4267; and T. D. 5550, C. B. 1947-1, 183, approved March 5, 1947, 12 F. R. 1649), issued pursuant to section 2(d) of the Federal Alcohol Administration Act, 27 U. S. C. 202(d), section 3170, Internal Revenue Code, and 5 U. S. C. 22, provides, among other things, that the procedure prescribed by Regulations 3, Industrial Alcohol, for the issuance, amendment, and denial of permits, under part II of subchapter C of chapter 26 of the Internal Revenue Code is extended to the issuance, amendment, denial, revocation, suspension, and annulment of basic permits under the Federal Alcohol Administration Act, insofar as such procedure is not in conflict with the provisions of such act.

3. *Regulations 3 procedure made applicable.*—As regards changes in location of persons holding basic permits under the Internal Revenue Code, sections 182.267 and 182.295 of Regulations 3 require the filing of applications for new basic permits. In view thereof, and since such procedure is not in conflict with any provision of the Federal Alcohol Administration Act, it is felt that it should be made applicable to all changes of location of permittees under the Federal Alcohol Administration Act.

4. *Uniform procedure prescribed.*—Some districts have followed this procedure, while others have followed the practice of the former Federal Alcohol Administration in amending existing permits to recognize such changes. As a means of assuring uniform procedure in all districts, changes of location of basic permittees under the Federal Alcohol Administration Act no longer will be recognized by the

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*Originally issued as IR Mimeograph 125, dated February 4, 1953.

amendment of existing permits. Hereafter, any permittee under the Federal Alcohol Administration Act who moves from one location to another will be required to file application for a new basic permit to cover the authorized operations at the new location.

5. *Use of Form 1643.*—Form 1643, Application for Amended Basic Permit Under the Federal Alcohol Administration Act, will continue to be used to report any change of address (resulting from the redesignation of a street name, street number, or building) which does not involve a change of location. It will not be used to report changes of location, and will be appropriately revised to conform with this revised procedure.

6. *Correspondence.*—Any correspondence relative to this Revenue Ruling should refer to its number and the symbols O:AT:BP.

SECTION 171.213, MISCELLANEOUS REGULATIONS RELATING TO LIQUOR: Transferred between bonded premises by tank cars, tank trucks, or tank barges.
(Also Regulations 3, 4, 5, 10, 15, and Gauging Manual.)

T. D. 6005

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PARTS 171, 182, 183, 184, 185, 186, AND 190

Removals of distilled spirits and alcohol, in bulk containers, at whole or fractional degrees of proof.

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

District Commissioners, Assistant District Commissioners, Alcohol and Tobacco Tax, and Others Concerned:

On January 1, 1953, a notice of proposed rulemaking was published in the Federal Register (18 F. R. 38) to amend "Miscellaneous Regulations Relating to Liquors," Regulations 3, Regulations 4, Regulations 5, Regulations 10, Regulations 15, and the Gauging Manual (parts 171, 182, 183, 184, 185, 190, and 186, chapter 26 of the Code of Federal Regulations). No objections to the rules proposed having been received, the amendments to such regulations set forth below are hereby adopted:

1. Sections 171.213 and 171.217 of "Miscellaneous Regulations Relating to Liquor" (26 CFR, part 171) are amended as follows:

SUBPART G—NATIONAL EMERGENCY TRANSFERS OF DISTILLED SPIRITS

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GAUGING OF DISTILLED SPIRITS

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SEC. 171.213. TRANSFERRED BETWEEN BONDED PREMISES BY TANK CARS, TANK TRUCKS, OR TANK BARGES.—When distilled spirits of any proof are transferred by tank cars, tank trucks, or tank barges, between distilleries, internal revenue bonded warehouses, industrial alcohol plants, and industrial alcohol bonded warehouses, and when distilled spirits of 160° or more of proof are removed, free of tax, from any such premises for transfer by tank cars, tank trucks, or

tank barges to a denaturing plant, for denaturation, such distilled spirits shall be gauged in a suitable weighing tank in the shipping premises at the time of shipment and in the receiving premises at the time of receipt: *Provided*, That where the shipping or receiving premises, or both, are not equipped with a weighing tank, the spirits transferred in tank cars or tank trucks may be weighed on railroad car or tank truck scales, as the case may be, located on the bonded premises, by weighing the railroad car or tank truck both before and after filling or emptying, or both, as the case may be: *And provided further*, That where the shipping or receiving premises, or both, are not equipped with a weighing tank, or railroad car or tank truck scales, the spirits may be gauged by volume in accurately calibrated tanks, but, in any event, they must be gauged (either by weight or by volume) in both the shipping and receiving premises: *And provided further*, That distilled spirits transferred from an industrial alcohol plant or industrial alcohol bonded warehouse to an internal revenue bonded warehouse in tank cars for storage in the internal revenue bonded warehouse in such tank cars, shall be gauged at, and removed from, the internal revenue bonded warehouse in accordance with the provisions of Regulations 10 (26 CFR, part 185) applicable to tank cars of spirits transferred in bond to internal revenue bonded warehouses. (65 Stat. 116; 26 U. S. C. 3183.)

SEC. 171.217. DETERMINATION OF PROOF.—The proof of distilled spirits drawn off into containers other than tank cars, tank trucks, tank ships, and tank barges, or by pipeline, under the provisions of this subpart, shall be adjusted to a whole or complete degree. Where removals are to be made under the provisions of this subpart in tank cars, tank trucks, tank ships, tank barges, or by pipeline, the proof of the distilled spirits may be adjusted to a whole or complete degree of proof prior to gauge for removal or the distilled spirits may be removed without such reduction. Where the proof of spirits removed in tank cars, tank trucks, tank ships, tank barges, or by pipeline, for taxpayment, is not adjusted to a whole degree of proof, the fractional degree of proof, if any, shall be determined to the nearest tenth, which shall be used in determining the taxable gallons in accordance with this subpart and table 4 of the Gauging Manual (26 CFR, part 186). Where the proof of distilled spirits removed in tank cars, tank trucks, tank ships, tank barges, or by pipeline, for purposes other than taxpayment, is not adjusted to a whole degree, the proof shall be determined to the nearest tenth but shall be rounded to a whole degree in accordance with section 186.20 of the Gauging Manual and such whole degree shall be the proof of removal: *Provided*, That, where the proprietor or the consignee so desires, the fractional proof may be stated as the proof of the spirits and used in determining the proof gallonage of the spirits, in lieu of the whole degree of proof. Where distilled spirits are to be transferred in bond to an internal revenue bonded warehouse in a tank car and the consignee desires to taxpay the spirits in the tank car within 30 days after filling, and without regauge, the distilled spirits shall be reduced to a whole or flat degree of proof before being drawn into the tank car, or the proof gallonage shall be determined by use of the fractional degree of proof. In any such case the storekeeper-gauger shall make notation on Form 1520, that the distilled spirits were reduced to a whole degree of proof or, if they were not so adjusted, the fractional degree of proof at which withdrawn. (65 Stat. 116; 26 U. S. C. 3183.)

2. Section 182.405 of Regulations 3 (26 CFR, part 182; 7 F. R. 1858), "Industrial Alcohol," as amended, is amended as follows:

OPERATION OF INDUSTRIAL ALCOHOL PLANTS

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DRAWING OFF, GAUGING, AND REMOVAL OF ALCOHOL

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SEC. 182.405. GAUGING OF ALCOHOL.—All alcohol drawn from receiving tanks will be carefully gauged by the proprietor by weighing and proofing the spirits in accordance with this part and the Gauging Manual (26 CFR, part 186), and the details thereof shall be entered by the proprietor on Form 1440. Entries shall be made as indicated by the headings of the various columns and lines and in accordance with the instructions printed on the form or issued in respect thereto and as required by this part. Packages shall be marked in accordance

with this part. The storekeeper-gauger will verify the proof, weight, and gallonage of all alcohol withdrawn and will see that the instructions in the Gauging Manual respecting the proofing of alcohol are strictly followed in order that the proof may be accurately determined. The proof of the alcohol shall be adjusted to a whole or complete degree of proof before being removed from the receiving tanks for filling approved containers such as drums or barrels, bottles, containers made of tin, glass, or similar substance and steel containers having a capacity of not more than 10 wine gallons. Where removals from receiving tanks are to be made in tank cars, tank trucks, tank ships, tank barges, or by pipeline, the proof of the alcohol may be adjusted to a whole or complete degree of proof prior to gauge for removal or the alcohol may be removed without such reduction. Where the proof of alcohol removed in tank cars, tank trucks, tank ships, tank barges, or by pipeline, for taxpayment, is not so adjusted to a whole or complete degree, the fractional degree of proof, if any, shall be determined to the nearest tenth, which shall be used in determining the taxable gallons in accordance with this part and table 4 of the Gauging Manual. Where the proof of alcohol removed in tank cars, tank trucks, tank ships, tank barges, or by pipeline, for purposes other than taxpayment, is not adjusted to a whole or complete degree, the proof shall be determined to the nearest tenth but shall be rounded to a whole degree in accordance with section 186.20 of the Gauging Manual and such whole degree shall be the proof of removal: *Provided*, That, where the proprietor or the consignee so desires, the fractional proof may be stated as the proof of the alcohol and used in determining the proof gallonage, in lieu of the whole degree of proof. The alcohol in the receiving tank must be thoroughly agitated before taking the proof. The proof determined after such agitation will be regarded as the proof of alcohol run into all packages filled from the receiving tank and all alcohol removed from such tank by pipeline or in tank cars or tank trucks. However, the proof of the alcohol in the receiving tank will be checked several times while the alcohol is being drawn off. The proprietor shall provide, at his own expense, accurate hydrometers, hydrometer cups, and thermometers for the purpose of gauging alcohol. Alcohol to be transferred by pipeline or in railroad tank cars or tank trucks for shipment shall be gauged in a weighing tank as provided in section 182.407. (53 Stat. 307, 357, 358, 364, 375; 26 U. S. C. 2808, 3103, 3105, 3124, 3176.)

3. Section 183.515 of Regulations 4 (26 CFR, part 183; 15 F. R. 5334), "Production of Distilled Spirits," is amended as follows:

SUBPART W—TAXPAYMENT, REMOVAL, AND TRANSFER OF DISTILLED SPIRITS FROM CISTERN ROOM

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DRAWING OFF, GAUGING, AND REMOVAL OF SPIRITS

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SEC. 183.515. GAUGING OF SPIRITS.—All distilled spirits drawn from receiving cisterns will be carefully gauged by the storekeeper-gauger by weighing and proofing the spirits in accordance with this subpart and the Gauging Manual (26 CFR, part 186), and the details thereof will be entered on the report of gauge, Form 1520. Entries shall be made as indicated by the headings of the various columns and lines and in accordance with the instructions printed on the form or issued in respect thereto and as required by this part. The storekeeper-gauger shall, in every instance, note on Form 1520 the proof of distillation of the spirits gauged. The proof of spirits shall be adjusted to a complete or whole degree before being removed from the receiving cisterns in casks, barrels, or similar wooden packages or drums or similar metal packages. Where removals from receiving cisterns are to be made in tank cars, tank trucks, or by pipeline, the proof of the spirits may be adjusted to a whole or complete degree of proof prior to gauge for removal or the spirits may be removed without such reduction. Where the proof of spirits removed in tank cars, tank trucks, or by pipeline, for taxpayment, is not adjusted to a whole or complete degree, the fractional degree of proof, if any, shall be determined to the nearest tenth, which shall be used in determining the taxable gallons in accordance with this part and table 4 of the Gauging Manual. Where the proof of spirits removed in tank cars, tank trucks, or by pipeline, for purposes other than taxpayment, is not adjusted to a whole or complete degree, the proof shall be determined to the nearest tenth but shall be rounded to a whole degree in accordance with section

186.20 of the Gauging Manual and such whole degree shall be the proof of removal: *Provided*, That, where the proprietor or the consignee so desires, the fractional proof may be stated as the proof of the spirits and used in determining the proof gallonage, in lieu of the whole degree of proof. Where spirits are to be transferred in bond to an internal revenue bonded warehouse in a tank car and the consignee desires to taxpay the spirits in the tank car within 30 days after filling, and without regauge, the spirits shall be reduced to a whole degree of proof before being drawn into the tank car, or the proof gallonage shall be determined by use of the fractional degree of proof. In any such case the storekeeper-gauger shall make notation on Form 1520 that the spirits were reduced to a whole degree of proof or, if they were not so adjusted, the fractional degree of proof at which withdrawn. The spirits in the cistern must be thoroughly agitated before taking the proof. The proof determined after such agitation will be regarded as the proof of spirits run into all packages filled from the cistern and all spirits removed by pipeline or in tank cars or in tank trucks. However, the proof of the spirits in the cistern will be checked several times while spirits are being drawn off. Distilled spirits to be transferred by pipeline or in tank cars or tank trucks for shipment will be gauged in a weighing tank as provided in sections 183.517, 183.519, and 183.555. (53 Stat. 298 as amended, 307, 333, 335 as amended, 355, 375, 492; 26 U. S. C. 2800, 2808, 2878, 2883, 3070, 3176, 4017.)

4. Sections 184.561 and 184.565 of Regulations 5 (26 CFR, part 184; 15 F. R. 5552), "Production of Brandy," are amended as follows:

SUBPART X—TAXPAYMENT, REMOVAL, AND TRANSFER OF BRANDY FROM DISTILLERY

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DRAWING OFF, GAUGING, AND REMOVAL OF BRANDY

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SEC. 184.561. GAUGING OF BRANDY.—All brandy drawn from receiving tanks will be carefully gauged by the storekeeper-gauger by weighing and proofing the brandy in accordance with this subpart and the Gauging Manual (26 CFR, part 186), and the details thereof entered on the report of gauge, Form 1520. Entries shall be made as indicated by the headings of the various columns and lines and in accordance with the instructions printed on the form or issued in respect thereto and as required by this part. The storekeeper-gauger shall, in every instance, note on Form 1520 the proof of distillation of the brandy gauged. The proof of brandy shall be adjusted to a whole or complete degree before being removed from the receiving tanks in casks, barrels, or similar wooden packages or drums or similar metal packages. Where removals from receiving tanks are to be made in tank cars, tank trucks, or by pipeline, the brandy may be adjusted to a whole or complete degree of proof prior to gauge for removal or the brandy may be removed without such reduction. Where the proof of brandy removed in tanks cars, tank trucks, or by pipeline, for taxpayment, is not so adjusted to a whole or complete degree, the fractional degree of proof, if any, shall be determined to the nearest tenth, which shall be used in determining the taxable gallons in accordance with this part and table 4 of the Gauging Manual. Where the proof of brandy removed in tank cars, tank trucks, or by pipeline, for purposes other than taxpayment, is not adjusted to a whole or complete degree, the proof shall be determined to the nearest tenth but shall be rounded to a whole degree in accordance with section 186.20 of the Gauging Manual and such whole degree shall be the proof of removal: *Provided*, That, where the proprietor or the consignee so desires, the fractional proof may be stated as the proof of the brandy, and used in determining the proof gallonage, in lieu of the whole degree of proof. Where brandy is to be transferred in bond to an internal revenue bonded warehouse in a tank car and the consignee desires to taxpay the brandy in the tank car within 30 days after filling, and without regauge, the brandy shall be reduced to a whole degree of proof before being drawn into the tank car, or the proof gallonage shall be determined by use of the fractional proof. In any such case the storekeeper-gauger shall make notation on Form 1520 that the spirits were reduced to a whole degree of proof or, if they were not so adjusted, the fractional degree of proof at which withdrawn. The brandy in the receiving tank must be thoroughly agitated before taking the proof. The proof determined after such agitation will be regarded as the proof of brandy run into all packages filled from the receiving tank and all brandy removed by pipeline or in tank cars or in tank trucks. However, the proof of the brandy

in the receiving tank will be checked several times while brandy is being drawn off. Brandy to be transferred by pipeline or in tank cars for shipment will be gauged in a weighing tank as provided in section 184.562. (53 Stat. 307, 333, 335 as amended, 375, 492; 26 U. S. C. 2808, 2878, 2883, 3176, 4017.)

SEC. 184.565. UPON WITHDRAWAL FROM STORAGE TANKS.—When brandy is transferred to storage tanks in the brandy deposit room after it has been gauged, it will be regauged by weighing tanks upon removal, unless it is drawn into packages and gauged. The proof of brandy removed from storage tanks in the brandy deposit room shall be adjusted or determined in accordance with the provisions of section 184.561. (53 Stat. 307, 333, 335 as amended, 375; 26 U. S. C. 2808, 2878, 2883, 3176.)

5. Regulations 10 (26 CFR, part 185; 15 F. R. 5233), "Warehousing of Distilled Spirits," as amended, are amended as follows:

(*a*) Sections 185.377, 185.576, 185.622, and 185.660 are amended; and

(*b*) Section 185.377a is added.

SUBPART S—DEPOSIT OF SPIRITS IN WAREHOUSE

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SPIRITS RECEIVED IN CASKS OR OTHER APPROVED CONTAINERS

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SEC. 185.377. EXAMINATION OF TANK CARS.—The storekeeper-gauger will carefully examine each tank car of spirits upon its arrival at the warehouse for evidence of loss and will determine if the seals affixed at the shipping premises are intact. Where the tank car bears evidence of tampering, or of unusual loss that cannot be satisfactorily explained, it will be temporarily detained pending further investigation in accordance with the applicable provisions of sections 185.480-185.496. Where the tank car bears no evidence of tampering, or of unusual loss that cannot be satisfactorily explained, the spirits may be taxpaid on the filling gauge, within 30 days of the date of filling, in accordance with sections 185.377a and 185.660. Where the spirits are not to be so taxpaid, they will be gauged in a gauging tank, or by volumetric measurement in the tank car, and reported on Form 1520 covering the transfer. Where the spirits are less than 160° of proof and are gauged in a gauging tank, they will be immediately returned to the tank car for storage therein in the warehouse pending taxpayment or further transfer in bond in accordance with section 185.392. Where the spirits are 160° or more of proof, they may be returned to the tank car, or transferred to warehouse storage tanks in accordance with section 185.392. Where, after gauge, the spirits are retained in or returned to the tank car, the car will be sealed pending taxpayment or further transfer in bond. Where the spirits are not taxpaid on the filling gauge within 30 days of the date of filling, they must be regauged prior to taxpayment. (53 Stat. 298 as amended, 335 as amended, 340 as amended, 375; 26 U. S. C. 2800, 2883, 2901, 3176.)

SEC. 185.377a. TAXPAYMENT ON FILLING GAUGE.—When spirits are received in bond in a tank car they may be taxpaid without regauge only where the spirits were reduced to a whole degree of proof when the car was filled, or the fractional degree of proof was used in determining the proof gallonage drawn into the car, and such fact was noted by the storekeeper-gauger on the Form 1520 covering the filling gauge. (53 Stat. 298 as amended, 335 as amended, 375; 26 U. S. C. 2800, 2883, 3176.)

SUBPART AA—WITHDRAWAL OF DISTILLED SPIRITS FROM WAREHOUSE

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DRAWING OFF SPIRITS FROM GAUGING OR STORAGE TANKS

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SEC. 185.576. ADJUSTING PROOF.—The proof of distilled spirits in warehouse gauging tanks and storage tanks shall be adjusted to a whole degree of proof prior to filling packages such as barrels or drums: *Provided*, That such adjustment will not be required prior to filling such packages from gauging tanks when the proof of the spirits is less than 100°. Adjusting the proof to tenths of a degree, either above or below the whole degree, will not be permitted. Where spirits are to be transferred by pipeline from gauging tanks to tanks in the bottling-in-bond department or are to be removed from gauging or storage tanks in tank cars, tank trucks, or by pipeline, the proof of the spirits may be adjusted to a whole or complete degree prior to gauge for transfer or removal

or the spirits may be transferred or removed without such reduction. Where the proof of spirits removed in tank cars, tank trucks, or by pipeline, for taxpayment, is not adjusted to a whole degree of proof, the fractional degree of proof, if any, shall be determined to the nearest tenth, which shall be used in determining the taxable gallons in accordance with this part and table 4 of the Gauging Manual (26 CFR, part 186). Where the proof of spirits removed in tank cars, tank trucks, or by pipeline, for purposes other than taxpayment, is not adjusted to a whole degree, the proof shall be determined to the nearest tenth but shall be rounded to a whole degree in accordance with section 186.20 of the Gauging Manual and such whole degree shall be the proof of removal: *Provided*, That where the proprietor or the consignee so desires, the fractional proof may be stated as the proof of the spirits and used in determining the proof gallonage of the spirits, in lieu of the whole degree of proof. Where spirits are to be transferred in bond to an internal revenue bonded warehouse in a tank car and the consignee desires to taxpay the spirits in the tank car within 30 days after filling, and without regauge, the spirits shall be reduced to a whole or flat degree of proof before being drawn into the tank car, or the proof gallonage shall be determined by use of the fractional degree of proof. In any such case the storekeeper-gauger shall make notation on Form 1520 that the spirits were reduced to a whole degree of proof or, if they were not so adjusted, the fractional degree of proof at which withdrawn. (53 Stat. 307, 375; 26 U. S. C. 2808, 3176.)

SUBPART CC—TAXPAID WITHDRAWALS BY GAUGE TANK

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SEC. 185.622. GAUGE AND TAXPAYMENT.—If the spirits to be withdrawn are in packages, the storekeeper-gauger, upon receipt of the Form 179 and Form 1520, will carefully examine and supervise the weighing of each package and enter the weights on Form 1520. Where it is determined that any package bears evidence of unusual loss that cannot be satisfactorily explained, or of tampering, such package will be detained pending further investigation in accordance with the applicable provisions of section 185.480–185.496. When the contents of the packages have been dumped into the gauging tank, the empty packages, including the char and wood chips, if any, will be thoroughly rinsed: *Provided*, That if the contents of the packages dumped for bulk gauging are to be drawn from the gauging tank for shipment in as many of the original packages as may be required, the packages to be used as shipping containers need not be rinsed if a declaration to that effect has been made by the proprietor prior to the dumping of the spirits, in which event recovery of spirits by rinsing at the time of dumping for bottling or rectification will be precluded. Water of any temperature may be used to rinse the packages. The rinsings will be added to the spirits dumped from the packages into the gauging tank prior to gauging: *Provided*, That where the proprietor does not wish to add any or all of the rinse water to the spirits in the gauging tank, such rinse water must be poured on the ground or into a sewer in the presence of the storekeeper-gauger. The temperature of water used for rinsing must be marked on the packages used as shipping containers in accordance with section 185.628. Loose char and wood chips, if any, collected from packages, the contents of which have been dumped into bulk gauging tanks after rinsing, must be destroyed in accordance with section 185.902, unless added to the packages which are to be used as shipping containers. The tare of any shipping container must include the weight of loose char and wood chips which are placed therein. After the packages have been dumped and rinsed, all marks and brands shall be obliterated, except where the packages are to be used for shipping of spirits dumped therefrom for gauging, in which case, only the kind of cooperage, serial number of the package, the word "Filled," the date of filling, and the original proof and proof gallons need be obliterated. The spirits in the gauging tank will be gauged with an official hydrometer and the details of the gauge and the number of the gauging tank entered by the storekeeper-gauger on Form 1520. The proof of the spirits shall be adjusted or determined in accordance with the provisions of section 185.576. If the spirits to be withdrawn are contained in a storage tank or tank car, they will be drawn into the gauging tank, gauged and reported in the same manner as packages dumped for bulk gauging. Four copies of Form 179 with the storekeeper-gauger's report thereon, duly executed, and four copies of Form 1520 will be delivered by the storekeeper-gauger to the proprietor of the warehouse. One copy of Form 1520 will be retained by the storekeeper-gauger pending taxpayment of the spirits rep-

resented thereby. (53 Stat. 298 as amended, 335, 335 as amended, 375; 26 U. S. C. 2800, 2882, 2883, 3176.)

SUBPART DD—TAXPAID WITHDRAWALS IN TANK CARS AND TANK TRUCKS

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IN TANK CARS RECEIVED IN BOND

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SEC. 185.660. PROCEDURE.—Where spirits are received in bond in tank cars at an internal revenue bonded warehouse and taxpaid thereat, the procedure prescribed in sections 185.650-185.657 for the taxpayment of tank cars of spirits filled from warehouse storage tanks will be followed, except that if the spirits in the tank car are taxpaid within 30 days after filling, they need not be regauged but may be taxpaid on the filling gauge under the provisions of sections 185.377 and 185.377a. (53 Stat. 298 as amended, 335 as amended, 375; 26 U. S. C. 2800, 2883, 3176.)

6. Sections 186.20 and 186.23 of the Gauging Manual (26 CFR, part 186; 15 F. R. 4787), are amended as follows:

SUBPART E—PRESCRIBED TABLES

SEC. 186.20. TABLE 1, SHOWING THE TRUE PERCENTS OF PROOF SPIRITS FOR ANY INDICATION OF THE HYDROMETER AT TEMPERATURES BETWEEN ZERO AND 100° F.—This table shows the true percent of proof of distilled spirits for indications of the hydrometer likely to occur in practice at temperatures between zero and 100° F. The left hand column contains the reading of the hydrometer and on the same horizontal line, in the body of the table, in the "Temperature" column corresponding to the reading of the thermometer is the corrected reading or "True percent of proof." The table is computed for tenths of a percent. Where distilled spirits or alcohol are gauged in packages, if the decimal is less than five it will be dropped; if it is five or over a unit will be added. Thus column 69°, indication 114, the true percent, 110.4, is called 110; column 69°, indication 117, the true percent of proof 113.5, is called 114. Where distilled spirits or alcohol are gauged for taxpayment in bulk for removal by pipeline, tank car, tank truck, tank ship, or tank barge without adjustment of the proof to a whole or complete degree, the proof shall be determined to the nearest tenth of a degree and such fractional proof will be used in determining the taxable gallons. Thus column 71°, indication 193, the true percent, 190.4, will be recorded and used to calculate the taxable gallons. The proof of distilled spirits or alcohol withdrawn in tank cars, tank trucks, tank ships, tank barges, and by pipeline, for purposes other than taxpayment, shall be determined to the nearest tenth of a degree; however, except where the proprietor or consignee desires to remove distilled spirits or alcohol at a fractional degree, if the decimal is less than five it will be dropped; if it is five or over, a unit will be added. Thus column 71°, indication 193, the true percent, 190.4, is called 190; column 71°, indication 194, the true percent of proof, 191.5, is called 192. Where fractional readings are ascertained, the proper interpolations will be made, e. g., for a hydrometer reading of 151, temperature 71½°, the true percent of proof would be 147.0, or for a hydrometer reading 179.4, temperature 75°, the true percent of proof would be 175.0. (53 Stat. 307, 333, 335 as amended, 373 as amended, 375, 467; 26 U. S. C. 2808, 2878, 2883, 3170, 3176, 3791.)

SEC. 186.23. TABLE 4, SHOWING THE FRACTIONAL PART OF A GALLON PER POUND AT EACH PERCENT AND EACH TENTH PERCENT OF PROOF OF SPIRITUOUS LIQUOR.—This table provides a method for use in ascertaining the wine gallon (at 60° F.) and/or proof gallon contents of containers of spirits by multiplying the net weight of the spirits by the fractional part of a gallon per pound shown in the table for spirits of the same proof. Fractional gallons beyond the first decimal will be dropped if less than 0.05 or will be added as 0.1 if 0.05 or more. This table may also be used for ascertaining the quantity of water required to reduce to a given proof. To do this, divide the proof gallons of spirits to be reduced by the fractional part of a proof gallon per pound of spirits at the proof to which the spirits are to be reduced, and subtract from the quotient the net weight of the spirits before reduction. The remainder will be the pounds of water needed to reduce the spirits to the desired proof.

Example. It is desired to ascertain the quantity of water needed to reduce 1,000 pounds of 200 proof spirits, 302.6 proof gallons, to 190 proof:

302.6 divided by 0.27964 equals 1,082.11 pounds, weight of spirits after reduction.

1,082.11 minus 1,000 equals 82.11 pounds, weight of water required to reduce to desired proof.

The slight variation between this table and tables 2, 3, and 5 on some calculations is due to the dropping or adding of fractions beyond the first decimal on those tables. (53 Stat. 307, 333, 335 as amended, 373 as amended, 375, 467; 26 U. S. C. 2808, 2878, 2883, 3170, 3176, 3791.)

7. Section 190.566 of Regulations 15 (26 CFR, part 190; 15 F. R. 4790), "Rectification of Spirits and Wines," is amended as follows:

SUBPART BB—GAUGE, RETURN, AND TAXPAYMENT OF RECTIFIED SPIRITS

GAUGE OF RECTIFIED SPIRITS

* * * * * * *

SEC. 190.566. ADJUSTMENT OF PROOF.—The proof of rectified spirits shall be adjusted to a whole degree of proof in accordance with the provisions of the Gauging Manual (26 CFR, part 186), preparatory to filling barrels or bottles. Adjusting the proof to tenths of a degree, either above or below the whole or complete degree, will not be permitted: *Provided*, That when spirits are being prepared for bottling and are to be bottled and labeled in tenths of a degree of proof, such as 86.4, the proof of the spirits shall be adjusted to such tenths of a degree of proof. If the proof is so adjusted to tenths, the fractional degree of proof shall be used in determining the taxable gallons, for payment of the rectification tax, in accordance with the Gauging Manual. The proof in each instance shall be verified as to accuracy by the Government officer. (53 Stat. 300 as amended, 329, 375; 26 U. S. C. 2801, 2861, 3176.)

8. These regulations shall be effective on the 31st day after publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in 53 Stat. 298 as amended, 300 as amended, 307, 329, 333, 335, 335 as amended, 340 as amended, 355, 357, 358, 364, 373 as amended, 375, 467, 492; 65 Stat. 116; 26 U. S. C. 2800, 2801, 2808, 2861, 2878, 2882, 2883, 2901, 3070, 3103, 3105, 3124, 3170, 3176, 3791, 4017, and 3183.)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved April 10, 1953.

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

(Published in the Federal Register April 16, 1953)

CHAPTER 27.—OCCUPATIONAL TAXES

SUBCHAPTER A.—SPECIAL PROVISIONS

PART IX.—COIN-OPERATED AMUSEMENT AND GAMING DEVICES

SECTION 3267.—TAX ON COIN-OPERATED AMUSEMENT AND GAMING DEVICES

SECTION 323.22, REGULATIONS 59: Rates and computation of tax. Rev. Rul. 40

INTERNAL REVENUE CODE

A mechanical horse or other similar device which is activated by the insertion of a coin is considered to be a coin-operated amusement device within the meaning of section 3267 of the Internal Revenue

Code, and persons who maintain for use, or permit the use of such devices, on premises occupied by them, incur liability for the special tax of $10 per year with respect to each such device.

SECTION 323.22, REGULATIONS 59: Rates and computation of tax. Rev. Rul. 58

INTERNAL REVENUE CODE

Coin-operated still or moving picture machines are considered to be coin-operated amusement devices for purposes of the special $10 tax under section 3267 of the Internal Revenue Code; however, coin-operated radio and television sets are primarily instruments for receiving communications, and are not considered to be amusement devices subject to such tax liability.

Advice is requested concerning the application of the special tax under section 3267 of the Internal Revenue Code to the maintenance for use of coin-operated still or moving picture devices, and of coin-operated radio and television sets.

Section 3267 of the Internal Revenue Code provides in part as follows:

(a) RATE.—Every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device shall pay a special tax as follows:

(1) $10 per year in the case of a device defined in clause (1) of subsection (b):

* * * * * * *

(b) DEFINITION.—As used in this Part, the term coin-operated amusement and gaming devices means (1) any amusement or music machine operated by means of the insertion of a coin, token, or similar object * * *.

Machines operated by the insertion of a coin, for which the viewer may witness still or moving pictures, clearly fall within the purview of section 3267 of the Code, as coin-operated amusement devices.

However, radio and television sets, although used for amusement or entertainment, are primarily instruments for receiving communications by which the listener or viewer is enabled to receive the sound and images being transmitted on the air waves. The insertion of a coin in a radio or television set does not place in operation a device that by itself produces music, a play, or any other form of entertainment. Rather, in such a case, the coin merely controls a mechanism that permits the use of the radio or television set for the reception of a program that is produced elsewhere and is broadcast generally to be received by all sets tuned in to the broadcast wave-band, regardless of whether any particular set is "coin-operated." (See *Dunbar* v. *Spratt-Snyder Co. et al.*, 226 N. W. 22.) Moreover, a coin inserted in such a set usually serves to permit the operation of the set for a given period of time and, therefore, is an amount paid in effect as a rental for the use of the set for the time allotted.

In view of the foregoing, it is held that coin-operated still or moving picture machines are considered to be coin-operated amusement devices for purposes of the special $10 tax under section 3267 of the Internal Revenue Code. However, coin-operated radio and television sets are primarily instruments for receiving communications and, therefore, are not considered to be amusement devices subject to such tax liability.

PART X.—BOWLING ALLEYS, AND BILLIARD AND POOL TABLES

SECTION 3268.—TAX ON BOWLING ALLEYS, AND BILLIARD AND POOL TABLES

SECTION 323.31, REGULATIONS 59: Persons liable for tax. **Rev. Rul. 86**

INTERNAL REVENUE CODE

Bowling alleys maintained exclusively for the use of members of the Armed Forces on property owned by the United States are not exempt from the special occupational tax imposed by section 3268(a) of the Internal Revenue Code where, as a condition precedent to using the alleys, a charge is collected from the players and paid to pinsetters. The amount collected from the players is considered to constitute a charge for the use of the alleys within the meaning of the law.

Advice is requested whether the exemption from the special occupational tax imposed by section 3268(a) of the Internal Revenue Code, as added by Public Law 576, Eighty-second Congress, C. B. 1952–2, 361, with respect to bowling alleys maintained exclusively for the use of the Armed Forces, is applicable where a charge of 10 cents a game is collected from players and paid to pinsetters.

Section 3268(a) of the Code provides, in part, that the special tax of $20 per year shall not apply for any period after June 30, 1952, with respect to any bowling alley, billiard table, or pool table maintained exclusively for the use of members of the Armed Forces on any property owned, reserved, or used by, or otherwise acquired for the use of, the United States if no charge is made for their use.

It is held that an amount collected from a player using a bowling alley and paid to a pinsetter constitutes a charge made for its use within the meaning of the statute where the charge is a condition precedent to the use of the alley. Accordingly, the exemption from the special tax provided by section 3268(a) of the Code, as added by Public Law 576, *supra*, does not apply where, under the circumstances stated, amounts are collected from players for the use of the bowling alleys, even though the amounts collected are in turn paid to pinsetters.

CHAPTER 27A.—WAGERING TAXES

SUBCHAPTER A.—TAX ON WAGES

SECTION 3285.—TAX

SECTION 325.21, Regulations 132: Scope of tax. (Also Section 325.26; Section 3290, Section 325.41.) **Rev. Rul. 52***

INTERNAL REVENUE CODE

Suit or merchandise clubs operated pursuant to a plan whereby some participants may, by drawing or other element of chance, receive merchandise having a retail value in excess of their payments,

*Originally issued as IR-Mimeograph 148, dated March 11, 1953.

and all other participants receive merchandise having a retail value equivalent to the amount of their payments, do not constitute lotteries conducted for profit for purposes of the wagering taxes. Mimeograph 6814, C. B. 1952-1, 210, revoked.

1. Further consideration has been given to the applicability of the wagering taxes imposed by sections 3285 and 3290 of the Internal Revenue Code with respect to the operation of suit and merchandise clubs as set forth in Mimeograph 6814, C. B. 1952-1, 210, wherein it was held that clubs operated in the manner described below meet the definition of a lottery conducted for profit for the purposes of the wagering taxes and, therefore, all sums placed with or advanced to merchants in the operation of such clubs constitute wagers subject to the wagering tax:

One hundred persons pay $1 a week for a period of 30 weeks, and after the second week one person's name is drawn from a members' list and the winner receives $30 worth of merchandise for the $2 paid in and is not required to make any further payments. The second person receives $30 worth of merchandise for the $3 paid in, and so on until the 30 weeks expire. However, each member in the club receives the full $30 in trade, credit, or payment on account. Should any member drop out before the expiration of the 30-week period, he receives the amount he has paid in trade, credit, or on account.

2. Section 3285 of the Internal Revenue Code imposes a tax on, among other wagers, any wager placed in a lottery conducted for profit, and section 325.21(f) of Regulations 132, pertaining to the wagering tax, states, in part, that in general a lottery conducted for profit includes any scheme or method for the disposition of prizes among persons who have paid or promised a consideration for a chance to win such prizes. Section 325.26(a) of Regulations 132 states that the tax is imposed at the rate of 10 percent of the amount of any taxable wager, and that the amount of the wager is the amount risked by the bettor, rather than the amount which he stands to win.

3. The Bureau has given further study to suit and merchandise clubs in which the participants make periodic payments to be applied on the purchase of merchandise pursuant to a plan under which some participants may, by drawing or other element of chance, receive as a prize merchandise having a retail value in excess of their payments, and all other participants receive merchandise having a retail value equivalent to the amount of their payments, which amount is no more than they would ordinarily pay for the same merchandise if they were not members of the club.

4. It is now the position of the Bureau that where suit or merchandise clubs are operated in the manner described in paragraph 3, the sums placed with merchants in the operation of such clubs do not constitute "wagers" within the meaning and intent of the law involved. Therefore, since no wager is involved, such operation would not fall within the scope of the wagering tax law, and the 10 percent excise tax and the $50 per year occupational tax imposed by sections 3285 and 3290 of the Internal Revenue Code would not apply. However, this ruling is applicable only to such clubs as are operated under the circumstances set forth in paragraph 3, that is, where the participant receives merchandise having a retail value at least equivalent to his payments.

5. The ruling set forth in Mimeograph 6814, *supra*, is revoked.

6. Correspondence relating to the contents of this Revenue Ruling should refer to its number and the symbols T:R:ExSt.

SUBCHAPTER B.—OCCUPATIONAL TAX

SECTION 3290.—TAX

SECTION 325.41, Regulations 132: Person liable for tax.

INTERNAL REVENUE CODE

Suit or merchandise clubs. (See Rev. Rul. 52, page 454.)

SECTION 3291.—REGISTRATION

SECTION 325.50, REGULATIONS 132: Registry, return, and payment of tax. Ct. D. 1755

OCCUPATIONAL TAXES—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

WAGERING TAX—CONSTITUTIONALITY.

The occupational tax provisions of the Revenue Act of 1951, which levy a tax on persons engaged in the business of accepting wagers and require such persons to register with the collector of internal revenue, are not unconstitutional. They do not infringe the police power which is reserved to the States, nor do they violate the privilege against self-incrimination.

SUPREME COURT OF THE UNITED STATES

The United States of America, appellant, v. *Joseph Kahriger*

On appeal from the United States District Court for the Eastern District of Pennsylvania

[March 9, 1953]

OPINION

Mr. Justice REED delivered the opinion of the Court.

The issue raised by this appeal is the constitutionality of the occupational tax provisions of the Revenue Act of 1951,[1] which levy a tax on persons engaged

[1] 26 U. S. C. (supp. V) sec. 3285:
"(a) WAGERS.
"There shall be imposed on wagers, as defined in subsection (b), an excise tax equal to 10 per centum of the amount thereof.
* * * * * * *
"(d) PERSONS LIABLE FOR TAX.
"Each person who is engaged in the business of accepting wagers shall be liable for and shall pay the tax under this subchapter on all wagers placed with him. Each person who conducts any wagering pool or lottery shall be liable for and shall pay the tax under this subchapter on all wagers placed in such pool or lottery.
"(e) EXCLUSIONS FROM TAX.
"No tax shall be imposed by this subchapter (1) on any wager placed with, or on any wager placed in a wagering pool conducted by, a parimutuel wagering enterprise licensed under State law, and (2) on any wager placed in a coin-operated device with respect to which an occupational tax is imposed by section 3267."
26 U. S. C. (supp. V) sec. 3290:
"A special tax of $50 per year shall be paid by each person who is liable for tax under subchapter A or who is engaged in receiving wagers for or on behalf of any person so liable."
26 U. S. C. (supp. V) sec. 3291:
"(a) Each person required to pay a special tax under this subchapter shall register with the collector of the district—
"(1) his name and place of residence;
"(2) if he is liable for tax under subchapter A, each place of business where the activity

in the business of accepting wagers, and require such persons to register with the collector of internal revenue. The unconstitutionality of the tax is asserted on two grounds. First, it is said that Congress, under the pretense of exercising its power to tax has attempted to penalize illegal intrastate gambling through the regulatory features of the Act (26 U. S. C. (supp. V) sec. 3291) and has thus infringed the police power which is reserved to the States. Secondly, it is urged that the registration provisions of the tax violate the privilege against self-incrimination and are arbitrary and vague, contrary to the guarantees of the fifth amendment.

The case comes here on appeal, in accordance with 18 U. S. C. section 3731, from the United States District Court for the Eastern District of Pennsylvania, where an information was filed against appellee alleging that he was in the business of accepting wagers and that he willfully failed to register for and pay the occupational tax in question. Appellee moved to dismiss on the ground that the sections upon which the indictment was based were unconstitutional. The district court sustained the motion on the authority of our opinion in *United States* v. *Constantine*, 296 U. S. 287 [Ct. D. 1053, C. B. XIV-2, 403 (1935)]. The court reasoned that "while the subject matter of this legislation so far as revenue purposes is concerned is within the scope of Federal authorities," the tax was unconstitutional in that the information called for by the registration provisions was "peculiarly applicable to the applicant from the standpoint of law enforcement and vice control," and therefore the whole of the legislation was an infringement by the Federal Government on the police power reserved to the States by the tenth amendment. *United States* v. *Kahriger*, 105 F. Supp. 322, 323.

The result below is at odds with the position of the seven other district courts which have considered the matter,[2] and, in our opinion, is erroneous.

In the term following the *Constantine* opinion, this court pointed out in *Sonzinsky* v. *United States*, 300 U. S. 506 [Ct. D. 1217, C. B. 1937-1, 351], at 513 (a case involving a tax on a "limited class" of objectionable firearms alleged to be prohibitory in effect and "to disclose unmistakably the legislative purpose to regulate rather than to tax"), that the subject of the tax in *Constantine* was "described or treated as criminal by the taxing statute." The tax in the *Constantine* case was a special additional excise tax of $1,000, placed only on persons who carried on a liquor business in violation of State law. The wagering tax with which we are here concerned applies to all persons engaged in the business of receiving wagers regardless of whether such activity violates State law.

The substance of respondent's position with respect to the tenth amendment is that Congress has chosen to tax a specified business which is not within its power to regulate. The precedents are many upholding taxes similar to this wagering tax as a proper exercise of the Federal taxing power. In the *License Tax Cases*, 5 Wall. 462, the controversy arose out of indictments for selling lottery tickets and retailing liquor in various States without having first obtained and paid for a license under the Internal Revenue Act of Congress. The objecting taxpayers urged that Congress could not constitutionally tax or regulate activities carried on within a State. P. 470. The court pointed out that Congress had "no power of regulation nor any direct control" (5 Wall., at 471, 472) over the business there involved. The court said if the licenses

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which makes him so liable is carried on, and the name and place of residence of each person who is engaged in receiving wagers for him or on his behalf; and

"(3) if he is engaged in receiving wagers for or on behalf of any person liable for tax under subchapter A, the name and place of residence of each such person."

26 U. S. C. (supp. V) sec. 3294:

"(a) FAILURE TO PAY TAX.

"Any person who does any act which makes him liable for special tax under this subchapter, without having paid such tax, shall, besides being liable to the payment of the tax, be fined not less than $1,000 and not more than $5,000.

* * * * * * *

"(c) WILLFUL VIOLATIONS.

"The penalties prescribed by section 2707 with respect to the tax imposed by section 2700 shall apply with respect to the tax imposed by this subchapter."

[2] *United States* v. *Smith*, 106 F. Supp. 9 (D. C. S. D. Cal.); *United States* v. *Nadler*, 105 F. Supp. 918 (D. C. N. D. Cal.); *United States* v. *Forrester*, 105 F. Supp. 136 (D. C. N. D. Ga.); *United States* v. *Robinson*, 107 F. Supp. 38 (D. C. E. D. Mich.); *United States* v. *Arnold, Jordan, and Wingate*, No. 478 (D. C. E. D. Va.), September 18, 1952. *United States* v. *Penn*, No. 2021 (D. C. M. D. N. C.), May 1952. *Combs* v. *Snyder*, 101 F. Supp. 531 (D. D. C.), affirmed, 342 U. S. 939.

were to be regarded as by themselves giving authority to carry on the licensed business it might be impossible to reconcile the granting of them with the Constitution. P. 471.

> "But it is not necessary to regard these laws as giving such authority. So far as they relate to trade within State limits, they give none, and can give none. They simply express the purpose of the government not to interfere by penal proceedings with the trade nominally licensed, if the required taxes are paid. The power to tax is not questioned, nor the power to impose penalties for non-payment of taxes. The granting of a license, therefore, must be regarded as nothing more than a mere form of imposing a tax, and of implying nothing except that the licensee shall be subject to no penalties under national law, if he pays it." *Id.*, at 471.

Appellee would have us say that because there is legislative history [3] indicating a congressional motive to suppress wagering, this tax is not a proper exercise of such taxing power. In the *License Cases, supra*, it was admitted that the Federal license "discouraged" the activities. The intent to curtail and hinder, as well as tax, was also manifest in the following cases, and in each of them the tax was upheld: *Veazie Bank* v. *Fenno*, 8 Wall. 533 (tax on paper money issued by State banks); *McCray* v. *United States*, 195 U. S. 27, 59 (tax on colored oleomargarine); *United States* v. *Doremus*, 249 U. S. 86, and *Nigro* v. *United States*, 276 U. S. 332 (tax on narcotics); *Sonzinsky* v. *United States*, 300 U. S. 506 (tax on firearms); *United States* v. *Sanchez*, 340 U. S. 42 (tax on marihuana) [Ct. D. 1735, C. B. 1950-2, 139].

It is conceded that a Federal excise tax does not cease to be valid merely because it discourages or deters the activities taxed. Nor is the tax invalid because the revenue obtained is negligible. Appellee, however, argues that the sole purpose of the statute is to penalize only illegal gambling in the States through the guise of a tax measure. As with the above excise taxes which we have held to be valid, the instant tax has a regulatory effect. But regardless of its regulatory effect, the wagering tax produces revenue. As such it surpasses both the narcotics and firearms taxes which we have found valid.[4]

It is axiomatic that the power of Congress to tax is extensive and sometimes falls with crushing effect on businesses deemed unessential or inimical to the public welfare, or where, as in dealings with narcotics, the collection of the tax also is difficult. As is well known, the constitutional restraints on taxing are few. "Congress cannot tax exports, and it must impose direct taxes by the rule of apportionment and indirect taxes by the rule of uniformity." *License Tax Cases, supra*, 471.[5] The remedy for excessive taxation is in the hands of Congress, not the courts. *Veazie Bank* v. *Fenno*, 8 Wall. 533, 548. Speaking of the creation of the Bank of the United States, as an instrument for carrying out Federal fiscal policies, this Court said in *McCulloch* v. *Maryland*, 4 Wheat. 316, 423:

> "Should Congress, in the execution of its powers, adopt measures which are prohibited by the constitution; or should Congress, under the pretext of executing its powers, pass laws for the accomplishment of objects not entrusted to the government; it would become the painful duty of this

[3] There are suggestions in the debates that Congress sought to hinder, if not prevent the type of gambling taxed. See 97 Cong. Rec. 6892:

"Mr. HOFFMAN of Michigan. Then I will renew my observation that it might if properly construed be considered an additional penalty on the illegal activities.

"Mr. COOPER. Certainly, and we might indulge the hope that the imposition of this type of tax would eliminate that kind of activity." 97 Cong. Rec. 12236: "If the local official does not want to enforce the law and no one catches him winking at the law, he may keep on winking at it, but when the Federal Government identifies a law violator and the local newspaper gets hold of it and the local church organizations get hold of it and the people who do want the law enforced get hold of it, they say, 'Mr. Sheriff, what about it? We understand that there is a place down here licensed to sell liquor.' He says, 'Is that so? I will put him out of business.'"

[4] One of the indicia which appellee offers to support his contention that the wagering tax is not a proper revenue measure is that the tax amount collected under it was $4,371,869 as compared with an expected amount of $400,000,000 a year. The figure of $4,371,869, however, is relatively large when it is compared with the $3,501 collected under the tax on adulterated and process or renovated butter and filled cheese, the $914,910 collected under the tax on narcotics, including marihuana and special taxes, and the $28,911 collected under the tax on firearms transfer and occupational taxes. (Summary of Internal Revenue collections, released by Bureau of Internal Revenue, October 3, 1952.)

[5] But see the argument for defendant in the *Child Labor Tax Case*, 259 U. S. 20, 30.

tribunal, should a case requiring such a decision come before it, to say that such an act was not the law of the land. But where the law is not prohibited, and is really calculated to effect any of the objects entrusted to the government, to undertake here to inquire into the degree of its necessity, would be to pass the line which circumscribes the judicial department, and to tread on legislative ground. This court disclaims all pretensions to such a power."

The difficulty of saying when the power to lay uniform taxes is curtailed, because its use brings a result beyond the direct legislative power of Congress, has given rise to diverse decisions. In that area of abstract ideas, a final definition of the line between State and Federal power has baffled judges and legislators.

While the Court has never questioned the above-quoted statement of Mr. Chief Justice Marshall in the *Bank* case, the application of the rule has brought varying holdings on constitutionality. Where Federal legislation has rested on other congressional powers, such as the Necessary and Proper Clause or the Commerce Clause, this Court has generally sustained the statutes, despite their effect on matters ordinarily considered State concern. When Federal power to regulate is found, its exercise is a matter for Congress.[6] Where Congress has employed the taxing clause a greater variation in the decisions has resulted. The division in this Court has been more acute. Without any specific differentiation between the power to tax and other Federal powers, the indirect results from the exercise of the power to tax have raised more doubts. This is strikingly illustrated by the shifting course of adjudication in taxation of the handling of narcotics.[7] The tax ground in the *Veazie Bank* case, *supra*, recognized that strictly State governmental activities such as the right to pass laws were beyond the Federal taxing power.[8] That case allowed a tax, however, that obliterated from circulation all State bank notes. A reason was that "the judicial cannot prescribe to the legislative departments of the Government limitations upon the exercise of its acknowledged powers." *Id.*, at 548. The tax cases cited above in the third preceding paragraph followed that theory. It is hard to understand why the power to tax should raise more doubts because of indirect effects than other Federal powers.[9]

Penalty provisions in tax statutes added for breach of a regulation concerning activities in themselves subject only to State regulation have caused this Court to declare the enactments invalid.[10] Unless there are provisions, extraneous to any tax need, courts are without authority to limit the exercise of the taxing power.[11] All the provisions of this excise are adapted to the collection of a valid tax.

Nor do we find the registration requirements of the wagering tax offensive. All that is required is the filing of names, addresses, and places of business.

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[6] *McCulloch* v. *Maryland*, 4 Wheat. 316, 472, upheld the creation of a bank under the necessary and proper clause. *Veazie Bank* v. *Fenno*, 8 Wall. 533, 548, depends partly on the alternate ground of the Federal power to provide money for circulation. *In re Rapier*, 143 U. S. 111, the use of the mails by papers that advertised the Louisiana Lottery was barred. The *Lottery Case*, 188 U. S. 321, approved the same result through the commerce power. That power was enough to bar transportation of pictures of prize fights, *Weber* v. *Freed*, 239 U. S. 325; to seize contraband eggs after shipment had ended, *Hipolite Egg Co.* v. *United States*, 220 U. S. 45, 56; and to bar transportation of women for immoral purposes, *Caminetti* v. *United States*, 242 U. S. 470. While in *United States* v. *Butler*, 297 U. S. 1, 68, 73, a use of a tax for regulation was disapproved, an enactment that resulted in regulation under the Commerce Clause met judicial favor. *Mulford* v. *Smith*, 307 U. S. 38, 47; *Wickard* v *Filburn*, 317 U. S. 111. *Hill* v. *Wallace*, 259 U. S. 44, 67, and *Trusler* v. *Crooks*, 269 U. S. 475, based on taxation, held taxes that regulated the grain markets were unconstitutional as an interference with State power. In *Chicago Board of Trade* v. *Olsen*, 262 U. S. 4, regulations based on the Commerce Clause were upheld. The departure from this line of decisions in *Hammer* v. *Dagenhart*, 247 U. S. 251, was reversed in *United States* v. *Darby*, 312 U. S. 100, 115–124, where we said:

"Whatever their motive and purpose, regulations of commerce which do not infringe some constitutional prohibition are within the plenary power conferred on Congress by the Commerce Clause." *Id.*, at 115. "The power of Congress over interstate commerce * * * extends to those activities intrastate which so affect interstate commerce or the exercise of the power of Congress over it as to make regulation of them appropriate means to the attainment of a legitimate end, the exercise of the granted power of Congress to regulate interstate commerce." *Id.*, at 118.

[7] *United States* v. *Jin Fuey Moy*, 241 U. S. 394, 402; *United States* v. *Doremus*, 249 U. S. 86; *Linder* v. *United States*, 268 U. S. 5; *Nigro* v. *United States*, 276 U. S. 332.

[8] Cf. *New York* v. *United States*, 326 U. S. 572, 582, 587–588.

[9] Cf. *McCulloch* v. *Maryland*, 4 Wheat., at 422.

[10] *Child Labor Tax Case*, 259 U. S. 20, 34, 38; *Hill* v. *Wallace*, 259 U. S. 44, 63, 70; *United States* v. *Constantine*, 296 U. S. 287.

[11] But see *Linder* v. *United States*, 268 U. S. 5, 18; *Trusler* v. *Crooks*, 269 U. S. 475.

This is quite general in tax returns.[12] Such data are directly and intimately related to the collection of the tax and are "obviously supportable as in aid of a revenue purpose." *Sonzinsky* v. *United States*, 300 U. S. 506, at 513. The registration provisions make the tax simpler to collect.

Appellee's second assertion is that the wagering tax is unconstitutional because it is a denial of the privilege against self-incrimination as guaranteed by the fifth amendment.

Since appellee failed to register for the wagering tax, it is difficult to see how he can now claim the privilege even assuming that the disclosure of violations of law are called for. In *United States* v. *Sullivan*, 274 U. S. 259 [T. D. 4028, C. B. VI-2, 177 (1927)], defendant was convicted of refusing to file an income tax return. It was assumed that his income "was derived from business in violation of the National Prohibition Act." *Id.*, at 263. "As the defendant's income was taxed, the statute, of course, required a return. See *United States* v. *Sischo*, 262 U. S. 165. In the decision that this was contrary to the Constitution, we are of the opinion that the protection of the fifth amendment was pressed too far. If the form of return provided called for answers that the defendant was privileged from making he could have raised the objection in the return, but could not on that account refuse to make any return at all." 274 U. S., at 263.

Assuming that respondent can raise the self-incrimination issue, that privilege has relation only to past acts, not to future acts that may or may not be committed. 8 Wigmore (3d ed., 1940) section 2259(c). If respondent wishes to take wagers subject to excise taxes under section 3285, *supra*, he must pay an occupational tax and register. Under the registration provisions of the wagering tax, appellee is not compelled to confess to acts already committed, he is merely informed by the statute that in order to engage in the business of wagering in the future he must fulfill certain conditions.[13]

Finally, we consider respondent's contention that the order of dismissal was correct because a conviction under the sections in question would violate the Due Process Clause because the classification is arbitrary and the statutory definitions are vague.[14] The applicable definitions are 26 U. S. C. (supp. V) section 3285 (b), (d) and (e).[15] The arbitrariness is said to arise from discrimination because some wagering activities are excluded. The Constitution does not require that a tax statute cover all phases of a taxed or licensed business.[16] Respondent predicates vagueness of the statute upon the use, in defining the subject of the tax, of the description "engaged in the business" of wagering and "usually" in section 3285(b)(2). We have no doubt the definitions make clear the activities covered and excluded.

Reversed.

Concurring opinion by Mr. Justice JACKSON; dissenting opinions by Mr. Justice BLACK, with whom Mr. Justice DOUGLAS concurs, and by Mr. Justice FRANKFURTER.

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[12] 26 U. S. C. sec. 2011 *et seq.*, require registration by tobacco manufacturers, dealers and peddlers of the "name, or style, place of residence, trade, or business, and place where such trade or business is to be carried on." 26 U. S. C. sec. 2810 requires the possessor of distilling apparatus to register "the particular place where such still or distilling apparatus is set up * * * the owner thereof, his place of residence * * *." See also 26 U. S. C. sec. 3270.

[13] Cf. *Davis* v. *United States*, 328 U. S. 582, 590; *Shapiro* v. *United States*, 335 U. S. 1, 35; see *E. Fougera & Co.* v. *City of New York*, 224 N. Y. 269, 281, 120 N. E. 692.

[14] These defenses are open under the demurrer to facts alleged in the indictment and the judgment of dismissal although the opinion of the District Court relied only upon usurpation of state police power by the federal enactment. *United States* v. *Curtis-Wright Corp.*, 299 U. S. 304, 330. Compare *United States* v. *The Beacon Brass Co.*, No. 30, this Term, decided November 10, 1952 [Ct. D. 1751, I. R. B. 1952-25, 36].

[15] 26 U. S. C. (supp. V) sec. 3285:

"(b) DEFINITIONS.

"For the purposes of this chapter—

"(1) The term 'wager' means (A) any wager with respect to a sports event or a contest placed with a person engaged in the business of accepting such wagers, (B) any wager placed in a wagering pool with respect to a sports event or a contest, if such pool is conducted for profit, and (C) any wager placed in a lottery conducted for profit.

"(2) The term 'lottery' includes the numbers-game, policy and similar types of wagering. The term does not include (A) any game of a type in which usually (i) the wagers are placed, (ii) the winners are determined, and (iii) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game, and (B) any drawing conducted by an organization exempt from tax under section 101, if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual."

[16] *Steward Machine Co.* v. *Davis*, 301 U. S. 548, 584 [Ct. D. 1236, C. B. 1937-1, 444].

CHAPTER 29.—MANUFACTURERS' EXCISE AND IMPORT TAXES

SUBCHAPTER A.—MANUFACTURERS' EXCISE TAXES

SECTION 3403.—TAX ON AUTOMOBILES, ETC.

SECTION 316.24, REGULATIONS 46: Sales to States or political subdivisions thereof and to the United States. Rev. Rul. 99

INTERNAL REVENUE CODE

An automobile sold to a county sheriff for his official use, where payment is made from his personal funds, is subject to the tax imposed under section 3403(b) of the Internal Revenue Code.

Advice is requested whether the tax imposed under section 3403(b) of the Internal Revenue Code is applicable to the sale of an automobile to a county sheriff for use in his official capacity where payment is not made from public funds.

Section 3442(3) of the Internal Revenue Code, as amended, provides that no tax attaches to articles enumerated under chapter 29 of the Code when sold for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Since the automobile in question was sold to the county sheriff and payment therefor was made from his personal funds rather than from public funds it is not considered that the sale of the automobile was made to a State or political subdivision thereof for its exclusive use within the meaning of section 3442(3) of the Code. Therefore, it is held that the sale of the automobile to the county sheriff is subject to the tax imposed under section 3403(b) of the Code.

SECTION 316.50, REGULATIONS 46: Scope of tax. Rev. Rul. 100

INTERNAL REVENUE CODE

A trailer equipped with living or sleeping facilities, though of the folding type, the upper portion of which is made of canvas or fabric material supported by collapsible bows, frames, or similar devices, is considered to be a house trailer within the purview of section 3403(b) of the Internal Revenue Code, as amended by section 481(b) of the Revenue Act of 1951, and sales thereof on or after November 1, 1951, by the manufacturer, producer, or importer are not subject to the tax imposed by that section of the Code.

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SECTION 316.55, REGULATIONS 46: Definition of parts or accessories. Rev. Rul. 21

INTERNAL REVENUE CODE

Clarification of S. T. 941 (C. B. 1952-1, 215) with respect to the classes of lifting jacks which are taxable as parts or accessories under section 3403(c) of the Internal Revenue Code.

Clarification of S. T. 941 (C. B. 1952-1, 215) is requested as to the classes of lifting jacks which are taxable as parts or accessories under section 3403(c) of the Internal Revenue Code.

It is stated in S. T. 941, *supra*, that there are a number of factors to be considered in arriving at a decision as to the taxability of lifting jacks, and each case must be determined on its facts. It was concluded that a jack which has no peculiar characteristics limiting its use to motor vehicles but which is held out by the manufacturer as especially designed for such use is taxable under section 3403(c) when sold by the manufacturer. In addition jacks which (1) are sold and chiefly used in connection with a taxable motor vehicle or (2) are almost universally sold and used in motor vehicle trade channels are presumed to be taxable under section 3403(c) when sold by the manufacturer. The fact that a jack is mechanical rather than hydraulic does not, standing alone, establish taxability.

Upon further consideration of the question involved, it is held that a lifting jack, either the mechanical or hydraulic type, which is included as original equipment for a vehicle enumerated in subsection (a) or (b) of section 3403 of the Code when the vehicle is sold by the manufacturer, is deemed to be an accessory for the vehicle and, as such, is includible in the basis of the vehicle for computing the tax applicable to the sale.

It is further held that the following classes of jacks are taxable under section 3403(c) of the Code when sold separately by the jack manufacturer: (1) scissors jacks; (2) bumper jacks, either the mechanical or hydraulic type, which are primarily designed to be carried as accessories in vehicles enumerated in subsection (a) or (b) of section 3403 of the Code as distinguished from the more rugged and heavier types of bumper jacks designed and adapted for use as service equipment in garages, repair shops, etc.; and (3) screw, ratchet or other types of mechanical jacks having a closed height of ten inches or less which are primarily designed, or primarily adapted, or held out by the manufacturer as being primarily designed or adapted, to be carried as accessories in vehicles enumerated in subsection (a) or (b) of section 3403 of the Code. (Certain portable, hand hydraulic jacks, other than bumper or scissors types, are not taxable because of their design and construction for use as general purpose tools in industry and commerce, and as service or maintenance equipment in garages and repair shops; however, where such jacks are sold as original equipment, as stated above, or where they are held out by a manufacturer as being especially designed to be carried as accessories for such vehicles they are taxable under section 3403(c) of the Code.)

SECTION 316.55, REGULATIONS 46: Definition of parts or accessories. Rev. Rul. 42

INTERNAL REVENUE CODE

Clarification of S. T. 944, I. R. B. 1952-17, 14, with respect to the fair market price for tax computation purposes, of custom-made automobile seat covers sold by a manufacturer or fabricator only at retail.

Clarification of S. T. 944, C. B. 1952-2, 255, is requested with respect to the fair market price of custom-made automobile seat covers sold by a manufacturer or fabricator at retail for the purpose of computing the tax on automobile parts or accessories imposed by section 3403(c) of the Internal Revenue Code.

S. T. 944, *supra*, holds that where a manufacturer furnishes the material and produces automobile seat covers for the consumer therof, according to individual design and measurement (i. e. a fabricator of custom-made seat covers), the sale by the manufacturer of such seat covers is taxable under section 3403(c) of the Code, as amended, regardless of whether they are installed by the manufacturer or by other persons.

Section 3441(b)(1) of the Code, provides that where a manufacturer sells an article at retail, the tax shall be computed on the price for which such articles are sold by manufacturers or producers in the ordinary course of trade as determined by the Commissioner. Such determination has been made with respect to automobile seat covers and it has been found to represent 75 percent of the retail list price in those cases where the manufacturer sells only at retail. In addition, in determining the price for which an article is sold, section 3441(a) of the Code, provides, *inter alia*, that charges for installation shall be excluded. The adjustments specified in section 3441(a) of the Code must be taken into consideration by the Commissioner in determining a fair market price under section 3441(b) of the Code. (See G. C. M. 21114, C. B. 1939-1 (Part 1), 351.)

Therefore, where a bona fide installation charge is made separately, in addition to the retail price of the seat covers, such charge is not to be included in the sale price of the seat covers for the purpose of computing the tax. It is understood, however, that the stated price charged for custom-made seat covers ordinarily includes the expense of installation. Assuming that the total charge for the seat covers is $45 and that a separate charge for installation is not made, but that the expense of installing the seat covers is $5, the tax should be computed as follows: First, the price of $45 should be reduced to $33.75 by application of the 75 percent as determined above. Then the discounted price should be adjusted to $28.75 by deducting the installation expense of $5. If the tax is not included in the retail price of $45, the tax is to be computed at 8 percent of $28.75. Where the tax is included in the price of $45, the tax may be computed at 2/27 (8/108) of $28.75 in order to provide for exclusion of the tax from the price on which it is based.

SECTION 316.55, REGULATIONS 46: Definition of parts or accessories.
(Also Section 1651, Section 320.60, Regulations 51.)

Rev. Rul. 59

INTERNAL REVENUE CODE

Saddle bags, primarily designed or adapted for use on motorcycles, are considered accessories for such vehicles and when sold separately by the manufacturer are subject to a tax of 8 percent under section 3403(c) of the Code. However, under section 3403(b) of the Code, when such bags are included as original equipment for motorcycles sold by the manufacturer, a tax of 10 percent attaches to the sales price of the motorcycles including the price charged for the bags. Such bags, as are taxable under the aforementioned provisions of law, are not subject to the 20 percent excise tax on luggage, etc., under section 1651 of the Code, when sold at retail.

Bicycle and other saddle bags which are not designed or adapted for use on motorcycles but which are offered, promoted, advertised, or sold for use as bags for carrying toilet articles or articles of wearing apparel or for use as other receptacles named in section 1651 of the Code, are subject to the tax imposed under such section when sold at retail. However, bicycle saddle bags which have features of design and construction indicating that they are intended for the sole purpose of carrying school books, pens, pencils, and lunches, and which are offered, promoted, advertised, and sold for such purposes are not subject to tax.

SECTION 316.55, REGULATIONS 46: Definition of parts or accessories.

Rev. Rul. 87

INTERNAL REVENUE CODE

Racks which are custom-made to fit bodies of delivery trucks for the purpose of holding trays for bread or other articles constitute parts or accessories of automobile truck bodies within the meaning of section 3403(c) of the Internal Revenue Code and are subject to tax upon sale by the manufacturer.

Advice is requested concerning the application of the tax on automobile parts or accessories, imposed by section 3403(c) of the Internal Revenue Code, as amended, to the sale by a manufacturer of racks which are custom-made to fit bodies of delivery trucks for the purpose of holding trays for bread or other articles. It is stated that the manufacturer furnishes the labor and material for the racks and sells them at retail to the ultimate consumers thereof.

Section 3403(c) of the Code imposes a tax of 8 percent on the sale by the manufacturer of parts or accessories for articles taxable under subsections (a) and (b) of section 3403 of the Code.

It is held that the racks in question are parts or accessories of automobile truck bodies within the meaning of section 3403(c) of the Code. Accordingly, sales of the racks by the manufacturer to the consumers thereof are subject to tax, regardless of whether they are installed by the manufacturer or by other persons.

Section 3441(b)(1) of the Code, provides that where a manufacturer sells an article at retail, the tax shall be computed on the price for which such articles are sold by manufacturers or producers in the ordinary course of trade as determined by the Commissioner. Such

determination has been made with respect to the above-described racks and it has been found to represent 75 percent of the retail list price in those cases where the manufacturer sells only at retail. In addition, in determining the price for which an article is sold, section 3441(a) of the Code, provides, *inter alia* that charges for installation shall be excluded. The adjustments specified in section 3441(a) of the Code must be taken into consideration by the Commissioner in determining a fair market price under section 3441(b) of the Code. (See G. C. M. 21114, C. B. 1939-1 (Part 1), 351.)

Therefore, where a bona fide installation charge is made separately, in addition to the retail price of the racks, such charge is not to be included in the sale price of the racks for the purpose of computing the tax. However, where the retail price charged for custom-made racks includes the expense of installation the tax should be computed as follows: First, assuming a retail price of $40x$ dollars, such price should be reduced to $30x$ dollars by the application of the 75 percent as determined above. Then the discounted price of $30x$ dollars should be adjusted by deducting therefrom the installation expense. If the tax is not included in the retail price of $40x$ dollars, the tax is to be computed at 8 percent of the discounted price after adjustment for installation expense. Where the tax is included in the retail price of $40x$ dollars the tax may be computed at two twenty-sevenths (8/108) of the discounted price after adjustment for installation expense, in order to provide for exclusion of the tax from the price on which it is based. (See Rev. Rul. 42, page 463, this Bulletin.)

SECTION 316.55, REGULATIONS 46: Definition of parts or accessories. Rev. Rul. 101

INTERNAL REVENUE CODE

Coil springs of the types used in automobile distributors or fuel pumps, are not generally considered automobile parts or accessories within the meaning of section 3403(c) of the Internal Revenue Code. A manufacturer of such springs is not liable for the tax imposed by that section on his sales of such coil springs. However, such a spring is subject to tax if it is designed and manufactured for the special purpose of being used as, or to replace, a component part of a taxable body, chassis, or vehicle and, by reason of some characteristic, is usable only for that purpose and is not such a commercial article as would be sold for general use. Motor exhaust and intake valve springs, clutch springs, and drag-link springs are deemed to be primarily designed and adapted for use as automobile parts, and, therefore, subject to such tax.

SECTION 3406.—EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941

Rev. Rul. 116

INTERNAL REVENUE CODE

Power lawn mowers of the "household type," as that term is used in section 3406(a)(3) of the Internal Revenue Code, include those with a cutting width of less than 24 inches, unless the mower by reason of its design and construction is primarily adapted for another purpose, such as mowing golf greens.

SUBCHAPTER C.—GENERAL ADMINISTRATIVE PROVISIONS

SECTION 3443.—CREDITS AND REFUNDS

SECTION 316.204, REGULATIONS 46: Credits and refunds. Rev. Rul. 41

INTERNAL REVENUE CODE

Application of the credit or refund provisions of section 3443(a)(3) (A) and (B) of the Internal Revenue Code, where an article, with respect to which manufacturers' excise tax was paid under chapter 29 of the Code, is purchased by a contractor and installed in the fulfillment of a construction, repair, or maintenance contract between such contractor and a political subdivision of a State.

Advice is requested concerning the application of the credit or refund provisions of section 3443(a)(3) (A) and (B) of the Internal Revenue Code, where an article, with respect to which manufacturers' excise tax was paid under chapter 29 of the Code, is purchased by a contractor and installed in the fulfillment of a construction, repair, or maintenance contract between such contractor and a political subdivision of a State.

Under section 3443(a)(3) (A) and (B) of the Code, a credit against tax under chapter 29 of the Code, or a refund, may be allowed to a manufacturer, producer, or importer, in the amount of the tax paid by him with respect to the sale of any article to any vendee, if the manufacturer, producer, or importer has in his possession evidence as the regulations may prescribe that such article was by any person resold for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia, and that the manufacturer, producer, or importer has repaid or agreed to repay the amount of such tax to the ultimate vendor or has obtained the consent of the ultimate vendor to the allowance of the credit or refund.

It is held that where an article is purchased by a contractor and installed in the fulfillment of a construction, repair, or maintenance contract between such contractor and a political subdivision of a State, and where the article remains in substantially unaltered form and becomes the property of the political subdivision, the article is considered to have been "resold" for the exclusive use of the political subdivision within the meaning of section 3443(a)(3)(A) of the Code.

Accordingly, under the circumstances stated, a credit or refund is allowable to the manufacturer in the amount of tax paid by him with respect to the sale of the article, provided the claim for credit or refund is supported by evidence prescribed by section 316.204 of Regulations 46.

CHAPTER 30.—TRANSPORTATION AND COMMUNICATION

SUBCHAPTER B.—TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES

SECTION 3465.—IMPOSITION AND RATE OF TAX

SECTION 130.38, REGULATIONS 42: Rate and application of tax. Rev. Rul. 88

INTERNAL REVENUE CODE

Television program service furnished over wires leading from a central television receiving antenna to premises of subscribers constitutes wire and equipment service within the meaning of section 3465(a)(2)(B) of the Internal Revenue Code, as amended, and all charges made in connection with the furnishing of such service are subject to tax.

Advice is requested whether the tax on wire and equipment service imposed by section 3465(a)(2)(B) of the Internal Revenue Code, as amended, applies to amounts paid for a television program service which is furnished to subscribers located in areas where direct reception is obstructed. The service is furnished over wires leading from a central television receiving antenna to premises of the subscribers.

Section 3465(a)(2)(B) of the Code, as amended, imposes a tax equivalent to 8 per centum of the amount paid for any wire and equipment service.

Section 130.38(b)(3) of Regulations 42, provides that wire and equipment service includes channels furnished between a point of origin and the subscriber's premises over which are given stock and bond market quotations and reports, racing results, baseball scores and other sporting results, news items, musical programs, weather reports, the time, etc. Section 130.38(c) of such regulations provides that in determining the amount of tax due there shall be included all charges made in connection with the furnishing of the service such as charges for equipment, instruments, and other apparatus, and installation charges.

Accordingly, it is held that a television program service furnished over wires leading from a central receiving antenna to premises of subscribers constitutes wire and equipment service within the meaning of section 3465(a)(2)(B) of the Code, as amended, and that all charges made in connection with the furnishing of such service are subject to tax.

SECTION 3466.—EXEMPTION FROM TAX

SECTION 130.44, REGULATIONS 42: Services furnished to the United States, States, or political subdivisions thereof.

INTERNAL REVENUE CODE

Regulations 42 amended. (See T. D. 5994, page 405.)

SUBCHAPTER C.—TRANSPORTATION OF PERSONS

SECTION 3469.—TAX ON TRANSPORTATION OF PERSONS, ETC.

SECTION 130.51, REGULATIONS 42: Scope of tax. Rev. Rul. 50

INTERNAL REVENUE CODE

The amount paid at a port of entry in the United States for the purchase of a ticket for transportation to a destination elsewhere in the United States, whether a one-way or a round-trip ticket, is subject to the tax on transportation of persons under section 3469 of the Internal Revenue Code, even though such transportation is part of a continuous international journey from a foreign country to a destination in the United States.

SECTION 130.51, REGULATIONS 42: Scope of tax.

INTERNAL REVENUE CODE

Regulations 42 amended. (T. D. 5994, page 405.)

SECTION 130.61, REGULATIONS 42: Transportation and facilities furnished to the United States, to States, or political subdivisions thereof. Rev. Rul. 60

INTERNAL REVENUE CODE

Payment for the transportation of a teacher to a State convention as a delegate of a teachers' association which payment is made from the treasury of the association, the funds of which are derived from its members, is not exempt from tax under section 3469(f) of the Internal Revenue Code as a payment for transportation furnished to a State or a political subdivision thereof.

SUBCHAPTER D.—ADMINISTRATIVE PROVISIONS

SECTION 3471.—REFUNDS AND CREDITS

SECTION 130.77, REGULATIONS 42: Credits. Rev. Rul. 9

INTERNAL REVENUE CODE

Application of the refund and credit provisions of section 3471 of the Internal Revenue Code, where the value of an unused portion of a round-trip transportation ticket, on which the tax imposed by section 3469 of the Code has been paid, is credited by the carrier against the purchase of a ticket for nontaxable transportation.

A carrier in the United States sold a round-trip passage ticket to Bermuda with respect to which the tax on the transportation of persons, imposed by section 3469 of the Internal Revenue Code, was

collected and included in the return filed by the carrier. The purchaser of the round-trip ticket, after arriving in Bermuda, decides to continue on to Nassau and in purchasing a ticket to such destination, from the carrier's agent in Bermuda, is allowed a credit for the value of the unused return ticket from Bermuda to the United States. The transportation tax is not asserted upon the ticket issued in Bermuda, since the payment for that ticket (including the amount allowed as a credit in the purchase thereof) constitutes a nontaxable payment made outside the United States for transportation not beginning and ending within the United States. Because a portion of the amount originally paid in the United States for the round-trip ticket is thus applied in Bermuda upon the purchase of nontaxable transportation, advice is requested whether, in allowing such credit, the carrier may include an allowance for that portion of the tax which is properly allocable to the value of the unused return ticket. If so, advice is also requested whether the carrier is entitled to a credit for such tax adjustment on its subsequent return.

The tax on the transportation of persons, imposed by section 3469 of the Code, applies, with certain exceptions not material herein, to amounts paid within the United States for the transportation by rail, motor vehicle, water, or air within or without the United States, and to amounts paid without the United States for transportation by similar means which begins and ends in the United States.

Under the provisions of section 3471(c) of the Code, any person making a refund of any payment on which the tax has been collected, may repay therewith the amount of tax collected on such payment, and the amount of tax so repaid may be credited against the tax under any subsequent return.

The allowance by the carrier of the value of the unused return ticket as a credit in the purchase of nontaxable transportation in Bermuda constitutes, to the extent of such credit, a refund of a transportation payment within the meaning of section 3471(c). Accordingly, in such case, the carrier may allow the passenger a credit for that portion of the tax originally paid on the round-trip ticket which is properly allocable to the value of the unused return ticket. The carrier, in turn, is entitled to a credit for such tax adjustment on its subsequent return.

SUBCHAPTER E.—TRANSPORTATION OF PROPERTY

SECTION 3475.—TRANSPORTATION OF PROPERTY

SECTION 143.13, REGULATIONS 113: Application of tax. Rev. Rul. 68

INTERNAL REVENUE CODE

Application of the tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code, to amounts paid by a barge line for the towing of barges, and related services.

Advice is requested concerning the application of the tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code, under the following circumstances.

A towing company, pursuant to a subcontract with a barge line, tows loaded barges from a pickup station to unloading points and returns the empty barges to the pickup station. It also tows loaded barges from loading areas to the pickup station, switches barges both loaded and empty within the same harbor or dock area, rescues barges both loaded and empty which have blown loose from their moorings, and repairs barges both loaded and empty. A charge for waiting time is also made by the towing company where a tug is required to stand by before performing towing services. The barge line collects the tax from the shipper or consignee on its charges for the complete transportation movement.

In general, the towing of a barge either loaded or empty constitutes transportation of property by water within the meaning of section 3475 of the Code, and accordingly is taxable. However, the tax imposed by this section does not apply to amounts paid by one carrier to another for towing a barge which at the time is carrying cargo with respect to which the transportation charges are being collected from the shipper or consignee by the carrier for whom such barge is being towed. Furthermore, the tax does not apply to the amounts paid by one carrier to another for towing an empty barge to a loading point or from an unloading point if such towage is incidental to the fulfillment of a contract for the transportation of property by the carrier for whom the empty barge is being towed. Where the towing services are not taxable the tax does not apply to charges paid by a carrier for standby or waiting time.

The tax applies to amounts paid by one carrier to another for towing services which are not incidental to the fulfillment of a contract for the transportation of property, such as the rescue of barges which have blown loose from their moorings. However, amounts paid by one carrier to another for the repair of barges are not taxable if such charges are billed separately.

SECTION 143.13(a), ETC., REGULATIONS 113: Application of tax. T. D. 5960

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 143.—TAX WITH RESPECT TO THE TRANSPORTATION OF PROPERTY

Transportation of material excavated in the course of construction work.

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

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

On October 9, 1952, notice of proposed rule making to conform Regulations 113 [26 CFR, part 143], relating to the tax on the amount paid for the transportation of property, to section 495 of the Revenue Act of 1951, approved October 20, 1951, was published in the Federal Register (17 F. R. 9019). After consideration of all relevant matter presented by interested persons, the amendments to such regulations set forth below are hereby adopted.

PARAGRAPH 1. There is inserted immediately preceding section 143.10 the following:

SEC. 495. TRANSPORTATION OF MATERIAL EXCAVATED IN THE COURSE OF CONSTRUCTION WORK [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

(a) AMENDMENT OF SECTION 3475.—Section 3475 (relating to tax on transportation of property) is hereby amended by adding at the end thereof the following: "The tax imposed by this section shall not apply to the transportation of earth, rock, or other material excavated within the boundaries of, and in the course of, a construction project and transported to any place within, or adjacent to, the boundaries of such project." The determination as to the applicability of the tax imposed by section 3475 in the case of the transportation of any excavated material, other than transportation to which the amendment made by this subsection applies, shall be made as if this subsection had not been enacted and without inferences drawn from the fact that the amendment made by this subsection is not expressly applicable to the transportation of such other excavated material.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts paid on or after the first day of the first month which begins more than ten days after the date of enactment of this Act for transportation on or after such first day.

PAR. 2. Section 143.13(*a*), as amended by Treasury Decision 5826, approved January 12, 1951, is further amended by redesignating clause (3) in the first sentence of the eighth undesignated paragraph as clause (4) and by inserting after clause (2) the following: "(3) to an amount paid for the transportation of material excavated within the boundaries of, and in the course of, a construction project, where the transportation is to any place within, or adjacent to, the boundaries of such project (see section 143.16);".

PAR. 3. Immediately following section 143.15, there is inserted the following new section:

SEC. 143.16. EXCAVATED MATERIAL.—The tax does not apply to an amount paid on or after November 1, 1951, for the transportation, originating on or after that date, of earth, rock, or other material excavated within the boundaries of, and in the course of, a construction project and transported to any place within, or adjacent to, the boundaries of such project.

To come within the exemption it is necessary that two conditions be met, namely, (1) that the property be earth, rock, or other material excavated within the boundaries of, and in the course of, a construction project, and (2) that the transportation of the excavated material be within the boundaries of the construction project or to a place adjacent thereto.

In determining the boundaries of a construction project, consideration will be given to the type of construction operation which is involved and the area which is required to perform and carry out the necessary work. For example, in the case of a road-building operation, the boundaries of the project would embrace the area covered by the length and width of the roadway, plus any adjoining right-of-way. In the case of the construction of an airport, the boundaries would include the outermost limits of the airport.

(This Treasury Decision is issued pursuant to the authority contained in sections 3472 and 3791 of the Internal Revenue Code (53 Stat. 423 and 467, 55 Stat. 722; 26 U. S. C. 3472, 3791).)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 16, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 19, 1952, 8:57 a. m.)

SECTION 143.20, REGULATIONS 113: United States Government: General provisions. Rev. Rul. 69

INTERNAL REVENUE CODE

The tax on the transportation of property applies to charges paid by a private shipper for the transportation of property consigned to the Reconstruction Finance Corporation, or to such Corporation in care of a private concern. The specific exemption from tax provided by the statute creating the Reconstruction Finance Corporation and enunciated in M. T. 21, C. B. 1944, 594, applies only where the charges for transportation are paid directly to the carrier by such Corporation.

Advice is requested concerning the application of the tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code, to charges paid by a private shipper with respect to shipments consigned to the Reconstruction Finance Corporation, or to such Corporation in care of a private concern.

Section 307 of the Revenue Act of 1943, effective June 1, 1944, terminated the general exemption from tax on the transportation of property to or from the Government of the United States. (See Mim. 6194, C. B. 1947-2, 210.) However, pursuant to the provisions of section 307(c) of the Revenue Act of 1943, as amended, the Secretary of the Treasury has continued the exemption with respect to the transportation of property to or from the Government of the United States on United States Government bills of lading. (See authorization of the Secretary of the Treasury, dated June 20, 1947, C. B. 1947-2, 211.)

In M. T. 21, C. B. 1944, 594, it is held that the specific exemption from Federal taxes provided by statutes creating certain agencies or instrumentalities of the United States listed therein, was not terminated or otherwise affected by section 307 of the Revenue Act of 1943. With respect to the tax on the transportation of property such specific exemption is limited to transportation charges paid directly by such agencies or instrumentalities.

Accordingly, amounts paid to a carrier for the transportation of property to or from agencies or instrumentalities of the United States Government are subject to tax unless (1) the shipments are made on United States Government bills of lading, Standard Form 1103, or (2) the transportation charges are paid directly to the carrier by one of the Government agencies listed in M. T. 21, *supra*. Under section 3475(b) of the Internal Revenue Code amounts paid for the transportation of property to or from any corporation created by Act of Congress to act in matters of relief under the treaty of Geneva of August 22, 1864 (American National Red Cross) are exempt.

In view of the fact that the Reconstruction Finance Corporation is one of the Government agencies listed in M. T. 21, amounts paid directly to a carrier by such Corporation for the transportation of property are exempt from tax. However, such exemption does not extend to charges paid to a carrier by a private shipper for transportation of property consigned to the Reconstruction Finance Corporation, or to such Corporation in care of a private concern, and charges so paid are subject to tax.

CHAPTER 34.—INFORMATION AND RETURNS

SUBCHAPTER A.—DISCOVERY OF TAX LIABILITY

SECTION 3604.—RETURNS AS TO FORMATION, ETC., OF FOREIGN CORPORATIONS

SECTION 20.2 (formerly 20D.1), T. D. 4917, C. B. 1939-2, 139: Information returns. Rev. Rul. 77

INTERNAL REVENUE CODE

A company that furnishes advice and information to a lawyer, which enables him to advise his client with respect to the formation, organization, or reorganization of any foreign corporation, is required to file an information return as provided in section 3604 of the Internal Revenue Code.

Advice is requested whether a company that furnishes advice and information to a lawyer, which enables him to advise his client with respect to the formation, organization, or reorganization of any foreign corporation, is required to file an information return pursuant to section 3604 of the Internal Revenue Code.

Section 3604 of the Internal Revenue Code provides in part as follows:

(a) REQUIREMENT.—Under regulations prescribed by the Commissioner with the approval of the Secretary, any attorney, accountant, fiduciary, bank, trust company, financial institution, or other person, who aids, assists, counsels, or advises in, or with respect to, the formation, organization, or reorganization of any foreign corporation, shall, within 30 days thereafter, file with the Commissioner a return.

(b) FORM AND CONTENTS OF RETURN.—Such return shall be in such form, and shall set forth under oath, in respect of each such corporation, to the full extent of the information within the possession or knowledge or under the control of the person required to file the return, such information as the Commissioner with the approval of the Secretary prescribes by regulations as necessary for carrying out the provisions of the income tax laws. Nothing in this section shall be construed to require the filing by an attorney-at-law of a return with respect to any advice given or information obtained through the relationship of attorney and client.

The regulations promulgated under the above-mentioned section of the law, as set forth in Treasury Decision 4917, C. B. 1939-2, 139, provide that the returns shall be made on Form 959, and must be filed within 30 days after giving such aid, assistance, counsel, or advice in every such case, (1) regardless of the nature of the counsel or advice given, whether for or against the formation, organization, or reorganization of the foreign corporation, or the nature of the aid or assistance rendered and (2) regardless of the action taken upon the advice or counsel, that is, whether the foreign corporation is actually formed, organized, or reorganized. If such aid or assistance is given through subordinates or employees, then the return of the employer is sufficient and the employees need file no return.

A company furnishing advice and information with respect to the formation, organization, or reorganization of any foreign corporation,

is considered to be within the meaning of the term "other person" as contemplated by the statute. The fact that such service is rendered by a company solely to a member of the legal profession engaging its services and that no direct contact is made by the company with clients of the attorney in no way alters such position, nor does the filing of the information return by the company under such circumstances constitute a violation of an attorney-client relationship. Aid or assistance of this nature furnished by a company does not place it in the category of a clerk, employee, or subordinate of an attorney utilizing such services.

Accordingly, it is held that where a company furnishes advice and information to a lawyer, which enables him to advise his client with respect to the formation, organization, or reorganization of any foreign corporation, it is required to file an information return as provided in section 3604 of the Internal Revenue Code.

CHAPTER 36.—COLLECTION

SUBCHAPTER B.—LIEN FOR TAXES

SECTION 3670.—PROPERTY SUBJECT TO LIEN

Rev. Rul. 89

INTERNAL REVENUE CODE

Alimony payments granted by decree are subject to distraint for Federal income taxes incurred after the entry of such decree and monthly payments thereof may be reached by service of levy on the former husband. Where such amounts are paid to the taxpayer from an alimony trust created pursuant to a divorce decree, the Government may reach by distraint the income from such trust in the hands of the trustee for satisfaction of unpaid taxes of the beneficiary.

SECTION 3672.—VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

Ct. D. 1757

FEDERAL TAXES—INTERNAL REVENUE CODE—REVISED STATUTES—DECISION OF SUPREME COURT

LIENS—PRIORITY—FEDERAL LIEN AND TOWN LIEN—INSOLVENT CORPORATION.

A lien of the town of M arose from assessments on April 1, 1947, and April 1, 1948, of ad valorem taxes upon certain machinery of taxpayer corporation for the years 1947 and 1948. The corporation was thereafter declared insolvent and a receiver was appointed. The receiver sold the property after the town had bid in the property at its own tax sales on September 25, 1948, and September 24, 1949, but had never taken possession. The Federal lien was for employment, withholding, and income taxes which became due between 1943 and June 30, 1948. Notice of lien was filed on August 6, 1948. *Held:* Whatever the tax proceedings of the town may

amount to for the purposes of the State, they were not such as resulted in making the town a judgment creditor within the meaning of section 3672 of the Internal Revenue Code. Congress intended the term "judgment creditor" in that section to apply only to judgments of courts of record. The taxpayer had not been divested by the town of either title or possession. The town, therefore, had only a general, unperfected lien. Where the lien of the town and that of the Federal Government are both general, and the taxpayer is insolvent, section 3466, Revised Statutes, clearly awards priority to the United States.

SUPREME COURT OF THE UNITED STATES

The United States of America, petitioner, v. *Gilbert Associates, Inc.*

On writ of certiorari to the Supreme Court of the State of New Hampshire

[April 6, 1953]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

This case involves the question of whether the town of Walpole, New Hampshire, or the Federal Government has the prior right to a fund in the hands of a State court receiver of the respondent-taxpayer, an insolvent corporation. The Supreme Court of New Hampshire held the town was entitled to priority, 97 N. H. 411, 90 A. 2d 499, and we granted certiorari, 344 U. S. 911.

The claims of both arise from tax liens. The town's lien grew out of an assessment of an ad valorem tax upon certain machinery of Gilbert Associates, Inc., the respondent, for the years 1947 and 1948 in the amounts of $612.95 and $690.85, respectively. The corporation was thereafter declared insolvent, and a temporary receiver was appointed August 12, 1949, and made permanent January 30, 1950. The town's taxes were assessed April 1, 1947, and April 1, 1948. On September 25, 1948, the town sold the taxpayer's property at a tax sale to pay the taxes accrued for the year 1947. On September 24, 1949, the town sold the same property at a tax sale for taxes accrued for the year 1948. The record does not disclose the nature of these tax-sale proceedings. We are informed that the town bid in the property at its own sales. At least, the town never took possession of the property, which was later sold by the receiver, creating the fund involved here. The Federal Government's lien was for employment, withholding, and income taxes that became due between 1943 and June 30, 1948, in the sum of $3,171.97. Notice of this lien was filed in the office of the clerk of the United States District Court for the District of New Hampshire on August 6, 1948.

Under section 3672 of the Internal Revenue Code, 56 Stat. 798, 26 U. S. C. (1946 ed.) section 3672, the lien of the United States "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector * * *. In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated * * *." The Supreme Court of New Hampshire held that since notice of the Government's lien was not filed until August 6, 1948, and the town's taxes were assessed on April 1, 1947, and April 1, 1948, respectively, and such tax assessments are "in the nature of a judgment" under the law of New Hampshire, the town was a judgment creditor within the meaning of section 3672, and the Government's lien was not valid as against the town's.

Was the town a judgment creditor within the meaning of section 3672? The New Hampshire Supreme Court in the instant case said:

> "It is settled by our decisions that the assessment of a tax is in the nature of a judgment, enforced by a warrant instead of an execution. *Boody* v. *Watson*, 64 N. H. 162, 167; *Jaffrey* v. *Smith*, 76 N. H. 168, 171; *Nottingham* v. *Company*, 84 N. H. 419. See also, *Automatic Sprinkler Corp.* v. *Marston*, 94 N. H. 375." 97 N. H. 411, 414, 90 A. 2d 499, 502.

We would not question or presume to say what the nature and effect of a tax proceeding is in New Hampshire. The State is free to give its own interpretation for the purpose of its own internal administration. *United States* v. *Waddill Co.*, 323 U. S. 353 [Ct. D. 1624, C. B. 1945, 459]. See also *Howard* v. *Commissioners of Louisville Sinking Fund*, 344 U. S. 624.

The Supreme Court of New Hampshire freely concedes, however, as it must, that the meaning of a federal statute is for this Court to decide. *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47 [Ct. D. 1736, C. B. 1950–2, 151]. Congress enacted section 3672 to meet the harsh condition created by the holding in *United States* v. *Snyder*, 149 U. S. 210, when federal liens were few, that a secret federal tax lien was good against a purchaser for value without notice.

A cardinal principle of Congress in its tax scheme is uniformity, as far as may be. Therefore, a "judgment creditor" should have the same application in all the states. In this instance, we think Congress used the words "judgment creditor" in section 3672 in the usual, conventional sense of a judgment of a court of record, since all states have such courts.[1] We do not think Congress had in mind the action of taxing authorities who may be acting judicially as in New Hampshire and some other states,[2] where the end result is something "in the nature of a judgment," while in other states the taxing authorities act quasi-judicially and are considered administrative bodies.[3]

We conclude that whatever the tax proceedings of the town of Walpole may amount to for the purposes of the State of New Hampshire, they were not such proceedings as resulted in making the town a judgment creditor within the meaning of section 3672.

While the town was not a judgment creditor, it was the holder of a general lien on all the taxpayer's property. So was the United States a general lienholder on all the taxpayer's property.[4] But since the taxpayer was insolvent, the United States claims the benefit of another statute to give it priority, section 3466 of the Revised Statutes, 31 U. S. C. (1946 ed.) section 191, the provisions of which are set forth in the margin.[5]

As is usual in cases like this, the town asserts that its lien is a perfected and specific lien which is impliedly excepted from this statute. This Court has never actually held that there is such an exception. Once again, we find it unnecessary to meet this issue because the lien asserted here does not raise the question.

In claims of this type, "specificity" requires that the lien be attached to certain property by reducing it to possession, on the theory that the United States has no claim against property no longer in the possession of the debtor. *Thelusson* v. *Smith* 2 Wheat. 396. Until such possession, it remains a general lien. There is no ground for the contention here that the town had perfected its lien by reducing the property to possession. The record reveals no such action. The mere attachment of the town's lien before the recording of the federal lier does not, contrary to the holding of the Supreme Court of New Hampshire, give the town priority over the United States. The taxpayer had not been divested by the town of either title or possession. The town, there-

[1] See concurring opinion of Mr. Justice JACKSON in *United States* v. *Security Trust & Savings Bank*, *supra*, at p. 52.

[2] The decisions have arrived at the conclusion that assessments are judgments for purposes of preventing collateral attacks upon them, ascertaining rights to a hearing in connection with them, or deciding under local procedure on the applicable method of collecting them. These cases, prior to the instant decision, have never actually declared that the status of a technical judgment creditor has been created. *People ex rel. Harding* v. *Hart*, 332 Ill. 467, 163 N. E. 769; *Nottingham* v. *Newmarket Mfg. Co.*, 84 N. H. 419, 151 A. 709; *People ex rel. Glens Falls Ins. Co.* v. *Ferguson*, 38 N. Y. 89; *Williams* v. *Weaver*, 75 N. Y. 30; *State* v. *Georgia Co.*, 112 N. C. 34, 17 S. E. 10; *Union Tanning Co.* v. *Commonwealth*, 123 Va. 610, 96 S. E. 780. But see *Hibbard* v. *Clark*, 56 N. H. 155, holding that it is not a judgment. 1 Cooley, Taxation (4th ed., 1924), 91–92, points out that assessments, though they may be enough like judgments to definitely establish a demand for taxes, are not technical judgments.

[3] *First National Bank of Remsen* v. *Hayes*, 186 Iowa 892, 171 N. W. 715; *Alexander* v. *Commonwealth*, 137 Va. 477, 120 S. E. 296; *Weyerhaeuser Timber Co.* v. *Pierce County*, 97 Wash. 534, 167 P. 35; *Simson Timber Co.* v. *Mason County*, 112 Wash. 603, 192 P. 994.

[4] "Sec. 3670. Property subject to lien.

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Sec. 3670 I. R. C., 26 U. S. C. (1946 ed.) sec. 3670.

[5] R. S. sec. 3466. "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

fore, had only a general, unperfected lien. *United States* v. *Waddill Co., supra; Illinois* v. *Campbell*, 329 U. S. 362, 370. Where the lien of the town and that of the Federal Government are both general, and the taxpayer is insolvent, section 3466 clearly awards priority to the United States. *United States* v. *Texas*, 314 U. S. 480, 488 [Ct. D. 1534, C. B. 1942-1, 345].

The judgment of the Supreme Court of New Hampshire is Reversed.

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

CHAPTER 38.—MISCELLANEOUS PROVISIONS

SECTION 3805.—INCOME TAX DUE DATES POSTPONED IN CASE OF CHINA TRADE ACT CORPORATIONS

T. D. 5959

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 472.—REGULATIONS UNDER SECTION 3804 OF THE INTERNAL REVENUE CODE

Treasury Decision 5279 [C. B. 1943, 952], relating to period of time disregarded under section 3804 of the Internal Revenue Code in determining whether certain acts are timely performed, amended to conform to section 614 of the Revenue Act of 1951.

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

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

On October 29, 1952, there was published in the Federal Register (17 F. R. 9749) a notice of proposed rule making to conform Treasury Decision 5279 [C. B. 1943, 952], approved July 10, 1943, as amended by Treasury Decision 5610 [C. B. 1948-1, 98], approved March 15, 1948 [26 CFR, part 472], to section 614 of the Revenue Act of 1951, relating to postponement of time for performing certain acts in case of China Trade Act corporations, approved October 20, 1951. No objection to the proposed rules having been received, the amendments set forth below are hereby adopted.

PARAGRAPH 1. Immediately preceding the caption "PUBLIC LAW 490 (SEVENTY-SEVENTH CONGRESS), APPROVED MARCH 7, 1942", which precedes section 472.0 [26 CFR 472.0], the following is inserted:

SEC. 614. TIME FOR PERFORMING CERTAIN ACTS POSTPONED IN CASE OF CHINA TRADE ACT CORPORATIONS [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Section 3805 (relating to postponement of income tax due dates in the case of China Trade Act corporations) is hereby amended to read as follows:

"SEC. 3805. INCOME TAX DUE DATES POSTPONED IN CASE OF CHINA TRADE ACT CORPORATIONS.

"In the case of any taxable year beginning after December 31, 1948, and ending before October 1, 1953, no Federal income tax return of, or payment of any Federal income tax by, any corporation organized under the China Trade Act of 1922 (42 Stat. 849, U. S. C., Title 15, chapter 4), as amended, shall become due until December 31, 1953, but only with

respect to any such corporation and any such taxable year which the Secretary may determine reasonable under the circumstances in China pursuant to such regulations as he may prescribe. Such due date shall be subject to the power of the Secretary to extend the time for filing such return or paying such tax, as in other cases."

PAR. 2. Section 472.806, as amended by Treasury Decision 5610 [26 CFR 472.806], is further amended by striking therefrom paragraph (*a*) and inserting in lieu thereof the following new paragraph:

(*a*) *Income tax.*—(1) *In general.*—Section 3805, immediately prior to amendment by section 614 of the Revenue Act of 1951, approved October 20, 1951, provided that in the case of any taxable year beginning after December 31, 1940, no Federal income tax return of, or payment of any Federal income tax by, any corporation organized under the China Trade Act, 1922, should become due until December 31, 1947. Section 3805, as amended by section 614 of the Revenue Act of 1951, provides with respect to any taxable year beginning after December 31, 1948, and ending before October 1, 1953, that the Federal income tax return of, or the payment of Federal income tax by, a corporation organized under such China Trade Act shall not become due until December 31, 1953, if, in the case of any such taxable year of any such corporation, the application of such postponed due date is determined by the Secretary under regulations to be reasonable in view of the circumstances in China.

The due dates (December 31, 1947, or December 31, 1953, whichever is applicable) thus prescribed are expressly subject to the power of the Commissioner to extend, as in other cases, the time for filing the income tax return or paying the income tax. See sections 53(a)(2) and 56(c)(1); and, the regulations thereunder.

(2) *Specific rules applicable to taxable years beginning after December 31, 1948, and ending before October 1, 1953.*—The postponement of the due date to December 31, 1953, permitted by section 3805 shall apply with respect to—

(i) any taxable year beginning after December 31, 1948, and ending before October 1, 1953, of any corporation organized under the China Trade Act, 1922, as amended, if during such taxable year conditions in China have been generally so unsettled as to militate against the normal commercial operations and corporate activities of such corporation, except—

(A) in the case of any such taxable year of any such corporation in respect to which the situation is such that, despite such unsettled conditions, the books of account and business records are available so as to permit the filing of a proper return and the corporation has otherwise been in a position to carry on its commercial operations and corporate activities and to make a proper distribution of its earnings or profits, if any, so as to permit the certification required by section 262(b); or

(B) in the case of any such taxable year of any such corporation during which all the commercial operations and corporate activities of such corporation have been carried on in Hong Kong, Macao, or Taiwan; and

(ii) any such taxable year of any such corporation excepted under (i) (A) or (B) in respect of which the corporation satisfies the Commissioner that special circumstances exist, related to the unsettled conditions in China, which warrant such postponement.

(This Treasury Decision is issued under the authority contained in sections 62 and 3791 (53 Stat. 32, 467; 26 U. S. C. 62, 3791) of the Internal Revenue Code and in section 3805 of such Code, as amended by section 614 of the Revenue Act of 1951.)

JOHN S. GRAHAM,
Acting Commissioner of Internal Revenue.

Approved December 16, 1952.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 19, 1952, 8:56 a. m.)

SECTION 3806.—MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT

Rev. Rul. 53

INTERNAL REVENUE CODE

Treatment for Federal income tax purposes of price adjustments made by contracting officers of the Government in pursuance of price redetermination clauses embodied in Government contracts and the allowance of credits against such price adjustments, under section 3806 of the Internal Revenue Code, of the Federal income taxes attributable to such price adjustments.

Advice is requested as to the position of the Bureau with respect to the treatment of refunds made to contracting officers of the Government in pursuance of a price redetermination clause embodied in a Government contract.

Section 508 of the Revenue Act of 1942 added section 3806 to the Internal Revenue Code. Section 3806 of the Code, as amended, provides for the mitigation of effect of renegotiation of war contracts or disallowance of reimbursement. Subsections (a)(1) (A) and (B) of this section were amended by section 203 of the Renegotiation Act of 1951 (Public Law 9, 82d Cong., C. B. 1951-1, 180) approved March 23, 1951, to read:

> (A) The term "renegotiation" includes any transaction which is a renegotiation within the meaning of the Federal renegotiation act applicable to such transaction, 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.
>
> (B) The term "excessive profits" includes any amount which constitutes excessive profits within the meaning assigned to such term by the applicable Federal renegotiation act, any part of the contract price of a contract with the United States or any agency thereof, any part of the subcontract price of a subcontract under such a contract, and any profits derived from one or more such contracts or subcontracts.

Accordingly, 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 is a "renegotiation" as that term is defined in section 3806(a)(1)(A) of the Internal Revenue Code, as amended; and any part of the contract price of such a contract or subcontract is "excessive profits" as that term is defined in section 3806(a)(1)(B) of the Internal evenue Code, as amended.

Section 3806(a)(1) of the Internal Revenue Code, as amended, provides that a payment or repayment within a taxable year ending after December 31, 1941, of excessive profits pursuant to a 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. Section 3806(b)(1) of the Code requires that there shall be credited against the amount of excessive profits eliminated through renegotiation the amount by which the Federal income tax for the prior taxable year is decreased by reason of the excessive profits eliminated. Subsection (c) of section 3806 of the Code provides that,

if a credit is allowed under subsection (b) with respect to a prior taxable year, no other refund or credit under the internal revenue laws founded on the application of subsection (a) shall be made on account of the amount allowed with respect to such taxable year. If the amount allowable under subsection (b) exceeds the amount allowed under such subsection, the excess shall, for the purposes of the internal revenue laws relating to credit or refund of tax, be treated as an overpayment for the prior taxable year which was made at the time the payment, repayment, or offset was made.

Based on the foregoing, any refund made to the United States or any agency thereof in pursuance of a price redetermination clause in a Government contract is a renegotiation under the provisions of section 3806(a), and accordingly the taxpayer is entitled to a credit against the excessive profits of the amount of the decrease in Federal income taxes attributable to such excessive profits and is required to pay or repay to the United States only the amount of the excessive profits remaining after there has been credited against such excessive profits the amount of the Federal income taxes attributable thereto.

In case a repayment under a price redetermination clause is determined prior to the time the taxpayer files its income tax return, consideration should be given to I. T. 3611, C. B. 1943, 978. This ruling reads in part as follows:

> In giving effect to the principles applied by section 3806 of the Code in case the renegotiation agreement determines reduced contract prices to be charged during the year of the agreement or subsequent thereto, or a repayment is to be made in lieu thereof which is not applicable to profits for a year for which an income tax return has been filed, and on which profits income and excess profits taxes have not been assessed or paid, the practice of the Bureau has been to permit the taxpayer to reduce the gross income to be reported in the returns for such years to conform with the reduced price or, in case of repayment, to permit a deduction to be taken in computing net income, provided, excessive profits determined to have been realized and received by the taxpayer are repaid to the Government. Likewise, in case the reduced contract prices are determined for the immediately preceding taxable year or a repayment is to be made in lieu thereof, and the completed income and excess profits tax returns for such year have not been filed at the time of such determination, the taxpayer has been permitted to report the gross income for such preceding year to conform with the reduced prices agreed upon or to take a deduction in computing net income, as the case may be, provided the taxpayer repays to the Government the excessive profits determined to have been realized. No deduction from gross income is allowed for any other taxable year for the amount of such excessive profits so repaid. This method of treatment will continue to be followed, subject to the condition that the excessive profits be paid or repaid to the United States or credited against amounts due and payable from the United States, and no deduction from gross income will be allowed for any other taxable year for the amount of such excessive profits so repaid. (See I. T. 3577, C. B. 1942-2, 163.)

Accordingly, it is held that where a taxpayer has entered into a price redetermination agreement with a contracting officer of the Government which provides for reduced contract prices to be charged for the immediately preceding taxable year for which a completed income tax return has not been filed and with respect to which profits

income and excess profits taxes have not been paid or assessed, the taxpayer will be permitted to take a deduction for such excessive profits in computing the net income in such return, provided the excessive profits determined to have been realized and received by the taxpayer are repaid to the Government. A taxpayer will not be entitled to set up and deduct a liability for excessive profits merely because it is performing a contract containing a price redetermination clause and there is a probability that excessive profits may be determined under such contract at a later date. In the case of any amounts repayable under a price redetermination clause which, however, are definitely determinable at the time the complete income and excess profits tax return for the year such profits were realized and received by the taxpayer is filed, the taxpayer will be permitted to reduce the contract prices to be reported in the return for such year or to take a deduction in computing the net income to be reported in such return by the amounts which can be definitely determined, provided such excessive profits are repaid to the Government. In case no amount of excessive profits has been determined or repaid prior to the time the income and excess profits tax returns for the year in which the contract prices were received or accrued were filed, it is considered that no basis exists at the time the returns are filed for determining the amount by which the contract prices should be reduced and that, for the purpose of reporting taxable income from the applicable Government contracts under sections 41, 42, and 43 of the Internal Revenue Code, the taxpayer is required to report in full the contract prices in the taxable year in which received or accrued, depending upon the method employed in keeping the books, unless, upon submission of all the facts and circumstances, permission is granted by the Commissioner for reporting income on a different basis. If, at a later date, the taxpayer is required to repay excessive profits in pursuance of a price redetermination clause embodied in a Government contract, adjustment should be made under section 3806 of the Code as the facts warrant.

SECTION 3813.—REQUIREMENTS FOR EXEMPTION OF CERTAIN ORGANIZATIONS UNDER SECTION 101(6) AND FOR DEDUCTIBILITY OF CONTRIBUTIONS MADE TO SUCH ORGANIZATIONS

SECTION 29.3813-1: Denial of exemption to organizations engaged in prohibited transactions.

INTERNAL REVENUE CODE

Exemption status of trust where employees of donor corporation derive benefits from organizations to which trust contributions are made. (See Rev. Rul. 96, page 264.)

PART II.—ADMINISTRATIVE MATTERS

REGULATIONS ESTABLISHING OFFICE OF DIRECTOR OF PRACTICE

TITLE 31, SUBTITLE A, PART 14, CODE OF FEDERAL REGULATIONS: Section 14.1, Director of Practice.

The general notice, public rule making, and effective date requirements of section 4 of the Administrative Procedure Act do not apply to these regulations because they pertain to agency organization.

AUTHORITY: Sections 14.1 to 14.6 issued under section 3, 23 Stat. 258; 5 U. S. C. 261.

14.1. *Director of Practice.*—The Committee on Practice and the office of Attorney for the Government are abolished, and there is established in the Bureau of Internal Revenue in their place and stead the office of Director of Practice. The Director of Practice shall be under the direction and supervision of the Commissioner of Internal Revenue, except that decisions of the Director in individual cases relating to enrollment, disbarment, or disciplinary measures shall not be subject to change by the Commissioner.

14.2. *Duties.*—Except as provided for in section 3, the powers, functions, and duties heretofore exercised and performed by the Committee and the Attorney are conferred upon and assigned to the Director.

14.3. *Customhouse brokers.*—The powers, functions, and duties heretofore exercised and performed by the Committee and the Attorney under Part 11 of this Subtitle (relating to customhouse brokers) are conferred upon and assigned to the Commissioner of Customs to be exercised through such officers and employees of the Bureau of Customs as he may designate.

14.4. *Appeals.*—Review of disbarment recommendations by the Secretary of the Treasury provided for in this Subtitle shall remain in full force and effect, and in addition decisions of the Director of Practice or the Commissioner of Customs denying enrollment or licensing as a customhouse broker may be appealed to the Secretary of the Treasury.

14.5. *Relation to other regulations.*—Parts 10, 11, 12, and 13 of this Subtitle are modified and amended to the extent necessary to bring them into conformity with the regulations in this part.

14.6. *Effective date.*—The regulations in this part shall be effective immediately.

JOHN W. SNYDER,
Secretary of the Treasury.

Dated January 9, 1953.

Publication in the Internal Revenue Bulletin of communications to field offices of the Internal Revenue Service.

1. Purpose.

The purpose of this Revenue Ruling is to establish a system for increased publication in the Internal Revenue Bulletin of communications to field offices involving substantive tax law, procedures affecting taxpayers' rights or duties, or industry regulation. Such publication has the following objectives:

(*a*) to inform, through the Internal Revenue Bulletin, all examining officers and other Bureau personnel of communications to any field office from the Washington headquarters which are intended to be precedents or guides;

(*b*) to provide a source, namely, the Internal Revenue Bulletin, in which such communications will be found and may be kept in a permanent, indexed reference work; and

(*c*) to make available to the public communications to field offices which are intended to be used as precedents or guides.

The standards for the publication of such communications are stated in paragraph 4 below. Consideration is also being given to the increased publication of rulings addressed to taxpayers or their representatives, and the procedure with respect thereto will be made the subject of a subsequent announcement. Pending the issuance of such announcement, publication of rulings to taxpayers or their representatives will continue under present standards.

2. Use to be made of the Internal Revenue Bulletin.

The Bulletin will be used to advise internal revenue employees of precedents and guides in the application of laws administered by the Bureau. Other media used in the past for this purpose will be gradually discontinued as the need for them is eliminated through the greater use of the Bulletin. Accordingly, in the future, internal revenue employees will find it necessary not only to study the Bulletin more carefully, but also to have copies available for reference. It will be the responsibility of supervisory officers to see that the Bulletin is available to all employees concerned. Matters relating solely to internal management (as distinguished from rulings on substantive tax law, procedures affecting taxpayers' rights or duties, or industry regulation) will continue to be issued in mimeographed or multilithed form and will not be published in the Bulletin.

3. Establishment of Revenue Ruling (Rev. Rul.) Series.

Effective with the first issue of the Bulletin for 1953, each Bureau announcement published in the Bulletin as a ruling or a statement of procedure will be designated as a Revenue Ruling (Rev. Rul.). This designation will be used in lieu of former designations such as E. T., Em. T., G. C. M., IR-Mim., I. T., S. T., etc. No change will be made in the designations or abbreviations of Treasury Decisions, other De-

*Originally issued as IR-Mimeograph 89, dated December 23, 1952.

partmental issuances, or published court decisions. The designation IR-Mim. and other designations may continue to be used for internal purposes as the need exists.

4. Publication standards.

Beginning in 1953, every communication issued to a field office dealing with substantive tax law, procedures affecting taxpayers' rights or duties, or industry regulation will be deemed to be of a character potentially publishable, with the following exceptions:

(*a*) those involving questions specifically and clearly covered by statute or regulations;

(*b*) those involving questions specifically covered by rulings, opinions, or court decisions previously published in the Bulletin;

(*c*) those dealing with issues upon which court action is pending and publication would be prejudicial to the best interest of the Government;

(*d*) those in which the facts involved are so unique or specific that the issue is not likely to arise again;

(*e*) those which constitute determinations of fact rather than interpretations of law;

(*f*) those dealing with the acceptability under the law and regulations of containers, labels, and advertising involving alcoholic beverages or tobacco products;

(*g*) those dealing with tobacco operations, such as the disposition of abandoned, seized, or condemned tobacco products;

(*h*) those dealing with secret formulae or business practices;

(*i*) those dealing with informers and informers' rewards; or

(*j*) those which in the interest of a wise administration of the Revenue Service should not be published, but only if a memorandum stating the reasons therefor is attached to the file and the Commissioner approves the determination of nonpublication.

5. Form of publication.

It will be the practice to publish as much of the communication as is necessary for a proper understanding of the position stated or the instruction given. In view of the expected increase in the number of matters to be published, Revenue Rulings will be published either in digest form or in full-text form, depending upon the nature of the communication and the issue involved. A digest may be either a brief statement of the conclusions reached or a brief statement of the facts together with such conclusions. The full-text form of publication will not necessarily be taken verbatim from the Bureau ruling or opinion as issued, but it will contain the basic elements of the discussion therein where that is necessary to an understanding of the position taken.

6. Procedure for publication.

Effective January 2, 1953, the following responsibilities and procedures are established:

(*a*) It will be the responsibility of each Assistant Commissioner and each Division Head in Washington headquarters, as well as of the Chief Counsel, to see that each matter issued to any field

office involving substantive tax law, procedures affecting taxpayers' rights or duties, or industry regulation, which originates in an office under his supervision, is duly considered for publication. Generally, this means that the Heads of the following Divisions will be responsible for observing the prescribed procedures and the referral to the Bulletin and Ruling Analysis Branch of the necessary papers for publication: Alcohol and Tobacco Tax Division, Appellate Division, Audit Division, Collection Division, Intelligence Division, Special Technical Services Division, Technical Planning Division, and Technical Ruling Division.

(*b*) Each person in any of the above-named Divisions or Offices who is initially charged with the preparation of a communication or instruction intended for the field, which involves substantive tax law, procedures affecting taxpayers' rights or duties, or industry regulation, will prepare the prescribed form with respect to that communication or instruction. In general this procedure will apply to all communications to be sent to any field office, except those relating exclusively to matters of internal management. The prescribed form will be attached to the file when the proposed communication is forwarded for review and signature. If, upon review, revision of the communication becomes necessary, the question of publication should be reconsidered based upon the revision required. As a result, if the recommendations on the prescribed form no longer prevail, a new form should be prepared and attached to the file, and the form initially prepared may be destroyed. Where there is doubt whether or not the matter should be referred to the Bulletin and Ruling Analysis Branch for consideration as to publication, the question should be resolved in favor of such reference. If it is determined that the matter is not to be published, the file will not be referred to the Bulletin and Ruling Analysis Branch, but the completed form with respect to the recommendation as to publication will be placed in the file. Where the reason for nonpublication is "in the interest of a wise administration of the Revenue Service," the memorandum required under Paragraph 4 above must be prepared and attached to the file, and the file forwarded to the Bulletin and Ruling Analysis Branch for reference to the Office of the Commissioner.

(*c*) Completion of the form with respect to publication requires the determination as to the manner in which the communication should be published. Where the matter is to be published in digest form, a digest will be prepared for reference to the Bulletin and Ruling Analysis Branch.

(*d*) Standards previously in effect for referral to the Chief Counsel's office for review of communications to field offices will continue in effect; but in view of the broader scope of publication under this Revenue Ruling, it is not intended that merely because a communication is to be considered for publication it is to be automatically referred to the Chief Counsel's office prior to issuance. However, in determining whether or not a matter should be so referred, officials having responsibility for issuing

such communications will give consideration to the added importance which may attach to such communication if published, especially with the view that rulings which may be cited as establishing legal principles should be so reviewed before issuance.

(*e*) Where a communication is to be referred to the Bulletin and Ruling Analysis Branch for consideration as to publication, the Washington headquarter's file, together with an extra copy of the communication, will be transmitted to that Branch immediately after signature and release of the signed communication. After the file has served its purpose in the Bulletin and Ruling Analysis Branch, it will be returned to the originating office with a copy of the published Revenue Ruling or a notation of nonpublication.

(*f*) The Bulletin and Ruling Analysis Branch will, upon receiving material recommended for publication, analyze such material and determine whether to adopt the recommendations with respect to publication. If that Branch concurs in the recommendation for publication, it will (1) prepare the ruling for publication in appropriate form and context, (2) prepare a digest for research and reference purposes in the Central Library (using or revising any digest of the communication which may be in the file), (3) select proper Code Classification headings for the filing of digest cards in the Library, (4) prepare the matter for publication, including a syllabus where necessary, (5) refer the material prepared for publication to the Office of the Chief Counsel for review, (6) prepare final copy of the Bulletin material and refer it to the Bulletin Section, Printing and Reproduction Branch, (7) select the index headings and prepare the index cards to be distributed to Bureau offices for research use, as hereinafter described, and (8) where appropriate, advise the field office to which the communication was addressed of publication in the Bulletin.

(*g*) If the Head of the Bulletin and Ruling Analysis Branch does not concur in the recommendation for publication, it will be his responsibility to take appropriate steps to obtain agreement by the officials concerned.

(*h*) The Bulletin and Ruling Analysis Branch will submit the material prepared for publication, with the necessary files, to the Office of the Chief Counsel for review.

(*i*) If the Chief Counsel agrees that the matter submitted should be published, he will so signify and return the file to the Head of the Bulletin and Ruling Analysis Branch. If the Chief Counsel believes it inadvisable to publish such matter, he will return it, stating his reasons therefor. It will be the responsibility of the Head of the Bulletin and Ruling Analysis Branch to take appropriate steps to obtain agreement by the officials concerned.

(*j*) The Bulletin and Ruling Analysis Branch will be responsible for the selection of index headings and the preparation of index cards to serve Bureau personnel for research and reference purposes. The index cards will contain pertinent

subject headings, a brief statement of the matter published, and the Bulletin citation for its publication. With respect to the contents of each issue of the Bulletin, the cards will be reproduced as a set and copies thereof furnished by the Printing and Reproduction Branch to each District Commissioner, District Counsel, Chief Inspector, and Director. It will be the responsibility of each such officer to see that the catalog of such cards be made available and kept current for field officers under his jurisdiction. A complete set of such cards will be maintained in the Bulletin and Ruling Analysis Branch. Each published ruling, order, and decision will have an index card for each of its subject headings (to be filed according to the alphabetical sequence of the heading) and a master card for the published matter itself (to be filed according to the numerical sequence of the ruling or decision). An initial supply of such index cards will be furnished to the offices concerned. A limited number of additional sets may be furnished upon request.

7. P. S. No. 2 dated July 29, 1944, authorized the issuance of a Pension Trust Division Information Service as an aid to officers, employees of the Bureau of Internal Revenue, and others concerned. Under the provisions of this mimeograph, such releases will be discontinued. Accordingly, P. S. No. 2 is hereby revoked.

8. Correspondence relating to the contents of this Revenue Ruling should refer to its number and to the symbols T:S:B.

Rev. Rul. 10*

Procedure regarding requests for rulings or closing agreements on specific matters.
Mimeograph 4963 (C. B. 1939–2, 459) superseded.

1. Reconsideration has been given to Mimeograph 4963 (C. B. 1939–2, 459) relating to consideration by the Bureau of requests by taxpayers for rulings or advice on matters affecting tax liability. The policies and requirements hereinafter set forth govern the submission to the Washington headquarters office of the Bureau of requests for rulings or closing agreements on such matters and the handling of those requests.

2. Rulings will be made on prospective transactions where the law or regulations provide for a determination of the effect of a proposed transaction for tax purposes, as in the case of a transfer coming under the provisions of sections 1250 and 1251 of the Internal Revenue Code, or an exchange coming under the provisions of section 112(i) of the Code.

3. In cases of prospective transactions other than those described in paragraph 2, the Bureau has discretionary authority to make rulings (or to recommend the approval of closing agreements pursuant to section 3760 of the Internal Revenue Code). That discretion will be exercised in the light of all relevant circumstances, including the business or other reasons motivating the transaction, and with a view to

*Originally issued as IR-Mimeograph 100, dated January 12, 1953.

issuing rulings (or recommending approval of closing agreements) only to the extent consistent with a wise administration of the revenue system.

4. Ordinarily rulings will not be issued where the determination requested is primarily one of fact, e. g., (1) market value of property, (2) whether compensation is reasonable in amount, (3) whether a transfer is one in contemplation of death, (4) whether retention of earnings and profits by a corporation is for the purpose of avoiding surtax on its shareholders, or (5) whether a transfer or acquisition is within section 15 (c) or section 129 of the Internal Revenue Code.

5. The Washington headquarters office of the Bureau will rule on completed transactions affecting a return or returns to be filed, unless the question is one of fact or otherwise unsuitable for issuance of a headquarters ruling. (See, however, the exception in the following paragraph.) It is not intended that Bureau field offices be prevented from rendering assistance in the filing of returns.

6. In order to conform to the Bureau's policy of decentralization of the examination and audit of tax returns, a request for a ruling on a question involved in a return or returns already filed generally will be referred to the Bureau field office having jurisdiction of the return or returns for consideration in connection with the examination and audit of such return or returns or other appropriate action. A request for a ruling on a question affecting a return or returns to be filed may also be handled in this manner if the identical issue is involved in a return or returns already filed for a taxable period or periods with respect to which the statutory period of limitation on assessment or refund of tax has not expired. The person requesting the ruling will be advised of the reference of the request to the field office. It is not intended to prevent the field office to which the request is referred from seeking advice or information from the Washington headquarters office before taking action.

7. Requests for rulings should be submitted in duplicate. Requests relating to prospective transactions should not contain alternative plans. Each request for a ruling on a prospective or completed transaction must include the following:

(*a*) The complete facts regarding the transaction, including the names and addresses of all the interested parties, together with a copy of each contract or other document necessary to present such facts. If the subject matter is a corporate reorganization, distribution, or similar or related transaction, there should also be submitted the corporate balance sheet nearest to the date of the transaction (the most recent balance sheet if the transaction is prospective).

(*b*) A full and precise statement of the business reasons, if any, for the transaction.

(*c*) If the taxpayer is contending for a particular determination, an explanation of the ground for such contention, together with a memorandum of relevant authorities.

8. It is the policy of the Bureau to process requests for rulings in regular order and as expeditiously as possible. Compliance with a request for consideration of a particular case ahead of its regular order

tends to delay the disposition of other cases. However, requests for processing ahead of the regular order, made in writing and showing the clear need for such treatment, will be given consideration as the particular circumstances warrant.

9. A taxpayer or his representative who desires an oral discussion of the case should indicate such desire in writing when filing the request or shortly thereafter in order that the conference may be arranged for that stage of the consideration of the case when it will be most helpful. Since a conference is usually more helpful during earlier stages of a case, the taxpayer or his representative should not request that the conference be deferred until Bureau action (whether or not in accord with the taxpayer's contention) is imminent. More than one conference should not be sought unless the taxpayer has important new matter to present, or unless the problems involved require consideration of the case by different Divisions or Offices of the Internal Revenue Service. If the Bureau finds that additional conferences are necessary the taxpayer or his representative will be so advised.

10. A request by or on behalf of a taxpayer must be signed by the taxpayer or his duly authorized representative. Requests should be addressed to the Commissioner of Internal Revenue, Washington 25, D. C. If the matter is being handled by a representative of the taxpayer, the conference and practice requirements regarding the furnishing of power of attorney and evidence of enrollment to practice, etc., must be met.

11. Even though a request for a ruling is withdrawn the Bureau may furnish its views or other information with respect to the matter to its field offices.

12. The taxpayer should attach to his return the ruling (or a copy thereof) with respect to any transaction which has been consummated and which is relevant to the return being filed. Under Bureau procedure examining officers will compare the facts with the representations upon which the ruling was based, in order to determine whether there has been a misstatement or omission of a material fact, or whether the transaction upon which the ruling was based was actually carried out in a manner materially different from that represented.

13. If in any case it is the opinion of the field office that a conclusion contrary to that expressed in the ruling is indicated, the findings and recommendation of the field office should be forwarded to the Washington headquarters for consideration of the matter prior to further action by the field office. Otherwise, the field office should apply the outstanding ruling in the computation of the tax liability.

14. Since each ruling represents the Bureau's conclusion as to the application of the law to the entire state of facts involved, Revenue officers are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. Furthermore, Bureau personnel should, of course, in this connection consider the effect of subsequent legislation, regulations, court decisions, and rulings.

15. Mimeograph 4963 (C. B. 1939–2, 459) is hereby superseded.

Symbols for use in correspondence originating in, or addressed to, Washington headquarters offices.

There is set forth below a list of symbols to be used in correspondence originating in, or addressed to, the various offices in the Washington headquarters of the Bureau of Internal Revenue.

OFFICE OF THE COMMISSIONER

C	COMMISSIONER
I	ASSISTANT COMMISSIONER (INSPECTION)
O	ASSISTANT COMMISSIONER (OPERATIONS)
T	ASSISTANT COMMISSIONER (TECHNICAL)
A	ASSISTANT TO THE COMMISSIONER
C:I	INFORMATION OFFICER
C:TA	TECHNICAL ADVISOR

C:A ADMINISTRATIVE ASSISTANT TO THE COMMISSIONER

C:A:A	ADMINISTRATIVE SERVICES DIVISION
C:A:AC	Communications Branch
C:A:AP	Printing and Reproduction Branch
C:A:APP	Publications Section
C:A:APDi	Distribution Section
C:A:APD	Duplicating Section
C:A:APD:S	Stenographic and Typing Unit
C:A:AS	Space Procurement and Utilization Branch
C:A:ASR	Records Section
C:A:AE	Supplies and Equipment Branch
C:A:AEA	Automotive Equipment and Telephone Records Section
C:A:AEC	Continuing Service Contracts Section
C:A:AEP	Purchases and Invoicing Section
C:A:AESP	Stationery Purchase Section
C:A:AESS	Stationery Stock Issue Section
C:A:AEL	Surplus Equipment and Labor Section
C:A:B	BUDGET AND FINANCE DIVISION
C:A:BB	Budget Branch
C:A:BBC	Computation and Compilation Section
C:A:BF	Finance Branch
C:A:BFS	Accounting Systems Section
C:A:BFA	Central Accounting Section
C:A:BFR	Reports Section
C:A:P	PERSONNEL DIVISION
C:A:PE	Employee Relations Branch
C:A:PC	Position Classification Branch
C:A:PR	Recruitment and Standards Branch
C:A:S	STATISTICAL DIVISION
C:A:SCP	Card Punch and Verifying Branch
C:A:SC	Coding Branch
C:A:SP	Production Statistics Branch
C:A:SR	Research and Compilation Branch
C:A:SA	Statistical Auditing Branch
C:A:T	TRAINING DIVISION
C:A:TD	Departmental Instructions Branch
C:A:TDB	Bookkeeping and Accounting Section
C:A:TDS	Stenographic, Typing, and Secretarial Section
C:A:TE	Executive and Supervisory Development Branch
C:A:TF	Field Supervision and Coordination Branch
C:A:TP	Program Development Branch
C:A:TPS	Service Section
C:A:TPSC	Correspondence, Files, and Records Unit
C:A:TPSP	Printing and Publications Unit

I ASSISTANT COMMISSIONER (INSPECTION)

I:Ad ADMINISTRATIVE DIVISION
I:A ANALYSIS AND APPRAISAL DIVISION
I:L LIAISON AND SPECIAL INVESTIGATIONS DIVISION
I:PE PERSONNEL EVALUATION DIVISION
I:P PLANNING AND PROGRAMING DIVISION
I:R REVIEW DIVISION

O ASSISTANT COMMISSIONER (OPERATIONS)

O:AT ALCOHOL AND TOBACCO TAX DIVISION
O:AT:A Assistant to Head of Division
O:AT:A-RI Records Identification
O:AT:B Basic Permit and Trade Practice Branch
O:AT:BA Advertising Section
O:AT:BP Permit and Label Sectio·
O:AT:BT Trade Practice Section
O:AT:E Enforcement Branch
O:AT:EE Examining and Coordinating Section
O:AT:EF Firearms Section
O:AT:EP Pardon and Parole Section
O:AT:ER Raw Materials Section
O:AT:ET Technical Laboratory Section
O:AT:P Permissive Branch
O:AT:PF Field Section
O:AT:PL Laboratory Section
O:AT:PP Planning and Procedure Section
O:AT:PPS Statistical Unit
O:AT:PPR Regulations Unit
O:AT:PPt Plant Section
O:AT:PPtR Regulatory Unit
O:AT:PPtT Tax Unit
O:AT:PPtD Drawback Unit
O:AT:T Tobacco Tax Branch

O:Ap APPELLATE DIVISION
O:Ap:E Excess Profits Tax Council

O:A AUDIT DIVISION
O:A:A Audit Services Branch
O:A:AF Files Section
O:A:AR Returns Inspection and Bankruptcy Section
O:A:D Delinquent Accounts and Returns Branch
O:A:P Planning and Procedure Branch
O:A:PA Audit Procedure Section
O:A:PF Forms and Manuals Section
O:A:U Uniform Audit Branch
O:A:UA Alien Returns Section
O:A:UC Corporation Audit Section
O:A:UE Estate and Gift Audit Section
O:A:UI Individual Audit Section
O:A:UW Wage and Excise Audit Section

O:C COLLECTION DIVISION
O:C:A Collection Accounting Branch
O:C:AC Control Section
O:C:ACA Assessment Unit
O:C:ACC Compromise Unit
O:C:ACO Overassessment Unit
O:C:ACR Readjustment Unit
O:C:AR Revenue Accounts Section
O:C:ARC Collection Accounts Auditing Unit
O:C:ARR Refund Accounts Auditing Unit
O:C:ARS Statistical Unit
O:C:AS Stamp Section
O:C:P Collection Procedures Branch

ASSISTANT COMMISSIONER (OPERATIONS)—Con.

O:M — Field Management and Planning Division
O:M:B — Budget Management Branch
O:M:S — General Services Branch
O:M:O — Operations Control Staff
O:I — Intelligence Division

T — ASSISTANT COMMISSIONER (TECHNICAL)
T:I — Office of International Tax Relations
T:S — Special Technical Services Division
T:S:B — Bulletin and Rulings Analysis Branch
T:S:E — Engineering and Valuation Branch
T:S:EA — Appraisal Section
T:S:EC — Court Defense Section
T:S:EE — Estate and Gift Tax Valuation Section
T:S:EN — Natural Resources Section
T:S:EP — Public Utilities Section
T:S:EO — Exempt Organizations Branch
T:S:EOR — Review Section
T:S:EO1 — Section 1
T:S:EO2 — Section 2
T:S:EO3 — Section 3
T:S:EO4 — Section 4
T:S:EO5 — Section 5
T:S:P — Pension Trust Branch
T:S:R — Reorganization and Dividend Branch
T:P — Technical Planning Division
T:P:A — Technical Analysis Branch
T:P:P — Technical Program Branch
T:R — Technical Ruling Division
T:R:C — Corporation Tax Ruling Branch
T:R:E — Employment Tax Ruling Branch
T:R:E1 — Ruling Section 1
T:R:E2 — Ruling Section 2
T:R:E3 — Ruling Section 3
T:R:ES — Service Section
T:R:Ex — Excise Tax Ruling Branch
T:R:ExA — Admissions and Communications Section
T:R:ExS — Sales Tax Section
T:R:ExSe — Service Section
T:R:ExSt — Stamp and Special Tax Section
T:R:ExT — Transportation Tax Section
T:R:I — Individual Income Tax Ruling Branch
T:R:EG — Estate and Gift Tax Ruling Branch

CC — CHIEF COUNSEL
CC:AT — Alcohol and Tobacco Tax Legal Division
CC:A — Appeals Division
CC:C — Civil Division
CC:Cl — Claims Division
CC:En — Enforcement Division
CC:I — Interpretative Division
CC:L — Library
CC:LR — Legislation and Regulations Division
CC:M — Mail and Records Section
CC:R — Review Division

Standard abbreviations for the names of the district commissioners' districts and symbols for the Appellate Division offices.

Set forth below are the standard abbreviations prescribed by the Bureau for the names of the various district commissioners' districts and the symbols prescribed for use by the Appellate Division offices of the various districts. Each district commissioner's district and each office of the Appellate Division will place the appropriate symbol on all memoranda, letters, communications, forms, reports, documents, action memoranda and supporting statements, and other papers requiring such identification under existing procedure.

The standard abbreviations prescribed for the district commissioners' districts are:

District	*Standard abbreviation*
Atlanta	ATL
Baltimore	BAL
Birmingham	BIR
Boston	BOS
Buffalo	BUF
Chicago	CHI
Cleveland	CLE
Dallas	DAL
Denver	DEN
Detroit	DET
Los Angeles	LA
Louisville	LOU
New York City	NYC
Philadelphia	PHI
St. Louis	ST.L
St. Paul	ST.P
Seattle	SEA

The symbols prescribed for use by the Appellate Division offices are:

District	*Appellate office*	*Appellate symbol*
Atlanta	Atlanta	ADC–Ap:ATL Atl:
	Greensboro	ADC–Ap:ATL Gbr:
	Jacksonville	ADC–Ap:ATL Jax:
Baltimore	Baltimore	ADC–Ap:BAL Bal:
	Washington	ADC–Ap:BAL Wash:
	Richmond	ADC–Ap:BAL Rich:
	Huntington	ADC–Ap:BAL Hunt:
Birmingham	Birmingham	ADC–Ap:BIR Bir:
	New Orleans	ADC–Ap:BIR NO:
Boston	Boston	ADC–Ap:BOS Bos:
	New Haven	ADC–Ap:BOS NH:
Buffalo	Buffalo	ADC–Ap:BUF Buf:
Chicago	Chicago	ADC–Ap:CHI Chi:
	Milwaukee	ADC–Ap:CHI Milw:
Cleveland	Cleveland	ADC–Ap:CLE Cle:
	Cincinnati	ADC–Ap:CLE Cin:
Dallas	Dallas	ADC–Ap:DAL Dal:
	Houston	ADC–Ap:DAL Hou:
	Oklahoma City	ADC–Ap:DAL Ok:
Denver	Denver	ADC–Ap:DEN Den:
Detroit	Detroit	ADC–Ap:DET Det:
Los Angeles	Los Angeles	ADC–Ap:LA LA:
	San Francisco	ADC–Ap:LA SF:
Louisville	Louisville	ADC–Ap:LOU Lou:
	Indianapolis	ADC–Ap:LOU Ind:
	Nashville	ADC–Ap:LOU Nash:

District	Appellate office	Appellate symbol
New York City	New York City	ADC–Ap:NYC NYC:
Philadelphia	Philadelphia	ADC–AP:PHI Phi:
	Pittsburgh	ADC–Ap:PHI Pgh:
	Newark	ADC–Ap:PHI Nwk:
St. Louis	St. Louis	ADC–Ap:ST. L St. L:
	Kansas City	ADC–Ap:ST. L KCMo:
St. Paul	St. Paul	ADC–Ap:ST. P St. P:
	Omaha	ADC–Ap:ST. P Omaha:
Seattle	Seattle	ADC–Ap:SEA Sea:
	Portland	ADC–Ap:SEA Port:

Inquiries relating to this Revenue Ruling should refer to the number hereof, attention O:AP.

Rev. Rul. 70*

Powers of attorney in Federal tax matters, except those concerning alcohol and tobacco taxes.

1. The purpose of this Revenue Ruling is to prescribe procedures for the processing and handling of powers of attorney and related files in all Federal tax matters, except those concerning alcohol and tobacco taxes.

2. Agents and attorneys representing taxpayers in connection with Federal tax matters and contracting parties on Vinson Act excess profit cases are required to file appropriate powers of attorney in accordance with the provisions of "Conference and Practice Requirements, Bureau of Internal Revenue," revised February 1942, C. B. 1942–1, 384. Ordinarily, under the reorganization the powers authorizing representation in Federal tax cases (except alcohol and tobacco tax cases) will be filed in the office of the director of internal revenue in which the case is under consideration; and powers authorizing representation before the Bureau in connection with Bureau rulings and similar matters of a specific nature which do not directly affect field operations will be filed with the Bureau in Washington, marked for the attention of the Power of Attorney Clerk, Office of Director of Practice. Any powers received directly from taxpayers or their representatives in the offices of the district commissioner, such as powers filed in cases pending in the Appellate Division, will be forwarded to the appropriate director of internal revenue for recording and disposition in accordance with the provisions of this mimeograph. When the power in an income, profits, or gift tax case, or a Vinson Act case, covers more than 1 tax year, sufficient authenticated copies of such power will be required in order that either the original or a copy thereof may be placed with the return, report or case record for each tax year under consideration.

3. Upon receipt in their offices of powers of attorney, directors of internal revenue will prepare appropriate card records on card Forms 787 and 788 of the names of the taxpayers and of the names of the attorney or attorneys, and such cards will be arranged alphabetically under the names of the attorney or attorneys or the agent or agents to whom the powers of attorney or substituted powers of attorney have been granted and under the names of the taxpayers executing the

*Originally issued as IR-Mimeograph 133, dated February 5, 1953.

instruments. The original powers of attorney, except "general" powers and powers covering "all years," will be placed with the returns or case records. In those income, profits, or gift tax cases, or Vinson Act cases, involving more than 1 tax year, either the original or an authenticated copy of the power will be placed with the return or case record for each year under consideration. The original "general" powers and powers covering "all years" will be filed in a special power of attorney file, and authenticated copies thereof will be placed with the return or case record for each tax year under consideration.

4. Effective immediately, the practice of forwarding card Forms 787 and 788 to the Bureau, as heretofore required, will be discontinued; and no record of powers of attorney will be maintained in the Bureau, except in instances where the powers of attorney are filed with or are forwarded directly to the Bureau. In such instances (a) appropriate card records of the names of the taxpayers and of the names of the attorney or attorneys will be prepared on Forms 787 and 788 and retained by the Power of Attorney Clerk, Office of Director of Practice in the Bureau; (b) the powers relating to rulings and similar matters not directly affecting field operations, after being properly recorded by the Power of Attorney Clerk, Office of Director of Practice in the Bureau, will be placed with the administrative file in the Bureau; and (c) those powers which either affect or may be of assistance in field operations, such as those covering "all Federal taxes," after being properly recorded in the Bureau will be forwarded by the Power of Attorney Clerk, Office of Director of Practice, to the appropriate director of internal revenue for processing and disposition in accordance with the standard procedure outlined above. The field offices will advise the Bureau, attention Power of Attorney Clerk, Office of Director of Practice, with respect to the revocation of an original power of attorney, or a substituted power of attorney, only in those cases enumerated above where records of the original power are maintained in the Bureau.

5. Upon the transfer of a case from the office of one director of internal revenue to that of another director of internal revenue, the original power of attorney will be transferred with the case record.

6. The card records and other files relating to powers of attorney maintained in the offices of directors of internal revenue will be available for the information of and aid to the Internal Revenue Service as a whole. IR Form 7003 will be used by the Bureau and the field service in requesting and supplying routine information relating to powers of attorney. All Bureau requests of the field and all field requests of the Bureau for such information will be routed through the Power of Attorney Clerk, Office of Director of Practice in the Bureau, who, in appropriate cases, will also verify the enrollment status of the attorney or agent concerned.

7. Employees charged with the duty of managing the powers of attorney files and others concerned should be familiar with the provisions of Department Circular 230 (Revised), "Laws and Regulations Governing the Recognition of Agents, Attorneys, and Other Persons Representing Claimants Before the Treasury Department," C. B. 1947–2, 288, and "Conference and Practice Requirements, Bureau of Internal Revenue," revised February 1942, *supra*.

8. Mimeograph 4886, C. B. 1939–2, 461, and all other prior instructions insofar as they are inconsistent with the provisions of this Revenue Ruling are hereby revoked.

9. Any inquiries pertaining to this Revenue Ruling should be addressed for the attention of C: A.

SECTION 3657.—PAYMENT BY UNITED STATES NOTES AND CERTIFICATES OF INDEBTEDNESS

Rev. Rul. 51

INTERNAL REVENUE CODE

> Treasury bills which, by the terms of their issue, may be accepted by directors of internal revenue, at maturity value, whether at or before maturity, in payment of income and profits taxes may be surrendered to any Federal Reserve bank or branch, acting as fiscal agent of the United States, 15 days or less before the date on which the taxes become due. Bank receipts issued to the owners thereof may be accepted by directors in lieu of the Treasury bills. The difference between the purchase price and the redemption or sale price is ordinary gain or loss to the owner of such bills.

Under the provisions of Treasury Department Circular 418, as amended, Treasury bills which, by the terms of their issue, are acceptable in payment of income and profits taxes, may be accepted by directors of internal revenue, at maturity value, whether at or before maturity, on or before the date the taxes become due, provided they are accompanied by the tax returns or by statements of taxes due. However, an owner of such Treasury bills may surrender them to a Federal Reserve bank or branch at face value, not more than 15 days prior to the date on which the taxes become due. The bank will then place the bills in a suspense account and issue receipts therefor which the taxpayer may forward to the appropriate director together with tax returns or statements of taxes due. The director may accept such receipts in lieu of the actual Treasury bills.

Treasury bills are issued on a discount basis redeemable at maturity value on a specified date. For the purposes of taxation the amount of discount at which they are originally sold by the United States is considered to be interest. The income derived from such bills by their owners, whether interest or gain from their sale or other disposition, does not have any exemption, as such, and loss from their sale or other disposition does not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills are subject to estate, inheritance, gift, or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For the purposes of Federal income taxes, Treasury bills are excluded from consideration as capital assets by the provisions of section 117(a)(1)(D) of the Internal Revenue Code. Under section 42(c) of the Code the amount of discount at which the bills are originally sold by the United States shall not be considered to accrue as interest prior to the redemption, sale, or other disposition thereof. Therefore, the owner of Treasury bills (other than insur-

ance companies) should include in his tax return, as ordinary gain or loss for the year in which the transaction occurred, the difference between the price paid, whether on original issue or on subsequent purchase, and the amount actually received upon the redemption, sale, or other disposition of the bills.

SECTION 3761.—COMPROMISES

Rev. Rul. 117

INTERNAL REVENUE CODE

Jurisdiction and procedure relating to offers in compromise of liabilities under the internal revenue laws.

SUMMARY

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3. Investigation of Compromise Cases.
   (*a*) Reports Covering Rejection or Withdrawal of Offers.
      (1) Tax Cases.
      (2) Ad Valorem Penalty Cases.
      (3) Specific Penalty Cases.
   (*b*) Reports Covering Acceptance of Offers.
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      (2) Ad Valorem and Specific Penalty Cases.
   (*c*) Collateral Information.
4. Procedure for the Processing, Rejection, and Acceptance of Offers in Compromise.
   (*a*) Offers Rejected or Withdrawn.
      (1) Authority to Process Rejected and Withdrawn Offers.
      (2) Amended Offers.
      (3) Rejection Memorandum and Letter to Proponent.
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      (5) Post Review of Offers.
      (6) Informal Conference with Proponent.
      (7) Conference of Assistant District Commissioner, Appellate, with Proponent.
   (*b*) Offers Accepted by Director—Liability Less Than $500.
      (1) General.
      (2) Post Review of Offers.
   (*c*) Offers Recommended for Acceptance by Director of Internal Revenue—Liability of $500 or More.
   (*d*) Procedure in Cases Involving Joint Jurisdiction.
      (1) Cases to be Referred to Intelligence Division, Office of the Director.
      (2) Cases to be Referred to Assistant District Commissioner, Appellate.
      (3) Cases to be Referred to District Counsel.
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5. Default in Payment.
   (*a*) Accepted Offers—Liability Less Than $500.
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CHIEF COUNSEL CASES

6. Jurisdiction of the Chief Counsel.
7. Processing Procedure and Reports of Investigation.
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9. Preparation of Memoranda and Letters.

GENERAL

10. Responsibility for Collection.
11. Schedule of Offers in Compromise.
12. Delegation of Authority.
13. Revocation of Prior Inconsistent Instructions and Procedures.
14. Correspondence.
15. Effective Date.

EXHIBITS

EXHIBIT	TITLE	PURPOSE OR USE
A	Rejection or Withdrawal Memorandum.	Rejection memorandum.
B	Rejection or Withdrawal Memorandum.	Withdrawal memorandum.
C	Abstract and Statement	Ad valorem penalty cases.
D	Abstract and Statement	Specific penalty cases.
E	Schedule of Accepted Offers in Compromise.	Scheduling of accepted offers.
F	Abstract and Statement	Tax offers.
G	Form Letter	Rejection letter—Tax cases.
H	Form Letter	Rejection letter—Penalties only.
I	Form Letter	Withdrawal letter—Deposit applied on liability.
J	Form Letter	Withdrawal letter—Deposit refunded.
K	Form Letter	Acceptance letter—Delinquency penalty.
L	Form Letter	Acceptance letter—Cash offer.
M	Form Letter	Acceptance letter—Installment offer.
N	Form Letter	Default letter—Tax cases.
O	Form Letter	Special deposit account letter—Defaulted offer.
P	Schedule of Offers in Compromise.	Voucher for special deposit account.
Q	Schedule of Rejected or Withdrawn Offers in Compromise.	Schedules rejected offers.
R	Schedule of Accepted Offers in Compromise.	Schedules offers accepted by directors.

INTRODUCTION

1. *Purposes.*—The purposes of this Revenue Ruling are:

(*a*) To prescribe new jurisdictional lines over certain offers in compromise coming within the provisions of section 3761 of the Internal Revenue Code;

(*b*) To prescribe revised procedures, pursuant to Reorganization Plan No. 26 of 1950, Reorganization Plan No. 1 of 1952, and Treasury Department Order No. 150–25, with respect to the investigation, processing, and disposition of certain offers in compromise;

(*c*) To transfer to the directors of internal revenue certain duties, functions, and responsibilities with respect to the processing and disposition of offers in compromise; and,

(*d*) To set forth the authority of the directors of internal revenue with respect to offers in compromise covered by this Revenue Ruling.

2. *Scope of this Revenue Ruling:*

(*a*) The jurisdictional and procedural provisions of this Revenue Ruling shall apply—

(1) To offers in compromise coming within the jurisdiction of the Chief Counsel only to the extent provided in paragraphs 6, 7, 8, and 9 herein; and,

(2) To all other offers in compromise filed pursuant to section 3761 of the Internal Revenue Code, except those cases arising under laws relating to:

(A) narcotics, smoking opium, and marihuana; and,

(B) alcohol, tobacco tax, and firearms.

(*b*) Offers in compromise not coming within the jurisdictional and procedural provisions of this Revenue Ruling will be handled in accordance with existing instructions.

INVESTIGATION AND PROCESSING OF CASES

3. *Investigation of compromise cases.*—The directors of internal revenue will have investigative jurisdiction over all offers in compromise cases coming within the scope of this Revenue Ruling. The reports covering the investigations will generally follow the pattern outlined in the attached exhibits, as indicated below:

(*a*) *Reports covering rejection or withdrawal of offers:*

(1) *Tax cases—*

(A) For rejection cases, see exhibit A.

(B) For withdrawal cases, see short form report, exhibit B.

(2) *Ad valorem penalty cases—*

For rejection or withdrawal cases, see exhibit C.

(3) *Specific penalty cases—*

For rejection or withdrawal cases, see exhibit D.

(*b*) *Reports covering acceptance of offers:*

(1) *Tax cases—*

For acceptance cases, see exhibit F. In cases involving liabilities of $500 or more, the internal revenue agent will also prepare Form 7251–C. See exhibit E.

(2) *Ad valorem and specific penalty cases—*

For acceptance cases, see exhibits C and D.

(*c*) *Collateral information:*

Collateral information which the internal revenue agent believes should be made a part of the file, but which should not be included in the statement supporting the recommendation for acceptance or rejection of the offer, should be included in the transmittal letter accompanying the report of investigation.

4. *Procedure for the processing, rejection, and acceptance of offers in compromise.*—The procedures to be followed in the processing, rejection, or acceptance of offers in compromise are revised in the manner and to the extent set forth in the following subparagraphs.

(*a*) *Offers rejected or withdrawn.*—(1) *Authority to process rejected and withdrawn offers.*—The director will process rejected and withdrawn offers in compromise; subject, however, to the provisions of paragraph 4(a)(7) herein. The processing will include (A) the adjustment of the accounts in those cases where the proponent authorizes application of the amounts on deposit against the liabilities, and (B) the scheduling and refunding of

the amounts in the special deposit account in those instances where the proponent does not authorize the amounts on deposit to be applied against the liabilities. Form 7879, as revised (Schedule of Rejected or Withdrawn Offers in Compromise), (exhibit Q), will be used as a voucher for rejected or withdrawn offers.

(2) *Amended offers.*—In instances where the proponent has tendered an amended offer, no formal action will be necessary on the prior offer inasmuch as the amended offer supersedes the prior offer or offers.

(3) *Rejection memorandum and letter to proponent.*—In those cases where the director concludes that the offer should be rejected, he will sign the rejection memorandum (exhibit A) or abstract and statement (exhibit C or D), and issue to the proponent a rejection letter (exhibit G or H). One carbon of the letter will be forwarded to the Commissioner of Internal Revenue, Attention: O:A, Washington 25, D. C.

(4) *Withdrawal memorandum and letter to proponent.*—Where the proponent withdraws an offer, the director will sign the withdrawal memorandum or abstract and statement (exhibit B, C, or D), and issue the appropriate type of letter to the proponent. One carbon of the letter will be forwarded to the Commissioner of Internal Revenue, Attention: O:A, Washington 25, D. C. If the proponent authorizes the application of the amount deposited with the offer on the liability sought to be compromised, the letter will be in the form shown in exhibit I attached. If such application is not authorized by the proponent, the letter to the proponent will be in the form shown in exhibit J attached.

(5) *Post review of offers.*—Post review of cases involving rejected and withdrawn offers in compromise will be conducted in accordance with instructions to be issued.

(6) *Informal conference with proponent.*—Where the proponent disagrees with the recommendations of the internal revenue agent, the proponent, upon oral or written request either before or after rejection, may be granted an informal conference in the director's office. It will be the duty of the conferee to arrive at an independent conclusion as to the sufficiency of the offer made by the proponent.

(7) *Conference of Assistant District Commissioner, Appellate, with proponent.*—Where the proponent does not agree with the rejection or proposed rejection, and neither the internal revenue agent nor the conferee of the director's office has been able to convince the proponent of the correctness of the conclusion reached, the proponent will be apprized of his privilege of submitting a request in writing for a hearing before the Assistant District Commissioner, Appellate. Such request should be addressed to the director. The proponent should also be informed, however, that such a request will not necessarily stay action by the director to collect the liability due. Upon receipt from the proponent of the request for a hearing, the director will forward the case to the Assistant District Commissioner, Appellate, for consideration. The Assistant District Commissioner, Appellate, will arrange a conference for a time which will be mutually con-

venient, and after such conference will prepare a memorandum setting forth the facts, issues discussed, and the reasons for the conclusion reached. This memorandum, together with the entire file, will be returned to the director for processing of the case by him in accordance with the conclusion reached by the Assistant District Commissioner, Appellate, and the procedure outlined in paragraph 4(*a*), 4(*b*), or 4(*c*) herein.

(*b*) *Offers accepted by director—Liability less than $500.*—(1) *General.*—Where the director concludes that the offer should be accepted and the unpaid amount of tax (including any interest, penalty, additional amount, or addition to the tax) is less than $500, he will prepare and sign an appropriate abstract and statement and approve the case for acceptance. (Exhibits C and F.) A letter will be prepared and mailed by the director to the proponent, notifying the proponent of the acceptance of the offer. (Exhibit K, L, or M.) Copies of such letter and the abstract and statement will be forwarded to the Commissioner of Internal Revenue, Attention: O:A, Washington 25, D. C., for filing in accordance with section 3761(b) of the Code. In cases accepted by the director and involving income, excess-profits, declared value excess-profits, capital stock, estate or gift taxes (other than cases involving penalties or interest only), a copy of the abstract and statement will also be forwarded to the Information Officer, Office of the Commissioner, to comply with Executive Order 10386 and related T. D. 5927, both approved August 20, 1952, C. B. 1952–2, 298. After receipt of payment in full in accordance with the terms of the offer, the director will prepare Form 7878–D, Schedule of Accepted Offers in Compromise (exhibit R), adjust the account of the proponent, and, where applicable, abate the liability compromised. Form 7878–D will be used as a voucher for accepted offers.

(2) *Post review of offers.*—Post review of offers accepted by the director in compromise of liabilities of less than $500 will be conducted in accordance with instructions to be issued.

(*c*) *Offers recommended for acceptance by director of internal revenue—Liability of $500 or more.*—Where the director concludes that the offer should be accepted, and either (1) the unpaid amount of tax (including any interest, penalty, additional amount, or addition to the tax) is $500 or more, or (2) the offer is in compromise of a specific penalty, the director will prepare and sign an appropriate schedule and abstract and statement. (Exhibits E and C, D, or F.) The compromise file will be forwarded to the Commissioner of Internal Revenue, Attention: O:A, Washington 25, D. C., for review and approval, or disapproval, of the recommendation for acceptance. In those cases where the offer is based in whole or in part on doubt as to liability, the returns will also be forwarded to Washington with the case.

(*d*) *Procedure in cases involving joint jurisdiction.*—(1) *Cases to be referred to Intelligence Division, Office of the Director.*—Where (A) the merits of the ad valorem fraud penalty are involved, (B) the case is one in which the special agent has recommended assertion of the penalty, and (C) the Audit Division of

the director's office contemplates recommending acceptance of the offer, the entire file will be forwarded by the Audit Division to the Intelligence Division for concurrence or comment. If the Intelligence Division concurs in the recommended disposition of the offer, the offer will be processed in accordance with paragraph 4(*b*) or 4(*c*). If no agreement is reached as to the disposition of the offer, the entire file will be forwarded to the director for consideration. Final decision with respect to the disposition of the ad valorem fraud penalty is vested in the director in those districts in which the special agents are under the jurisdiction of the director; in other districts the final decision is vested in the district commissioner.

(2) *Cases to be referred to Assistant District Commissioner, Appellate.*—Where an offer is based in whole or in part on doubt as to liability, and such liability was determined by the former Technical Staff, the former Appellate Staff, or the Appellate Division, the offer and related file will be forwarded by the director to the Assistant District Commissioner, Appellate, for consideration. The Assistant District Commissioner, Appellate, in connection with his consideration of the case, may call upon the director to conduct any investigation considered necessary, and will prepare a memorandum setting forth the facts, issues discussed, and the reasons for the conclusions reached. This memorandum, together with the entire file, will be forwarded to the director for processing of the case by him in accordance with the conclusions reached by the Assistant District Commissioner, Appellate, and the procedure outlined in subparagraph 4(*a*), 4(*b*), or 4(*c*) herein.

(3) *Cases to be referred to district counsel.*—The director will refer to the district counsel for an opinion any offer which the director finds to involve a doubtful question of law or with respect to which for any other reason in the judgment of the director such an opinion should be obtained.

(*e*) *Headquarters procedure.*—(1) *Approved cases.*—The offers in compromise recommended for acceptance by the director will be reviewed in the office of the Assistant Commissioner (Operations), Washington 25, D. C., and, if such recommendations are approved, the offers will be forwarded to the Chief Counsel for review, and then to the Commissioner for approval. If approved by the Commissioner, a letter will be prepared and mailed in Washington notifying the proponent of the acceptance of the offer. In cases accepted by the Commissioner and involving income, excess profits, declared value excess-profits, capital stock, estate or gift taxes (other than cases involving penalties or interest only), a copy of the abstract and statement will be forwarded to the Information Officer, Office of the Commissioner, to comply with Executive Order 10386 and related T. D. 5927, *supra*. Copies of the letter mailed to the proponent, including copies of the schedule and abstract and statement, will be retained by the Assistant Commissioner (Operations), for compliance with section 3761(b) of the Code, and the preparation of the required

documents in accordance with other established procedures. The compromise file, including the original schedule and the abstract and statement, a copy of the letter mailed to the proponent, and any returns or related papers which had been forwarded to Washington, will be returned to and retained by the director having jurisdiction of the case.

(2) *Cases returned for further consideration.*—In the event the recommendation of the director for acceptance of the offer is returned by the Bureau for further consideration, the compromise file will be accompanied by a memorandum containing the reasons for such action and any instructions which may be considered appropriate.

5. *Default in payment:*

(*a*) *Accepted offers—Liability less than $500.*—Where an installment offer in compromise which has been accepted by the director is in default, the director has the option under the specific printed terms of the offer, by reason of his delegated authority, either (1) to proceed by suit to collect the balance due on the offer; or (2) to terminate the offer, apply the amount deposited on the offer against the tax liability, and proceed to collect the balance due. (Exhibits N and O.) Where the proponent is in default, the director may reinvestigate the proponent's financial condition, and, if it appears to be in the best interests of the Government to permit the proponent to make payment of the balance due on a revised basis, a letter will be prepared by the director advising the proponent that payments on the offer will be accepted on the revised terms suggested by the proponent, and that action looking toward declaring the offer in default will be held in abeyance pending payments under the revised terms. However, if it appears to be in the best interests of the Government to declare the offer in default and proceed with the collection of the balance due on the liability, the director will advise the proponent by letter that the arrangements looking toward the compromise of the liability have been terminated. Copies of such letters declaring the offer in default will be forwarded to the offices which previously received copies of the acceptance letter.

(*b*) *Accepted offers—Liability $500 or more.*—It is the responsibility of the director to advise the Commissioner of the default in the terms of an accepted installment offer in compromise involving a liability of $500 or more. Where the director advises the Commissioner that payments on such an accepted installment offer in compromise are in default, the Commissioner has the option, under the specific printed terms of the offer, either (1) to proceed by suit to collect the balance due on the offer; or (2) to terminate the offer, apply the amount deposited on the offer against the tax liability, and proceed to collect the balance due. Where a proponent is in default and he submits a letter to the director or to the Commissioner requesting permission to make payments on the offer on a revised basis, the Commissioner may request information from the director as to the current financial condition of the proponent, the director's recommendation as to

the action to be taken on the offer and his reasons therefor. If, upon receipt of the report of the director, it appears to be in the best interests of the Government to permit the proponent to make payment of the balance due on the revised basis suggested by the proponent, letters will be prepared in the Bureau advising the director or the proponent that payments on the offer will be accepted on the new terms, and that action looking toward declaring the offer in default will be held in abeyance pending payment under the revised terms. However, if it appears to be in the best interests of the Government to declare the offer in default and proceed with the collection of the balance due on the liability, the Bureau will advise the proponent by letter that the arrangements looking toward the compromise of the liability have been terminated. Copies of such letters declaring the offer in default, or revising the terms of the offer, will be forwarded to the offices which previously received copies of the acceptance letter.

CHIEF COUNSEL CASES

6. *Jurisdiction of the Chief Counsel.*—The Chief Counsel will represent the Commissioner in the consideration of offers in compromise of liability in the following cases:

(*a*) Cases in which recommendations for prosecution are pending in the Chief Counsel's office, the Department of Justice, or offices of United States attorneys, including cases in which criminal proceedings have been instituted but not disposed of and related cases in which offers in compromise have been submitted or are pending;

(*b*) Cases in which the taxpayer is in receivership or is involved in a proceeding under any provision of the Bankruptcy Act;

(*c*) Cases in which the taxpayer is deceased (all classes of taxes, including estate tax, and gift tax where donor is deceased);

(*d*) Cases involving proposals to discharge property from the effect of tax liens;

(*e*) Cases involving insolvent banks;

(*f*) Cases involving assignments for the benefit of creditors;

(*g*) Cases involving liquidation proceedings; and

(*h*) Other cases in which court proceedings are pending.

7. *Processing procedure and reports of investigation.*—In those cases described in items (*b*) through (*h*) of paragraph 6, the director of internal revenue will record the offer in compromise in accordance with existing procedures and forward the original of the offer and the Form 433, Statement of Financial Condition and Other Information, to the Chief Counsel, Bureau of Internal Revenue, Washington 25, D. C., advising that he is retaining the duplicate copy of the offer and financial statement for investigation. Upon completion of the report, it will be reviewed and transmitted by the director to the Chief Counsel with his recommendation as to acceptance or rejection.

8. *Cases involving criminal proceedings.*—In those cases described in item (*a*) of paragraph 6, the offer will be recorded in accordance with existing procedures and the original thereof will be forwarded to

the Chief Counsel. In such cases no investigation will be made unless specifically requested by the Chief Counsel.

9. *Preparation of memoranda and letters.*—In cases to be considered by the Chief Counsel's office, the rejection and acceptance letters, rejection memorandums, and abstracts and statements recommending acceptance will be prepared in that office in accordance with existing procedure.

GENERAL

10. *Responsibility for collection:*

(*a*) The Government's interests as determined by the director will govern in establishing whether or not collection of the liability will be suspended during consideration of an offer in compromise.

(*b*) It is also the responsibility of the director to collect any amount due under the terms of an offer in compromise.

11. *Schedule of offers in compromise.*—Forms 879 (Revised), 7878, 7878-D, and 7879 (Revised) will be used as vouchers to support the account and the records of the directors. Form 879 (Revised), Schedule of Offers in Compromise, (exhibit P), in addition to serving as a voucher to the special deposit account, will be used as a means of transmitting the list of offers in compromise to the Commissioner of Internal Revenue, Washington 25, D. C., with the Account Current, Standard Form 1019. No offers will be forwarded to the Commissioner for control purposes. Forms 879 (Revised), will be used only as vouchers. Form 7879 (Revised), Schedule of Rejected or Withdrawn Offers in Compromise, (exhibit Q), will be used as a voucher only and will always be prepared in the offices of the directors. Form 7878, Schedule of Accepted Offers in Compromise, will be continued in use and will always be prepared in Washington for the scheduling of offers which are accepted by the Commissioner. Form 7878-D, Schedule of Accepted Offers in Compromise, (exhibit R), will be provided for the use of the directors in instances where the offer is accepted by the director.

12. *Delegation of authority.*—There is hereby delegated to each officer and employee of the Bureau of Internal Revenue who is authorized or required herein to exercise or perform any function or functions, such authority, duty, and power as is necessary to the performance of such function or functions.

13. *Revocation of prior inconsistent instructions and procedures.*—All prior mimeographs, instructions, and procedures which are inconsistent with the provisions of this Revenue Ruling are, to the extent of such inconsistency, superseded or revoked.

14. *Correspondence.*—Correspondence relating to the contents of this Revenue Ruling should refer to its number and to the symbols O:A.

15. *Effective date.*—This Revenue Ruling will be effective with respect to all offers in compromise coming within its jurisdiction and which are filed on or after July 1, 1953. Offers in compromise filed prior to July 1, 1953, will be processed in accordance with existing procedures by the offices now having jurisdiction of such offers, except as otherwise directed by the Assistant Commissioner (Operations).

EXHIBIT A

(Rejection memorandum)

Form 1271
U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

REJECTION OR WITHDRAWAL MEMORANDUM

BUREAU OF INTERNAL REVENUE

In re: Offer to compromise liability of:

XYZ Company
Southland, Fla.

Case No. _____ Date _____
Symbols _____
Office _____
City Jacksonville, Fla.
Collection District Florida

Liability as follows:

YEAR	DATE ASSESSED	TAX	INTEREST ASSESSED	PENALTY ASSESSED	TOTAL ASSESSED
12-31-49	6-15-52	I. T. $4,500.00	$607. 50	-0-	$5, 107. 50
12-31-50	6-15-52	I. T. 14,000.00	1, 050. 00		15, 050. 00
TOTALS		$18, 500. 00	$1, 657. 50		$20, 157. 50

Kind of tax Income
Amount of offer $10,000
Number of pending offers One
Date notice of lien filed July 15, 1952

Recommend offer be rejected

(Signatures of person preparing memorandum and reviewers with date thereof)

Recommendation approved for reasons stated hereinafter:

(Director of Internal Revenue)

I. SUMMARY

The taxpayer is seeking to compromise under the authority of section 3761 of the Internal Revenue Code assessed income taxes, including interest, for the calendar years ended December 31, 1949, and December 31, 1950, totaling $20,157.50, plus accrued interest. The amount of the offer is $10,000 cash, together with waiver of refunds and other provisions on Form 656 (Revised January 1951). This appears to be the first offer submitted by the taxpayer.

The offer is based on doubt as to collectibility. It is recommended for rejection for the reason that the corporation has assets or equities in assets based on forced sale values totaling $32,000 from which the total amount of the liability is collectible.

II. FACTS AS TO LIABILITY

A review of the evidence of record indicates that the tax liability has been correctly determined. No objection was taken to the determination of the liability by the taxpayer. The tax therefore is held to be legally due.

III. FACTS AS TO COLLECTIBILITY

The taxpayer corporation is a canner and distributor of seafoods of all kinds, particularly specializing in canned shrimp, oysters, turtle soup, crabmeat, oyster gumbo, and shrimp gumbo. It was incorporated under the laws of the State of Florida in 1934 and its financial structure consists of common stock of $5,000 all issued and outstanding and held by John Smith and wife, Mrs. Jane Smith, who are officers of the company.

A Form 433, subscribed and sworn to under date of August 31, 1952, by the President of the corporation, was submitted, which discloses the following assets and liabilities:

Assets	*Present book value*	*Fair market value*	*Forced sale value*
Cash	$666. 55	$666. 55	$666. 55
Accounts receivable	36, 227. 73	28, 000. 00	20, 649. 78
Merchandise inventory	17, 869. 30	17, 869. 30	17, 869. 30
Real estate	15, 610. 83		
Furniture and fixtures	729. 35		
Machinery and equipment	8, 685. 06	18, 000. 00	15, 000. 00
Trucks and delivery equipment	1, 175. 59		
Automobiles	1, 005. 43		
Securities	2, 500. 00	2, 500. 00	2, 500. 00
Boats	87, 201. 66	47, 300. 00	8, 720. 16
Plant supplies	6, 431. 28	3, 431. 28	1, 000. 00
Total assets	178, 102. 78	117, 767. 13	66, 405. 79
Liabilities			
Accounts payable	$98, 402. 24		
Notes payable	32, 600. 00		
Mortgage	25, 000. 00		
Accrued real estate taxes	535. 16		
Prior years income tax and interest	24, 406. 83		
Total liabilities	180, 944. 23		
Net worth			
Capital stock issued and outstanding	$5, 000. 00		
Deficit	(7, 841. 45)		
Net deficit	(2, 841. 45)		

An investigation discloses that the valuations placed by the taxpayer on its assets, with the exception of the forced sale value of its boats, are substantially correct. The taxpayer estimated the forced sale values of the unencumbered boats to be $8,720.16, whereas it appears that approximately $25,000 could be obtained for them at an immediate sale.

A detailed analysis of the forced sale values of the assets of the taxpayer based upon the information contained in the Form 433, the investigation of the taxpayer's financial condition, and the additional information obtained at a conference with representatives of the taxpayer under date of October 31, 1952, is as follows:

Cash.—The representatives for the taxpayer stated that the bank balance is usually low and the amount shown on the statement is representative of the sum usually available.

Accounts receivable.—A detailed schedule of the accounts receivable was submitted by the accountant for the taxpayer corporation prior to the above-mentioned conference. This schedule disclosed total accounts receivable of $59,693.03, a reserve for bad debts of $23,465.30 and a net book value of $36,227.73. The representatives for the taxpayer agreed at the conference that a forced sale value of $20,649.78 for the good accounts appears reasonable.

Inventory.—The inventory of $17,869.30 is pledged with the Peoples Bank, Southland, Fla., as partial security for a loan of $22,000.

The real estate, furniture, and fixtures, delivery equipment and machinery and equipment, together with three or four of the boats are pledged with the Peoples Bank, Southland, Fla., for a loan of $25,000. There appears to be no realizable equity in these assets.

United States Bonds.—The Form 433 shows United States Savings Bonds with a forced sale value of $2,500. It is alleged that $1,500 of these bonds were lost in a hurricane sometime ago and the proponent is endeavoring to obtain duplicates for them.

Plant supplies.—The representatives for the taxpayer are in agreement as to the forced sale value of the plant supplies.

Boats.—The taxpayer corporation in the supporting documents filed with the Form 433, stated that Mr. C. J. Roe of Roe Marine Engine Co., Southland, Fla., was in their opinion "one of the best informed men, as to the value of boats, on the Gulf Coast." This appears to be true. Inquiry of Mr. C. J. Roe disclosed that in his opinion the boats had a fair market value of $47,300, but a forced sale value in excess of the $8,720.16 stated in the Form 433. Based on the conversation with Mr. Roe the boats appear to have a forced sale value of at least $25,000.

Accounts payable.—The accounts payable represent current amounts owed for supplies, inventories, repairs to boats, and miscellaneous expenses. These accounts do not have priority over the tax lien of the Government.

Notes payable.—The notes payable consist of $22,000 owed the Peoples Bank, Southland, Fla., which is partially secured by the inventory of the taxpayer and an unsecured note in the amount of $10,600 due the Second National Bank of Southland, Fla.

Mortgage.—This item represents the amount due the Peoples Bank, Southland, Fla., which is secured by the real estate, furniture and fixtures, trucks, and machinery and equipment.

Prior years income taxes and interest.—This item includes interest accrued on the unpaid assessment.

In summation of the foregoing and based on the forced sale value agreed to by the representatives for the taxpayer, it appears that the tax liability is collectible in full from the following assets:

	Forced sale values
Cash	$666.55
Accounts receivable	20,649.78
United States Bonds	1,500.00
Plant supplies	1,000.00
Boats	8,720.16
Total	32,536.49

The taxpayer disclosed the following losses on the Form 433:

	Loss
Calendar year 1950	($28,938.55)
Calendar year 1951	(474.31)
Period Jan. 1, 1952, to July 31, 1952	(18,128.68)

Prior to termination of the conference held on October 31, 1952, the representatives of the corporation stated that upon receipt of notification of rejection of the offer they would work out a method of payment of the liability on an installment basis.

Mr. Smith, president of the corporation, stated that while the corporation has had some bad years recently he is of the opinion that by reducing its expenses and obtaining some working capital it might be able to show a profit as he anticipates the industry to show a turn for the better.

IV. Conclusion

In view of the foregoing, it is recommended that the offer be rejected.

Explanatory Note.—This Exhibit is based solely on doubt as to collectibility. In such cases it is not necessary to show in detail how the tax liability was determined.

In cases involving doubt as to liability, part II, Facts as to Liability, should show briefly the issues, pertinent facts, contentions of proponent, and conclusions reached. In such cases it is sufficient under part III, Facts as to Collectibility, merely to show that the question of collectibility is not in issue and that the liability is collectible in full.

EXHIBIT B

(Withdrawal memorandum)

Form 1271
U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

REJECTION OR WITHDRAWAL MEMORANDUM

BUREAU OF INTERNAL REVENUE

In re: Offer to compromise liability of:
XYZ Company
Southland, Fla.

Case No. _____ Date _____
Symbols _____
Office _____
City Jacksonville, Fla.
Collection District Florida

Liability as follows:

YEAR	DATE ASSESSED	TAX	INTEREST ASSESSED	PENALTY	TOTAL
1949	3/15/51	$5,000	$300	—	$5,300
	TOTALS	$5,000	$300	—	$5,300

Kind of tax Income
Amount of offer $1,000
Number of pending offers One
Date notice of lien filed 4/15/51
Recommendation of examining officers _____

Recommend offer be considered withdrawn

(Signatures of person preparing memorandum and reviewers with date thereof)

Recommendation approved for reasons stated hereinafter:

(Director of Internal Revenue)

I. SUMMARY

The liability sought to be compromised represents a deficiency applicable to the return filed by the taxpayer for the year 1949. There is no dispute as to the propriety of the liability which is held to be legally due.

The taxpayer's present financial condition was reviewed with him and, based on information which he furnished it appeared that since the time he submitted his offer his financial condition has improved to such an extent that if given a reasonable period of time he could liquidate the total liability outstanding against him. The taxpayer withdrew his offer and agreed to allow all moneys already paid on the offer to be applied against the unpaid liability. He further stated he would make arrangements for payment of the balance due.

The taxpayer's letter of withdrawal, which is in the file, states in part as follows:

"In view of the fact that I have been advised that my offer cannot be recommended for acceptance, I hereby withdraw the said offer and request that you apply the $1,000 paid on the offer against the liability owing for the year 1949."

In view of the foregoing, the offer is considered withdrawn in accordance with the taxpayer's request.

EXHIBIT C

(Ad valorem penalty cases)

ABSTRACT AND STATEMENT

TREASURY DEPARTMENT

Office of the

DIRECTOR OF INTERNAL REVENUE

(Address)

UNITED STATES

vs.

(Name and address of proponent)

COMPROMISE CASE
No.----------

District

NOT IN SUIT

Charge: Liability incurred under the provisions of section ____ of the Internal Revenue Code, for failure to file _____ tax return, Form ____, within the time required, for the (period or year).

Terms of offer: The taxpayer is seeking to compromise under authority of section 3761, Internal Revenue Code, and submits $----------, together with waiver provisions on Form 656, to compromise liability in the amount of $----------, representing unpaid delinquency penalty or penalties.

Assessment: The taxpayer's return for the period involved has (not) been audited and closed. The tax, (nonpayment penalty), and interest have been paid in full.

Taxable period	*Tax paid*	*Date due*	*Date filed*	*Unpaid penalty*	*Offer*

Statement: (To be used if accepted) ☐ The offer is substantially in conformity with the requirements of section 5220, Part V, Internal Revenue Manual.* Therefore, it is recommended that this offer be accepted with waiver of refund limited to the amounts which may have been paid on the penalty or penalties and the case closed.

(To be used if rejected or withdrawn) ☐ The offer is rejected since (1) it is not in conformity with the requirements of section 5220, Part V, Internal Revenue Manual,* or (2) reasonable cause has been clearly established and the penalty will be abated, or (3) the offer has been withdrawn.

APPROVED:
(Acceptance) (Rejection) (Withdrawal)

RECOMMENDED BY: DATE
(Signatures of person preparing memorandum and reviewers.)
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Director of Internal Revenue

*For use of Bureau employees only.

EXHIBIT D

(Specific penalty cases)

ABSTRACT AND STATEMENT

TREASURY DEPARTMENT

Office of the

DIRECTOR OF INTERNAL REVENUE

(Address)

UNITED STATES

vs.

(Name and address of proponent)

COMPROMISE CASE
No._____
District
NOT IN SUIT

Charge: Violation of section _____, Internal Revenue Code, through failure to:

(State the nature of the violation)

TERMS OF OFFER

Under authority of section 3761, Internal Revenue Code, the taxpayer submits $_____, to compromise the specific penalty imposed by section _____, of the Code, for failure to comply with the law.

ASSESSMENT

The specific penalty in this case has not been assessed. The tax, and ad valorem penalty where applicable, in the total amount of $_____, have been paid in full, or the documentary stamps, in the amount of $_____, have been properly affixed and cancelled.

STATEMENT*

☐ (*a*) Acceptance is recommended since it appears that the offer is substantially in conformity with the requirements of section 5227, et al., Part V, Internal Revenue Manual **; or

☐ (*b*) Rejection is recommended for the reason that (1) additional evidence submitted discloses that the specific penalty should not be asserted, (2) the offer is insufficient to compromise the penalty incurred, or (3) it is a second offer inadvertently submitted covering the same offense which has previously been compromised; or

☐ (*c*) Offer is withdrawn.

APPROVED: (Acceptance recommended)	(For rejection)	(For withdrawal)	RECOMMENDED BY: (Signatures of person preparing abstract and statement, and reviewers)	DATE
			_____	_____
			_____	_____
			_____	_____
			_____	_____

_____
Director of Internal Revenue

*Check paragraph applicable.
**For use of Bureau employees only.

EXHIBIT E

(Schedule of accepted offers in compromise)

Form 7251A
(*Rev. June 1953*)

TREASURY DEPARTMENT

Office of the

COMMISSIONER OF INTERNAL REVENUE
WASHINGTON, D. C.

THE COMMISSIONER OF INTERNAL REVENUE

I submit for your consideration the following schedule of offers in compromise, which I recommend for acceptance:

CASE NO.	NAME OF TAXPAYER	AMOUNT OF LIABILITY	AMOUNT OF OFFERS
	(Name and address of proponent)	$13, 933.70	$5,000 consisting of $1,000 cash with offer, $1,000 payable on Nov. 1, 1953, and balance payable $500 every 6 months thereafter, with interest at the rate of 6 percent per annum on all deferred payments from the date this offer is accepted until the respective payments are made in full, together with waiver of refunds, default agreements and other provisions on Form 656–C (Revised April 1950). The taxpayer has also executed a collateral agreement with respect to additional payments from future earnings.

Total number of cases, 1; Total liability, $13,933.70; Total offers, $5,000

In accordance with the provisions of Treasury Department Order No. 150–25 the offers in compromise listed on this schedule have been considered and they are hereby accepted.

(Date)

Commissioner

EXHIBIT F

(Tax offers)

Form 7249

TREASURY DEPARTMENT

BUREAU OF INTERNAL REVENUE

Office of _____
(Address)

ABSTRACT AND STATEMENT

In re: Offer in Compromise:
Liability of

John Doe
(Address)

Symbols:
District:

Not in suit.

Liability as follows:

Year	Tax	Date Assessed	6% Interest Assessed	Interest Accrued To 6/30/53	Penalty	Total
1948	$11, 000. 00	6/15/52	$2, 145. 00	$788. 70		$13, 933. 70
Total	11, 000. 00	x x x x x	2, 145. 00	788. 70		13, 933. 70

Amount of offer $5,000

Kind of tax Income Tax

Date notice of lien filed 9/20/52

Is case pending before The Tax Court of U. S.? No

Was collection of tax barred at time offer filed? No

Was bond filed? No

Acceptance recommended by:

(Signatures of person preparing memorandum and reviewers.)

_____ (Date)

_____ (Date)

_____ (Date)

_____ (Date)

_____ (Date)

Terms of offer: $5,000 consisting of $1,000 cash with offer, $1,000 payable on November 1, 1953, and balance payable $500 every six months thereafter, with interest at the rate of 6 percent per annum on all deferred payments from the date this offer is accepted until the respective payments are made in full, together with waiver of refunds, default agreement and other provisions on Form 656–C (Revised April 1950). The taxpayer has also executed a collateral agreement with respect to additional payments from future income.

I (accept) (recommend acceptance) for the reasons embodied in the attached statement.

_____ _____
Director of Internal Revenue. (Date)

In re: John Doe.

I. Summary

The taxpayer is seeking to compromise under the authority of section 3761 of the Internal Revenue Code, an unpaid income tax liability including interest for the year 1950, totaling $13,933.70. The amount of the offer is $5,000, con-

sisting of $1,000 cash with offer, $1,000 payable on November 1, 1953, and balance payable $500 every 6 months thereafter, with interest at the rate of 6 percent per annum on all deferred payments from the date this offer is accepted until the respective payments are made in full, together with waiver of refunds, default agreement and other provisions on Form 656–C (Revised April 1950). In addition to the foregoing, the taxpayer has agreed to pay a graduated percentage of his future income in excess of $7,500 to the Director for the years 1954 to 1960, inclusive, such amount not to exceed the total unpaid tax liability, including assessed and accrued interest.

The offer is recommended for acceptance for the reason that it appears to be in excess of the sum collectible from a forced sale of all of the taxpayer's assets and gives adequate consideration to his earning capacity and future prospects.

II. Facts as to Liability

The taxpayer filed an income tax return for the year 1950 disclosing a net income of $16,000 and a tax liability of $153, which was paid. As a result of an investigation, a deficiency in the amount of $11,000 was asserted. The taxpayer filed a petition with The Tax Court of the United States but as he failed to prosecute the petition it was dismissed for lack of prosecution. The court's order was entered on March 31, 1952. As the tax liability has been assessed pursuant to an order of The Tax Court of the United States, which has become final, the tax is legally due.

III. Facts as to Collectibility

Taxpayer is 50 years of age, married, and has two children, ages six and two, dependent upon him for support. He is actively engaged as president of the ABC, Inc.

The taxpayer's sworn statement of assets and liabilities as of March 31, 1953, discloses the following:

Assets	*Book value*	*Forced sale value*	*Encumbrances and exemptions*	*Realizable equity*
(1) Cash	$150. 00	$150. 00	----------	$150. 00
(2) Land contract	500. 00	200. 00	----------	200. 00
(3) Residence	14, 500. 00	12, 575. 00	$11, 575. 00	1, 000. 00
(4) 18 shares ABC, Inc. pfd. stock	1, 800. 00	500. 00	----------	500. 00
(5) 2140 shares ABC, Inc. common stock	2, 140. 00	none	----------	none
(6) Automobile	600. 00	300. 00	----------	300. 00
(7) Life insurance (cash value)	4, 961. 47	4, 961. 47	4, 861. 47	100. 00
(8) Household furniture	2, 500. 00	500. 00	300. 00	200. 00
Total assets	27, 151. 47	19, 186. 47	16, 736. 47	2, 450. 00

Liabilities	
(9) Bank loan, Second National Bank	$600. 00
(10) Bank loan, First National Bank	250. 00
(11) Edwin Black	1, 416. 00
(12) Current bills	1, 338. 86
(13) Mortgage payable and contract payable	11, 575. 00
(14) Life insurance loan	4, 861. 47
(15) Income tax liability	13, 933. 70
Deficit	(6, 823. 56)
Total	27, 151. 47

(1) The investigation made of the taxpayer's financial condition indicates the taxpayer has only a small amount of cash on hand at all times.

(2) The taxpayer sold his former home located at 200 Blank Avenue, ----------, Ohio, during October 1952. The sales price was $3,500, the purchaser assuming the outstanding mortgage on the property of $2,500, paid $350 in cash and gave the taxpayer a land contract in the amount of $650

to cover the balance. The purchaser is paying the taxpayer $20 per month on the contract. This sum, the taxpayer states, is being paid to The Realty Company for the purpose of repaying an advance made by that company to the taxpayer at the time he purchased his new home. Mr. Doe in a sworn statement submitted by him, shows this contract as having no forced sale value. While such contracts usually have very little resale value, nevertheless it is believed that in view of the fact the purchaser is making the payments thereon, a buyer could be found who would be willing to pay somewhere between $200 and $250 for the contract.

(3) In July 1950, the taxpayer purchased a new home for $14,500 located at 4500 White Avenue, _____, Ohio. He paid $2,000 cash, $600 of which was borrowed from The Realty Company, and the balance was financed by a land contract in the sum of $12,500 given to the seller. Subsequently, the taxpayer secured an $8,000 first mortgage on the property and paid this sum on the land contract, which together with monthly payments made by him, has reduced the land contract to its present value of $3,575. The first mortgage bears interest at the rate of 4½ percent and the land contract at 5 percent per annum. The property was purchased in Mrs. Doe's name. It appears that if an immediate sale were made of the property, no more than $12,575 could be realized, for the reason that it was purchased new by the taxpayer and there are a number of other homes of the same type in the locality, unsold. A purchaser, to be interested in the taxpayer's property, very likely would demand a substantial discount, otherwise such a purchaser would buy one of the new homes.

(4) ABC, Inc., was incorporated in April 1944 for the purpose of engaging in the stock brokerage business. The taxpayer's original interest in the company was one-fourth, but he later returned some stock to be issued as a bonus with preferred stock which the company issued to provide working capital. At the time of the issuance of the preferred stock, the taxpayer was financially unable to acquire any of it himself. In 1950, a disagreement arose between the principal active officers and stockholders of the corporation and Mr. Green, one of the principal stockholders, expressed his desire to withdraw from the company and sell his stock. The taxpayer, on October 30, 1950, purchased 25 shares of the preferred stock held by Mr. Green at its par value of $100 per share, or $2,500. The taxpayer raised the amount necessary for the purchase of this stock by permitting $2,000 of his salary to remain in the business and also by the application of a small dividend received on his stock against the purchase price. Subsequently, the taxpayer sold 7 shares of the preferred stock back to the firm for $700 and purchased 300 shares of common stock at $2.23 a share. The preferred stock and additional common stock was purchased by Mr. Doe in his wife's name.

The balance sheet of ABC, Inc., as of March 31, 1953, follows:

Assets

Cash	$14,682.58
Bonds and stocks	72,049.29
Accrued interest receivable	374.33
Notes receivable officers and employees	11,787.50
Accounts receivable (customers)	63,527.86
Investments	975.00
Furniture, fixtures and equipment	9,208.78
Prepaid expense	957.88
Treasury stock	4,101.36
Surplus (loss)	(12,249.34)
	189,913.92

Liabilities

Accounts payable	$76,622.86
Notes payable bank	50,100.00
Reserve for taxes—State and Federal 1952	1,054.91
Salesmen drawing account	1,379.33
Reserve for depreciation	3,600.08
Social security—Employees liability	28.37
Social security—ABC, Inc	28.37
Preferred stock (471 shares—Par value $100)	47,100.00
Common stock (3,000 shares Class A and 7,000 shares Class B)	10,000.00
	189,913.92

A summary of the operating statement of the ABC, Inc., for the 8 months ended March 31, 1953, follows:

Gross earnings	$67,395.56
Less: Expenses	91,208.03
Net loss	23,812.47

The taxpayer stated that he anticipated the loss of the ABC, Inc., for the calendar year 1953 would exceed $26,000.

From the foregoing balance sheet, it is clearly evident that the common stock has no value based on book figures and that the preferred stock is worth substantially less than its par value. Furthermore, this company is a personal service corporation and any sale of the stock would necessarily have to be made to one of the other stockholders, since an outside purchaser would not be interested in acquiring the stock unless he could obtain control of the brokerage business.

The taxpayer places a fair market value on the 18 shares of preferred stock of $900 and no forced sale value. It appears that one of the other stockholders might be willing to pay $500 for this stock if seized and offered for sale. Any value placed on stock of this character is highly speculative.

(5) As previously stated, the taxpayer's original interest in ABC, Inc., was one-fourth, or 2,500 shares. He later returned 450 shares to the corporation to be issued as a bonus with the preferred stock which the corporation issued to provide working capital. In December 1950 he sold 350 shares at book value of $2.50 per share, which reduced his holdings to 1,700 shares. He later reacquired 140 shares at the same price. In the latter part of 1951, the taxpayer sold 7 shares of preferred stock to the corporation and purchased an additional 300 shares of common stock at $2.23 per share. The taxpayer at the present time, therefore, owns 2,140 shares of the common stock.

It is noted that there has been some activity in the purchase and sale of the common stock of the corporation, but its activity merely represents readjustments of stock holdings between the principal officers and stockholders. The recent adjustments resulted from a disagreement between the officers and the retirement from active participation in the affairs of the corporation of Mr. Green.

The taxpayer, in his sworn statement of assets and liabilities, listed the common stock as having no fair market or forced sale value. This item appears to be correctly valued.

An analysis of the above shown balance sheet of ABC, Inc., as of March 31, 1953, clearly indicates that based on book values, the stock has no value. Furthermore, with an operating loss for the 8-month period ended March 31, 1953, of $23,812.47, and an anticipated loss for the calendar year 1953 of $26,000 or more, the future prospects of the corporation do not appear very bright.

The taxpayer submitted two letters dated May 20, 1953, and May 21, 1953, from officers of ABC, Inc., and Mr. Black, vice president of the First National Bank, respectively, for the purpose of showing the market value of the common stock. The pertinent parts of these letters are quoted below:

"With reference to the shares of Class B common stock of ABC, Inc., which are owned by Mr. Doe we (officers of company) wish to advise you that in our opinion the only market for this stock is among the other stockholders of the company. The company is dependent upon the personal activities of its officers for its profits and we do not believe the stock could be sold for any price other than that which we, as officers, were willing to pay for it. We therefore believe it has only a nominal value at the present time and that its value would be materially lessened by reason of the severance of Mr. Doe's relations with the company."

"We have your letter of May 20 stating that you are negotiating with the Director of Internal Revenue in regard to a tax claim for 1950 income tax, and that in your negotiations you have represented to the Director that the Class B common stock of ABC, Inc., has no value as collateral to a loan at this bank; and you ask that we so indicate to you.

* * * * * * *

"You are correct in your statement in that we should have to consider that such stock would have no market whatsoever, outside of the present stock-

holders, possibly ten in number, all of whom are actively engaged in the operation of the business. It is possible that we might lend you a nominal amount—say, a few hundred dollars—and take the stock as collateral; but, even in such a case, the loan would be considered by us as based upon your character and reputation rather than upon the possible realizable value of the collateral in the event you did not pay the loan."

The taxpayer owns only Class B common stock. The single difference between Class A and Class B stock is a preference as to dividends. Both stocks share equally in the event of dissolution.

(6) The taxpayer owns a 1946 Plymouth automobile which has an estimated forced sale value of $300.

(7) A statement of the taxpayer's life insurance policies is as follows:

Policy	*Amount*	*Loan value*	*Loan*	*Equity*
X Y Z Company	$10,000	$4,861.47	$4,861.47	None
M N Company	1,000	100.00	----------	$100
	5,000	Term policy	----------	None
	2,500	Term policy	----------	None

(8) The household furniture has been acquired over a period of 25 years. It consists of the usual furniture found in a modest home. The taxpayer owns no valuable antiques, curios, tapestries, etc. It is estimated the furniture has a forced sale value not in excess of $500. Under section 3691 of the Internal Revenue Code the taxpayer is entitled to an exemption of $300, thus indicating a realizable equity in this asset of approximately $200.

(9), (10), (11), and (12) These liabilities represent unsecured debts which do not have priority over the Government's tax claim.

(13) and (14) These items were fully explained under items 3 and 7.

(15) This item represents the unpaid income tax liability made the subject of the offer in compromise.

As previously stated, the taxpayer is actively engaged as president of the brokerage firm of ABC, Inc. His gross income for the years 1950, 1951, and 1952 amounted to $4,600, $8,500, and $8,000, respectively. The evidence of record indicates that ABC, Inc., showed a substantial increase in business for the years 1951 and 1952 which enabled the stockholders to increase their salaries. For the 8-month period ended March 31, 1953, however, the file indicates that the corporation had suffered a severe loss (approximately $24,000). The taxpayer stated at the conference that it was unlikely that the active officers and stockholders, of which he is one, will receive in excess of the basic salary of $500 per month for the year 1953. He further stated that it may be necessary to substantially reduce their compensation.

A statement of the taxpayer's receipts and disbursements for the 12 months ended March 31, 1953, is as follows:

Receipts	
Salary	[a] $7,500
Dividends	[b] 920
Loans from banks	[c] 850
Total receipts	9,270
Disbursements	
Club dues, etc	$422
Taxes	443
Traveling—necessary to business	1,000
Insurance	[d] 700
Payments on home	2,080
Interest	820
Living expenses	3,805
Total disbursements	9,270

[a] This item includes salary for 9 months at the annual rate of $8,000 and 3 months at the rate of $6,000.

[b] These dividends were received by the taxpayer from the ABC, Inc., as of September 30, 1952, and applied on the purchase price of its stock.

[c] This item represents two unsecured loans obtained in 1952; $250 from the First National Bank and $600 from the Second National Bank.

[d] Represents partial payment of life insurance premiums after applying available cash surrender value remaining in policies. This item also includes accident insurance premiums, insurance on home, and insurance on automobile.

IV. Conclusion

An examination of the balance sheet shown herein discloses that the value of the taxpayer's equity in assets is not in excess of $2,450, and there is considerable doubt as to whether or not such an amount would be realized from a forced sale. The taxpayer's earnings, while comparatively high for the years 1951 and 1952, have been reduced for the year 1953, in view of the serious loss sustained by the brokerage firm of which the taxpayer is a member. The taxpayer's salary since January 1, 1953, has been at the rate of $500 per month, or $6,000 per annum.

Due to the nature of the taxpayer's business, stock brokerage, it is essential that he maintain business contacts, necessitating membership in social clubs and doing considerable entertaining in connection with securing accounts for the firm. Under such circumstances, it does not appear that the taxpayer can diminish certain expenses to any appreciable extent and still maintain his business contacts. Considering the nature of the taxpayer's assets and the expense of a forced sale, the amount offered appears to be at least $3,000 in excess of the total forced sale value of his assets available for the payment of the tax liability and gives adequate consideration to his present earning capacity. In addition to the foregoing, the taxpayer has executed the following collateral agreement:

"Commissioner of Internal Revenue,
Washington, D. C.

"The undersigned taxpayer has submitted an offer dated _____, in the amount of $5,000, to compromise income tax liability, including interest, for the year 1948. The purpose of this letter is to amend the above offer to provide that as further consideration for its acceptance this proponent expressly agrees:

"(1) It is understood and agreed that in addition to the regular annual installments specified in the offer I will pay out of annual income beginning with the calendar year 1954 additional amounts each year as follows:

(*a*) Nothing with respect to the first $7,500 of annual income,

(*b*) 20 per cent of annual income in excess of $7,500 and not in excess of $10,000,

(*c*) 30 per cent of annual income in excess of $10,000 and not in excess of $15,000, and

(*d*) 50 per cent of annual income in excess of $15,000.

"(2) It is understood and agreed that the term 'annual income' as used herein means adjusted gross income as defined in section 22(n) of the Internal Revenue Code, plus any portion of capital gains which are not subject to tax, plus other nontaxable income, and includes all earnings, profits, or gains from any source whatsoever, less the amount of Federal income tax paid which is applicable to such income and payments made on offer in compromise.

"(3) It is understood and agreed that the annual payments provided for in the foregoing paragraphs shall be paid to the Director of Internal Revenue, without notice by him, on or before March 15 next following the close of the calendar year; such payments to be accompanied by a sworn statement which shall refer to this agreement and set forth the annual income computed in accordance herewith. In the event my annual income is not sufficient to require a payment under the terms of this collateral agreement I shall nevertheless furnish the Director a statement of my income for the preceding calendar year. All my books, records, and accounts will be open at all reasonable times for inspection to verify the income set forth in the statement.

"(4) It is understood and agreed that the aggregate of all the regular specified installments plus the additional amounts, which may be paid from income under the terms of this collateral agreement, shall not exceed $13,933.70 plus interest on each installment to the date of payment.

"(5) It is understood and agreed that interest shall be paid with respect to any annual payments based on income the same as is required to be paid on the regular annual installments.

"(6) As a part of this offer, it is agreed that upon notice of acceptance of the offer in compromise the undersigned taxpayer waives any and all right, in the event of default in payment of the annual payments hereinabove described, to contest in court or otherwise the amount of the liability sought to be compro-

mised, and that in the event of such default the Commissioner of Internal Revenue, at his option, (1) may proceed immediately by suit to collect any payment or payments in default, or (2) may disregard the amount of this offer and apply all amounts previously paid hereunder against the amount of the liability sought to be compromised, and may, without further notice of any kind, assess and/or collect by distraint or suit (the restrictions against assessment and/or collection being specifically waived) the balance of such liability.

"(7) It is understood that this agreement shall be of no force or effect unless the offer in compromise dated _____ is accepted.

_____
John Doe"

In view of the foregoing, it is recommended that the offer be accepted.

EXHIBIT G

(Rejection letter—Tax cases)

(On office letterhead)

(Name and address of proponent)

(Salutation)

This refers to the (original) (amended) offer of $_____, submitted to compromise your _____ tax liability, including interest (and ad valorem penalty), for the (fiscal) year(s) _____ (period _____).

Careful consideration has been given to the above offer and it is hereby rejected for the reason that the tax is legally due and (the total amount) (an amount in excess of that offered) (is) (appears to be) collectible. There is no authority in the law for the acceptance of an offer in compromise of a tax legally due (if it can be collected) (for an amount less than can be collected).

It is requested that you promptly take up the matter of payment of the liability with this office.

Very truly yours,

Director of Internal Revenue.

(On carbons only):
1 cc Asst. Commissioner (Operations).

EXHIBIT I

(Rejection letter—Penalties only)

(On office letterhead)

(Name and address of proponent)

(Salutation)

This refers to your offer of $_____ submitted in compromise of (here state nature of penalty and year or other period involved).

(Here state the basis of the rejection, such as, "You have subsequently established reasonable cause for delay in filing your return"; or "The amount of the offer is insufficient to compromise the penalty incurred," etc.)

Your offer is therefore rejected and a check covering the amount submitted is enclosed.

Very truly yours,

Director of Internal Revenue.

(On carbons only):
1 cc Asst. Commissioner (Operations).

EXHIBIT I

(Withdrawal letter—Deposit applied on liability)

(On office letterhead)

(Name and address of proponent)

(Salutation)

This refers to the offer of $1,000 submitted to compromise your income tax liability, including interest, for the year 1949.

This office is in receipt of a letter dated November 1, 1952, from you, which reads in part as follows:

> "In view of the fact that I have been advised that my offer cannot be recommended for acceptance, I hereby withdraw the said offer and request that you apply the $1,000 paid on the offer against the liability owing for the year 1949."

In view of the above, the offer is hereby considered as withdrawn and the amount deposited with the offer will be applied against your unpaid liability. If you have not already done so, it is requested that you promptly take up the matter of payment of the balance due on the liability with this office.

Very truly yours,

Director of Internal Revenue.

(On carbons only):
2 cc Asst. Commissioner (Operations).

EXHIBIT J

(Withdrawal letter—Deposit refunded)

(On office letterhead)

(Name and address of proponent)

(Salutation)

This refers to the offer of $1,000 submitted to compromise your income tax liability, including interest and ad valorem penalty for the year 1949.

This office is in receipt of a letter dated November 1, 1952, from you, which reads in part as follows:

> "I hereby withdraw my offer of $1,000 to compromise my unpaid income tax liability for the calendar year 1949."

In view of the above, the offer is hereby considered as withdrawn.

If you have not already done so, it is requested that you promptly take up the matter of payment of the liability with this office.

Very truly yours,

Director of Internal Revenue.

(On carbons only):
1 cc Asst. Commissioner (Operations).

EXHIBIT K

(Acceptance letter—Delinquency penalty)

(On appropriate letterhead)

(Name and address of proponent)

(Salutation)

This refers to your offer submitted in compromise of delinquency penalty liability, as shown below:

Tax return(s) involved:
Period(s):
Amount of offer: $----------
Amount of delinquency penalty liability: $----------

The offer, with the waiver or refund provisions limited to the amount which may have been paid on the penalty, has been accepted.

The amount offered having been paid, the case is considered closed, and no further action on your part is necessary.

Very truly yours,

Director of Internal Revenue.

(On carbons only):
1 cc Asst. Commissioner (Operations).

EXHIBIT L

(Acceptance letter—Cash offer)

(On office letterhead)

(Name and address of proponent)

(Salutation)

This refers to the (---------- amended) cash offer of $----------, which, together with waiver of refunds and other provisions on Form 656, was submitted to compromise your liability for ----------.

The offer referred to above has been accepted.

Very truly yours,

Director of Internal Revenue.

(On carbons only):
1 cc Asst. Commissioner (Operations).

EXHIBIT M

(Acceptance letter—Installment offer)

(On office letterhead)

(Name and address of proponent)

(Salutation)

This refers to the (_____ amended) offer of $ _____, which, together with waiver of refunds, interest and default agreement, and other provisions on Form 656–C, was submitted to compromise your liability for _____
_____
_____.

Under the terms of the above-indicated offer the sum of $ _____ is to be paid as follows: "_____
_____
_____."

Interest at the rate of 6 percent per annum is payable on all deferred payments from the date of this letter _____ until the respective payments are made in full.

As a part of this offer you agree that upon notice to you of the acceptance of this offer in compromise of the liability aforesaid, you shall have no right in the event of default in payment of any installment of principal or interest due under the terms of the offer, to contest in court or otherwise the amount of the liability sought to be compromised and that in the event of such default the Commissioner of Internal Revenue at his option, (1) may proceed immediately by suit to collect the entire unpaid balance of the offer or (2) may disregard the amount of such offer and apply all amounts previously paid thereunder against the amount of the liability sought to be compromised and may, without further notice of any kind, assess and/or collect by distraint or suit (the restrictions against assessment and/or collection being specifically waived) the balance of such liability.

The offer referred to above has been accepted upon the terms proposed. Deferred payments should be made to this office.

Very truly yours,

Director of Internal Revenue.

(On carbons only):

1 cc Asst. Commissioner (Operations).

EXHIBIT N

(Default letter—Tax cases)

(On appropriate letterhead)

(Name and address of proponent)

(Salutation)

This refers to a letter dated _____ in which you were advised that your (original) (amended) offer of $_____, together with waiver of refunds, interest and default agreements, and other provisions on Form 656–C to compromise your liability for _____ for the (year) (period), had been accepted upon the terms proposed.

Under the terms of the above-mentioned offer, the sum of $_____ was to have been paid as follows: (Quote terms shown on offer) together with interest at the rate of 6 percent per annum on all deferred payments from _____ until the respective payments are made in full.

The records of this office indicate that only $_____ has been paid on the offer.

Since you have failed to make payments in accordance with the terms of the offer as set forth in letter dated _____ there is an absence of mutuality in the intention of the parties and, therefore, no compromise was effected. The arrangements looking to the compromise of your tax liability are therefore terminated.

The default agreement contained in the offer provides that in case of default the (Commissioner) (Director) of Internal Revenue, at his option, may disregard the amount of such offer and apply all the amounts previously paid thereunder against the amount of the liability sought to be compromised and may, without further notice of any kind, assess and/or collect by distraint or suit (the restrictions against assessment and/or collection being specifically waived) the balance of such liability.

It is requested that you promptly take up the matter of payment of the liability with this office.

Very truly yours,

Director of Internal Revenue.

(On carbons only):

1 cc Asst. Commissioner (Operations).

EXHIBIT O

(Special deposit account letter—Defaulted offer)

(On office letterhead)

COMMISSIONER OF INTERNAL REVENUE,
Attention: Collection Division,
Washington 25, D. C.

Subject: Offer in compromise terminated

In re: (Name)
(Address)

Kind of tax:

Year or period:

The above-named taxpayer has defaulted in payment of installments due under the terms of (his) (its) (original) (amended) offer of $---------- ($---------- cash with offer, and installment payments in the total amount of $----------), as indicated in the attached letter to the taxpayer.

You are advised that the amount deposited with the offer (and the installments paid) have been transferred from the Special Deposit Account to Internal Revenue Collections and applied against the taxpayer's outstanding liability.

Director of Internal Revenue.

Enclosure:
1 cc letter to taxpayer.

NOTE.—The original and one copy of this letter will be attached to the director's monthly Account Current.

EXHIBIT P

(Voucher for special deposit account)

SCHEDULE OF OFFERS IN COMPROMISE

Form No. 879
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
Approved by Comptroller General U. S.
Mar. 27, 1925

Schedule No. _____
Page No. _____
Number of pages _____
Number of items _____
Total amount, $_____

Class of tax_____

COMMISSIONER OF INTERNAL REVENUE,

Attention: Collection Division

Washington 25, D. C.

From: Director of Internal Revenue (Office location)

The offers in compromise (Forms 656) listed below have been received.

_____
Director.

Date _____

SERIAL NUMBER ON DOCUMENT	NAME OF PROPONENT	AMOUNT	FOR USE OF GENERAL ACCOUNTING OFFICE

EXHIBIT Q

(Schedules rejected offers)

SCHEDULE OF REJECTED OR WITHDRAWN OFFERS IN COMPROMISE

Form No. 7879
TREASURY DEPARTMENT
INTERNAL REVENUE BUREAU
Approved by Comptroller General U. S.
Mar. 27, 1925

Schedule No. _____
Page No. _____
Number of pages _____
Number of items _____
Total amount, $_____

COMMISSIONER OF INTERNAL REVENUE,
Attention: Collection Division,
Washington 25, D. C.

From: Director of Internal Revenue (Office location)

The following offers in compromise (Form 656) have been examined and rejected or withdrawn as of the respective dates opposite each item below. The respective amounts have been refunded to the persons listed, under the provisions of section 3971(b) of the Internal Revenue Code.

Date _____ _____
Director.

NUMBER OF ITEM	DATE OF REJECTION	SERIAL NUMBER ON DOCUMENT	NAME OF PERSON ENTITLED TO REFUND	AMOUNT	CHECK NO.

EXHIBIT R

(Schedule offers accepted by directors)

SCHEDULE OF ACCEPTED OFFERS IN COMPROMISE

Form No. 7878
TREASURY DEPARTMENT
INTERNAL REVENUE BUREAU
Approved by the Comptroller General, U. S.
Mar. 27, 1925

Schedule No._____
Page No._____
Number of pages_____
Number of items_____
Total amount, $_____
Check No. _____ covering total of this schedule.

COMMISSIONER OF INTERNAL REVENUE,
Attention: Collection Division,
Washington 25, D. C.

From: Director of Internal Revenue (Office location)

The following offers in compromise have been examined and accepted as of the respective dates opposite each item below. The respective amounts have been withdrawn from the special deposit account and deposited as internal revenue collections, in accordance with the provisions of section 3971(b) of the Internal Revenue Code.

_____
Director.

NUMBER OF ITEM	DATE OF ACCEPTANCE	SERIAL NUMBER ON DOCUMENT	NAME OF PERSON WHOSE LIABILITY HAS BEEN COMPROMISED	AMOUNT

PART III.—MISCELLANEOUS

H. R. 568. PUBLIC LAW 4, EIGHTY-THIRD CONGRESS
[CHAPTER 4, FIRST SESSION]

An Act To continue until the close of June 30, 1954, the suspension of 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 Act entitled "An Act to suspend certain import taxes on copper", approved May 22, 1951 (Public Law 38, 82d Cong.) [C. B. 1951-1, 184], is hereby amended by striking out "February 15, 1953, or the termination of the national emergency proclaimed by the President on December 16, 1950, whichever is earlier" and inserting in lieu thereof "June 30, 1954".

Approved February 14, 1953.

Ct. D. 1759

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. RES. JUDICATA—ESTOPPEL BY JUDGMENT.

The Tax Court, pursuant to stipulations filed, entered formal decisions that there were no deficiencies for the taxable years in question. The issue was the basis for depreciation of taxpayer's leasehold property. The Court held no hearing, no stipulations of fact were entered into, no briefs were filed or argument had. Tax payer later brought suit in District Court on the same issue for subsequent years, claiming that the Tax Court decisions were *res judicata* of the issue. *Held:* The Tax Court decisions were only a *pro forma* acceptance by it of an agreement between the parties to settle their controversy. On the record, it is not determinable whether the agreement was based on the merits or on some collateral consideration. Estoppel by judgment includes matters in a second proceeding which were actually presented and determined in an earlier suit. A judgment entered with the consent of the parties may involve a determination of questions of fact and law by the court, but unless a showing is made that that was the case, the judgment has no greater dignity, so far as collateral estoppel is concerned, than any judgment entered only as a compromise of the parties.

2. DECISION REVERSED.

Decision of the United States Court of Appeals, Eighth Circuit, 199 F. 2d 12 (1952), reversing decision of the United States District Court, E. D. Missouri, 97 F. Supp. 595 (1951), reversed.

SUPREME COURT OF THE UNITED STATES

United States of America, petitioner, v. *International Building Company, a Corporation*

On writ of certiorari to the United States Court of Appeals for the Eighth Circuit

[May 4, 1953]

OPINION

Mr. Justice DOUGLAS delivered the opinion of the Court.

Respondent, a Missouri corporation, owns a leasehold of a plot of ground together with an office building erected on it. In 1942 the Commissioner assessed

deficiencies against respondent for the taxable years 1933, 1938, and 1939, determining that it had claimed an excessive value as its basis for depreciating the property. These deficiencies were predicated on a basis of $385,000 amortized over the life of the lease. Respondent, who claimed a base of $860,000 amortized over a shorter period, filed petitions for review with the Tax Court. Meanwhile respondent filed a petition under ch. X of the Bankruptcy Act which ended in a confirmed plan of reorganization. Although the collector filed proof of claim for the deficiencies in those proceedings, he later withdrew the claim under a stipulation that the withdrawal was "without prejudice" and did not constitute a determination of or prejudice the rights of the United States to any taxes with respect to any year other than those involved in the claim. Shortly thereafter respondent and the Commissioner filed stipulations in the pending Tax Court proceedings stating that "there is no deficiency in Federal income tax due" from respondent for the taxable years in question, that the tax liability for each of the years was nil, and that the jeopardy assessment was abated.[1] The Tax Court, pursuant to the stipulation, entered formal decisions that there were no deficiencies for the taxable years in question. The Tax Court, however, held no hearing; no stipulations of fact were entered into; no briefs were filed or argument had. The issue as to the correctness of the basis of depreciation used by respondent was, however, the basis of its appeal to the Tax Court. And so, when the Commissioner in 1948 assessed deficiencies for the years 1943, 1944, and 1945, challenging once more the correctness of the basis of depreciation, respondent paid the deficiencies and brought this suit to recover, alleging *inter alia* that the decisions of the Tax Court for the years 1933, 1938, and 1939 were *res judicata* of the fact that the basis for depreciation was $860,000. The district court held against respondent. 97 F. Supp. 595. The court of appeals reversed. 199 F. 2d 12. Because of a conflict between that decision and *Trapp* v. *United States*, 177 F. 2d 1, decided by the Court of Appeals for the Tenth Circuit, we granted certiorari.

The governing principle is stated in *Cromwell* v. *County of Sac*, 94 U. S. 351, 352–353. A judgment is an absolute bar to a subsequent action on the same claim.

"But where the second action between the same parties is upon a different claim or demand, the judgment in the prior action operates as an estoppel only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered. In all cases, therefore, where it is sought to apply the estoppel of a judgment rendered upon one cause of action to matters arising in a suit upon a different cause of action, the inquiry must always be as to the point or question actually litigated and determined in the original action; not what might have been thus litigated and determined. Only upon such matters is the judgment conclusive in another action."

And see *Tait* v. *Western Md. R. Co.*, 289 U. S. 620, 623 [Ct. D. 683, C. B. XII–1, 351 (1933)]; *Mercoid Corp.* v. *Mid-Continent Co.*, 320 U. S. 661, 671; *Commissioner* v. *Sunnen*, 333 U. S. 591, 597–598 [Ct. D. 1698, C. B. 1948–1, 7]. Estoppel by judgment, or collateral estoppel as it is often called, is applicable in the federal income tax field. *Tait* v. *Western Md. R. Co.*, *supra*, 624; *Commissioner* v. *Sunnen*, *supra*, 598.

We conclude that the decisions entered by the Tax Court for the years 1933, 1938, and 1939 were only a *pro forma* acceptance by the Tax Court of an agreement between the parties to settle their controversy for reasons undisclosed. There is no showing either in the record or by extrinsic evidence (see *Russell* v. *Place*, 94 U. S. 606, 608) that the issues raised by the pleadings were submitted to the Tax Court for determination or determined by that court. They may or may not have been agreed upon by the parties. Perhaps, as the court of appeals inferred, the parties did agree on the basis for depreciation. Perhaps the settlement was made for a different reason, for some exigency

[1] The stipulation for the year 1933, which is typical, reads as follows:

"It is hereby stipulated that there is no deficiency in Federal income tax due from the petitioner for the taxable year 1933 and that the following statement shows the petitioner's Federal income tax liability for the taxable year 1933:

"Tax liability	None
"Assessment (jeopardy): January 23, 1942 (not paid)	$2,188.12
"Assessment to be abated	2,188.12"

arising out of the bankruptcy proceeding. As the case reaches us, we are unable to tell whether the agreement of the parties was based on the merits or on some collateral consideration. Certainly the judgments entered are *res judicata* of the tax claims for the years 1933, 1938 and 1939, whether or not the basis of the agreements on which they rest reached the merits. But unless we can say that they were an adjudication of the merits, the doctrine of estoppel by judgment would serve an unjust cause: it would become a device by which a decision not shown to be on the merits would forever foreclose inquiry into the merits. Estoppel by judgment includes matters in a second proceeding which were actually presented and determined in an earlier suit. See *Commissioner* v. *Sunnen*, *supra*, 598. A judgment entered with the consent of the parties may involve a determination of questions of fact and law by the court. But unless a showing is made that that was the case, the judgment has no greater dignity, so far as collateral estoppel is concerned, than any judgment entered only as a compromise of the parties.

Reversed.

LARGE CIGARS

Large cigars manufactured in and removed from domestic factories during the month of October 1952, compared with the same month of 1951

	1952	1951
Manufactured	578, 952, 332	562, 953, 243
Removed:		
Tax-paid—		
Class A	2, 995, 615	2, 012, 424
Class B	17, 204, 576	22, 566, 365
Class C	210, 090, 298	186, 281, 200
Class D	59, 452, 224	56, 597, 851
Class E	238, 701, 939	240, 693, 860
Class F	11, 710, 742	11, 778, 911
Class G	8, 040, 156	7. 319, 790
Total tax-paid	548, 195, 550	527, 250, 401
Tax-free	17, 309, 325	5, 858, 972

NOTE.—These figures are subject to revision until incorporated in the total for the calendar year to be published in the Commissioner's annual report.

TOBACCO AND SNUFF

Tobacco and snuff manufactured in and removed from domestic factories during the month of November 1952, compared with the same month of 1951

	Manufactured		Removed			
			Tax-paid		Tax-free	
	1952	1951	1952	1951	1952	1951
	Pounds	*Pounds*	*Pounds*	*Pounds*	*Pounds*	*Pounds*
Plug	2, 837, 206	3, 775, 873	2, 633, 856	3, 603, 231	176, 656	53, 549
Twist	402, 003	476, 234	290, 631	437, 171	115, 606	38, 935
Fine-cut chewing	223, 439	244, 223	225, 804	235, 087		
Scrap chewing	2, 914, 994	3, 356, 636	2, 869, 038	3, 110, 424	2, 924	5, 548
Smoking	6, 842, 583	9, 242, 676	6, 688, 133	9, 039, 697	337, 272	210, 377
Snuff	2, 902, 558	3, 528, 369	2, 945, 583	3, 571, 370	4, 500	6, 879
Total	16, 122, 783	20, 624, 011	15, 653, 145	19, 996, 980	636, 958	315, 288

NOTE.—These figures are subject to revision until incorporated in the total for the calendar year to be published in the Commissioner's annual report.

CIGARETTES AND SMALL CIGARS

Cigarettes and small cigars manufactured in and removed from domestic factories during the month of November 1952, compared with the same month of 1951

	Small cigarettes		Large cigarettes		Small cigars	
	1952	1951	1952	1951	1952	1951
Manufactured	33, 562, 713, 209	38, 017, 487, 880	124, 260	55, 300	5, 109, 840	5, 624, 390
Removed tax-paid	30, 385, 955, 178	33, 993, 650, 738	156, 760	55, 700	5, 252, 150	5, 896, 220
Removed tax free	3, 407, 775, 687	3, 707, 965, 156	300	600	195, 000	12, 000

NOTE.—These figures are subject to revision until incorporated in the total for the calendar year to be published in the Commissioner's annual report.

TOBACCO, SNUFF, CIGARS, CIGARETTES, ETC.

Rev. Rul. 11

The publication in the Internal Revenue Bulletin of the tables covering the manufacture and withdrawal of (1) tobacco and snuff, (2) cigarettes and small cigars, and (3) large cigars is now discontinued. In the future, such tables will be prepared as the necessary statistical data become available and will be furnished upon request to those interested. Requests to be placed on the mailing lists, specifying the particular table or tables desired, should be addressed to the Commissioner of Internal Revenue, Washington 25, D. C., for the attention of the Information Officer.

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