Internal Revenue Bulletin

CUMULATIVE BULLETIN 1960-2

JULY-DECEMBER 1960

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*Denotes Revenue Procedure.

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* Denotes Revenue Procedure.

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.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
C.F.R.—Code of Federal Regulations.
Ct. D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department circular.
E.O.—Executive Order.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
F.R.—Federal Register.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim.—Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—The names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax-ruling.
Mim.—Published mimeograph.
O.D.—Office Decision.
P.L.—Public Law.
P.S.—Pension, profit-sharing, stock bonus or annuity plan ruling.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security tax.
S.T.—Sales tax ruling.
Stat.—Statutes at Large.
T.C.—The Tax Court of the United States.
T.D.—Treasury Decision.
TIR—Technical Information Release.
U.S.C.—United States Code.
x and y used to represent certain numbers and when used with the word "dollars" represent sums of money.

FOREWORD

The Cumulative Bulletin is prepared in five parts, as follows:

I. Part I includes rulings and decisions which are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise stated in the ruling or decision, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939 or other related public laws.

II. Part II includes rulings and decisions which are based on the application of the Internal Revenue Code of 1939 and other public laws except those pertaining to the various alcohol taxes; and, unless otherwise noted therein, they are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954. Part II is subdivided into two subparts according to matters issued under the Internal Revenue Code of 1939 (Subpart A) and other public laws (Subpart B.)

III. Part III contains rulings and decisions pertaining to the various alcohol taxes. This part is subdivided into two subparts according to matters issued under the Internal Revenue Code of 1954 (Subpart A), and the Federal Alcohol Administration Act (Subpart B).

IV. Part IV contains treaties and tax legislation, including related Committee and Conference Reports. This part is subdivided into three subparts according to Tax Conventions, Treasury Decisions and Revenue Rulings issued with respect thereto (Subpart A), legislation (Subpart B), and Committee Reports (Subpart C). House, Senate and Conference Committee Reports printed in the Bulletin do not include the portion entitled "Changes in Existing Law."

V. Part V is devoted to administrative, procedural, and miscellaneous matters. The weekly Internal Revenue Bulletins contained Part VI consisting of items of general interest; those items are not reproduced herein.

INTRODUCTION

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for the announcement of official rulings and procedures of the Internal Revenue Service, and for the publication of Treasury Decisions, Executive Orders, tax conventions, legislation, and court decisions pertaining to internal revenue matters. Other items considered to be of general interest are also published in the Bulletin, such as announcements relating to proposed regulations published with notice of proposed rulemaking, announcements relating to decisions of the Tax Court of the United States, announcements of the disbarment and suspension of attorneys and agents from practice before the Treasury Department, supplements to the Cumulative List of Organizations contributions to which are deductible under section 170 of the Internal Revenue Code of 1954, Delegation Orders, etc.

It is the policy of the Service to publish in the Bulletin all substantive and procedural rulings of importance or of 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 and statements of procedures which supersede, revoke, modify, or amend any published ruling or procedure. Except where otherwise indicated, published rulings and procedures apply retroactively. Rulings and statements of procedures relating solely to matters of internal management are not published. However, statements of internal practices and procedures affecting rights or duties of taxpayers, or industry regulation, which appear in internal management documents, are published. Revenue Rulings and Revenue Procedures are based upon rulings and internal management documents prepared in the various divisions of the National Office, including the Office of the Chief Counsel for the Internal Revenue Service. In the preparation of these, caution is exercised to conceal the identity of the taxpayer, as well as any confidential personal and business information.

Revenue Rulings and Revenue Procedures 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 that purpose. No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Internal Revenue Service as a precedent in the disposition of other cases.

Since each published ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same. In applying rulings and procedures published in the Bulletin, personnel of the Service and others concerned

must consider the effect of subsequent legislation, regulations, court decisions, rulings and procedures.

Each published ruling is designated as a "Revenue Ruling," and each published procedure is designated as a "Revenue Procedure." These should be cited by reference to the year of issuance and the Bulletin and page where reported. Thus, Revenue Ruling No. 232 for 1960 should be cited as "Rev. Rul. 60–232, C.B. 1960–2, 115." Similarly, Revenue Procedure No. 14 for 1960 should be cited as "Rev. Proc. 60–14, C.B. 1960–2, 937." Revenue Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1960–2 contains all rulings, decisions, and procedures pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 27–52, inclusive, for the period July 1 to December 31, 1960. It includes an index to all matters published during the year in the weekly Bulletins and consolidated in the Cumulative Bulletins. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States published in the Internal Revenue Bulletins.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the *Cumulative Bulletin* as the source would be appropriate.

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, 1960, TO DECEMBER 31, 1960, INCLUSIVE

It is the policy of the Internal Revenue Service to announce in the INTERNAL REVENUE BULLETIN at the earliest practicable date the determination of the Commissioner to acquiesce or not 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. Actions of acquiescences in adverse decisions should be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon. Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions. No announcements are made in the Bulletin with respect to memorandum opinions of The Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated. Semiannual consolidations appear in the first Bulletins for July and January and in the Cumulative Bulletin for the first half of the year. An annual consolidation appears in the Cumulative Bulletin for the last half of the year.

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Fallis, James P., et ux	65905	32	1314
Finley, Charles O., et ux	58664	33	753
Fiorito, Angela, executrix of estate of Nicolo Fiorito[9]	68409	33	440
Fiorito, Nicolo, estate of [9]			
Fleming-Kimbell Corp.[12]	548	3	13
Gann, Eleanor	67129	31	211
Gann, Ernest K	67113		

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Goldstein, Abraham, estate of	64232	33	1032
Goldstein, Anna, et al., executors of estate of Abraham Goldstein, and Anna Goldstein			
Goldstein, Ben, et ux	71620	33	241
Gratuity Fund of Philadelphia-Baltimore Stock Exchange and Trustees of Gratuity Fund [14]	69041	32	515
Growers Credit Corp	60562	33	981
Gsell & Co., R., Inc	69106	34	41
Hack, Fredrick F., et ux	65335	33	1089
Harteveld, Dolph, et al., trustees of Henry A. Marks Trust No. 1	69237	33	1
Harteveld, Dolph, et ux	69232		
Harteveld, Lillian, et al., trustees of Dolph Harteveld Trust No. 1	69231		
Harteveld Trust No. 1, Dolph, for the benefit of Bette Harteveld Gillman, et al			
Heaberlin, John W	84559	34	58
Hearne, Mary Milton	54688	29	433
Heuer, William L., Jr., et ux	65538	32	947
Hilby, Francis M., et ux	65284 73036	33	465
Hobart, John H., executor of estate of Ralph H. Hobart [15]	27397	18	570
Hobart, Ralph H., estate of [15]			
Howard, Harrison M., et ux	65907	32	1314
Howard, Robert S., et ux	62090	32	1284
Howes, Ernest G., estate of [6]	55517	30	909
Howes Leather Co., Inc.[6]	55556		
Ima Mines Corp	65045	32	1360
Isenberg, Max, et ux	68525	31	1046
Johnson, Earl, et al., executors of estate of Ernest G. Howes [6]	55517	30	909
Johnson Fare Box Co., alleged transferee [4, 5]	60974	32	1222
Johnson, Oscar Doyle, et ux.[1]	71379	32	515
Kasey, J. Bryant, et ux	62599	33	656
Kennedy Mining & Milling Co.[16]	ª 99507	43	617
Kilroe, E. G., et ux	73257	32	1304
Klamath Medical Service Bureau	60345	29	339
Ladyman, William J., Jr., et ux	65906	32	1314
Lewis, Laura	54390	33	215
LoBue, Philip J.[17]	41595	28	1317
Longstreet, Roy W., et ux	65285 73038	33	465
Lustig, Halina	65477	30	926
Lydiade Investment Trust	64691 70298	33	484
Markle, George B., Jr., et ux	22060	17	1593
Marks, Henry A., et ux	69233	33	1
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Merrimac Hat Corp.[18]	50382	32	1082
Mieg, Charles E., et ux	65904	32	1314
Missouri Group Account of Longstreet-Abbott & Co	65290, 73035	33	465
Missouri Trading Fund Account of Longstreet-Abbott & Co	65291, 73033		
Model Laundry Co	69230	33	1
Model Laundry Co., transferee	69229		
Monteleone, Michele, et ux	72859	34	688
Morgan, Walter L., et ux.[19]	63331	33	30
Moyer, C. Leigh, Jr., executor of estate of Clarence L. Moyer [1]	59017	32	515
Moyer, Clarence L., estate of, and Lena W. Moyer, widow [1]			
Newhall, C. Stevenson, et al., surviving and succeed-trustees of Trustees Common Stock John Wanamaker Philadelphia, under will of Rodman Wanamaker [20]	15065	11	365
Newlin, J. J.[21]	64098, 67766	31	451
Newlin, Ruth Owen [21]	64107, 67767		
Nichols, Beulah H., surviving spouse and as executrix of estate of Harold E. Nichols	74982	32	1322
Nichols, Harold E., estate of			
North American Service Co., Inc	61968	33	677
North American Service Co., Inc., et al	61969		
Oates, James F.[15]	27396	18	570
O'Donohue, Joseph J	68263	33	698
Ogsbury, Florence N., executrix of estate of James S. Ogsbury and as surviving wife[17]	52837	28	93
Ogsbury, James S., estate of [17]			
Olkjer, William I., et ux	68410	32	464
Parks, Earle C., et ux	67563	33	298
Paull, Mary Virginia	54687	29	433
Perfumers Manufacturing Corp., transferee	66863	33	532
Personal Trading Fund Account of Longstreet-Abbott & Co	65288, 73034	33	465
Pervere, Everett W.[6]	59155	30	909
Porter & Co., Inc., H.W., & Subsidiary [22]	17773	14	307
Producers Gin Association, A.A.L	72041	33	608
Ragner, George O., et ux	71595	34	111
Rand, Norfleet H., et ux	66462	33	548
Reece, Franklin A.[23]	50107	24	187
Rickaby, Hamilton C., estate of [24]	55403	27	886
Rickaby, Marcy W., executrix of estate of Hamilton C. Rickaby and Marcy W. Rickaby, individually [24]	56023		
Rollins Burdick Hunter Co.[25]	11691	9	169
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Shainberg, Herbert, et ux	71618	33	241
Shainberg, Nathan, et ux	71619		
Shelby Corp.[10]	50204	25	55
Shiffman, A., et ux	65686	32	1073
Shiffman Foundation	71524		
Shivers, Myra E.[7]	39453	20	679
Sibole, J. Wesley, et ux	55279	28	40
Smith, Calvin L., et ux	58665	33	753
Smith, Craig M., et al	65283	33	465
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Smith, Jack, et ux	63284	32	1261
Smith, Raymond I., Inc	72999	33	141
Souza, Frank, et ux	66156	33	817
Spencer, Lottie E.[7]	39452	20	679
Spindler Metal Processing Co	58829	30	10
Spitaleri, Anthony E., et ux	57845	32	988
Standard Linen Service, Inc	67447	33	1
Steinert, Lena L	75067	33	447
Stern, Melvin B., et ux	69235	33	1
Stofflet & Tillotson	64297	32	1031
Stone, George I., et ux	66682	32	1021
Tesche, Richard P., et ux.[18]	72275	33	122
Tighe, Mary	63867	33	557
Timken Detroit Axle Co., an Ohio Corp.[27]	38160	21	769
Triboro Coach Corp	61905	29	1274
Truck Terminals, Inc	66330	33	876
Trunk, Anton L., et ux	63380	32	1127
Truschel, W. H., et ux. (Louise)	54568	29	433
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Trustees Common Stock John Wanamaker Philadelphia under will of Rodman Wanamaker[20]	15065	11	365
United States Potash Co.[28]	61532	29	1071
Webster Corp.[10]	50203	25	55
Weidenhoff, Inc., Joseph[4 5]	60793	32	1222
Wesley Heat Treating Co	58828	30	10
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Winderman, Stanley D	65081	32	1197
Zietz, Hedwig, estate of[9]	58654	34	351
Zietz, Willy, administrator of estate of Hedwig Zietz[9]			
Zietz, Willy, et ux.[29]	49427	34	369
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The Commissioner does NOT ACQUIESCE in the following decisions:

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Bilder, Robert M., et ux.[31]	71548	33	155
Coady, Edmund P., et ux	70734	33	771
Forest Lawn Memorial Park Assn., Inc.[32]	[a]102989	45	1091
Fry, William N., Jr., et ux	61844	31	522
Garber, Bernice, estate of	63524	31	165
Garber, J. Ferry, estate of			
Garber, J. Ferry, executor of estate of Bernice Garber			
Garber, John F., executor of estate of J. Ferry Garber			
Goldberg, Bertha K	65118	31	258
Greenspon, Abraham [33]	8684	8	431
Greenspon, Louis [33]	9206		
Heckel, Frank P., et ux	63525	31	165
Hess, H. Loyd, et ux	61221		
Johnson, Abbott L., et ux	68382	32	257
McCall, Sam G., et ux	53584	27	133
McCall, Walter Bernard, et ux	53583		
Morgan, Walter L., et ux.[34]	63331	33	30
Morris Plan Co., of California, a corp	63676	33	720
Northway Securities Co.[35]	[a]33996	23	532
Ridgway, Craig Sawyer, executors of estate of Ellis Branson Ridgway [9]	70260	33	1000
Ridgway, Ellis Branson, estate of [9]			
Turnbow, Grover D., et ux	69429	32	646
Valley Morris Plan, formerly The Stockton Morris Plan Co	61293	33	572
Virginia Metal Products, Inc	74959	33	788
WAGE, Inc.[36]	31630	19	249
Walters, William Stokes, et ux	61845	31	522
Wilkinson, Earl R., et ux	61977	29	421
Zietz, Willy, et ux.[37]	49427	34	369

[a] United States Board of Tax Appeals.

[1] Acquiescence relates only to the issue whether amounts received in 1950 and 1954 by the beneficiaries of deceased members of a gratuity fund are excludable from the recipient's income under section 22(b)(1) of the 1939 Code as amounts paid by reason of the death of the insured.

[2] Nonacquiescence published in C.B. 1948–1, 4, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–328, page 427.

[3] Acquiescence relates to the issue whether petitioners were entitled to deduct the cost of transportation between New Jersey and Florida as a medical expense.

[4] Acquiescence in result only relates to the issue whether sections 24.31(b)(24) (i) and (ii) of Regulations 129 limiting the consolidated excess profits credit for the taxable year of an affiliated group formed subsequent to March 14, 1941, are applicable. Acquiescence "in result only" means acceptance of the decision of the court but disagreement with some or all of the reasons assigned for the decision.

[5] Acquiescence relates to the issue whether Bowser, Inc., and its affiliated group are entitled to carry forward in their consolidated income tax returns for 1950 and 1951 the 1948 and 1949 net operating losses of The Fostoria Screw Company.

[6] Nonacquiescence published in C.B. 1959–2, 8, is withdrawn and acquiescence is substituted therefor.

[7] Nonacquiescence published in C.B. 1954–1, 8, is withdrawn and acquiescence is substituted therefor.

[8] Acquiescence in result only. Acquiescence "in result only" means acceptance of the decision of the court but disagreement with some or all of the reasons for the decision.
[9] Estate tax decision.
[10] Nonacquiescence published in C.B. 1956–2, 10, is withdrawn and acquiescence is substituted therefor.
[11] Nonacquiescence published in C.B. 1944, 37, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–74, C.B. 1960–1, 253.
[12] Nonacquiescence published in C.B. 1944, 38, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–74, C.B. 1960–1, 253.
[13] Acquiescence relates to the implication that petitioner was entitled to a deduction for Federal income tax purposes in 1952 of the additional 1951 state excise tax which was redetermined and paid in 1952. See Rev. Rul. 57–105, C.B. 1957–1, 193.
[14] Acquiescence in result only in the issue whether the petitioner is a mutual insurance company (other than life) exempt from tax under sections 101(11) of the 1939 Code and 501(15) of the 1954 Code. Acquiescence "in result only" means acceptance of the decision of the court but disagreement with some or all of the reasons assigned for the decision.
[15] Nonacquiescence published in C.B. 1952–2, 5, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–31, C.B. 1960–1, 174.
[16] Nonacquiescence published in C.B. 1941–1, 16, and C.B. 1944, 42, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–176, C.B. 1960–1, 686.
[17] Nonacquiescence published in C.B. 1958–2, 9, is withdrawn and acquiescence is substituted therefor.
[18] Acquiescence in result only. Acquiescence "in result only" means acceptance of the decision of the court but disagreement with some or all of the reasons assigned for the decision.
[19] Acquiescence relates to the issue whether the gain realized on distribution by Fund Shares, Inc., was ordinary income under section 115(g)(1) or capital gains under section 115(c) of the 1939 Code.
[20] Nonacquiescence published in C.B. 1949–1, 7, relating to the issue whether sales by petitioner-stockholders of their stock in John Wanamaker Philadelphia, to John Wanamaker New York, its wholly owned subsidiary, constituted a cancellation or redemption of the parent corporation's stock which resulted in a distribution essentially equivalent to a dividend under section 115(g) of the 1939 Code prior to the amendment of that section in 1950, is withdrawn and acquiescence is substituted therefor. Acquiescence published in C.B. 1949–1, 4, relating to the issue whether the fiduciary is entitled to deduct amounts of current income retained by it to reimburse itself for inheritance tax advances on behalf of the beneficiary, remains unchanged.
[21] Gift tax decision.
[22] Nonacquiescence in the issue relating to the taxability of gain realized from the sale of petitioner's own stock to its stockholders and employees, which stock had been acquired and held in its treasury, published in C.B. 1950–1, 7, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–328, page 427. Acquiescence in the issue involving the deductibility of an addition to a reserve for bad debts, published in C.B. 1950–1, 4, remains unchanged.
[23] Nonacquiescence published in C.B. 1956–1, 6, and C.B. 1956–2, 10, is withdrawn and acquiescence is substituted therefor.
[24] See Rev. Rul. 60–248, page 35.
[25] Nonacquiescence published in C.B. 1948–1, 4, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–328, page 427.
[26] Nonacquiescence published in C.B. 1958–2, 9, is withdrawn and acquiescence is substituted therefor.
[27] Nonacquiescence published in C.B. 1954–2, 6, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 60–328, page 427.
[28] See Rev. Rul. 60–74, C.B. 1960–1, 253.
[29] Acquiescence relates to the issues whether the legal fees were incurred on behalf of the petitioner or on behalf of his mother's estate, and whether certain legal fees incurred in the defense of suits brought by an alleged widow of petitioner's brother, or by a party appointed by her, were incurred to conserve income producing property or to perfect title to that property.
[30] Acquiescence published in C.B. 1950–2, 1, in the issue as to the application of unused 1941 and 1942 net operating loss and excess profits tax credit carryovers attributable to the book business to offset the 1943 income from the corrugated container business, is withdrawn and nonacquiescence is substituted therefor. Acquiescence in the issue as to the deduction of the current year's expenses and losses of the book business department in the fiscal year 1943 so as to reduce taxable income computed without those deductions, published in C.B. 1950–2, 1, remains unchanged.
[31] Nonacquiescence relates to the issue whether rent paid for a Florida apartment is a deductible medical expense. Acquiescence in the issue whether petitioners were entitled to deduct the cost of transportation between New Jersey and Florida as a medical expense was published in C.B. 1960–1, 4.
[32] Acquiescence published in C.B. 1946–2, 2, is withdrawn and nonacquiescence is substituted therefor.
[33] Acquiescence published in C.B. 1947–1, 2, is withdrawn and nonacquiescence is substituted therefor. See Rev. Rul. 60–48, C.B. 1960–1, 112.
[34] Nonacquiescence relates to the issue whether gain realized on distributions by Wellington Corporation was ordinary income under section 112(c)(2) or capital gain under section 115(c) of the 1939 Code. Acquiescence in the issue whether gain realized on distributions by Fund Shares, Inc. was ordinary income or capital gain published in C.B. 1960–1, 5, remains unchanged.
[35] Acquiescence published in C.B. X–2, 52 (1931), is withdrawn and nonacquiescence is substituted therefor.
[36] Acquiescence published in C.B. 1954–2, 6, relating to the issue whether the petitioner was entitled to carryover unused excess profits credits from years in which it was engaged as an automobile dealer and distributor to years in which it was engaged in the radio broadcasting business, is withdrawn and nonacquiescence is substituted therefor. The acquiescence in the issue relating to computation of invested capital credit for postmerger years and in the issue involving the computation of excess profits tax liability for the year of merger, published in C.B. 1954–2, 6, remain unchanged.
[37] Nonacquiescence relates to the issue whether legal fees incurred by petitioner for the handling of claims by both the Swiss and United States Government for taxes allegedly due were deductible under section 23(a)(2) of the 1939 Code as expenses for maintaining and conserving petitioner's income producing property.
[38] Acquiescence has no bearing on pre-March 1, 1913 adjustments which are required by reason of a taxpayer's change from the retirement method to another method of accounting for depreciation. See Rev. Rul. 60–390, page 463.

PART I

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

Rulings and decisions published in Part I of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise stated in the rulings or decisions, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939 or related public laws.

SUBTITLE A.—INCOME TAXES

CHAPTER 1.—NORMAL TAXES AND SURTAXES

SUBCHAPTER B.—COMPUTATION OF TAXABLE INCOME

PART I.—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, AND TAXABLE INCOME

SECTION 61.—GROSS INCOME DEFINED

26 CFR 1.61–1: Gross income. Rev. Rul. 60–279

Relocation payments received by individuals and families for their reasonable and necessary moving expenses and for any actual direct losses of property resulting from their displacement by an urban renewal project are not includible in the gross incomes of the recipients under section 61 of the Internal Revenue Code of 1954 to the extent that such payments are expended for the purpose for which provided.

Advice has been requested whether relocation payments received by individuals and families for moving expenses and for actual direct losses of property resulting from their displacement from their personal residences by an urban renewal project must be included in the gross incomes of the recipients.

The relocation payments involved in the instant case are defined by section 106(f)(2) of the Housing Act of 1949, P.L. 171, 42 U.S.C. 1441 and 1450 et seq., as amended, which provides as follows:

As used in this subsection, the term "relocation payments" means payments by a local public agency to individuals, families, and business concerns for their reasonable and necessary moving expenses and any actual direct losses of property except goodwill or profit (which are incurred on and after August 7, 1956, and for which reimbursement or compensation is not otherwise made)

resulting from their displacement from an urban renewal area made necessary by (i) the acquisition of real property by a local public agency or by any other public body, (ii) code enforcement activities undertaken in connection with an urban renewal project, or (iii) a program of voluntary rehabilitation of buildings or other improvements in accordance with an urban renewal plan: Provided, That such payments shall not be made after completion of the project or if completion is deferred solely for the purpose of obtaining further relocation payments. Such payments shall be made subject to such rules and regulations as may be prescribed by the Administrator, and shall not exceed $200 in the case of an individual or family, or $3,000 in the case of a business concern. Such rules and regulations may include provisions authorizing payment to individuals and families of fixed amounts (not to exceed $200 in any case) in lieu of their respective reasonable and necessary moving expenses.

These payments are reimbursable by the Federal Government, since provision is made whereby capital grants made to the local public agencies are increased by an amount equal to such relocation payments. See section 106(f)(1) of the Housing Act of 1949, as amended. The purpose of the payments is to ease the personal and financial hardships resulting to the individuals and families displaced by the clearing and rehabilitating of a slum area.

Section 61 of the Internal Revenue Code of 1954 provides that gross income means all income from whatever source derived, except as otherwise provided. However, an amount which is not income within the meaning of section 61 of the Code is not includible in the gross income of the recipient.

Revenue Ruling 57–60, C.B. 1957–1, 25, as modified by Revenue Ruling 60–280, below, this Bulletin, holds that a reimbursement for an expenditure made by a taxpayer is not includible in his gross income for Federal income tax purposes where the reimbursement was made by a school board and represented mileage allowance to parents and others, not engaged in the transportation business, for expenses incurred in transporting children to and from school where bus service was not made available. As in the instant case, it was the assumed obligation of the governmental unit in relation to the performance of a governmental function which caused the expense which the allowance was intended to defray.

Accordingly, it is held that relocation payments received by individuals and families for their reasonable and necessary moving expenses and for any actual direct losses of property resulting from their displacement from their personal residences by an urban renewal project are not includible in the gross incomes of the recipients to the extent that such payments are expended for the purposes for which they are provided. Any expenses incurred by such individuals and families for the relocation of their property in excess of the amounts provided therefor are nondeductible personal expenses.

Whether relocation payments received by a business are includible in income and whether its relocation expenses are deductible will depend upon the particular facts in a given case.

Rev. Rul. 60–280

Revenue Ruling 57–60, C.B. 1957–1, 25, holds, in part, that where payments are made by a school board to a parent or other person not engaged in the business of transporting children to school, for transporting children where bus service is not available, the money is

considered as reimbursement for the recipient's personal expenses and is not includible in his gross income for Federal income tax purposes. The exclusion is based on the fact that the reimbursement is for an expense incurred on behalf of the school board which was obligated to furnish transportation to the school children. Since the statement in the ruling that the money is considered as reimbursement for the recipient's personal expenses is subject to an erroneous interpretation that a reimbursement of personal expenses generally does not result in taxable income, Revenue Ruling 57–60 is hereby modified by deleting therefrom the words "is considered as reimbursement for the recipient's personal expenses and."

Rev. Rul. 60–377

With specified exceptions and limitations, the proceeds from the sale or exchange of cattle, horses, sheep and goats raised by an Indian on allotted and restricted land held in trust for him by the United States, in accordance with section 5 of the General Allotment Act of 1887, are exempt from income tax to the extent of an amount equal to the sum of the average per head grazing fees charged on his reservation for each year that the animal has grazed upon his trust allotment. However, if an Indian establishes that his allotment could have been leased for grazing the kind of animals that he sold at a rental yielding a higher per head fee, the latter per head fee may be used in computing exempt income.

Revenue Ruling 58–64, C.B. 1958–1, 12, modified.

The Internal Revenue Service has reconsidered Revenue Ruling 58–64, C.B. 1958–1, 12, which holds that income derived by an Indian from the sale of cattle raised on allotted and restricted Indian lands while such lands are held in trust for him by the United States, in accordance with section 5 of the General Allotment Act of 1887, 25 U.S.C. 348, is not considered derived directly from the land and is, therefore, includible in gross income.

The effect of Revenue Ruling 58–64 is to deny a tax exemption to Indians who raise cattle on their own allotments, while Indians who lease their own allotments may treat their grazing fees as exempt income under Revenue Ruling 56–342, C.B. 1956–2, 20. Upon reconsideration, it has been determined that the exemption accorded income derived directly from the land should be extended to that portion of the proceeds from the sale or exchange of cattle attributable to the grazing capacity of the land and that such portion can best be determined by reference to the fair rental value of the land for grazing purposes. Accordingly, a method has been developed to determine the portion of the proceeds from the sale or exchange of cattle, as well as horses, sheep and goats, which will be treated as income derived from the use of land for grazing purposes, within the meaning of Revenue Ruling 56–342.

This method may be utilized by obtaining from the Bureau of Indian Affairs of the Department of the Interior statistics indicating the average annual grazing fees obtained from the leasing of grazing privileges on each reservation. As a matter of course, the Bureau's Branch of Land Operations prepares abstracts from which the average annual rate per head of cattle, horses, sheep and goats may be easily computed.

On the basis of an assumption that the grazing value of unleased grazing land is equal to the average grazing value of leased land, it is held that an Indian who has raised cattle, horses, sheep or goats upon allotted and restricted land held in trust for him by the United States, in accordance with section 5 of the General Allotment Act, may treat the proceeds of sale or exchange of these animals as exempt to the extent of an amount equal to the sum of the average per head grazing fees charged on his reservation for each year that the particular animal sold has grazed upon his trust allotment, provided, however, the maximum amount exempted shall not exceed the annual fair rental value of the trust allotment for the year of sale.

The following examples illustrate the method of computation set forth in the preceding paragraph:

Example 1. An Indian has an exempt allotment having a grazing capacity of 40 head of cattle. In a given year he sells 10 head which had grazed upon his land for three years, during all of which period the average annual fee charged for grazing cattle on his reservation was $10x$ dollars per head. The proceeds would be considered exempt income to the extent of $300x$ dollars ($10 \times 10x$ dollars $\times 3$) since the exempt portion is not in excess of the maximum limitation of $400x$ dollars ($40 \times 10x$ dollars).

Example 2. If the grazing capacity of the land in Example 1 were 20 head of cattle per year and the Indian sold 10 head in a given year, the amount considered exempt would be held to the maximum limitation of the annual fair rental value, $200x$ dollars ($20 \times 10x$ dollars).

The amount of the proceeds from the sale or exchange of horses, sheep and goats that may be treated as exempt would be computed in the same manner, based upon the average annual grazing fees charged on the reservation for the particular kind of animal sold.

In the event an Indian supplies proof that his allotment could have been leased at a higher per head grazing fee, he will be permitted to use the greater amount in computing the exempt income. For example, if the Indian taxpayer in Example 1 above could establish that during each of the years his ten head of cattle had grazed he could have leased his allotment for grazing cattle at the rate of $11x$ dollars per head, rather than $10x$ dollars per head, the proceeds from the sale of his cattle would be considered exempt income to the extent of $330x$ dollars ($10 \times 11x$ dollars $\times 3$).

The exemption described herein applies only to income derived by an Indian from the sale or exchange of animals raised by him on his own allotted and restricted lands, if the income derived directly from such lands is exempt under the decision of the Supreme Court of the United States in *Squire* v. *Horton Capoeman et ux.*, 351 U.S. 1. Ct. D. 1796, C.B. 1956–1, 605, and rulings interpreting that decision. Except as otherwise provided by law, such exemption will not be applicable in those instances where the Indian has obtained his interest in the exempt lands through an arm's-length purchase rather than, for example, through allotment, gift, devise or inheritance.

Where the taxpayer has grazed animals not only upon his own exempt lands but upon other lands, it will be assumed that the animals sold have grazed upon the taxpayer's exempt lands and the other

lands for periods proportional to the grazing capacity of each. For example, if an Indian sold ten head of cattle, which for each of the three years they had been grazed by him had grazed both upon his exempt lands and upon lands leased by him from others, and his exempt lands constituted one-fifth of the total grazing capacity, the amount of the proceeds considered exempt income, where the applicable annual grazing fee was $10x$ dollars per head, would be $60x$ dollars ($10 \times 10x$ dollars $\times 3 \div 5$) provided the maximum limitation is not exceeded.

Revenue Ruling 58–64, C.B. 1958–1, 12, is modified to the extent that a portion of the proceeds from the sale of cattle raised on exempt allotted and restricted Indian land may be treated as exempt income in accordance with this ruling.

Earnings on investment by a reciprocal insurance exchange of "premium deposits" made by member corporations and credited to or withdrawn by such members. See Rev. Rul. 60–275, page 43.

Payments received by an employee directly from an employer under supplemental unemployment benefit plan. See Rev. Rul. 60–330, page 46.

Gain on transfer of partnership interest. See Rev. Rul. 60–352, page 208.

Inclusion of amounts received under a fellowship grant in excess of the limitations of section 117(b)(2)(B) of the Internal Revenue Code of 1954. See Rev. Rul. 60–378, page 38.

Strike benefits paid by a labor union. See Ct. D. 1851, page 33.

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26 CFR 1.61–2: Compensation for services, including fees, commissions, and similar items.

Amounts received by individuals from an organization for teaching services performed in connection with experimental text material in mathematics. See Rev. Rul. 60–274, page 39.

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26 CFR 1.61–3: Gross income derived from business.

Computation of gross income in the case of oil and gas producing properties. See Rev. Rul. 60–344, page 186.

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26 CFR 1.61–6: Gains derived from dealing in property. (Also Section 1221, 1.1221–1.) Rev. Rul. 60–301

The decision in the case of *Estate of F. G. Masquelette et al.*, v. *Commissioner*, 239 Fed. (2d) 322, will be followed in similar cases by the Internal Revenue Service only to the extent it recognizes

that transferable goodwill may exist in connection with a sale of a business, the success of which is *not* dependent solely upon the personal qualifications of the owner, even though such a sale does not involve the assignment of the exclusive use of the firm name. However, where a business which is dependent *solely* upon the professional skill or other characteristics of the owner is sold, no portion of the sales price may be treated as the proceeds from the sale of goodwill even though such sale involves a valid assignment of the right to the exclusive use of the firm name.
Revenue Ruling 57–480, C.B. 1957–2, 47, clarified.

The Internal Revenue Service has been requested to state whether the decision of the Court of Appeals for the Fifth Circuit in the case of *Estate of F. G. Masquelette et al.*, v. *Commissioner*, 239 Fed. (2d) 322, affects the position expressed in Revenue Ruling 57–480, C.B. 1957–2, 47.

Revenue Ruling 57–480 states, in part, that vendible goodwill may attach to a particular firm name, if the right to the exclusive use of such name may be assigned to and exercised by the assignee. It concludes that where the business of a professional man or firm, or any other business, which is dependent solely upon the professional skill or other characteristics of the owner, is sold without a valid assignment of the right to the exclusive use of the firm name, no portion of the sales price may be treated as the proceeds from the sale of goodwill.

In the *Masquelette* case, an accounting firm sold the "practice" of its El Paso office to the four local partners. The contract of sale stated that a certain amount was paid for the tangible assets of the firm and an additional amount was paid for such intangibles as the right to serve clients within a restricted area, vendors' interests in clients' files, library, office quarters, etc., and an agreement by the sellers not to compete, but excluding the right to use the firm name. The Court of Appeals, in reversing the Tax Court of the United States, concluded that the stipulations, written contract, and undisputed evidence required a decision that the taxpayers sold their goodwill and that this was partially effectuated by their agreement not to compete. The fact that the contract of sale specifically provided that the purchasers should not use the name "Masquelette" in connection with their accounting practice was not regarded as controlling.

The Service will follow the decision in the *Masquelette* case only to the extent that it stands for the proposition that the existence of transferable goodwill may be recognized in connection with the sale of a business or profession, the success of which is *not* dependent solely upon the personal qualifications of the owner, even though such a sale does not involve the assignment of the right to the exclusive use of the firm name.

It is, therefore, the position of the Service that personal characteristics or qualifications do not constitute goodwill as an item of property and do not exist in such form that they can be the subject of transfer. Consequently, if a business is dependent *solely* upon the personal characteristics and competence of the owner, no element of goodwill exists with respect thereto and no portion of the sale price of the business may be treated as proceeds from the sale of goodwill, irrespective of whether or not such sale comprehends a valid assignment of the right to the exclusive use of the firm name.

However, the existence of transferable goodwill may be recognized in connection with the sale of a business, the success of which is *not*

dependent solely upon the personal characteristics of the owner, even though such sale does not comprehend a valid assignment of the exclusive use of the firm name. As indicated in Revenue Ruling 57–480, the question whether goodwill is involved in the sale of a business is essentially one of fact to be determined in each case in the light of all the surrounding circumstances.

It follows from the above that Revenue Ruling 57–480 was *not* intended to approve the concept that the professional skill, ability, integrity and other personal characteristics of the owner may qualify as that item of property called goodwill.

Accordingly, Revenue Ruling 57–480 is hereby clarified to reflect the view that where a business which is dependent *solely* upon the professional skill or other personal characteristics of the owner is sold, no portion of the sales price may be treated as proceeds from the sale of goodwill even though such sale involves a valid assignment of the right to the exclusive use of the firm name. That ruling is further clarified to reflect the view that the existence of transferable goodwill may be recognized in connection with the sale of a business, the success of which is *not* dependent solely upon the personal characteristics of the owner, even though such sale does not comprehend a valid assignment of the exclusive use of the firm name.

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26 CFR 1.61–9: Dividends.

Constructive receipt of a deficiency dividend distributed by a personal holding company. See Rev. Rul. 60–331, page 189.

SECTION 62.—ADJUSTED GROSS INCOME DEFINED

26 CFR 1.62–1: Adjusted gross income.

Malpractice insurance premiums paid by a physician who is an employee. See Rev. Rul. 60–365, page 49.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

SECTION 71.—ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

26 CFR 1.71–1: Alimony and separate maintenance; income to wife or former wife. (Also Section 215; 1.215–1.) Rev. Rul. 60–238

> Where a wife who is separated from her husband receives payments from him under a decree entered prior to March 1, 1954, requiring him to make payments for her support or maintenance, and the decree is modified after that date, no portion of any of the payments received by her prior to the effective date of such modification is includible in her gross income under section 71(a)(3) of the Internal Revenue Code of 1954 nor deductible by the husband under section 215 of the Code.

Advice has been requested regarding the treatment of support payments received by a wife from her husband under a court decree

entered prior to March 1, 1954, where the decree is modified after that date.

In the instant case, the husband and wife were separated and in 1951 a local court issued a decree providing for support payments by the husband to the wife. On December 23, 1955, the decree was modified, the amount of the support being increased.

Section 71(a) of the Internal Revenue Code of 1954 provides, in part, as follows:

* * * * * * *

(2) * * * If a wife is separated from her husband and there is a written separation agreement executed after the date of the enactment of this title, the wife's gross income includes periodic payments * * * received after such agreement is executed which are made under such agreement and because of the marital or family relationship * * *.

(3) * * * If a wife is separated from her husband, the wife's gross income includes periodic payments * * * received by her after the date of the enactment of this title from her husband under a decree entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance. * * *

Section 1.71–1(b)(2)(ii) of the Income Tax Regulations provides that, for purposes of section 71(a)(2) of the Code, any written separation agreement executed on or before August 16, 1954, which is altered or modified in writing by the parties in any material respect after that date will be treated as an agreement executed after August 16, 1954, with respect to payments made after the date of alteration or modification.

Section 1.71–1(b)(3)(ii) of the regulations provides that, for purposes of section 71(a)(3) of the Code, any decree which is altered or modified by a court order entered after March 1, 1954, will be treated as a decree entered after such date.

In Senate Report 1622 to accompany H.R. 8300, 83d Congress, 2d Session, page 10, the Committee on Finance stated, in effect, that section 71(a)(3) of the Code, covering cases where amounts paid under a court decree for support have not been called separate maintenance payments, was added for the purpose of treating payments made under a support decree in the same manner as separate maintenance payments. It appears clear that it was not intended to make the effect of an alteration or modification of a support decree retroactive to payments received by the wife under the original decree prior to its alteration or modification.

Section 215 of the Code provides that, in the case of the husband, a deduction is allowable for amounts includible under section 71 of the Code in the wife's gross income, payment of which is made within the husband's taxable year.

Accordingly, it is held that where a wife who is separated from her husband receives payments from him under a court decree entered prior to March 1, 1954, requiring him to make payments for her support or maintenance, and the decree is modified after that date, no portion of any of the payments received by her prior to the effective date of such modification is includible in her gross income under section 71(a)(3) of the Code nor deductible by the husband under section 215 of the Code. However, payments received on and after the effective date of such modification in this case qualify for the treatment authorized by such sections.

SECTION 72.—ANNUITIES; CERTAIN PROCEEDS ON ENDOWMENT AND LIFE INSURANCE CONTRACTS

26 CFR 1.72–2: Applicability of section. T. D. 6497 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Amendment of the Income Tax Regulations to provide rules relating to distributions or payments under certain employee plans.

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

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

On February 4, 1960, notice of proposed rulemaking regarding the amendment of the Income Tax Regulations (26 CFR Part 1) in order to clarify the tax treatment of distributions or payments under certain employee plans was published in the Federal Register (25 F.R. 963). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments to the regulations are hereby adopted:

PARAGRAPH 1. Paragraph (a) of § 1.72–2 is amended (A) by revising subparagraph (1) and (B) by adding a new subparagraph at the end thereof. These amended and added provisions read as follows:

§ 1.72–2 APPLICABILITY OF SECTION.—(a) *Contracts.*—(1) The contracts under which amounts paid will be subject to the provisions of section 72 include contracts which are considered to be life insurance, endowment, and annuity contracts in accordance with the customary practice of life insurance companies. For the purposes of section 72, however, it is immaterial whether such contracts are entered into with an insurance company. The term "endowment contract" also includes the "face-amount certificates" described in section 72(1).

* * * * * * *

(3) (i) Sections 402 and 403 provide that certain distributions by employees' trusts and certain payments under employee plans are taxable under section 72, except that section 72(e)(3) does not apply to such distributions or payments. For purposes of applying section 72 to such distributions and payments (other than those described in subdivision (iii) of this subparagraph), each separate program of the employer consisting of interrelated contributions and benefits shall be considered a single contract. Therefore, all distributions or payments (other than those described in subdivision (iii) of this subparagraph) which are attributable to a separate program of interrelated contributions and benefits are considered as received under a single contract. A separate program of interrelated contributions and benefits may be financed by the purchase from an insurance company of one or more group contracts or one or more individual contracts, or may be financed partly by the purchase of contracts from an insurance company and partly through an investment fund, or may be financed completely through an investment fund. A program may be considered separate for purposes of section 72 although it is only a part of a plan which qualifies under section 401. There may be several trusts under one separate program, or several separate programs may make use of a single trust. See, however, subdivision (iii) of this subparagraph for rules relating to what constitutes a "contract" for purposes of applying section 72 to distributions commencing before October 20, 1960.

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[1] 25 F.R. 10019.

(ii) The following types of benefits, and the contributions used to provide them, are examples of separate programs of interrelated contributions and benefits:

(*a*) Definitely determinable retirement benefits.

(*b*) Definitely determinable benefits payable prior to retirement in case of disability.

(*c*) Life insurance.

(*d*) Accident and health insurance.

However, retirement benefits and life insurance will be considered part of a single separate program of interrelated contributions and benefits to the extent they are provided under retirement income, endowment, or other contracts providing life insurance protection. See examples (6), (7), and (8) contained in subdivision (iv) of this subparagraph for illustrations of the principles of this subdivision. See, also, § 1.72–15 for rules relating to the taxation of amounts received under an employee plan which provides both retirement benefits and accident and health benefits.

(iii) If any amount which is taxable under section 72 by reason of section 402 or 403 is actually distributed or made available to any person under an employees' trust or plan (other than the Civil Service Retirement Act) before October 20, 1960, section 72 shall, notwithstanding any other provisions in this subparagraph, be applied to all the distributions with respect to such person (or his beneficiaries) under such trust or plan (whether received before or after October 20, 1960) as though such distributions were provided under a single contract. For purposes of applying section 72 to distributions to which this subdivision applies, therefore, the term "contract" shall be considered to include the entire interest of an employee in each trust or plan described in sections 402 and 403 to the extent that distributions thereunder are subject to the provisions of section 72. Section 72 shall be applied to distributions received under the Civil Service Retirement Act in the manner prescribed in subdivision (i) of this subparagraph (see example (4) in subdivision (iv) of this subparagraph).

(iv) The application of this subparagraph may be illustrated by the following examples:

Example (1). On January 1, 1961, X Corporation established a noncontributory profit-sharing plan for its employees providing that the amount standing to the account of each participant will be paid to him at the time of his retirement and also established a contributory pension plan for its employees providing for the payment to each participant of a lifetime pension after retirement. The profit-sharing plan is designed to enable the employees to participate in the profits of X Corporation; the amount of the contributions to it are determined by reference to the profits of X Corporation; and the amount of any distribution is determined by reference to the amount of contributions made on behalf of any participant and the earnings thereon. On the other hand, the pension plan is designed to provide a lifetime pension for a retired employee; the amount of the pension is to be determined by a formula set forth in the plan; and the amount of contributions to the plan is the amount necessary to provide such pensions. In view of the fact that each of these plans constitutes a separate program of interrelated contributions and benefits, the distributions from each shall be treated as received under a separate contract. If these plans had been established before October 20, 1960, then, in the case of an employee who receives a distribution under the plans before October 20, 1960, the determination as to whether that distribution and all subsequent distributions to such employee are received under a single contract or under more than one contract shall be made by applying the rules in subdivision (iii) of this subparagraph. On the other hand, in the case of an employee who does not receive any distribution under these plans before October 20, 1960, the determinattion as to whether distributions to him are received under a single contract or under more than one contract shall be made in accordance with the rules illustrated by this example.

Example (2). On January 1, 1961, Z Corporation established a profit-sharing plan for its employees providing that any employee may make contributions, not in excess of 6 percent of his compensation, to a trust and that the employer would make matching contributions out of profits. Under the plan, a participant may receive a periodic distribution of the amount standing in his account during any period that he is absent from work due to a personal injury or sickness. On separation from service, the participant is entitled to receive a distribution of the balance standing in his account in accordance with one of several options. One option provides for the immediate distribution of one-half of the account and for the periodic distribution of the remaining one-half of the account. In ad-

dition, any participant may, after the completion of five years of participation, withdraw any part of his account, but in the case of such a withdrawal, the participant forfeits his rights to participate in the plan for a period of two years. Thus, a participant may receive distributions before separation from service; he may receive a distribution of a lump sum upon separation from service; he may also receive periodic distributions upon separation from service. However, since it is the total amount received under all the options that is interrelated with the contributions to the plan and not the amount received under any one option, his profit-sharing plan consists of only one separate program of interrelated contributions and benefits and all distributions under the plan (regardless of the option under which received) are treated as received under one contract. However, if, instead of providing that the amount standing in an employee's account would be paid to him during any period that he is absent from work due to a personal injury or sickness, the plan provided that a portion of the amount in the employee's account would be used to purchase incidental accident and health insurance, this plan would consist of two separate programs of interrelated contributions and benefits. The accident and health insurance, and the contributions used to purchase it, would be considered as one separate program of interrelated contributions and benefits and, therefore, a separate contract; whereas, the remaining contributions and benefits would be considered another separate program of interrelated contributions and benefits and, consequently, another separate contract.

Example (3). On January 1, 1961, N Corporation established a profit-sharing plan for its employees providing that the employees may make contributions, not in excess of 6 percent of their compensation, to a trust and that N Corporation would make matching contributions out of its profits. Under the plan, the employee may elect each year to have his and the employer's contributions for such year placed in either a savings arrangement or a retirement arrangement. Such an election is irrevocable. Under the savings arrangement, contributions to such arrangement for any one year and the earnings thereon will be distributed five years later. The retirement arrangement provides that all contributions thereto and the earnings thereon will be distributed when the employee is separated from the service of N Corporation. Since the distributions under the retirement arrangement are attributable solely to the contributions made to such arrangement and are not affected in any manner by contributions or distributions under the savings arrangement or any other plan, such distributions are treated as received under a separate program of interrelated contributions and benefits. Similarly, since distributions during any year under the savings arrangement are attributable only to contributions to such arrangement made during the fifth preceding year and are not affected in any manner by any other contributions to or distributions from such arrangement or any other plan, the savings arrangement constitutes a series of separate programs of interrelated contributions and benefits. The contributions to the savings arrangement for any year and the distribution in a subsequent year based thereon constitute a separate contract for purposes of section 72.

Example (4). The Civil Service Retirement Act, which provides retirement benefits for participating employees, consists of a compulsory program and a voluntary program. Under the compulsory program, all participating employees are required to make certain contributions and, upon retirement, are provided retirement benefits computed on the basis of compensation and length of service. Under the voluntary program, such participating employees are permitted to make contributions in addition to those required under the compulsory program and, upon retirement, are provided additional retirement benefits computed on the basis of their voluntary contributions. Distributions received under the Act constitute distributions from two separate contracts for purposes of section 72. Distributions received under the compulsory program are considered as received under a separate program of interrelated contributions and benefits since they are computed solely under the compulsory program and are not affected by any contributions or distributions under the voluntary program or under any other plan. For similar reasons, distributions which are attributable to the voluntary contributions are considered as received under a separate program of interrelated contributions and benefits.

Example (5). On January 1, 1961, M Corporation established a contributory pension plan for its employees and created a trust to which it makes contributions to fund such plan. The plan provides that each participant will receive after age 65 a pension of 1½ percent of his compensation for each year of service

performed subsequent to the establishment of such plan. In order to fund part of the benefits under the plan, the trustee purchased a group annuity contract. The remaining part of the benefits are to be paid out of a separate investment fund. This pension plan constitutes a single program of interrelated contributions and benefits and, therefore, all distributions received by an employee under the plan are considered as received under a single contract for purposes of section 72.

Example (6). On January 1, 1961, Y Corporation established a noncontributory pension plan (including incidental death benefits) for its employees and created a trust to which it makes contributions to fund such plan. The plan provides that each participant will receive after age 65 a pension of 1½ percent of his compensation for each year of service performed subsequent to the establishment of such plan. In addition, such plan provides for the payment of a death benefit if the employee dies before age 65. The trustee funded the death benefits through the purchase of a group term insurance policy and funded the retirement benefits through the purchase of a group annuity contract. Because of a subsequent change in funding from the deferred annuity method to the deposit administration method, the trustee purchased a second group annuity contract to provide the retirement benefits under the plan accruing after the effective date of the change in method of funding. Thus, retirement benefits distributed to an employee whose service with Y Corporation commenced before the effective date of the change in method of funding will be attributable to both group annuity contracts. This pension plan includes two separate programs of interrelated contributions and benefits. The death benefits, and the contributions required to provide them, are considered as one separate program of interrelated contributions and benefits; whereas, the retirement benefits, and the contributions required to provide them, are considered as another separate program of interrelated contributions and benefits. Therefore, any retirement benefits received by an employee, whether attributable to one or both of the group annuity contracts, shall be considered as received under a single contract for purposes of section 72. In determining the tax treatment of any such retirement benefits under section 72, no amount of the premiums used to purchase the group term insurance policy shall be taken into account, since such premiums, and the death benefits which they purchased, constitute a separate program of interrelated contributions and benefits.

Example (7). Assume the same facts as in example (6) except that, in lieu of funding the benefits in the manner described in that example, the trustee purchased individual retirement income contracts from an insurance company. Additional individual retirement income contracts are purchased in order to fund any increase in benefits resulting from increases in salary. Therefore, distributions to a particular employee may be attributable to a single retirement income contract or to more than one such contract. All distributions received by an employee under the pension plan, whether attributable to one or more retirement income contracts and whether made directly from the insurance company to the employee or made through the trustee, are considered as received under a single contract for purposes of section 72. For rules relating to the tax treatment of contributions and distributions under retirement income, endowment, or other life insurance contracts purchased by a trust described in section 401(a) and exempt under section 501(a), see paragraph (a) (2), (3), and (4) of § 1.402(a)–1.

Example (8). Assume the same facts as in example (6) except that, in lieu of funding the benefits in the manner described in that example, the trustee funded the death benefits and part of the retirement benefits by purchasing individual retirement income contracts from an insurance company. The remaining part of the retirement benefits (such as any increase in benefits resulting from increases in salary) are to be paid out of a separate investment fund. This pension plan includes, with respect to each participant, two separate contracts for purposes of section 72. The retirement income contract purchased by the trust for each participant is a separate program of interrelated contributions and benefits and all distributions attributable to such contract (whether made directly from the insurance company to the employee or made through the trustee) are considered as received under a single contract. For rules relating to the tax treatment of contributions and distributions under retirement income, endowment, or other life insurance contracts purchased by a trust described in section 401(a) and exempt under section 501(a), see paragraph (a) (2), (3), and (4) of § 1.402(a)–1. The remaining distributions under the plan are considered as received under another separate program of interrelated contributions and benefits.

PAR. 2. Paragraph (a)(3) of § 1.72–13 is amended to read as follows:

§ 1.72–13 SPECIAL RULE FOR EMPLOYEE CONTRIBUTIONS RECOVERABLE IN THREE YEARS.—(a) *Amounts received as an annuity.* * * *

(3) The aggregate of the amounts receivable as an annuity within the prescribed 3-year period shall be the total of all annuity payments anticipatable by an employee (or a beneficiary or beneficiaries of an employee, if the employee died before any amount was received as an annuity) under the contract as a whole as defined in paragraph (a) of § 1.72–2. See paragraph (a)(3) of § 1.72–2 for rules for determining what constitutes "the contract" in the case of distributions from an employees' trust or plan.

PAR. 3. Paragraph (a)(3)(i) of § 1.402(a)–1 is amended to read as follows:

§ 1.402(a)–1 TAXABILITY OF BENEFICIARY UNDER A TRUST WHICH MEETS THE REQUIREMENTS OF SECTION 401(a).—(a) *In general.* * * *

(3) (i) If a trust described in section 401(a) and exempt under section 501(a) purchases under the plan retirement income, endowment, or other contracts providing life insurance protection, payable upon the death of the employee participants, and either—

(*a*) The proceeds of such life insurance are payable to a beneficiary of the employee participant, other than the trust, or

(*b*) In case such proceeds are payable to the trust, by the terms of the plan the trustee is required to pay over all of such proceeds to a beneficiary of the employee participant,

then, the portion of the premiums paid for the life insurance protection provided under such contracts from either the contributions of the employer or earnings of the trust will constitute income to the employee for the year or years in which the contributions or earnings are applied toward the purchase of such life insurance. If the amount payable upon death at any time during the year exceeds the cash value of the insurance policy at the end of the year, the entire amount of such excess will be considered current life insurance protection. The cost of such insurance will be considered to be a reasonable net premium cost, as determined by the Commissioner, for such amount for the appropriate period. The amount thus to be included in the gross income of the employee under this subdivision shall be considered as premiums or other consideration paid or contributed by the employee only with respect to any benefits attributable to the contract (within the meaning of paragraph (a)(3) of § 1.72–2) providing the life insurance protection.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved October 14, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 19, 1960, 8:51 a.m., and published in the issue of the Federal Register for October 20, 1960, 25 F.R. 10019)

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26 CFR 1.72–6: Investment in the contract. Rev. Rul. 60–325

Application of an "approximate method" in determining the refund factor to be applied in computing the adjusted investment in an annuity contract containing a refund feature where, in addition to a whole life annuity, there are one or more temporary life annuities on the lives of children.

Advice has been requested concerning the method of determining the refund factor to be applied in computing the adjusted investment,

under section 72(c)(2) of the Internal Revenue Code of 1954, in an annuity contract containing a refund feature where, in addition to a whole life annuity, there are one or more temporary life annuities on the lives of children.

In the instant case, annuity benefits are being paid under the United States Civil Service Retirement Fund to the widow and child of an employee by reason of the death of the employee while in service. The widow, age 48, receives $171 per month for her remaining lifetime and the child, age 9, receives $50 per month until attaining 18 years of age. The employee's contributions to the fund totaled $7,559.45, with interest accrued thereon of $1,602.53, which in this case represent, in total, the guarantee or total refund feature of the contract.

Section 72(c)(2) of the Code provides, in part, that if (a) the expected return under the contract depends in whole or in part on the life expectancy of one or more individuals, (b) the contract provides for payments to be made to a beneficiary on or after the death of the annuitant or annuitants; and (c) such payments are in the nature of a refund of the consideration paid, then the value (computed without discount for interest) of such payments on the annuity starting date shall be subtracted from the investment in the contract. Such value is to be computed in accordance with actuarial tables prescribed by the Secretary of the Treasury or his delegate.

Section 1.72-6(b) of the Income Tax Regulations, involving a single contract containing two or more annuity elements, applies in the type of case here considered. Section 1.72-6(b) provides, in part, that where there are two or more annuity elements in the contract the investment in the contract shall be allocated to each of the annuity elements in the ratio that the expected return under each of the annuity elements bears to the aggregate of the expected returns under all the annuity elements. The exclusion ratio for the contract as a whole shall be determined by dividing the investment in the contract, after adjustment for the present value of any or all refund features, by the aggregate of the expected returns under all the annuity elements.

Ordinarily the principles forming the basis for the rules set forth in section 1.72-7(e) of the regulations should be applied to this type of case. However, the facts here are different from those forming the basis for the example given in that section. In that example, a separate death refund is determined under each annuity element, independently of the amount paid as an annuity under the other element. In the present case, the amount of the death refund depends upon the amounts previously paid to both annuitants in the aggregate. The determination of the adjustment for the refund feature in a case such as this, using the same method as that used in computing the multiple factors shown in Table III of section 1.72-9 of the regulations, requires a complicated actuarial calculation. This calculation, however, cannot be made by using only the tables published in the regulations. Similar acceptable results, in cases such as this, will be achieved by the use of an "approximate method" illustrated below.

This "approximate method" will produce reasonable results in cases where, in addition to a whole life annuity, there are involved one or more temporary life annuities on the lives of children and can be applied using only the published tables in section 1.72-9 of the regulations.

APPROXIMATE METHOD OF COMPUTING THE ADJUSTED INVESTMENT IN AN ANNUITY CONTRACT

I—Determination of Expected Return:		
(1) Widow's whole life annuity element		$64,022.40
Monthly annuity	$171.00	
Multiple factor from Table I (section 1.72-9 of the regulations) for female nearest age 48 years is	31.2	
Computation: $171×12×31.2=$64,022.40.		
(2) Child's temporary life element		5,340.00
Monthly annuity	50.00	
Multiple factor from Table IV (section 1.72-9 of the regulations) for male or female nearest age 9 years for term of 9 years is	8.9	
Computation: $50×12×8.9=$5,340.00.		
(3) Total expected return under the contract		$69,362.40
II—Computation of adjustment for refund feature in contract:		
(1) Amount equal to the smaller of (a) total refund feature in contract (contributions of $7,559.45 plus interest of $1,602.53) or (b) total investment in contract (see item III(1) below)		$9,161.98
(2) Less: Amount equal to the sum of expected return payable as temporary life element(s)		5,340.00
(3) Portion of refund feature considered applicable to whole life element		$3,821.98
(4) Multiple factor from Table III (section 1.72-9 of the regulations) female nearest age 48 years for 2 years duration (recovery of $3,821.98 at $171 per month to nearest whole year) is *one percent.*		
(5) Adjustment required for value of refund feature in contract attributable to employee's contribution (1%×$3,821.98 (nearest dollar))		$38.00
III—Determination of adjusted investment for the contract:		
(1) Investment in the contract (contributions of $7,559.45 plus $5,000 death benefit exclusion, (section 101(b) of the Code))		$12,559.45
(2) Less: Adjustment required for value of refund feature in contract		38.00
(3) Adjusted investment in the contract		$12,521.45

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26 CFR 1.72-11: Amounts not received as annuity payments. Rev. Rul. 60-235
(Also Section 101; 1.101-2.)
(Also Part II, Section 22(b); Regulations 118, Section 39.22(b)(1)-2.)

Monthly payments received from the United States Civil Service Retirement and Disability Fund by the widow of a deceased government employee under the authority of Public Law 85-465 do not constitute amounts received as an annuity under Section 72 of the Internal Revenue Code of 1954; neither are they subject to the

death benefit exclusion provided by Section 101(b) of the Code. Hence, the entire amount of such payments is includible in the gross income of the recipient.

Advice has been requested concerning the taxability of monthly payments received from the United States Civil Service Retirement and Disability Fund under the authority of Public Law 85–465, 72 Stat. 218, by the widow of a deceased government employee.

Section 2 of Public Law 85–465 provides that the unremarried widow or widower of an employee who died before February 29, 1948, had completed at least ten years of service creditable for civil service retirement purposes, and at the time of his death was either subject to or retired under an Act under which annuities granted before February 29, 1948, were or are now payable from the civil service retirement fund, shall be entitled to receive an annuity. In order to qualify for such annuity, the widow or widower must have been married to the employee for at least five years immediately prior to his death. The amount of such annuity is equal to one-half of the annuity which the employee was receiving on the date of his death if retired, or would have been receiving if he had been retired for disability on the date of his death, but not to exceed $750 per year. Section 3 of the law provides that the annuity provided by section 2 shall commence on August 1, 1958, or on the first day of the month in which an application for such annuity is received in the Civil Service Commission, whichever occurs later. Section 4 provides that the annuity shall terminate for each fiscal year beginning on or after July 1, 1960, for which an appropriation has not been made by the Congress to compensate the civil service fund for the cost thereof.

In the instant case, the widow's husband died in 1942 while in the employment of the United States Government. Immediately following his death, the widow was paid in a lump sum the total amount standing to the credit of her husband in the civil service fund. Under the Public Law cited above she became eligible to receive monthly payments of $50.

The taxability of amounts payable under the civil service fund is governed by section 402(a)(1) of the Internal Revenue Code of 1954, which provides that such distributions are taxable to the distributee under section 72, except that section 72(e)(3) does not apply.

If such amounts are received as an annuity, they are subject to inclusion in the gross income of the recipient under the general rule provided in section 72(a) of the Code. If the amounts are not received as an annuity, section 72(e)(1)(B) applies, and such amounts are includible in gross income to the extent they exceed the consideration paid therefor.

According to the provisions of section 1.72–2(b)(2) of the Income Tax Regulations, in order to be treated as an amount received as an annuity, the total of the amounts payable must be determinable at the annuity starting date. However, the amounts payable to the beneficiary in this case are for an indefinite period, being subject to the

will of Congress to appropriate funds therefor subsequent to June 30, 1960. The total amounts payable are not determinable at the annuity starting date; hence, they are not received as an annuity and are, therefore, taxable under section 72(e)(1)(B).

Section 101(b) of the Code provides that gross income does not include amounts received by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee. However, section 101(f) provides that section 22(b)(1) of the 1939 Code applies to amounts received by reason of the death of an insured or an employee occurring on or before August 16, 1954. In the instant case, the employee died in 1942; hence, section 22(b)(1) of the 1939 Code governs the allowance of an exclusion.

Section 22(b)(1) of the 1939 Code provides that amounts paid, under a contract of an employer, to the beneficiaries of an employee by reason of the death of the employee, are excludable from the gross income of the recipient in an amount not in excess of $5,000.

Section 39.22(b)(1)-2(a) of Regulations 118, promulgated under section 22(b)(1) of the 1939 Code, provides that the exclusion is applicable only where the amounts are paid by an employer in pursuance of an express contract. Paragraph (c) thereof states that an express contract is deemed to exist only if (1) the employer and employee had entered into a written contract, which required such payment, and was not revoked prior to the employee's death, or (2) the employer had an established plan which made provisions for such payments in case of his employees generally, or for a class or classes of his employees. In the latter case, the contract will be deemed to exist between the employer and the members of the class or classes of employees to whom the plan applies, provided such plan had been communicated to such employees and had not been rescinded before the death of the employee to whom the particular death payment relates.

The payments in question are being made under Public Law 85-465, *supra*, which was enacted on June 25, 1958. Thus, it is clear from the foregoing that an "express contract" is not deemed to have existed within the purview of section 22(b)(1) of the 1939 Code and the regulations promulgated thereunder, since a provision for the payment of the amounts presently received by the widow from the fund did not exist under the law at the time of the employee's death.

Accordingly, it is held that the entire amount of payments received by the widow of a deceased government employee from the United States Civil Service Retirement and Disability Fund under the authority of Public Law 85-465, *supra*, is includible in her gross income for Federal income tax purposes.

26 CFR 1.72–15: Applicability of section 72 to accident or health plans. (Also Section 105; 1.105–1.)

T. D. 6485 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Amendment of the Income Tax Regulations under sections 72, 105, and 402.

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

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

On April 29, 1960, notice of proposed rulemaking with respect to the amendments of the Income Tax Regulations (26 CFR Part 1) under sections 72, 105, and 402 of the Internal Revenue Code of 1954 to provide rules relating to certain distributions under employee plans was published in the Federal Register (25 F.R. 3762). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments of the regulations are hereby adopted.

PARAGRAPH 1. There is inserted immediately after § 1.72–14 the following new section:

§ 1.72–15 APPLICABILITY OF SECTION 72 TO ACCIDENT OR HEALTH PLANS.—(a) *Applicability of section.*—This section provides the rules for determining the taxation of amounts received from an employer-established plan which provides for distributions that are taxable under section 72 (or, in the case of certain total distributions, under section 402(a)(2) or section 403(a)(2)) and which also provides for distributions that may be excludable from gross income under section 104 or 105 as accident or health benefits. For example, this section will apply to a pension plan described in section 401 and exempt under section 501 which provides for the payment of pensions at retirement and the payment of an earlier pension in the event of permanent disability. This section will also apply to a profit-sharing plan described in section 401 and exempt under section 501 which provides for periodic distribution of the amount standing to the account of a participant during any period that the participant is absent from work due to a personal injury or sickness and for the distribution of any balance standing to the account of the participant upon his separation from service. For purposes of this section, the term "contributions of the employee" includes contributions by the employer which were includible in the employee's gross income.

(b) *General rule.*—Section 72 does not apply to any amount received as an accident or health benefit, and the tax treatment of any such amount shall be determined under sections 104 and 105. See paragraphs (c) and (d) of this section, paragraph (d) of § 1.104–1, and §§ 1.105–1 through 1.105–5. Section 72 (or, in the case of certain total distributions, section 402(a)(2) or section 403(a)(2)) does apply to any amount which is received under a plan to which this section applies and which is not an accident or health benefit. See paragraph (e) of this section.

(c) *Accident or health benefits attributable to employee contributions.*—(1) If a plan to which this section applies provides that any portion of the accident or health benefits is attributable to the contributions of the employee to such plan, then such portion of such benefits is excludable from gross income under section 104(a)(3) and paragraph (d) of § 1.104–1. Neither section 72 nor

[1] The publication of this Treasury Decision in 25 F.R. 7209, dated July 30, 1960, contains (1) instructions modifying the notice of proposed rule making published in 25 F.R. 3762, dated April 29, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

section 105 applies to any accident or health benefits (whether paid before or after retirement) attributable to contributions of the employee. Since such portion is excludable under section 104(a)(3), such portion is not subject to the $100-a-week limitation of section 105(d) and if such portion is payable after the retirement of the employee, it is excludable without regard to the provisions of § 1.105–4 and section 72.

(2) In determining the taxation of any amounts received as accident or health benefits from a plan to which this section applies, the first step is to determine the portion, if any, of the contributions of the employee which is used to provide the accident or health benefits and the portion of the accident or health benefits attributable to such portion of the employee's contributions. If such a plan expressly provides that the accident or health benefits are provided in whole or in part by employee contributions and the portion of employee contributions to be used for such purpose, the contributions so used will be treated as used to provide accident or health benefits. However, if the plan does not expressly provide that the accident or health benefits are to be provided with employee contributions and the portion of employee contributions to be used for such purpose, it will be presumed that none of the employee contributions is used to provide such benefits. Thus, in the case of a contributory pension plan, it will be presumed that the disability pension is provided by employer contributions, unless the plan expressly provides otherwise, or in the case of a contributory profit-sharing plan providing that a portion of the amount standing to the account of each participant will be used to purchase accident or health insurance, it will be presumed that such insurance is purchased with employer contributions, unless the plan expressly provides otherwise. Similarly, unless the plan expressly provides otherwise, it will be presumed that if a contributory profit-sharing plan provides for periodic distributions from the account of a participant during any absence from work because of a personal injury or sickness, all such distributions which do not exceed the contributions of the employer plus earnings thereon are provided by employer contributions.

(3) Any employee contributions that are treated under subparagraph (2) of this paragraph as used to provide accident or health benefits shall not be included for any purpose under section 72 as employee contributions or as aggregate premiums or other consideration paid. Thus, in the case of a pension plan, or in the case of a profit-sharing plan providing that a portion of the amount standing to the account of each participant will be used to purchase accident or health insurance, any employee whose contributions are so used must make the adjustment provided by this subparagraph irrespective of whether such employee receives any accident or health benefits under such plan. However, in the case of a profit-sharing plan providing for periodic distributions from the account of a participant during any absence from work because of a personal injury or sickness, an adjustment under this subparagraph is required only when an employee receives distributions in excess of the employer contributions and earnings thereon or receives distributions consisting in whole or in part of his own contributions.

(4) If any of the employee contributions are treated under subparagraph (2) of this paragraph as used to provide any of the accident or health benefits, the portion of the benefits attributable to employee contributions shall be determined in accordance with § 1.105–1. Any accident or health benefits that are excludable under section 104(a)(3) shall not be included in the expected return for purposes of section 72.

(d) *Accident or health benefits attributable to employer contributions.*—Any amounts received as accident or health benefits and not attributable to contributions of the employee are includible in gross income except to the extent that such amounts are excludable from gross income under section 105 (b), (c), or (d) and the regulations thereunder. Thus, such amounts may be excludable under 105(d) as payments under a wage continuation plan. However, if such payments, when added to other such payments attributable to employer contributions, exceed the limitations of section 105(d), then the excess is includible in gross income under section 105(a). Such excess is not excludable under section 72.

(e) *Other benefits under the plan.*—The taxability of amounts that are received under a plan to which this section applies and that are not accident or health benefits is determined under section 72 (or, in the case of certain total distributions, under section 402(a)(2) or section 403(a)(2)) without regard to any exclusion or inclusion of accident or health benefits under sections 104 and 105. For example, the investment in the contract or aggregate premiums

paid is determined without regard to the exclusion of any amount under section 104 or 105, and the annuity starting date is determined without regard to the receipt of any accident or health benefits. However, if any employee contributions are used to provide any accident or health benefits, the investment in the contract or aggregate premiums paid must be adjusted as provided in paragraph (c)(3) of this section.

(f) *Examples.*—The principles of this section may be illustrated by the following examples:

Example (1). A, an employee, is a participant in a contributory pension plan described in section 401(a) and exempt under section 501(a). Such plan provides for the payment of a pension to each participant when he retires at age 65 or when he retires earlier if the retirement is due to permanent and total disability. In 1958, A, who was age 52, became totally and permanently disabled because of an injury and commenced to receive a pension of $88 a week under this plan. A had contributed $11,804 to the plan. The plan does not expressly provide that any portion of the disability pension is purchased with employee contributions. Accordingly, it is presumed that no portion of the disability pension is purchased with A's contributions. The disability pension which A receives qualifies as payments under a wage continuation plan for purposes of section 105(d) and § 1.105–4, and if such payments are the only accident or health benefits which are attributable to the contributions of his employer, such payments are entirely excludable under section 105(d) until A reaches 65, his normal retirement age under the plan. The payments which A receives after he becomes age 65 are taxable under section 72. The payments which A receives do constitute an annuity as defined in paragraph (b) of § 1.72–2, but since the amounts which he will receive during the first three years after attaining age 65 exceed his contributions, he shall exclude under § 1.72–13 the entire amount of all payments that he receives as an annuity after attaining age 65 until such amounts equal his contributions to the plan, or $11,804. Thereafter, the payments that he receives under the plan are includible in gross income.

Example (2). B, an employee, is a participant in a contributory profit-sharing plan described in section 401(a) and exempt under section 501(a). Such plan provides that, in the event a participant is absent from work because of a personal injury or sickness, he will be paid $125 a week out of his account in such plan. Any amount standing to the account of a participant at the time of his separation from service will be paid to him at such time. During 1958, B incurred a personal injury and as a result was absent from work for nine weeks. He received nine weekly payments of $125, or a total of $1,125, on account of such absence from work. At the time B was injured, he had contributed $5,000 to the plan. The plan did not expressly provide that a participant's contributions are to be used to provide for the distributions during disability. Accordingly, it is presumed that B's contributions were not used to provide the accident or health benefits under the plan. Since these weekly payments are paid because of B's absence from work due to the injury, and since such payments are considered as attributable to contributions of his employer, such payments are required under section 105(a) to be included in B's gross income except to the extent that they are excludable under section 105(d). If B receives no other payments under a wage continuation plan attributable to contributions of his employer, $100 of each weekly payment is excludable from gross income under section 105(d), but $25 of each weekly payment is includible in gross income under section 105(a). The $100-a-week payment so excludable does not reduce B's investment in the contract or the amount of premiums considered to have been paid by B for purposes of any subsequent computations under section 72.

Example (3). The facts are the same as in example (2) except that B was absent from work for 130 weeks. At the time B was injured, his employer had contributed $10,000 to the plan on his account, and $6,000 of earnings of the plan had been allocated to his account. Thus, at the time he was injured, B's account included $21,000, and $14,000 of such amount consists of employer contributions of $10,000 plus earnings of $4,000 thereon. The first 112 weekly payments (totaling $14,000) which B receives are treated in the manner set forth in example (2). However, since the remaining payments exceed the employer contributions plus earnings thereon, such remaining payments are considered to be distributions of B's contributions plus earnings thereon. Since the total

of such payments, or $2,250, is less than B's contributions to the plan, $5,000, the entire amount of such payments is excludable from B's gross income, but a corresponding adjustment with respect to the return of B's contributions shall be made to his consideration in determining the taxation of any lump sum paid to B upon separation from service.

PAR. 2. Paragraph (c)(3) of § 1.105–1 is amended to read as follows:

§ 1.105–1 AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—

* * * * * * *

(c) *Contributory plans.* * * *

(3) Except as provided in paragraph (c)(2) of § 1.72–15, if the plan provides accident or health benefits as well as other benefits for the employees, and if the respective contributions made by the employer and the employees to provide the accident or health benefits cannot be ascertained, the determination of the portion of the accident or health benefits received under such plan which is attributable to the contributions of the employer shall be made in accordance with the rules of paragraph (d) or (e) of this section on the basis of the contributions of the employer and of the employees to the entire plan.

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PAR. 3. Paragraph (a)(3)(i) of § 1.105–4 is amended to read as follows:

§ 1.105–4 WAGE CONTINUATION PLANS.—(a) *In General.* * * *

(3)(i) Section 105(d) applies only to amounts attributable to periods during which the employee would be at work were it not for a personal injury or sickness. Thus, an employee is not absent from work if he is not expected to work because, for example, he has reached retirement age. If a plan provides that an employee, who is absent from work on account of a personal injury or sickness, will receive a disability pension as long as he is disabled, section 105(d) is applicable to any payments which such an employee receives under this plan before he reaches retirement age, but section 105(d) does not apply to the payments which such an employee receives after he reaches retirement age. See § 1.72–15 for additional rules relating to the tax treatment of disability pensions.

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PAR. 4. Paragraph (a)(1)(ii) of § 1.402(a)–1 is amended to read as follows:

§ 1.402(a)–1 TAXABILITY OF BENEFICIARY UNDER A TRUST WHICH MEETS THE REQUIREMENTS OF SECTION 401(A).—(a) *In general.*—(1) * * *

(ii) The provisions of section 402(a) relate only to a distribution by a trust described in section 401(a) which is exempt under section 501(a) for the taxable year of the trust in which the distribution is made. The distribution from such an exempt trust when received or made available is taxable to the distributee to the extent provided in section 72 (relating to annuities), except that section 72(e)(3) (relating to the treatment of certain lump sums) shall not apply, and except that certain total distributions described in section 402(a)(2) are taxable as long-term capital gains. For the treatment of such total distributions, see subparagraph (6) of this paragraph. Under certain circumstances, an amount representing the unrealized appreciation in the value of the securities of the employer is excludable from gross income for the year of distribution. For the rules relating to such exclusion, see paragraph (b) of this section. Furthermore, the exclusion provided by section 105(d) is applicable to a distribution from a trust described in section 401(a) and exempt under section 501(a) if such distribution constitutes wages or payments in lieu of wages for a period during which an employee is absent from work on account of a personal injury or sickness. See § 1.72–15 for the rules relating to the tax treatment of accident or health benefits received under a plan to which section 72 applies.

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(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved July 26, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 29, 1960, 8:47 a.m., and published in the issue of the Federal Register for July 30, 1960, 25 F.R. 7209)

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 101.—CERTAIN DEATH BENEFITS

26 CFR 1.101–2: Employees' death benefits. Rev. Rul. 60–326 [1]
(Also Section 102; 1.102–1.)

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Sixth Circuit in *United States* v. *Grace P. Reed et al.*, 277 Fed. (2d) 456.

The point at issue in this case was whether payments in the sum of $37,500, which the taxpayer received from the former employer of her deceased husband, constituted (1) a gift excludable from gross income under section 102(a) of the Internal Revenue Code of 1954, (2) an employee's death benefit within the meaning of section 101(b) of the Code excludable from gross income only up to a maximum of $5,000, or (3) wholly apart from section 101(b), taxable income.

The United States District Court for the Western District of Kentucky held that the payments constituted gifts excludable from gross income under section 102(a) of the Code and that no part thereof was includible in income under section 101(b) of the Code, or otherwise. The United States Court of Appeals for the Sixth Circuit affirmed the decision of the District Court without a written opinion.

This decision is contrary to the Service's position that these are employees death benefit payments and are, therefore, controlled by section 101(b) of the Code, under which a maximum of $5,000 is excludable from gross income, and that the gift exclusion provisions of section 102 of the Code are inapplicable to any part of such payments.

While it has been determined that review by the Supreme Court of the United States will not be requested in the *Reed* case, the decision will not be followed as a precedent in the disposition of similar cases pending further developments on the issue.

Taxability of payments received from the United States Civil Service Retirement Fund under authority of Public Law 85–465. See Rev. Rul. 60–235, page 25.

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[1] Based on Technical Information Release 252, dated September 12, 1960.

SECTION 102.—GIFTS AND INHERITANCES

26 CFR 1.102–1: Gifts and inheritances. (Also Section 61; 1.61–1.) Ct. D. 1851

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF COURT

1. GROSS INCOME—COMPENSATION VS. GIFT—STRIKE BENEFITS RECEIVED FROM UNION.

A labor union's strike assistance, by way of room rent and food vouchers, furnished to a needy worker participating in a strike constituted a gift to him excludable from income under section 102(a) of the 1954 Code.

The jury, as the trier of fact, taking into account such factors as the form and amount of the assistance, the conditions of personal need, the lack of other sources of income, compensation, or public assistance, and dependency status, which surrounded the program under which it was rendered, had the power to conclude, on the record, that the assistance, though furnished only to strikers, was not a recompense for striking. Accordingly, the District Court improperly set aside a jury's finding that the assistance was a gift in favor of a decision that, as a matter of law, the assistance was income. Since the jury could reach the decision it did on the evidence, the Supreme Court found it unnecessary to express any opinion as to whether the assistance in fact was income to taxpayer.

2. Judgment of United States Court of Appeals for the Seventh Circuit, 262 Fed. (2d) 367, affirmed.

SUPREME COURT OF THE UNITED STATES

United States, petitioner v. *Allen Kaiser*

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

[June 13, 1960]

MR. JUSTICE BRENNAN announced the judgment of the Court, and delivered an opinion in which THE CHIEF JUSTICE, MR. JUSTICE BLACK, and MR. JUSTICE DOUGLAS join.

This case presents the questions whether a labor union's strike assistance, by way of room rent and food vouchers, furnished to a worker participating in a strike constitutes income to him under section 61(a) of the Internal Revenue Code of 1954;[1] and whether the assistance furnished to this particular worker, who was in need, constituted a "gift" to him, and hence was excluded from income by section 102(a) of the Code.[2]

The respondent was employed by the Kohler Company in Wisconsin. The bargaining representative at the Kohler plant was Local 833 of the United Automobile, Aircraft, and Agricultural Implement Workers of America, CIO (UAW). In April 1954, the Local, with the approval of the International Union of the UAW, called a strike against Kohler in support of various bargaining demands in connection with a proposed renewal of their recently expired collective bargaining contract. The respondent was not a member

[1] "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
"(1) Compensation for services, including fees, commissions, and similar items;
"(2) Gross income derived from business;
"(3) Gains derived from dealings in property;
"(4) Interest;
"(5) Rents;
"(6) Royalties;
"(7) Dividends;
"(8) Alimony and separate maintenance payments;
"(9) Annuities;
"(10) Income from life insurance and endowment contracts;
"(11) Pensions;
"(12) Income from discharge of indebtedness;
"(13) Distributive share of partnership gross income;
"(14) Income in respect of a decedent;
"(15) Income from an interest in an estate or trust."

[2] "Gross income does not include the value of property acquired by gift * * *."

of the Union, but he went out on strike. He had been earning $2.16 an hour at his job. This was his sole source of income, and when he struck he soon found himself in financial need. He went to the Union headquarters and requested assistance. It was the policy of the Union to grant assistance to the many Kohler strikers simply on a need basis. It made no difference whether a striker was a union member. The Union representatives questioned respondent as to his financial resources, and his dependents. He had no other job and needed assistance with respect to the essentials of life. He was single during the period in question, and the Union provided him with a food voucher for $6 a week, redeemable in kind at a local store; the voucher was later increased to $7.50 a week. The Union also paid his room rent, which amounted to $9 a week. If in need, married strikers, and married strikers with children received respectively larger food vouchers.[3] The overall policy of the International Union was not to render strike assistance where strikers could obtain state unemployment compensation or local public assistance benefits. But the former condition does not prevail in Wisconsin,[4] and local public assistance was available only on a showing of a destitution evidently deemed extreme by the Union.

The Union thought that strikers ought to perform picketing duty, but did not require, advise or encourage strikers who were receiving assistance to picket or perform any other activity in furtherance of the strike; but assistance ceased for strikers who obtained work. Respondent performed some picketing, though apparently no considerable amount. After receiving assistance for several months, he joined the Union. This had in no way been required of him or suggested to him in connection with the continued receipt of assistance.

The program of strike assistance was primarily financed through the strike fund of the International Union, which had been raised through crediting to it 25 cents of the $1.25 per capita monthly assessment the International required from the local unions. The Local also had a small strike fund built up through monthly credits of 5 cents of the local members' dues, and contributions were received in some degree, not contended to be substantial, from other unions and outsiders. The constitution of the International Union required that it be the authorizing agency for strikes, and imposed on it the general duty to render financial assistance to the members on strike.[5]

During 1954, the Union furnished respondent assistance in the value of $565.54. In computing his federal tax for the year, he did not include in gross income any amount in respect of the assistance. The District Director of Internal Revenue informed respondent that the $565.54 should have been added to his gross income and the tax due increased by $108 accordingly. Respondent paid this amount, and after administrative rejection of a refund claim, sued for a refund in the District Court for the Eastern District of Wisconsin. A jury trial was had, and the court submitted to the jury the single interrogatory whether the assistance rendered to respondent was a gift. The jury answered in the affirmative; but the court entered judgment for the Government, n. o. v., on the basis that as a matter of law the assistance was income to the respondent, and did not fall within the statutory exclusion for gifts. 158 F. Supp. 865.

By a divided vote the Court of Appeals for the Seventh Circuit reversed. 262 F. 2d 367. It held alternatively that the assistance was not within the concept of income of section 61(a) of the Code, and that in any event the jury's determination that the assistance was a gift, and hence excluded from gross income by section 102(a), had rational support in the evidence and accordingly was within its province as trier of the facts. We granted the Government's petition for certiorari, because of the importance of the issues presented. 359 U. S. 1010. Later, when the Government petitioned for certiorari in No. 376, *Commissioner* v. *Duberstein*, and acquiesced in the taxpayer's petition in No. 546, *Stanton* v. *United States* [Ct. D. 1850, page 428, this Bulletin] it suggested that those cases be set down for argument with the case at bar, because they

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[3] After the increase referred to, married strikers without children received a $15 weekly food voucher; those with one child, a $18 voucher.

[4] Compare N.Y. Labor Law, sec. 592 (compensation payable after seven weeks of striking).

[5] Article 12, sec. 1 provides that "The Internal Executive Board * * * shall have the power to authorize strikes." Section 15 of that article provides that upon such authorization, "it shall be the duty of the International Executive Board to render all financial assistance to the members on strike consistent with the resources and responsibilities of the International Union."

The strike funds referred to are provided for by secs. 4 and 11 of Art. 16 of the International's constitution.

illustrated in a more general context the "gift" exclusion issues presented by this case. We agreed, and the cases were argued together. We conclude, on the basis of our opinion in the *Duberstein* case, p. 278, *ante*, that the jury in this case, as finder of the facts, acted within its competence in concluding that the assistance rendered here was a gift within section 102(a). Accordingly, we affirm the judgment of the Court of Appeals. Therefore, we think it unnecessary to consider or express any opinion as to whether the assistance in fact constituted income to the respondent within the meaning of Section 61(a).

At trial, counsel for the Government did not make objection to any part of the District Court's charge to the jury or the "gift" exclusion. In this Court, the charge is belatedly challenged, and only as part of the Government's position that there should be formulated a new "test" for application in this area.[6] We have rejected that contention in our opinion in *Duberstein*. In the absence of specific objection at trial, or of demonstration of any compelling reason for dispensing with such objection, we do not here notice any defect in the charge, in the light of the controlling legal principles as we have reviewed them in *Duberstein*.

We think, also, that the proofs were adequate to support the conclusion of the jury. Our opinion in *Duberstein* stresses the basically factual nature of the inquiry as to this issue. The factual inferences to be drawn from the basic facts were here for the jury. They had the power to conclude, on the record, taking into account such factors as the form and amount of the assistance and the conditions of personal need, of lack of other sources of income, compensation, or public assistance, and of dependency status, which surrounded the program under which it was rendered, that while the assistance was furnished only to strikers, it was not a recompense for striking. They could have concluded that the very general language of the Union's constitution, when considered with the nature of the Union as an entity and with the factors to which we have just referred, did not indicate that basically the assistance proceeded from any constraint of moral or legal obligation, of a nature that would preclude it from being a gift. And on all these circumstances, the jury could have concluded that assistance, rendered as it was to a class of persons in the community in economic need, proceeded primarily from generosity or charity, rather than from the incentive of anticipated economic benefit. We can hardly say that, as a matter of law, the fact that these transfers were made to one having a sympathetic interest with the giver prevents them from being a gift. This is present in many cases of the most unquestionable charity.

We need not stop to speculate as to what conclusion we would have drawn had we sat in the jury box rather than those who did. The question is one of the allocation of power to decide the question; and once we say that such conclusions could with reason be reached on the evidence, and that the District Court's instructions are not overthrown, our reviewing authority is exhausted, and we must recognize that the jury was empowered to render the verdict which it did.

Affirmed.

MR. JUSTICE FRANKFURTER, with whom MR. JUSTICE CLARK joins, concurring in result.

MR. JUSTICE WHITTAKER, with whom MR. JUSTICE HARLAN and MR. JUSTICE STEWART join, dissenting.

Payments received from former employer of taxpayer's deceased husband. See Rev. Rul. 60–326, page 32.

SECTION 103.—INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS

26 CFR 1.103–1: Interest upon obligations of a State, Territory, etc. Rev. Rul. 60–248

Bonds, notes, and other obligations issued by the New York State Housing Finance Agency, established pursuant to an Act of

[6] Specific challenge to the instructions was not made by the Government until its reply brief in this Court, and then only on the basis we have noted.

the New York State Legislature for the purpose of financing the construction of low rent housing facilities, are considered as issued on behalf of the State and the interest received therefrom is exempt from Federal income tax.

Advice has been requested whether interest received on obligations issued by the New York State Housing Finance Agency is exempt from Federal income tax.

In order to alleviate the shortage of safe and sanitary housing accommodations available to low income families, the New York State Legislature created the New York State Housing Finance Agency for the purpose of financing the construction of low-rent housing facilities through amending the Public Housing Law of the State of New York, Chapter 44–A, McKinney's Consolidated Laws of New York Annotated, by adding to such law Article XII–A, known as the New York State Housing Finance Agency Act. In furtherance of its purpose, the Agency issues bonds, notes, and other obligations to the investing public and makes the funds obtained therefrom available for mortgage loans, at low-interest rates, to private housing corporations organized to develop low-rent housing facilities in accordance with State regulations. 1960 Laws of New York, 183rd Session, Chap. 671, Sections 1 and 2.

The Act provides that the Agency shall be a corporate governmental agency, constituting a public benefit corporation. Its membership consists of the State Commissioner of Housing, the State Director of the Budget, the State Commissioner of Taxation and Finance, and two other members appointed by the Governor. The Governor may remove any member of the Agency for inefficiency, neglect of duty, or misconduct in office. The Agency and its corporate existence are to continue for as long as it shall have bonds, notes, and other obligations outstanding, and until its existence is terminated by law. Upon termination, all its rights and properties shall pass to and be vested in the State of New York. Article XII–A, Section 342.

The Agency has the power to sue and be sued; to make and execute contracts; to make rules and regulations governing the use of its property and facilities, which rules and regulations are to be filed with the New York Department of State like any other agency of the State; to appoint officers, agents, and employees, prescribe their duties and fix their compensation, subject to the provisions of the State Civil Service Law and to the rules of the State Civil Service Commission; to borrow money and issue negotiable bonds, notes, and other obligations to provide for the rights of the holders thereof; to make mortgage loans subject to the approval of the Commissioner of Housing, who is guided for this purpose by the provisions of law governing State loans under Article XII of the Public Housing Law; in connection with any property on which it has made a mortgage loan, to protect or enforce any right conferred upon it by any law, mortgage, contract, or other agreement; and to do any and all things necessary to carry out its purpose. Article XII–A, Section 343.

Transfers of officers and employees of the agency between it and other State agencies and departments are made without examination and without loss of any civil service status or rights. Article XII–A, Section 344.

The Act provides that the bonds and notes issued by the Agency are fully and unconditionally guaranteed by the State, both as to principal and interest, to the extent authorized by the State constitution at the time the obligations are issued. However, the Agency may issue notes and bonds without the guaranty of the State. The Act also provides for the subrogation of the State upon default of payment on State-guaranteed obligations and for extensive involvement of the State Comptroller in the issuance and sale of such obligations. Article XII–A, Section 347.

To assure the continued operation and solvency of the agency, provision is made for the accumulation in a capital reserve fund of an amount equal to the maximum amount of principal and interest maturing and becoming due in any succeeding calendar year on all bonds of the agency then outstanding. In order further to assure such maintenance of the capital reserve fund, there shall be annually apportioned and paid to the agency for deposit in the capital reserve fund such sum, if any, as shall be certified by the Chairman of the Agency to the Governor and Director of the Budget as necessary to restore the capital reserve fund to an amount equal to the maximum amount of principal and interest maturing and becoming due in any succeeding calendar year on the bonds of the agency then outstanding. Article XII–A, Section 346.

The State Comptroller, or his legally authorized representative, is authorized and empowered from time to time to examine the books and accounts of the Agency. Article XII–A, Section 350. The Agency submits a complete and detailed report of its finances, operations, and accomplishments to the Governor at the end of the fiscal year. Article XII–A, Section 355.

The property of the Agency and its income and operations are exempt from State taxation. Article XII–A, Section 352. The bonds and notes of the Agency and the income therefrom are free from State and local taxation, except for estate and gift taxes and taxes on transfers. Article XII–A, Section 353.

Section 103(a)(1) of the Internal Revenue Code of 1954 provides, in part, that gross income does not include interest on the obligations of a State or a political subdivision thereof.

Section 1.103–1 of the Income Tax Regulations provides, in part, that obligations issued by or on behalf of a State, or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, are the obligations of a State or a political subdivision thereof.

Accordingly, in view of the responsibility which the State of New York has assumed by reason of its actions and the substantial control which it, in effect, has over the management and operation of the Agency, it is held that the obligations issued by the New York State Housing Finance Agency are considered as issued on behalf of the State by a duly constituted authority empowered to issue such obligations, and the interest received from such obligations is exempt from Federal income tax under the provisions of section 103(a)(1) of the Code.

Rev. Rul. 60-376 [1]

Pursuant to the authority contained in section 7805(b) of the Internal Revenue Code of 1954, the provisions of Revenue Ruling 60-210, C.B. 1960-1, 38, dealing with municipal bond discount, shall be inapplicable to life insurance companies (as defined in section 801(a) of the Code) and mutual insurance companies subject to tax under section 821 of the Code for taxable years beginning prior to May 31, 1960, the date Revenue Ruling 60-210 was published in the Internal Revenue Bulletin.

SECTION 105.—AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS

26 CFR 1.105-1: Amounts attributable to employer contributions.

Employer-established plans which provide accident or health benefits as well as distributions taxable as annuities. See T.D. 6485, page 28.

SECTION 117.—SCHOLARSHIPS AND FELLOWSHIP GRANTS

26 CFR 1.117-1: Exclusion of amounts received as a scholarship or fellowship grant. Rev. Rul. 60-378

(Also Sections 61, 1402, 3121, 3301, 3401, 3402; 1.61-1, 1.1402(a)-1, 31.3121(a)-1, 31.3301 (a)-1, 31.3401(a)-1, 31.3402(a)-1.)

Recipients of scholarship or fellowship grants, who are not candidates for degrees, must include in their gross incomes under section 61(a) of the Internal Revenue Code of 1954 amounts received in excess of the limitations prescribed in section 117(b)(2) of the Code. Such grants do not constitute income from a trade or business and, hence, are not subject to the tax on self-employment income imposed by section 1401 of the Code. Similarly, such grants are not "wages" and are not subject to the provisions of chapters 21, 23 and 24 of the Internal Revenue Code of 1954.

Advice has been requested regarding the treatment under the Internal Revenue Code of 1954 of scholarship and fellowship grants.

During the period from July to December of the taxable year and January to June of the subsequent year, the taxpayer, a college teacher, received payments under a fellowship grant in excess of $300 per month.

Section 117(a) of the Code provides generally that gross income does not include amounts received as scholarship or fellowship grants. However, section 117(b)(2)(B) provides, in part, that in the case of individuals who are not candidates for degrees the exclusion from income is limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant.

Section 1.117-1(a) of the Income Tax Regulations provides, in part, as follows:

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[1] Also released as Technical Information Release 274, dated December 2, 1960.

* * * The exclusion from gross income of an amount which is a scholarship or fellowship grant is controlled solely by section 117. Accordingly, to the extent that a scholarship or a fellowship grant exceeds the limitations of section 117(b) and section 1.117–2, it is includible in the gross income of the recipient notwithstanding the provisions of section 102 relating to exclusion from gross income of gifts, or section 74(b) relating to exclusion from gross income of certain prizes and awards. * * *

Accordingly, it is held that where the recipients of grants are not candidates for degrees, the limitations prescribed in section 117(b)(2) of the Code are applicable, and amounts received in excess of such limitations are includible in gross income under the provisions of section 61(a) of the Code. See Rev. Rul. 57–50, C.B. 1957–1, 74.

It is further held that such grants do not constitute income from a trade or business and, hence, are not to be included in the recipient's net earnings from self-employment for purposes of the Self-Employment Contributions Act. The terms "fellowship grant" and "trade or business" are inconsistent and mutually exclusive. Amounts received under a fellowship grant which qualifies as such under section 117 of the Code cannot be deemed to be income from a trade or business. The characterization of an award as a qualified "fellowship grant" extends to the whole of the grant, and the unexcluded portion may not be treated as the product of a trade or business for self-employment tax purposes, just as it may not be excluded as a gift, or prize or award.

Accordingly, even though part of a section 117 scholarship or fellowship grant must be included in the recipient's gross income because of the limitations prescribed in section 117(b)(2) of the Code, no part of the grant is subject to the tax on self-employment income imposed by section 1401 of the Code. Similarly, such grants are not "wages" and, hence, are not subject to the provisions of chapters 21, 23 and 24, relating respectively to the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

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26 CFR 1.117–4: Items not considered as scholarships or fellowship grants. (Also Section 61; 1.61–2.) — Rev. Rul. 60–274

> Amounts received by teachers selected to teach mathematics to their students by use of experimental text material produced by a school mathematics study group, the work of which is financially supported by the National Science Foundation, are not scholarships or fellowship grants excludable from gross income but, rather, constitute compensation for services rendered which is includible in the gross incomes of the recipients for Federal income tax purposes. Revenue Ruling 58–498, C.B. 1958–2,47, distinguished.

Advice has been requested whether amounts paid by a school mathematics study group to certain individuals for teaching students by use of new text material in mathematics are includible in the gross incomes of the recipients, or whether such amounts are excludable from gross income under section 117 of the Internal Revenue Code of 1954.

A tax-exempt organization received a grant from the National Science Foundation, a government agency established for the purpose of promoting the progress of science, to organize and support a school mathematics study group having as its purpose the improvement of the teaching of mathematics in schools. The principal objectives of the

group are (1) to develop an improved curriculum which will offer students not only the basic mathematical skills but also a deeper understanding of the basic concepts and structure of mathematics; (2) to attract and train more capable students in mathematics programs; and (3) to provide all help possible for teachers who are preparing themselves to teach these mathematics courses. Since the study group was particularly concerned with mathematics in the seventh and eighth grades, its initial work was to produce a complete seventh grade course, with additional supplementary units for the eighth grade. Upon completion, this new material was distributed to a number of centers throughout the country and then applied on an experimental basis in school classrooms during the next academic year. Since the teaching and evaluation of the new texts in mathematics are an integral part of the program, payment for services is made out of the funds granted to the study group by the National Science Foundation.

The selection of teachers is made by the directors of the study group's various centers. The teachers do not make application for the program but are invited to participate on the basis of their interest in improving the mathematics curriculum and also on the basis of giving fair coverage to the various sections of the city involved. None of the teachers selected to participate in this program perform any direct services for the National Science Foundation. They perform services for the study group, but most of them are employed by local educational institutions. Since this material is new to these teachers, they are required to use additional time to study and prepare the material for class presentation. These teachers also meet with the center's director in a seminar which lasts two or three hours each week. After finishing the unit, the teacher fills out a brief questionnaire concerning the ability level of the students, the teachability of the unit, and the need for supplementary material. Although payment for such services varies from center to center, it is fixed at one and one-half times their normal rate of compensation and the average amounts to an extra two-days' pay per month. If the teachers assist in writing additional experimental or chapter texts, an appropriate increase in time allowance is made. If a teacher is prevented from participation for temporary periods of time, the compensation is appropriately reduced.

Gross income, as defined in section 61 of the Code, means all income from whatever source derived, unless exempt from tax by law. Section 117 of the Code excludes from the gross income of an individual amounts received as a scholarship at an educational institution or as a fellowship grant, subject to certain limitations. However, section 1.117-4(c) of the Income Tax Regulations provides, in part, that amounts paid as compensation for past, present, or future employment services are not considered as scholarship or fellowship grants.

Inasmuch as (1) no part of the funds given by the National Science Foundation in support of this particular program was allocated as scholarships or fellowship grants, (2) the study group has no other source of income, and (3) the payments by the study group to the teachers are made to compensate them for their efforts in connection with the program, the amounts paid to the teachers by the study group represent compensation for services rendered.

This position is not inconsistent with Revenue Ruling 58–498, C.B. 1958–2, 47, which holds that stipends granted by the National Science Foundation to high school and college teachers to attend a Summer Institute for Science during the summer months constitute scholarships and fellowship grants. There, the purpose of the grants was to give teachers an opportunity to improve their knowledge and for intellectual stimulation during their free summer periods. No obligation was incurred by the recipients by their acceptance of the stipends.

The facts in the instant case disclose that the teachers received compensation for services performed in connection with their participation in the school mathematics study group program. The Foundation did not give funds for the support of this program as scholarship or fellowship grants. The teachers are employees of the institutions in which they teach and program is a continuation of their daily program, for which they are paid at the same rate of salary. Thus, the situation, in the instant case, is distinguishable on its facts from the situation described in Revenue Ruling 58–498.

Accordingly, it is held that amounts received from the study group by teachers specially selected to teach their students by use of experimental text material in mathematics produced by the study group, whose work is financially supported by the National Science Foundation, constitute compensation for services rendered and not nontaxable scholarships or fellowship grants under section 117 of the Code. Such amounts are includible in the gross income of the recipients under section 61 of the Code.

SECTION 119.—MEALS OR LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER

26 CFR 1.119–1: Meals and lodging furnished for the convenience of the employer. Rev. Rul. 60–348

Upon reconsideration, Revenue Ruling 59–409, C.B. 1959–2, 48, is withdrawn. It holds, in part, that (1) the value of the meals and lodging furnished to the wives and children of resident faculty members at a boarding school constitutes additional compensation which is required to be included in the faculty members' gross incomes, and (2) the exclusion with respect to meals and lodging furnished to the faculty members themselves will not apply for any term or period when the students are not in residence.

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 152.—DEPENDENT DEFINED

26 CFR 1.152–2: Rules relating to general definition of dependent.

Medical expenses of a child paid by its adopting parents. See Rev. Rul. 60–255, page 105.

SECTION 162.—TRADE OR BUSINESS EXPENSES

26 CFR 1.162–1: Business expenses. Rev. Rul. 60–254
(Also Section 263; 1.263(a)–1.)

Cost incurred by a corporation in connection with the issuance of its capital stock in payment of a stock dividend is not deductible as an ordinary and necessary business expense under section 162 of the Internal Revenue Code of 1954, since such cost is a capital expenditure. See *Baltimore and Ohio Railroad Co.* v. *Commissioner*, 78 Fed. (2d) 460, Ct. D. 1035, C.B. XIV–2, 298 (1935), and *United Carbon Co.* v. *Commissioner*, 32 B.T.A. 1000, reversed on other issues, 90 Fed. (2d) 43, which held, in effect, that expenses incurred and paid in connection with the issuance of capital stock were not deductible as ordinary and necessary expenses in carrying on the taxpayer's business. See also I.T. 1836, C.B. II–2, 158 (1923); A.R.R. 6048, C.B. III–1, 293 (1924); and I.T. 3026, C.B. XV–2, 83 (1936).

(Also Section 263; 1.263(a)–2.) Rev. Rul. 60–261

Legal expenses are deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code of 1954 where they are incurred to establish the fact that a municipal ordinance which prohibits the operation of certain businesses within the municipal limits is not applicable to the taxpayer's business which had been conducted prior to the ordinance.
I.T. 1382, C.B. I–2, 146 (1922), modified.

The Internal Revenue Service has been requested to state whether legal expenditures, incurred to establish the fact that a municipal ordinance which prohibits the operation of certain businesses within the municipal limits does not apply to taxpayer's business, may be deducted as ordinary and necessary business expenses.

The taxpayer is engaged in the business of quarrying and supplying sand and stone. It owns land acquired for use in the quarrying business in a certain municipality. Application was made to the municipal building inspector for a permit to erect a crusher upon the land, but the permit was denied because a municipal ordinance (which was passed subsequent to the carrying on of the taxpayer's business on the land) prohibited the operation, within the municipal limits, of certain businesses and industries, including quarries and crushers. Thereafter, the taxpayer incurred attorney's fees and other expenses in the amount of $20x$ dollars in the successful prosecution of a suit to invalidate the ordinance insofar as it applied to taxpayer's business and to obtain the building permit. Title to the property was not in issue at any time.

I.T. 1382, C.B. I–2, 146 (1922), holds that legal expenditures incurred to invalidate a building line established by a municipality across the taxpayer's property, while more properly an amount expended for the defense of the enjoyment of the property, come within the principle of nondeductible capital expenditures similar to the cost of perfecting or defending title to property.

Section 162 of the Internal Revenue Code of 1954 provides, in part, as follows:

(a) IN GENERAL.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

For Federal income tax purposes, the word "ordinary" has consistently been given the connotation of normal, usual, or customary. An expense is ordinary where experience shows that payments for such item are the common and accepted practice in the field of business involved. An expense is necessary where it is appropriate and helpful in the development of the taxpayer's business. See Revenue Ruling 58–479, C.B. 1958–2, 60, and the cases cited therein.

The courts have viewed legal expenditures which proximately resulted from the operation of the business as being deductible, even though title or the use of property may be incidentally involved. See *Samuel J. Kornhauser* v. *United States*, 276 U.S. 145, T.D. 4222, C.B. VII–2, 267 (1928), and *Memphis Memorial Park* v. *Commissioner*, 28 B.T.A. 1037, affirmed 84 Fed. (2d) 1008, acquiescence, C.B. XII–2, 9 (1933). The latter case allowed the deduction of legal expenses incurred in defending a suit to enjoin the use of land for cemetery purposes. See also *Independent Brewing Company of Pittsburg* v. *Commissioner*, 4 B.T.A. 870, acquiescence, C.B. VI–1, 3 (1927), in which a deduction for expenditures made, in part, to contest the constitutionality of legislation affecting the taxpayer's business was allowed. Thus, where the expenditure is for a business purpose, such as the use and enjoyment or operation of a business asset already owned, the amount thereof would be deductible as a business expense.

The question as to whether an expenditure is classifiable as a business expense or as a capital expenditure is one of fact. Generally, amounts paid for assets having a more or less permanent value are capital expenditures; however, capital expenditures are not limited to the purchase of physical assets. Thus, legal expenses incurred in defending or perfecting title to property also are capital expenditures.

The instant taxpayer's expenditure clearly was proximate to its business and more specifically related to an asset thereof, the use and enjoyment of which had been hindered by the municipality. The expense of removing the hindrance is directly connected with the use of the business asset, rather than its acquisition, replacement or improvement, or for perfecting or recovering title thereto.

Therefore, based upon the facts involved in this case, it is held that legal expenses incurred to establish the fact that a municipal ordinance, which prohibits the operation of certain businesses within the municipal limits, is not applicable to the taxpayer's business are deductible as ordinary and necessary business expenses under section 162 of the Code.

I.T. 1382, *supra*, is hereby modified to remove the implication that legal expenses incurred to protect the continued use of property for income-producing purposes are capital expenditures.

(Also Section 61; 1.61–1.) Rev. Rul. 60–275

An annual "premium deposit" paid by a taxpayer to a certain "reciprocal flood insurance exchange," the total of which deposits

made over a specified number of years will equal the amount of "insurance" coverage desired by the taxpayer against flood losses, represents a nondeductible contingent deposit to the extent that it is withdrawable by the taxpayer. However, the nonwithdrawable one percent of the "premium deposit" which is credited by the exchange to its "General Reserve Fund" and applied to losses in excess of the "Catastrophe Loss Account" and to administrative expenses, is for a fixed liability deductible as an actual insurance expense. Amounts representing earnings from investment of the funds are income to the taxpayer for the taxable year in which such amounts are applied to the taxpayer's annual "premium deposit" or become withdrawable.

Advice has been requested whether the annual "premium deposit" paid by a taxpayer under a "subscriber's agreement" with a reciprocal flood insurance exchange, as described below, constitutes a deductible expense for Federal income tax purposes.

The taxpayer in the instant case is a contract carrier corporation engaged in hauling automobiles from an automobile assembly plant. It leases land on which it stores the automobiles as well as the equipment used in moving them. The leased land is bounded by a river, which exposes the leasehold improvements and the stored property to possible flood damage.

The taxpayer, and others exposed to flood risk, entered into an agreement with a "reciprocal flood insurance exchange," whereunder each subscriber pays annually over a specified period a "premium deposit," the total of which deposits by each subscriber is not in excess of the total insurance coverage desired by such subscriber. The taxpayer applied for $150x$ dollars of flood insurance, to be underwritten over a ten-year period, of which ten percent, or $15x$ dollars, became effective when the policy was issued and delivered. The taxpayer's property subject to flood loss was valued at $500x$ dollars, indicating that the taxpayer, like the other exchange subscribers, was not fully insured.

The exchange credited one percent of the first annual "premium deposit" of $15x$ dollars to its "General Reserve Fund" and the remaining amount of the deposit to its "Catastrophe Loss Account."

The "Catastrophe Loss Account" for each exchange subscriber is charged with a pro rata share of any losses occurring during the year and for any reinsurance costs incurred during the year. The "General Reserve Fund" is to be applied to losses in excess of the "Catastrophe Loss Account" and to certain administrative expenses. The agreement also provides that a subscriber can be called upon for an additional amount not exceeding one annual "premium deposit" to pay excess losses. The amount paid by a subscriber pursuant to such a call is limited to the amount of the excess of losses so that nothing would be available for the "General Reserve Fund" or the "Catastrophe Loss Account."

The funds of the "General Reserve Fund" and the "Catastrophe Loss Account" are commingled for investment purposes. From investment earnings, a corporation designated as attorney-in-fact to manage the business of the exchange receives a flat six-percent fee to operate the exchange. All net earnings, if any, are credited to the subscribers' "individual surplus accounts."

The unencumbered balance in an "individual surplus account" may, upon the election of the subscriber, be applied to the annual "premium deposit" or be withdrawn. If the balance is applied to the premium deposit, it becomes an integral part of the "Catastrophe Loss Account"

and the "General Reserve Fund." If the subscriber elects to withdraw the balance, he can do so only upon 30-days' prior notice, which appears to be more than a nominal rule (*i.e.*, a requirement which is seldom, if ever, enforced).

The agreement also provides that the credits in the "Catastrophe Loss Account" may be withdrawn upon 60-days' prior notice effective immediately after the end of the current policy year, but that the credits in the "General Reserve Fund" may not be withdrawn. If the exchange is terminated, however, the member subscribers at that time will share pro rata the net balance in the "General Reserve Fund," if any.

The agreement further states that the subscribers' risks shall be divided into classes or groups in accordance with the nature of their business, flood hazard, location, and flood district and the "Catastrophe Loss Account" shall be debited with the pro rata share of the payments of the adjusted losses incurred by similarly classified subscribers. This classification is to be made as soon as possible after the subscriber becomes a member of the exchange.

Section 162 of the Internal Revenue Code of 1954 provides, in part, as follows:

> (a) IN GENERAL.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. * * *.

Section 1.162–1 of the Income Tax Regulations provides that among items included in deductible business expenses are insurance premiums against fire, storm, theft, accident, or similar losses in the case of a business. Moreover, the Internal Revenue Service has taken the position that amounts paid by policyholders as premiums to a mutual insurance company are deductible even though there is a likelihood that a portion of the premium paid may be returned to them by the company. See G.C.M. 10798, C.B. XI–2, 58 (1932), and I.T. 2646, C.B. XI–2, 59 (1932).

Following a long-standing rule which denies deductions for all reserves except those specifically authorized by statute (*Arthur M. Brown* v. *Helvering*, 291 U.S. 193, Ct. D. 786, C.B. XIII–1, 223 (1934)), both the Service and the courts have long held that amounts set aside by a taxpayer as a reserve for self insurance, though equal to commercial insurance premiums, are not deductible for Federal income tax purposes as an expense "paid or incurred." See Rev. Rul. 57–485, C.B. 1957–2, 117, and *Pan American Hide Company* v. *Commissioner*, 1 B.T.A. 1249. The fact that the fund is administered by an independent agent does not make contributions to such a fund deductible. See *Spring Canyon Coal Company* v. *Commissioner*, 43 Fed. (2d) 78, Ct. D. 237, C.B. IX–2, 379 (1930), certiorari denied, 284 U.S. 654. Moreover, an element of risk-shifting or risk-distributing is one of the requisites of a true insurance contract. See *Guy T. Helvering* v. *Edythe LeGierse*, 312 U.S. 531, Ct. D. 1491, C.B. 1941–1, 430.

Since the eventual classification of the taxpayer with other member subscribers of the exchange will be limited to specific groups within the same flood district, each facing similar flood hazards, there is little likelihood that there could be a real sharing of the risks, because the occurrence of a major flood probably would affect all properties in a particular flood basin. Inasmuch as each subscriber to

the instant exchange is substantially underinsured, any proceeds received by the taxpayer in the event of flood damage would, in effect, be a return of the taxpayer's own money.

That portion of the "premium deposit" which is never withdrawable by the member subscribers, however, is for a fixed liability rather than a contingent deposit. This is true even though the member subscribers share pro rata the net balance in the "General Reserve Fund" if the exchange terminates, because this fund may be used not only for flood loss and damage claims in excess of the "Catastrophe Loss Account," but also for the expense of adjusting loss and damage claims and for various fees and taxes applicable to the insurance of the risks of the subscribers. Thus, there would be little or nothing to distribute if the exchange terminated because of excessive losses.

Accordingly, based upon the above-mentioned facts, it is held that an annual "premium deposit" paid by a taxpayer to the instant exchange, the total of which deposits made over a specified number of years will equal the amount of insurance coverage desired by the taxpayer against flood losses, represents a nondeductible contingent deposit to the extent that it is withdrawable by the taxpayer. The nonwithdrawable one percent of the "premium deposit" which is credited by the exchange to its "General Reserve Fund" and applied to losses in excess of the "Catastrophe Loss Account" and to administrative expenses, is for a fixed liability deductible as an actual insurance expense. Amounts representing earnings from investment of the funds are income to the taxpayer for the taxable year in which such amounts are credited to the taxpayer's annual "premium deposit" or become withdrawable.

(Also Sections 61, 3121, 3306, 3401; 1.61–1, 31.3121(a)–1, 31.3306(b)–1, 31.3401(a)–1.) Rev. Rul. 60–330

Supplemental unemployment benefit payments made by an employer direct to qualifying former employees pursuant to the provisions of a supplemental unemployment benefit plan constitute ordinary and necessary business expenses of the employer and are deductible from gross income under section 162(a) of the Internal Revenue Code of 1954 in the year paid or in the year in which liability to particular employees becomes fixed, depending upon the method of accounting employed.

Under such circumstances, the amounts received by the employees do not constitute "wages" for Federal employment tax purposes. However, such benefits are includible in the gross incomes of the recipients for the year in which received.

Revenue Rulings 56–102, C.B. 1956–1, 90, and 56–249, C.B. 1956–1, 488, amplified.

Advice has been requested regarding the Federal tax consequences resulting from payments made by an employer direct to certain former employees under a supplemental unemployment benefit plan, which plan does not involve the use of a trust.

An employer, in accordance with a collective bargaining agreement between the employer and representatives of the employees' union, adopted an unemployment benefit plan solely for the purpose of paying supplemental unemployment benefits to employees who qualify under the plan.

The terms of the plan, as far as here pertinent, provide for the establishment on the books of the corporation of a separate account

to be known as the "Supplemental Unemployment Benefit Account." The supplemental unemployment benefits provided under the plan arise from accruals to be made by the corporation to such account and are payable only to the extent accrued therein. No employee has any interest in or right to any supplemental unemployment benefits except to the extent to which he qualifies for them as expressly provided in the plan. The plan further provides the requirements for eligibility to receive benefits under the plan, as well as for the duration and amount of such benefits. Under the terms of the agreement, the employer is obligated to make such payments direct to the former employees entitled to benefits.

Section 162(a) of the Internal Revenue Code of 1954 provides, "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *."

Revenue Ruling 56–102, C.B. 1956–1, 90, holds that contributions made by an employer into an independently controlled trust fund, created solely for the purpose of furnishing supplemental unemployment benefits to certain of its employees qualifying under a supplemental unemployment benefit plan as part of a collective bargaining agreement, constitute ordinary and necessary business expenses and are deductible from gross income.

It is evident that the purpose of the supplemental unemployment benefit plan in the instant case is to promote the welfare of employees laid off and to make clear that the obligations of the employer involved thereunder arise directly in connection with, and relate proximately to, the carrying on of its trade or business.

Therefore, in the instant case, the supplemental unemployment benefit payments made by the employer direct to qualifying former employees constitute ordinary and necessary business expenses of the employer and are deductible from gross income under section 162(a) of the Code in the year paid or in the year in which liability to particular employees becomes fixed, depending upon the method of accounting employed. No deduction will be allowed on the accrual method solely by reason of the setting aside of funds in a special account or the making of a book entry.

Revenue Ruling 56–249, C.B. 1956–1, 488, holds that, under certain circumstances, benefits paid to individuals by the trustees of a trust created pursuant to the provisions of a supplemental unemployment benefit plan established as a result of a collective bargaining agreement do not constitute "wages" for purposes of the taxes imposed by the Federal Unemployment Tax Act, the Federal Insurance Contributions Act, or for purposes of the Collection of Income Tax at Source on Wages (chapters 23, 21, and 24, respectively, subtitle C, Internal Revenue Code of 1954). However, that ruling also holds that such benefits are includible in the gross incomes of the recipients for the taxable year in which received.

The main difference in the provisions of the supplemental unemployment benefit plan in the instant case from that considered in Revenue Ruling 56–249 is that, in the instant case, the plan does not provide for the accumulation and distribution of the benefits from a trust as was the case in that Revenue Ruling. However, since the basic or fundamental purposes and conditions of the plan are substantially the same as the purposes and conditions of the plans which

formed the basis for Revenue Ruling 56–249, the failure to provide for the accumulation of funds in a trusteed account, from which the supplemental unemployment benefits contemplated by the plan are to be paid, is not a material or controlling factor. Thus, the plan in the instant case is not sufficiently different from that which formed the basis for Revenue Ruling 56–249 to warrant different conclusions.

Accordingly, under the facts in this case, it is held that supplemental unemployment benefit payments received by the former employees do not constitute "wages" for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, or the Collection of Income Tax at Source on Wages. However, such benefits are includible in the gross incomes of the recipients for the year in which received.

The principles stated above are equally applicable to supplemental unemployment benefit plans which are similar in all material details except for having been unilaterally instituted by an employer and are not union negotiated, as in Revenue Ruling 58–128, C.B. 1958–1, 89.

Revenue Rulings 56–102, *supra*, and 56–249, *supra*, are hereby amplified.

Amounts equal to dividends paid with respect to stock borrowed to cover short sales. See Rev. Rul. 60–359, page 104.

Deductibility of North Carolina primary filing fee as a business expense. See Rev. Rul. 60–366, page 63.

Expenditures for sea walls to counteract the effect of land subsidence. See Rev. Rul. 60–386, page 107.

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26 CFR 1.162–2: Traveling expenses. Rev. Rul. 60–314

A new employment for a test period of one year with the understanding that satisfactory completion of such period will result in continued employment constitutes an "indefinite" employment. Accordingly, even though an employee must move to a location other than his usual residence for the test period in order to accept such employment, the cost of meals and lodging incurred by him at that location during such test period is not deductible under section 162(a)(2) of the Internal Revenue Code of 1954.

Advice has been requested whether the cost of meals and lodging incurred by an employee under the circumstances described below is deductible for Federal income tax purposes under section 162(a)(2) of the Internal Revenue Code of 1954.

A manufacturing corporation has an employment policy under which new engineering employees from various sections of the country are hired on a full-time basis to work at the main plant for a test period of one year, with the understanding that, if their services have been satisfactory during such period, they will then receive permanent appointments and will either continue to work at the main plant or be transferred to one of the branch plants.

Section 162(a)(2) of the Code provides, in substance, that there shall be allowed as a deduction the ordinary and necessary traveling expenses, including the entire amount expended for meals and lodg-

ing, while away from home in the pursuit of a trade or business. For purposes of section 162(a)(2), the word "home" has been interpreted to mean the principal or regular business location of the taxpayer. A taxpayer cannot deduct the cost of meals and lodging while discharging his duties at his principal or regular place of employment, merely because he maintains his family residence at another location. See Rev. Rul. 54–497, C.B. 1954–2, 75.

Since the employees in the instant case have accepted full-time employment at the main plant for a test period of one year, and as they may be permanently assigned to work at that location, it is evident that (1) their employment at the main plant is not temporary but indefinite; (2) these employees have relinquished any other business location which they had previously established, or at least restricted their activities at such other location to a spare-time basis and convert it into a minor or temporary post of duty; and (3) the main plant is their principal or regular post of duty, if not the only place where they are carrying on their trade or business, during such period.

Accordingly, it is held that the location of the main plant is their "home" for Federal income tax purposes, and they cannot deduct the cost of their meals and lodging there as traveling expenses while away from home in pursuit of a trade or business under section 162(a)(2) of the Code. This is true whether a particular employee at the end of the test period is given a permanent position at the main plant, whether he receives a permanent assignment to a branch plant in another city, or whether he is not retained after that time.

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26 CFR 1.162–6: Professional expenses. Rev. Rul. 60–365
(Also Section 62; 1.62–1.)

> Malpractice insurance premiums paid by a physician who is an employee constitute ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of section 162(a) of the Internal Revenue Code of 1954. However, such premiums may be deducted only from adjusted gross income in computing taxable income, provided the taxpayer does not use the tax table or the standard deduction in computing his individual tax liability for Federal income tax purposes.

Advice has been requested whether the costs of malpractice insurance premiums paid by a physician who is an employee may be deducted for Federal income tax purposes.

The taxpayer, a physician, was employed by a hospital. Under local law, he could become personally liable for negligence, resulting in injury to his employer's patients, in the same manner and to the same extent as if he were in private practice. In order to protect himself against suits for malpractice, the taxpayer, along with most of his fellow employees who are physicians, obtained malpractice insurance coverage. The premiums were paid by the taxpayer, and he was not reimbursed by his employer.

Section 162(a) of the Internal Revenue Code of 1954 provides, in part, as follows:

> (a) IN GENERAL.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *

Section 1.62–1 of the Income Tax Regulations provides, in effect, that expenses attributable to a trade or business carried on by the

taxpayer, where such trade or business consists of services performed as an employee, are not allowable in computing adjusted gross income of the employee, with certain exceptions not here material.

The expenses in the instant case were incurred in connection with the taxpayer's business as an employee. They were made to protect him from suits for malpractice to which he was subject in the same manner and to the same extent as if he were engaged in private practice. Furthermore, it is common and accepted practice to incur such expenses in the profession in which the taxpayer is engaged, and such expenses are appropriate and helpful to his business.

Accordingly, based on the foregoing, it is held that malpractice insurance premiums paid by a physician who is an employee are among the ordinary and necessary expenses incurred by a professional man in carrying on a trade or business within the meaning of section 162(a) of the Code. However, since the cost of such premiums is not among the expenses of employees which may be deducted from gross income in computing adjusted gross income under section 62 of the Code, such costs are deductible by the taxpayer from adjusted gross income in computing taxable income, as defined in section 63 of the Code, provided he does not use the tax table or the standard deduction in computing his individual tax liability for Federal income tax purposes.

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26 CFR 1.162–17: Reporting and substantiation of traveling and other business expenses of employees. — Rev. Rul. 58–453 Supplement VII

Revenue Ruling 58–453, C.B. 1958–2, 67, relating to certain fixed mileage allowances or per diem allowances received by employees, refers to the Standardized Government Travel Regulations in connection with the maximum per diem allowance in lieu of subsistence authorized to be paid by the Federal Government while traveling outside the continental United States. The following rates, obtained from official Government sources, are published as a supplement to Revenue Ruling 58–453 and may be amended or supplemented from time to time.

STANDARDIZED GOVERNMENT TRAVEL REGULATIONS

Appendix I, Revised—Maximum Per Diem Rates in Lieu of Subsistence for Travelers Beyond the Limits of the Continental United States

* * * * * * *

The changes, identified by asterisk, are effective June 1, 1960.

Locality	*Maximum per diem rates*
Aden	$15
*Afghanistan	
*Kabul	15
*Other	6
Alaska	
Anchorage	21
Fairbanks	21
Juneau	21
Nome	21
Other	15
Albania	10
Algeria	15
American Samoa	11
Andorra (See "Other Localities")	
Angola	13
Argentina	12
*Australia	
*Melbourne	$17
*Sydney	17
Other	12
Austria	12
Bahamas	
(Apr. 15–Dec. 14, incl.)	17
(Dec. 15–Apr. 14, incl.)	24
Basutoland (See "Other Localities")	
Bechuanaland (See "Other Localities")	
Belgian Congo	14
*Belgium	16
Bermuda	20
Bolivia	13

Locality	Maximum per diem rates
*Bonin Islands (See "Other Localities")	
Brazil	$15
*British Guiana	15
British Honduras	16
British Somaliland (See "Other Localities")	
Brunei	13
Bulgaria	14
*Burma	
Mandalay	12
*Rangoon	19
Other	6
*Cambodia	14
Cameroun	17
Canada	15
Canary Islands	10
Canton Island	15
*Central African Republic [1]	14
*Ceylon	
*Colombo	18
Other	14
*Chad, Republic of [1]	14
Chile	
Santiago	16
Other	13
*China	
*Taipei	16
*Other	11
*Colombia	16
*Congo, Republic of [1]	14
Costa Rica	15
*Cuba	
*Havana	
*(Apr.–Nov. incl.)	17
*(Dec.–Mar. incl.)	20
*Other	14
Cyprus	10
Czechoslovakia	15
*Dahomey, Republic of [2]	19
Denmark	12
Dominican Republic	
Ciudad Trujillo	
(Apr. 16–Dec. 15 incl.)	19
(Dec. 16–Apr. 15 incl.)	22
Other	11
*Ecuador	
*Guayaquil	18
*Other	12
El Salvador	20
*Eritrea	13
Estonia	16
*Ethiopia	13
Fiji Islands	16
*Finland	16
France	
Paris	15
Suresnes	15
Other	11
*French Guiana	13
*French Somaliland	$15
French West Indies	18
*Gabon Republic [1]	14
Gambia (See "Other Localities")	
Germany	
Saarland	12
Other	11
*Ghana	17
Gibralter	7
*Great Britain and North Ireland:	
London including Middlesex County, Bushey Hall, and Denham	15
*Other	13
*Greece	14
*Greenland (See "Other Localities")	
Guam	15
Guatemala	14
Guinea	20
Haiti	
Cap-Haitien	11
Port-au-Prince	14
Other	8
Hawaii	16
Honduras	14
Hong Kong	14
*Hungary	7
Iceland	13
*India	
Bombay	13
*Calcutta	15
New Delhi	13
Other	9
Indonesia	6
*Iran	
*Khorramshahr	15
*Tehran	17
Other	11
*Iraq	
*Baghdad	18
*Other	15
*Ireland	13
Israel	14
Italy	
Rome	15
Other	12
*Ivory Coast [2]	
*Abidjan	23
*Other	13
*Iwo Jima (See "Other Localities")	
Japan	14
Jerusalem (Palestine)	14
Jordan	10
Kenya	9
Korea	
Seoul	20
Other	10

[1] Formerly a part of French Equatorial Africa.
[2] Formerly a part of French West Africa.

Locality	Maximum per diem rates
*Kuwait	$14
Laos	15
Latvia	16
Lebanon	12
Liberia	
Monrovia	20
Other	8
*Libya	12
Liechtenstein	12
Lithuania	16
Luxembourg	14
*Malagasy Republic (formerly Madagascar)	18
Malaya	12
*Mauritania [2]	13
Mexico	
Chihuahua Ciudad Juarez, Ensenada, Guaymas, Matamoros, Mexicali, Mexico, D.F., Monterrey, Nogales, Nuevo Laredo, Piedras Negras, and Tijuana	12
Other	10
Midway	15
*Morocco	12
Mozambique	10
Nepal	11
Netherlands	12
Netherlands Antilles (Change in name)	20
New Caledonia	14
New Zealand	
Auckland	12
Wellington	12
Other	9
*Nicaragua	18
*Niger, Republic of [2]	19
*Nigeria	
Lagos	18
*Other	13
North Borneo	13
Norway	12
Nyasaland (See "Rhodesia and Nyasaland, Federation of")	
Pakistan	11
Panama	
Panama City	17
Other (including Canal Zone)	13
Paraguay	11
Peru	13
Philippines	
Manila	18
Other	12
Poland	6
Portugal	
Azores	7
Madeira Islands	7
Other	12
Portuguese Guinea	10
Puerto Rico	
San Juan	$24
Other	18
*Qatar	25
Rhodesia, Northern (See Rhodesia and Nyasaland, Federation of)	
Rhodesia, Southern (See Rhodesia and Nyasaland, Federation of)	
Rhodesia and Nyasaland, Federation of	14
*Rumania	14
*Ryukyu Islands (See "Other Localities")	
Saarland (See Germany)	
Sarawak	16
*Saudi Arabia	
*Jidda	17
*Riyad	25
Other	10
Senegal [2]	19
Sierra Leone	10
*Singapore	18
*Soudanese Republic (Soudan) [2]	19
Southwest Africa	8
*Spain (See also Canary Islands)	
*Madrid	13
*Other	10
Spanish Sahara (See "Other Localities")	
Sudan	12
Surinam	12
Swaziland (See "Other Localities")	
*Sweden	16
Switzerland	15
*Tanganyika	9
*Thailand	
*Bangkok	19
Other	8
Togo	20
Trust Territories	
Somaliland	10
Pacific Islands	11
Tunisia	13
*Turkey	
*Ankara	13
*Istanbul	15
Other	9
Uganda	10
*Union of South Africa	
*Capetown	12
*Johannesburg	12
*Other	9
Union of Soviet Socialist Republics	16

[2] Formerly a part of French West Africa.

Locality	Maximum per diem rates
*United Arab Republic	
*Egypt	
*Cairo	$13
*Other	10
Syria	11
Uruguay	13
*Venezuela	
*Caracas	28
*Maracaibo	28
*Other	22
*Viet-Nam	
Saigon-Cholon Area	16
Other	10
Virgin Islands	
(May–Nov. incl.)	20
(Dec.–Apr. incl.)	30
*Volta Republic [2]	$19
Wake	15
*West Indies	
*Jamaica (change in dates)	
*(Apr. 16–Dec. 14 incl.)	14
(Dec. 15–Apr. 15 incl.)	18
*Trinidad	17
Other	
(Apr. 16–Dec. 14 incl.)	12
(Dec. 15–Apr. 15 incl.)	16
Yugoslavia	8
Zanzibar (See "Other Localities")	
Other Localities	9

[2] Formerly a part of French West Africa.

Rev. Rul. 58–453 Supplement VIII

Revenue Ruling 58–453, C.B. 1958–2, 67, relating to certain fixed mileage allowances or per diem allowances received by employees, refers to the Standardized Government Travel Regulations in connection with the maximum per diem allowance in lieu of subsistence authorized to be paid by the Federal Government while traveling outside the continental United States. The following rates, obtained from official Government sources, are published as a supplement to Revenue Ruling 58–453 and may be amended or supplemented from time to time.

STANDARDIZED GOVERNMENT TRAVEL REGULATIONS

Appendix I, Revised—Maximum Per Diem Rates in Lieu of Subsistence for Travelers Beyond the Limits of the Continental United States

* * * * * * *

The changes, identified by asterisks, are effective December 1, 1960.

Locality	Maximum per diem rates
*Aden	$16
Afghanistan:	
Kabul	15
Other	6
Alaska:	
Anchorage	21
Fairbanks	21
Juneau	21
Nome	21
Other	15
Albania	10
Algeria	15
American Samoa	11
Andora (See "Other Localities")	
Angola	13
*Argentina	14
Australia:	
Melbourne	17
Sydney	17
Other	12
*Austria:	
*Vienna	$16
Other	12
Bahamas:	
(Apr. 15–Dec. 14, incl.)	17
(Dec. 15–Apr. 14, incl.)	24
*Bahrein Island	14
Basutoland (See "Other Localities")	
Bechuanaland (See "Other Localities")	
Belgium	16
Bermuda	20
Bolivia	13
Bonin Islands (See "Other Localities")	
*Brazil:	
*Brasilia	16
*Belem	16
*Rio de Janeiro	16

See footnotes at end of table.

Locality	Maximum per diem rates
Brazil (continued):	
*Sao Paulo	$16
*Other	9
British Guiana	15
British Honduras	16
British Somaliland (See "Other Localities")	
Brunei	13
Bulgaria	14
Burma:	
Mandalay	12
Rangoon	19
Other	6
Cambodia	14
Cameroun	17
*Canada	17
Canary Islands	10
Canton Island	15
Central African Republic [1]	14
*Ceylon:	
*Colombo	20
Other	12
Chad, Republic of [1]	14
Chile:	
Santiago	16
Other	13
China:	
Taipei	16
Other	11
Columbia	16
Congo, Republic of the [3] (including Ruanda-Urundi)	14
Costa Rica	15
*Cuba:	
*Havana	17
Other	14
Cyprus	10
*Czechoslovakia	12
*Dahomey, Republic of [2]	22
Denmark	12
Dominican Republic:	
Cuidad Trujillo	
(Apr. 16–Dec. 15 incl.)	19
(Dec. 16–Apr. 15 incl.)	22
Other	11
Ecuador:	
Guayaquil	18
Other	12
El Salvador	20
Eritrea	13
Estonia	16
Ethiopia	13
Fiji Islands	16
*Finland	20
*France:	
*Nice	14
Paris	15
Suresnes	15
Other	11
French Guiana	13
French Somaliland	15
French West Indies	18
Gabon, Republic of [1]	14

See footnotes at end of table.

Locality	Maximum per diem rates
Gambia (See "Other Localities")	
*Germany:	
Saarland	$12
*Other	12
*Ghana:	
*Accra	20
*Other	15
Gibraltar	7
Great Britain and North Ireland:	
London including Middlesex County, Bushey Hall, and Denham	15
Other	13
Greece	14
Greenland (See "Other Localities")	
Guam	15
Guatemala	14
Guinea	20
*Haiti:	
Cap-Haitien	11
*Port-au-Prince:	
(Apr. 16–Dec. 15 incl)	13
(Dec. 16–Apr. 15 incl)	16
Other	8
Hawaii	16
Honduras	14
Hong Kong	14
Hungary	7
Iceland	13
India:	
Bombay	13
Calcutta	15
New Delhi	13
Other	9
Indonesia	6
Iran:	
Khorramshahr	15
Tehran	17
Other	11
Iraq:	
Baghdad	18
Other	15
Ireland	13
Israel	14
*Italy:	
Rome	15
*Turin [4]	17
Other	12
Ivory Coast: [2]	
Abidjan	23
Other	13
Iwo Jima (See "Other Localities")	
Japan	14
Jerusalem	14
Jordan	10
Kenya	9
Korea:	
Seoul	20
Other	10
Kuwait	14

Locality	Maximum per diem rates
Laos	$15
Latvia	16
Lebanon	12
*Liberia:	
*Monrovia	25
Other	8
Libya	12
Liechtenstein	12
Lithuania	16
Luxembourg	14
Malagasy Republic (formerly Madagascar)	18
*Malaya	14
Mali, Republic of [2] (formerly Soudanese Republic)	19
Mauritania [2]	13
*Malta	12
*Mexico:	
*Acapulco	15
*Mexico, D.F.	15
*Other	12
Midway	15
*Monaco	14
Morocco	12
Mozambique	10
Nepal	11
*Netherlands:	
*The Hague	16
*Other	14
Netherlands Antilles (Change in name)	20
New Caledonia	14
New Zealand:	
Auckland	12
Wellington	12
Other	9
Nicaragua	18
Niger, Republic of [2]	19
Nigeria:	
Lagos	18
Other	13
North Borneo	13
*Norway	15
Nyasaland (See "Rhodesia and Nyasaland, Federation of")	
Pakistan	11
Panama:	
Panama City	17
Other (including Canal Zone)	13
*Paraguay	12
Peru	13
*Philippines:	
*Manila	13
*Other	9
Poland	6
Portugal:	
Azores	7
Madeira Islands	7
Other	12
Portuguese Guinea	10
Puerto Rico:	
San Juan	$24
Other	18
Qatar	25
Rhodesia, Northern (See Rhodesia and Nyasaland, Federation of)	
Rhodesia, Southern (See Rhodesia and Nyasaland, Federation of)	
Rhodesia and Nyasaland, Federation of	14
Rumania	14
Ryukyu Islands (See "Other Localities")	
Saarland (See Germany)	
Sarawak	16
Saudi Arabia:	
Jidda	17
Riyad	25
Other	10
Senegal, Republic of [2]	19
Sierra Leone	10
Singapore	18
Somali Republic	10
Southwest Africa	8
Spain (See also Canary Islands):	
Madrid	13
Other	10
Spanish Sahara (See "Other Localities")	
*Sudan	15
Surinam	12
Swaziland (See "Other Localities")	
Sweden	16
Switzerland	15
Tanganyika	9
Thailand:	
Bangkok	19
Other	8
Togo	20
Trust Territories:	
Pacific Islands	11
*Tunisia	15
Turkey:	
Ankara	13
Istanbul	15
Other	9
Uganda	10
Union of South Africa:	
Capetown	12
Johannesburg	12
Other	9
Union of Soviet Socialist Republics	16
United Arab Republic:	
Egypt:	
Cairo	13
Other	10
Syria	11

See footnotes at end of table.

Locality	Maximum per diem rates
Uruguay	$13
Venezuela:	
Caracas	28
Maracaibo	28
Other	22
Viet-Nam:	
Saigon-Cholon Area	16
Other	10
Virgin Islands:	
(May–Nov. incl.)	20
(Dec.–Apr. incl.)	30
Volta Republic [2]	19
Wake	15
West Indies:	
Jamaica (change in dates)	
(Apr. 16–Dec. 14 incl.)	$14
(Dec. 15–Apr. 15 incl.)	18
Trinidad	17
Other:	
(Apr. 16–Dec. 14 incl.)	12
(Dec. 15–Apr. 15 incl.)	16
Yugoslavia	8
Zanzibar (See "Other Localities")	
Other Localities	9

[1] Formerly a part of French Equatorial Africa.
[2] Formerly a part of French West Africa.
[3] Formerly Belgian Congo.
[4] Revised rates apply from December 1, 1960 through November 30, 1961; thereafter the country rate of $12 is reinstated.

(Also Section 6041; 1.6041–3.) Rev. Rul. 60–282

Mileage and per diem allowances paid by employers to their employees, which are in excess of the rates prescribed in Revenue Ruling 58–453, C.B. 1958–2, 67, but which constitute a reasonable business practice, are, under the circumstances, held to be equivalent to an accounting by an employee to his employer within the meaning of section 1.162–17(b) of the Income Tax Regulations, where the allowances are based upon geographical differences in costs, or provide for minimum payments or higher rates for an initial number of miles. However, such allowances in excess of those prescribed in Revenue Ruling 58–453, which are based upon differences in grade or salary, will not be approved for purposes of section 1.162–17(b) of the regulations.

Mileage and per diem allowances which are regarded as equivalent to an accounting by an employee to his employer, under section 1.162–17(b) of the regulations, will also be so regarded for purposes of section 1.6041–3(i) of the regulations, relating to the reporting, on Forms 1099, of payments to employees as reimbursements or advances for business expenses.

Revenue Ruling 58–453, C.B. 1958–2, 67, amplified; Revenue Ruling 55–637, C.B. 1955–2, 26, and I.T. 3541, C.B. 1942–1, 41, superseded.

Advice has been requested (1) whether certain per diem and mileage allowances paid by employers to their employees, which are in excess of the allowance prescribed in Revenue Ruling 58–453, C.B. 1958–2, 67, will be approved by the Commissioner of Internal Revenue as equivalent to an accounting by an employee to his employer for purposes of section 1.162–17(b) of the Income Tax Regulations; (2) whether allowances, either within the scope of Revenue Ruling 58–453 or approved by the Commissioner as equivalent to an accounting for purposes of section 1.162–17(b) of the regulations, will also be considered an accounting by an employee to his employer for purposes of section 1.6041–3(i) of the regulations, relating to the reporting by employers of reimbursements paid for travel expenses on Form 1099, and (3) whether Revenue Ruling 55–637, C.B. 1955–2, 26, and I.T. 3541, C.B. 1942–1, 41, relating to the reporting as income of mileage allowances received by rural mail carriers, are still applicable in view of section 1.162–17 of the regulations and Revenue Ruling 58–453.

Section 1.162–17 of the regulations provides rules for the reporting of information on income tax returns by taxpayers who pay or incur

ordinary and necessary business expenses in connection with the performance of services as employees. Section 1.162–17(b) of the regulations sets forth the rules for the reporting of expenses for which the employee is required to account to his employer. Subparagraph (4) of section 1.162–17(b) of the regulations provides, in part, that, in lieu of requiring the submission of an expense account or other written statement to an employer showing the nature and amounts of the employee's expenses, "the Commissioner in his discretion may approve reasonable business practices under which mileage, per diem in lieu of subsistence, and similar allowances providing for ordinary and necessary business expenses in accordance with a fixed scale may be regarded as equivalent to an accounting to the employer."

Revenue Ruling 58–453, *supra*, holds that an employee, who pays or incurs ordinary and necessary business expenses for travel (including meals and lodging) and transportation for which he is paid by his employer a fixed mileage allowance or a per diem allowance in lieu of subsistence at rates not in excess of 125 percent of the maximum rates authorized to be paid by the Federal Government in the locality in which the travel is performed, will be deemed to have been required to account to his employer for such expenses for purposes of section 1.162–17(b) of the regulations. Based upon this standard, the Revenue Ruling holds that a mileage allowance not in excess of 12.5 cents per mile and a per diem allowance not in excess of $15 per day while traveling within the continental United States would fall within the scope of the Revenue Ruling. However, if and when the maximum mileage and/or per diem allowance authorized to be paid by the Federal Government is changed, the 12.5 cents per mile and/or the $15 per day will likewise be adjusted to 125 percent of the changed amount. Allowances not in excess of 125 percent of the amount authorized to be paid by the Standardized Government Travel Regulations for employees traveling outside the continental United States would also be within the scope of the Revenue Ruling. The Revenue Ruling also states that the presence of unusual circumstances which account for allowances in excess of the rates prescribed therein may constitute grounds for considering the amounts allowed as having been accounted for to the employer, but the payment of allowances in amounts greater than those specified in that Revenue Ruling will not, in and of itself, constitute an unusual circumstance.

The following are some illustrations of mileage rates and per diem allowances in lieu of subsistence paid by particular employers for travel in the United States (other than the States of Alaska and Hawaii) which the Commissioner of Internal Revenue has been requested to approve as reasonable business practices which will be regarded as equivalent to an accounting by employees within the meaning of section 1.162–17(b) of the regulations.

(1) *M* corporation operates nine divisions located in various sections of the United States. Management employees of the company are reimbursed on an actual expense basis. Other executives are reimbursed for travel expenses on a per diem basis as follows:

Grade of employee	*California*	*All other states*
Group A executives	$30.00	$25.00
Group B executives	25.00	25.00
Group C executives	25.00	20.00

The above allowances apply only for a full day of travel, expenses of the day of departure and the day of return being made on an actual reimbursement or pro rata per diem basis. The allowance is supposed to cover expenses of hotel, meals, gratuities, cab and limousine fares, and other incidental expenses. Based upon the average rates of hotels patronized by its executives, it is the opinion of the company that $15 per day is inadequate and would require its employees to seek second-rate accommodations, which has never been demanded by the company. The company has established these allowances after a careful study by each division which indicated that the actual travel expenses of its employees would equal or exceed these allowances.

It is held that the reasons set forth by the company do not constitute grounds for regarding the per diem allowances which are in excess of $15 as equivalent to an accounting to an employer within the meaning of section 1.162–17(b) of the regulations.

(2) *N* corporation has plants in cities *X* and *Y*. The business of the company requires its employees to travel to all parts of the United States. All employees required to travel on company business are given per diem allowance as follows:

For nights spent in:	*Salary grades "1" through "11"*	*Salary grades "12" and above*
City *X*	$9.00	$9
City *Y*	11.50	14
Cities under 100,000	14.00	16
Cities over 100,000 and under 750,000	17.50	20
Cities over 750,000 (except New York City)	20.00	23
New York City	24.00	27
Nights on trains	10.00	10

The per diem rates are paid on the basis of 24 hours of travel time. For travel of less than 24 hours, the employee is reimbursed for actual expenses incurred and an accounting is required. Likewise, an employee in a travel status for 47 hours would receive the per diem rate for one day and reimbursements for actual expenses after the first 24 hours. These rates are designed to provide for hotel accommodations, local transportation, tips, telephone and telegraph charges, excess baggage charges, etc. There is no additional payment, except in unusual circumstances, where the employee's actual expenses materially exceed the per diem allowance. Any additional payment is based on an actual accounting.

Higher per diem rates are paid to employees in higher salary grades because such employees holding highly responsible positions are expected to utilize accommodations conforming to their status as high level representatives of the company.

N corporation has established to its satisfaction that its per diem rates are essentially equivalent to actual reasonable expenses. The executives charged with the administration of the travel policy regularly compare their personal travel expenses with the allowable per diem to test the reasonableness of the rates. The rates are reviewed from time to time and adjusted as circumstances may justify, and *N* corporation has furnished evidence both that the rates are reasonable for the area in which paid and that the rates are adjusted periodically in accordance with changing circumstances.

It is held that the per diem allowances paid to employees in salary grades "1" through "11," set forth above, will be regarded as equivalent to an accounting to an employer under section 1.162–17(b) of the regulations. The rates in excess of $15 for employees in salary grades "12" and above will not be so regarded, since the amounts by which they are greater than the allowances paid to other employees (and considered reasonable) are based upon differences in grade or salary rather than on geographical differences in costs.

(3) Members of the uniformed services (Army, Navy, Air Force, Marine Corps, Coast Guard, Coast and Geodetic Survey, and Public Health Service) are paid mileage and per diem allowances for official travel at rates prescribed in regulations promulgated by the Secretaries of the Army, Navy, Air Force, Treasury, Commerce, and Health, Education and Welfare under authority of section 303(h) of the Career Compensation Act of 1949, 37 U.S.C. 253(a). Under this authority, Joint Travel Regulations for the Uniformed Services have been issued setting forth the rates to be paid members of the uniformed services.

In establishing travel allowance, the Secretaries concerned are required under section 303(f) of the Career Compensation Act of 1949, to consider, in prescribing (1) monetary allowances in lieu of transportation, the average cost of first-class transportation, including sleeping accommodations; (2) per diem rates, the current economic data on costs of subsistence, including lodging and other related necessary incidental expenses; and (3) mileage rates, the average cost of first-class transportation including sleeping accommodations and current economic data on the cost of subsistence. The rates fixed in the Joint Travel Regulations are frequently reviewed and revised.

The maximum mileage allowances presently prescribed in the Joint Travel Regulations for travel within and without the United States and the maximum per diem allowances in lieu of subsistence for travel within the United States are equal to or less than the rates referred to in Revenue Ruling 58–453. The current per diem allowances for overseas travel are prescribed in Table 3, Appendix B, of the Joint Travel Regulations. Most of these rates are lower than or equal to 125 percent of the rates prescribed in the Standardized Government Travel Regulations, but a few are in excess of 125 percent of such rates.

It is held that the per diem allowances for official travel at rates prescribed in Table 3, Appendix B of the Joint Travel Regulations will be regarded as equivalent to an accounting to an employer under section 1.162–17(b) of the regulations.

(4) *O* corporation has a large number of employees who are required to have their automobiles available for use on company business during normal work hours and periods of on-call duty although the actual mileage driven during any one month may not be very great. The rate of reimbursement for the travel expenses of these employees is 29.7 cents per mile for the first 150 miles and 4.7 cents per mile for all mileage over 150 miles in each month. The policy of the company is to reimburse only for actual costs. Rates are adjusted when it is determined that the costs have increased or decreased. The present rates are designed to provide for reimbursement of fixed costs attributable to the company business by the mileage paid for the first 150 miles of travel each month.

During a six-month period in 1958, 81 percent of the more than 1,500 employees reimbursed under these rates were reimbursed at rates averaging 12.5 cents per mile or less. The remaining employees were reimbursed at rates ranging from 12.6 cents per mile to 29.7 cents per mile. The average rate for all employees during the period was 8.63 cents per mile.

It is held that reimbursements under the system of *O* corporation constitute a reasonable business practice which will be regarded as equivalent to an accounting to an employer under section 1.162–17(b) of the regulations.

(5) Section 609(a) of the Postal Field Service Compensation Act of 1955, 39 U.S.C. 1009, as amended by Public Law 85–399, 85th Cong., 72 Stat. 107, approved May 14, 1958, provides that rural mail carriers shall be paid for equipment maintenance a sum equal to 10 cents per mile for each mile or major fraction of a mile scheduled or $3.50 per day, whichever is greater.

The provisions of I.T. 3541, C.B. 1942–1, 41, as amplified by Revenue Ruling 55–637, C.B. 1955–2, 26, require rural mail carriers to report on their income tax returns all receipts and expenditures with respect to vehicular equipment maintenance by including the fixed minimum mileage allowance received in their gross income and deducting, to the extent supported by proper evidence, the cost of operation, repairs, upkeep, and depreciation incurred in connection with the use of vehicles in the performance of mail service for the Government.

In view of section 1.162–17(b) of the regulations and Revenue Ruling 58–453, it is held that rural mail carriers are considered as having accounted to their employer for their business expenses for the purposes of section 1.162–17(b) of the regulations. No accounting will be required on their Federal income tax returns for such allowances or the expenses covered thereby if the total amount of the allowances received does not exceed such expenses.

The foregoing examples illustrate some of the principles which are applied in determining what per diem and mileage allowance paid by particular employers, which do not fall within the scope of Revenue Ruling 58–453, will be approved as reasonable business practices which will be regarded as equivalent to an accounting to an employer for the purposes of section 1.162–17(b) of the regulations.

To summarize, per diem and mileage allowances in excess of the rates allowed by Revenue Ruling 58–453 will not be approved where the rates vary with the grade or salary of the employee. However, it is recognized that hotel and other costs in certain localities are higher than such costs in other localities and that reasonable tolerances in per diem allowances based upon such variations may be the basis for a reasonable business practice that will meet the requirements of section 1.162–17(b) of the regulations. While the Federal government pays generally the same allowances for travel anywhere in the United States, other employers may fix rates based upon the actual expenses of their employees with reasonable variations based upon differing costs in different localities in the United States, provided it is shown by objective evidence that the rates are reasonable for the area in which paid and that it is the policy of the payor to adjust the rates periodically as changing circumstances require. Finally, it is also recognized that certain fixed expenses of operating an automobile

while on the business of an employer may be incurred which will not be reflected in a fixed mileage rate for those employees who may only be required to drive a small number of miles in any period. Under these circumstances, it may be reasonable practice to provide either a minimum allowance or a mileage schedule which pays a greater rate for an initial number of miles and a lower rate for all excess miles.

Although the above principles illustrate payments of per diem and mileage allowances to employees, which, because of unusual circumstances, have been considered as an accounting to their employers for their business expenses, the requirement of Revenue Ruling 58–453, *supra*, that any employer who wishes per diem or mileage payments to his employees to be so considered should direct a request to that effect to the Commissioner of Internal Revenue, is still in effect. As specified in the Revenue Ruling, the request should set forth in detail an explanation of the arrangements under which these particular allowances are paid and the reasons for his belief that his special circumstances justify the same treatment as that accorded allowances falling within the scope of this ruling.

Section 6041 of the Code requires an information return to be filed by persons making payments to employees amounting to $600 or more in any year. Generally, if any part of such amounts are not required to be reported on a Withholding Tax Statement, Form W–2, they must be reported on Form 1099, U.S. Information Return.

Section 1.6041–3(i) of the regulations includes among the payments that need not be reported on Form 1099, advances, reimbursements, or charges for traveling and other business expenses of an employee to the extent that the employee is required to account to his employer (within the meaning of that term as set forth in paragraph (b)(4) of section 1.162–17 of the regulations) and does so account. Employees who receive per diem and mileage allowances within the scope of Revenue Ruling 58–453, or under plans that are approved by the Commissioner as equivalent to an accounting for the purposes of section 1.162–17(b) of the regulations, are considered to have been required to account to their employer within the meaning of section 1.6041–3(i) of the regulations. Therefore, such reimbursements need not be reported on Form 1099.

To the extent that I.T. 3541 and Revenue Ruling 55–637 require a specific accounting "supported by proper evidence" on the part of a rural mail carrier who receives a fixed minimum mileage allowance for the cost of operation, repairs, upkeep, and depreciation incurred in connection with his use of a vehicle in the performance of his postal services for the Government, it is held that such rulings are superseded by section 1.162–17(b)(4) of the regulations and Revenue Ruling 58–453.

Revenue Ruling 58–453, *supra*, is hereby amplified.

SECTION 164.—TAXES

26 CFR 1.164–1: Deduction for taxes. Rev. Rul. 60–239

The tax imposed by the California Cigarette Tax Law of 1959 is deductible under section 164(a) of the Internal Revenue Code of

1954 by the distributor who affixes the stamps, or imprints such stamps by means of a meter stamping machine or, as otherwise provided, makes payment of the tax to the State Board of Equalization. However, where the tax is imposed directly on the user or consumer by reason of his being the first person in possession in the State of untaxed cigarettes, such user or consumer may deduct the tax that he pays directly to the State.

Advice has been requested as to the deductibility, for Federal income tax purposes, of the cigarette tax imposed by the State of California under the Cigarette Tax Law enacted in 1959.

Part 13 of Division 2 of the California Revenue and Taxation Code, Enacted Statutes 1959, Chapter 1040, effective July 1, 1959, known as the California Cigarette Tax Law, imposes on all cigarettes upon distribution a tax at the rate of one and one-half mills ($0.0015) on each cigarette. The distributor, as defined in the statute, is required to pay the tax upon his distribution of cigarettes. However, where the user or the consumer is the first person in possession in the State of untaxed cigarettes transported to the State, he must pay the tax. The tax is prepaid by the distributor by the use of stamps or meter impressions which must be affixed to each package of cigarettes before it is distributed. The stamps are purchased from the State Board of Equalization and meter-machine settings are prepaid when the meter on the machine is sealed by the Board. Any cigarettes with respect to which the tax has been paid are not subject to the tax upon subsequent distribution. The distributors are required to obtain licenses, furnish bond, keep records, make reports, and pay the tax as provided in the law.

Section 164(a) of the Internal Revenue Code of 1954 provides as follows:

(a) GENERAL RULE.—Except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Section 1.164–1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

The tax, in the instant case, is imposed upon the distributor who first receives the cigarettes within the State. In those cases in which the retailer or consumer is the first person in possession in the State of untaxed cigarettes transported to the State, he must pay the tax. But inasmuch as the tax does not normally fall upon the retailer, it is not a retail sales tax.

Accordingly, it is held that the tax imposed by the California Cigarette Tax Law of 1959 is deductible under section 164(a) of the Code by the distributor who affixes the stamps, or imprints such stamps by means of a meter stamping device, or otherwise makes payment to the State Board of Equalization. Since the tax is not a retail sales tax, it is not deductible by the purchasers of the cigarettes under the provisions of section 164(c) of the Code. However, where the tax has been imposed directly on the user or consumer by reason of his being the first person in possession in the State of untaxed cigarettes, the tax paid directly to the State by such user or consumer is deductible by him under the provisions of section 164(a) of the Code.

(Also Sections 162, 212; 1.162–1, 1.212–1.) Rev. Rul. 60–366

The North Carolina primary filing fee, required of candidates for political office by section 163–120 of the General Statutes of North Carolina, is not deductible as a business expense under section 162 of the Internal Revenue Code of 1954, or as a tax under section 164 of the Code, or as an expense paid or incurred for the production of income under section 212 of the Code.

Revenue Ruling 57–345, C.B. 1957–2, 132, is revoked.

Advice has been requested whether a business expense deduction may be allowed a candidate for political office on account of the payment of the primary filing fee required by section 163–120 of the General Statutes of North Carolina; also, whether the filing fee is a tax for Federal income tax purposes and deductible as such by the candidate for political office who paid it during the taxable year.

Section 163–120, Chapter 163, of the General Statutes of North Carolina imposes a filing fee on candidates for political office, in terms as follows:

Filing fees required of candidates in primary.—At the time of filing a notice of candidacy for nomination for any congressional or State office, including judges of the Supreme and superior court and solicitors, each candidate for such office shall pay to the State Board of Elections a filing fee of one percent of the annual salary of such office. At the time of filing a notice of candidacy for nomination for any legislative or county office, each candidate for such office shall pay to the county board of elections of the county of their residence a filing fee of one percent of the annual salary of such office: Provided, that all candidates for nomination for any county or township office operated on a fee basis shall pay to the county board of elections a flat filing fee as follows: County commissioners, ten dollars ($10.00); county board of education, five dollars ($5.00); sheriff, clerk of the superior court and register of deeds, forty dollars ($40.00), plus one per cent (1%) of the income of the office above four thousand dollars ($4,000.00); and any other county office on a fee basis, twenty dollars ($20.00), plus one per cent (1%) of the income of the office above two thousand dollars ($2,000.00); township constable, ten dollars ($10.00), plus one per cent (1%) of the income of the office above one thousand dollars ($1,000.00); and justice of the peace, ten dollars ($10.00), plus one per cent (1%) of the income of the office above one thousand dollars ($1,000.00). The filing fees which shall be paid by candidates for a county or township office operated on a part salary and part-fee basis shall be one per cent (1%) of the first annual salary received and shall not include any fees received.

Section 162 of the Internal Revenue Code of 1954 provides for the deduction, in computing taxable income, of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162–1 of the Income Tax Regulations provides that among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles, etc. However, the expenses incurred in contending for political office are not included in trade or business expenses. The Supreme Court of the United States has held that the expenditures of one seeking election as a judge were not incurred in carrying on the taxpayer's business of "judging." See *Michael F. McDonald* v. *Commissioner*, 323 U.S. 57, Ct. D. 1617, C.B. 1944, 94. Similarly, in the instant case the payment of the filing fee is not an expenditure in carrying out the functions of the office to which the taxpayer may be elected.

Section 164 of the Code provides, in part, as follows:

(a) GENERAL RULE.—Except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year * * *.

The word "taxes" as used in the statute is nowhere defined in the Code, and, it must be "given its ordinary and commonly accepted meaning as established by the judicial decisions." See *United Gas Improvement Company* v. *Commissioner*, 25 B.T.A. 1382 at 1384. Generally, the word has been defined as an exaction of the state laid by some rule of apportionment according to which the persons or property taxed share the public burden and the proceeds of which go into the state's general revenue fund.

An important factor in distinguishing a fee from a tax is the purpose for the imposition of the charge. Clearly, if the only or the primary purpose is the raising of revenue, the charge is a tax, and governmental regulation arising merely as an incident will not alter the character of the exaction. See *Ward* v. *Maryland*, 12 Wall. 418. On the other hand, "if the fee is exacted for the primary purposes of regulating and restraining an occupation or privilege deemed dangerous to the public or to be specially in need of public control, and compliance with certain conditions is required in addition to the payment of the prescribed sum, such fee is a license * * *. A charge imposed as a consideration for a privilege granted one by a governmental unit is not a 'tax' in the sense in which the word is ordinarily used." See *53 Corpus Juris Secundum* 452 and 453.

As indicated above, a fee may be viewed as purely a regulatory measure or as a charge for a privilege or a service rendered. In *National Biscuit Co.* v. *City of Philadelphia*, 98 Atl. (2d) 182, the Supreme Court of Pennsylvania notes that the distinguishing features of a fee as a regulatory measure are (1) that it is applicable only to a type of business or occupation which is subject to supervision and regulation by the licensing authorities; (2) that such supervision and regulation are in fact conducted by the licensing authority; (3) that the payment of the fee is a condition upon which the licensee is permitted to transact his business or pursue his occupation; and (4) that the legislative purpose in exacting the charge is to reimburse the licensing authority for the expense of the supervision and regulation conducted by it.

In *Riter* v. *Douglass*, 109 Pac. 444, the Nevada Court considered a similar primary filing fee as a charge for a service and stated:

> The right of the legislature to exact a reasonable fee from candidates for office has been sustained in practically every state where a primary law exists, upon the same principle that fees in actions at law and proceedings in courts and for the filing and recording of documents are sustained.

In *McLean* v. *Durham County Board*, 21 S.E.(2d)842, at page 845, the Supreme Court of North Carolina, referring to the North Carolina provision here under consideration, observed:

> [The fee] is only one of the reasonable means adopted by the legislature to regulate primary elections for the selection of candidates for public office and to prevent an indiscriminate scramble for office and the wholesale filing of petitions for nomination regardless of fitness or qualification * * *. Nominations for office must be in accord with reasonable rules and regulations. The power and authority to control and regulate primaries and elections as they affect county and State offices rests exclusively in the legislative branch of the state government.

Since the North Carolina Supreme Court has held this levy was to regulate the primary election and was not a revenue measure, it is a regulatory fee. A regulatory fee is not a tax within the common and

accepted judicial meaning of the term, and hence this fee would not be deductible as a tax under section 164 of the Code. See I.T. 2796, C.B. XIII–2, 48 (1934); and I.T. 3511, C.B. 1941–2, 90.

Section 212 of the Code provides, in part, that in the case of an individual there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income.

Section 1.212–1(f) of the regulations provides that campaign expenses of a candidate for public office do not constitute an allowable deduction under section 212 of the Code.

Accordingly, it is held that a business expense deduction may not be allowed to a candidate for political office on account of the payment of the North Carolina primary filing fee which is required by section 163–120 of the General Statutes of North Carolina. Also, the North Carolina primary filing fee is not a tax for Federal income tax purposes and the taxpayer, a candidate for political office, may not deduct the amount of the fee paid during the taxable year as a tax or as an expense paid or incurred for the production of income.

In Revenue Ruling 57–345, C.B. 1957–2, 132, it was held that a similar filing fee required by New Mexico statutes to be paid to the Secretary of State of New Mexico by each candidate for primary election, constitutes a tax imposed by the State which is deductible for Federal income tax purposes. Inasmuch as that Revenue Ruling is in conflict with the principles stated above, it is hereby revoked.

Pursuant to authority contained in section 7805(b) of the Internal Revenue Code of 1954, the provisions hereof in respect of the nondeductibility, as taxes, of the referred to filing fees paid by candidates for public office will not be applied to fees paid prior to January 1, 1961.

State income taxes paid by a corporation on sales of its property in a section 337 liquidation. See Rev. Rul. 60–236, page 109.

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26 CFR 1.164–4: Taxes for local benefits. Rev. Rul. 60–327

> Assessments paid by property owners to a city-created parking improvement district constitute assessments against local benefits of a kind tending to increase the value of the property assessed within the meaning of section 164(b)(5) of the Internal Revenue Code of 1954, where such assessments are used to provide public parking facilities in or near the district. Such assessments are not deductible for Federal income tax purposes except for so much of such assessments as is properly allocable to maintenance or interest charges.

Advice has been requested whether assessments paid by property owners to a city-created parking improvement district are deductible, for Federal income tax purposes, where such assessments are used to provide public parking facilities within the central business area of the city.

In 1953 the city adopted a new zoning ordinance requiring minimum numbers of off-street parking spaces for each building, determined by a formula for each type, size, and use of the building. The downtown business district was excluded from the requirements of

this ordinance since it was realized that to require off-street parking spaces in a built-up area would be unreasonable. In order to provide the needed downtown parking spaces, the city, pursuant to authority granted by the applicable state statute, created parking improvement districts which purchased or leased parking lots in or near each parking improvement district.

To finance the parking lots, the city levied special assessments against commercial properties in each district. The assessments were determined by first calculating the number of off-street parking spaces each business would have been required to furnish if it were subject to the 1953 zoning ordinance. Then each such business was credited with the number of spaces it already provided on its own land or on the land of others occupied under a long-term lease. The assessment was then based upon the share of total required parking spaces not already provided by such business. The funds collected from these assessments were placed in special funds to be used only for the purpose of financing the off-street parking program of each district. The parking lots are primarily public in nature, but have the basic purpose of providing parking space for the commercial area and enhancing the economic activity of the area. None of the spaces in these parking lots are reserved for a taxpayer paying the assessment or for his tenants or customers.

Section 164 of the Internal Revenue Code of 1954 provides, in part, as follows:

> (a) GENERAL RULE.—Except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.
>
> (b) DEDUCTION DENIED IN CASE OF CERTAIN TAXES.—No deduction shall be allowed for the following taxes.
>
> * * * * * * *
>
> (5) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not prevent—
>
> (a) The deduction of so much of such taxes as is properly allocable to maintenance or interest charges * * *.

Section 1.164–4(a) of the Income Tax Regulations provides, in part, that so-called taxes, more properly assessments, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible even though an incidental benefit may inure to the public welfare. Section 1.164–4(b) of the regulations provides that insofar as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible. In such cases the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation cannot be made, none of the amount so paid is deductible.

Revenue Ruling 58–473, C.B. 1958–2, 100, at 101 states that assessments paid to a township authority by benefited property owners are not deductible either as charitable contributions or as taxes where the assessments are used for the construction of a sewer and water system. However, the same Revenue Ruling holds that contributions

to such township authority are deductible under section 170 of the Code by the donors as charitable contributions made to or for the use of a political subdivision of a State.

It is generally agreed that the value of downtown business property in some measure depends upon the number of people that can be attracted to the area. A parking lot in the area which will ease traffic congestion will ordinarily induce additional numbers of people to come into the area, and thereby increase the value of the property. In the instant case, each assessment is determined by the need for parking spaces created by each particular business and is, therefore, proportional to the benefit expected to be realized from the improvements.

Based on the foregoing, it is held that such assessment against property owners for a city-created parking improvement district to be used to provide public parking facilities in or near the district constitutes assessments against local benefits of a kind tending to increase the value of the property assessed within the meaning of section 164(b)(5) of the Code, and are, therefore, not deductible, for Federal income tax purposes, except for so much of the assessments as is properly allocable to maintenance or interest charges.

SECTION 165.—LOSSES

26 CFR 1.165–1: Losses. Rev. Rul. 60–329

Losses sustained from damage to property as the result of a "sonic boom" caused by an airplane exceeding the speed of sound constitute casualty losses and are deductible under section 165 of the Internal Revenue Code of 1954.

Revenue Ruling 59–344, C.B. 1959–2, 74, superseded.

Advice has been requested whether losses sustained from damage to property as the result of a "sonic boom" caused by an airplane exceeding the speed of sound constitute deductible casualty losses for Federal income tax purposes.

During an air show certain airplanes exceeded the speed of sound at an altitude lower than usual for such activity. The resulting "sonic boom" caused damage to property.

Section 165 of the Internal Revenue Code of 1954 provides, in part, as follows:

(a) GENERAL RULE.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * * *

(c) LIMITATION ON LOSSES OF INDIVIDUALS.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) Losses incurred in a trade or business;

(2) Losses incurred in any transaction entered into for profit, though not connected with a trade or business and

(3) Losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.

* * *

The term "other casualty," as used in section 165(c)(3) of the Code, relates to a casualty analogous to a fire, storm, or shipwreck, a common element of which is that the loss occurs suddenly or unexpectedly.

In the instant case the damage resulted from a disturbance similar in some ways to a windstorm and was sudden and unexpected. Such losses constitute casualty losses within the meaning of the foregoing section of the Code. See *Ray Durden et al.* v. *Commissioner*, 3 T.C. 1, acquiescence, C.B. 1944, 8.

In view of the foregoing, it is held that losses sustained from damage to property as the result of a "sonic boom" caused by an airplane exceeding the speed of sound are casualty losses deductible under section 165 of the Code. The burden of proving that any damage to the property is the result of a "sonic boom" and the amount of the resulting loss rests on the taxpayer claiming the deduction.

Revenue Ruling 59–344, C.B. 1959–2, 74, is hereby superseded.

SECTION 167.—DEPRECIATION

26 CFR 1.167(a)–1: Depreciation in general. Rev. Rul. 60–358

For Federal income tax purposes, the cost of leased or rented television films may be depreciated by use of the "income forecast" method.

Advice has been requested as to the proper method for recovering the cost of leased or rented television films (including taped shows for reproduction) for Federal income tax purposes.

It has come to the attention of the Internal Revenue Service that the methods of computing depreciation described in section 167(b) of the Code are in most cases inadequate when applied to television films, resulting in a distortion of income on the returns filed by taxpayers deriving income from such films. This distortion is caused by a strikingly uneven flow of income, earned by groups of programs within the series, resulting from contract restrictions, methods of distribution and audience appeal of the programs. If the film series is a success, additional income will be forthcoming from reruns over a period of years, depending upon its popularity; whereas, unsuccessful film series may produce little or no income after the initial exhibition. Thus the usefulness of such assets in the taxpayer's trade or business is measurable over the income it produces and cannot be adequately measured by the passage of time alone. Therefore, in order to avoid distortion, depreciation must follow the "flow of income."

Some producers of television films have used the so-called "cost recovery" method in reporting their income. By use of this method, no taxable income is reported until the income from the films exceeds the cost thereof. However, such "cost recovery" method is not acceptable for Federal income tax purposes.

After an extensive study and consideration of the matter, the Service has concluded that the so-called "income forecast" method is readily adaptable in computing depreciation of the cost of television films without producing any serious distortion of income. This method requires the application of a fraction, the numerator of which is the income from the films for the taxable year, and the denominator of

which is the forecasted or estimated total income to be derived from the films during their useful life, including estimated income from foreign exhibition or other exploitation of such films. The term "income" for purposes of computing this fraction means income from the films less the expense of distributing the films, not including depreciation. This fraction is multiplied by the cost of films which produced income during the taxable year, after appropriate adjustment for estimated salvage value. The "income forecast" method may be illustrated as follows:

Example: Certain television films which produced income within the first taxable year cost 800x dollars, after appropriate adjustment for estimated salvage value. The income therefrom for the first taxable year was 600x dollars; second year 150x dollars; and third year, 300x dollars. Total estimated income to be derived from the films 1200x dollars.

$$\frac{600x \text{ dollars}}{1200x \text{ dollars}} \times 800x \text{ dollars} = 400x \text{ dollars (first year's depreciation)}$$

$$\frac{150x \text{ dollars}}{1200x \text{ dollars}} \times 800x \text{ dollars} = 100x \text{ dollars (second year's depreciation)}$$

$$\frac{300x \text{ dollars}}{1200x \text{ dollars}} \times 800x \text{ dollars} = 200x \text{ dollars (third year's depreciation)}$$

If the estimated income from the television films should be less than the cost thereof, thus resulting in a loss, the use of the "income forecast" method for computing depreciation will reflect such loss in the proper taxable years based on the amount of income from the films derived in each taxable year.

If in subsequent years it is found that the income forecast was substantially overestimated or underestimated by reason of circumstances occurring in such subsequent years, an adjustment of the income forecast for such subsequent years may be made. In such case, the formula for computing depreciation would be as follows: income for the taxable year divided by the revised estimated income (the current year's income and estimated future income), multiplied by the unrecovered depreciable film cost remaining as of the beginning of the taxable year.

The total forecast or estimated income to be derived from the films should be based on the conditions known to exist at the end of the period for which the return is made. This estimate can be revised upward or downward, as explained above, at the end of subsequent taxable periods based on additional information which became available after the last prior estimate.

Accordingly, it is the position of the Service that the "income forecast" method described above constitutes an acceptable method for computing a reasonable allowance for depreciation of the cost of television films under section 167(a) of the Code.

In applying the above methods of depreciation, television films shall not be depreciated below a reasonable salvage value, such value being the amount which it is estimated will be realizable upon sale or other disposition of such films when they are no longer useful in the taxpayer's business or in the production of his income. The time when such films are no longer useful in the taxpayer's business, etc., may vary

according to his policy with respect to the use thereof. If the taxpayer's policy is to dispose of the films after the initial showing, the salvage value may represent a relatively large proportion of the original cost of such films. However, if the taxpayer customarily uses the films after the initial showing for reruns, syndication, foreign exhibition, or other exploitation thereof, the salvage value may represent a relatively small proportion of the original cost. If there is a redetermination of the "income forecast," as explained above, salvage value may be redetermined based upon the known facts at the time of such redetermination of the "income forecast."

The principle of "income forecast" as set forth in this Revenue Ruling is limited in its application to television films, taped shows for reproduction and other property of a similar character.

Expenditures for sea walls to counteract land subsidence. See Rev. Rul. 60–386, page 107.

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26 CFR 1.167(a)–3: Intangibles.

Depreciation deduction based upon exhaustion of right-of-way easements for pipelines used to transmit gas for considerable distances. See Rev. Rul. 60–317, page 452.

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26 CFR 1.167(c)–1: Limitation on methods of computing depreciation under section 167(b) (2), (3), and (4). Ct. D. 1848

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF COURT

1. DEDUCTIONS FROM GROSS INCOME—DEPRECIATION—USEFUL LIFE—DECLINING BALANCE METHOD—SALVAGE.

The useful life of a depreciable asset, as defined in section 1.167(a)–1(b) of the Income Tax Regulations, is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business, and not the period of the economic life of the asset. The regulation is valid.

Use of the double declining balance method is denied taxpayer in computing depreciation on its passenger cars in its rental automobile business because it held the cars for less than the three years of "useful life" required by section 167(c) of the Internal Revenue Code of 1954 as a condition precedent to the use of this method. The rental trucks had a useful life to taxpayer of at least three years and taxpayer could elect to use the declining balance method of depreciation. Having elected to use this method, however, taxpayer's trucks could not be depreciated below a reasonable salvage value.

There is nothing inherent in the declining balance system which requires that depreciation should be allowed beyond what reasonably appears to be the price that will be received when the asset is retired. This system merely affects the timing of depreciation not the ultimate amount deductible.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Third Circuit, 268 Fed. (2d) 604, affirmed.

SUPREME COURT OF THE UNITED STATES

The Hertz Corporation, a corporation (successor by merger to J. Frank Connor, Inc., a corporation), petitioner v. *United States of America*

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

[June 27, 1960]

MR. JUSTICE CLARK delivered the opinion of the Court.

This case like No. 141, *Massey Motors, Inc.*, v. *United States*, and No. 143, *Commissioner* v. *Evans* [Ct. D. 1847, page 445, this Bulletin], both decided today, involves the depreciation allowable on cars and trucks used by petitioner's predecessor in its automobile rental business during the years 1954–1956, inclusive. The taxpayer elected to avail itself of the accelerated method of depreciation provided in section 167(b)(2) [1] of the Internal Revenue Code of 1954—known as "the declining balance method." Section 167(c) of the Code limits the use of this method to property "with a useful life of 3 years or more." The applicable Treasury Regulation, section 1.167(a)–1(b), issued in 1956, defines useful life as the "period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business. . . ." Admittedly, if this regulation is valid, taxpayer's passenger cars covered by it would not meet the three-year requirement of section 167(c). The Commissioner denied the petitioner the right to use the declining balance method as to those cars. What we have said in *Massey* and *Evans*, *supra*, disposes of the contention as to the meaning of "useful life" here. We therefore hold, as did the Court of Appeals, 268 F. 2d 604, that the regulation as to "useful life" involved here is valid and applicable to petitioner.

The remaining issues pose questions that relate to the depreciation on the trucks of the taxpayer which concededly had a useful life in excess of three years and were therefore subject to depreciation under the declining balance method authorized under section 167(b)(2). Treasury Regulation section 1.167(a)–1(b), issued in 1956 and subsequent to some of the tax years involved in petitioner's claim, was applied by the Commissioner. He ruled that the salvage value of the trucks at the time of disposition must be accounted for in the depreciation equation. Petitioner contended that this resulted in a retroactive application of the regulation and, in any event, it was invalid because it was not authorized under the 1954 Code. After petitioner paid the assessed tax and was denied a refund, this case was filed. The trial court held in favor of petitioner, but the Court of Appeals reversed. It held that the regulation applied and was not retroactive because it was only declaratory of existing law and that salvage value must be computed in the depreciation equation. We granted certiorari, 361 U.S. 811, and heard the case as a companion to *Massey* and *Evans*, *supra*. We agree with the result reached by the Court of Appeals.

Petitioner succeeded J. Frank Connor, Inc., by merger in July 1956; the taxes accrued against Connor during the fiscal years 1954, 1955, and 1956. Connor was engaged in the business of renting and leasing automobiles and trucks, without drivers, during the pertinent years. In the preparation of its returns for the years ending March 31, 1954, 1955, and 1956, Connor claimed depreciation on its automobiles on the basis of a four-year useful life. The taxes so computed

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[1] The statute provides:

"(b) * * * the term 'reasonable allowance' * * * shall include * * * an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

"(1) the straight line method.

"(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1), * * *."

The applicable regulation provides:

"SEC. 1.167(b)–2. DECLINING BALANCE METHOD.—

"(a) *Application of method.*—Under the declining balance method a uniform rate is applied each year to the unrecovered cost or other basis of the property. The unrecovered cost or other basis is the basis provided by section 167(f), adjusted for depreciation previously allowed or allowable, and for all other adjustments provided by section 1016 and other applicable provisions of law. The declining balance rate may be determined without resort to formula. Such rate determined under section 167(b)(2) shall not exceed twice the appropriate straight line rate computed without adjustment for salvage. While salvage is not taken into account in determining the annual allowances under this method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See section 167(c) and sec. 1.167(c)–1 for restrictions on the use of the declining balance method."

were paid. Subsequently, and after merger, petitioner filed claims for refund on all three years. This claim was based on an election in accordance with § 1.167(c)–1(c)) of the Treasury Regulations issued under the 1954 Code, relating to the declining balance method of depreciation.[2] We see nothing to the contention of retroactive application. The petitioner chose his own weapon, began the struggle under it and, at this late date, cannot be allowed to abandon it.

As to the salvage issue, the petitioner claims that, under the method he chose, the Congress built in an artificial salvage value, *i.e.*, the amount remaining after the application of the depreciation equation. The regulation, however, says that "in no event shall an asset . . . be depreciated below a reasonable salvage value." The issue is the narrow one of whether this regulation is valid under the congressional authorization providing that, as to depreciation, the term "reasonable allowance" shall include an allowance "computed in accordance with regulations prescribed by the Secretary or his delegate." Internal Revenue Code of 1954, section 167(b). We think that it is.

As we pointed out in the companion cases, the purpose of depreciation accounting is to allocate the expense of using an asset to the various periods which are benefited by that asset. The declining balance method permits a rapid rate of depreciation in the early years of an asset's life. The Congress has permitted under this method an allowance not to exceed twice the "straight line" rate, which rate was approved in *Massey* and *Evans*, *supra*. In application, the taxpayer computes his straight-line percentage rate and then doubles it for the first year. This doubled rate is then applied each subsequent year to the declining balance. Because of a belief that most assets do lose more value in the earlier years, this method is justified as an attempt to level off the total costs, including maintenance expense, which will generally be greater in the later years. This means, even under the Commissioner's theory, that if an asset is disposed of early in what was expected to be its useful life in the business, the depreciation taken may greatly exceed the difference between the purchase price of the asset and its retirement price; this is a result of the conscious choice to permit rapid depreication. But this, by hypothesis, is an unusual situation. There is nothing inherent in the declining balance system which requires us to assume that depreciation should be allowed beyond what reasonably appears to be the price that will be received when the asset is retired. This would permit a knowing distortion of the expense of employing the asset in the years after that point is reached. It therefore appears that the interpretation contended for by the taxpayer does not comport with the overriding statutory requirement that the depreciation deduction be a *reasonable* allowance. Section 167(a).

In challenging the regulation, the taxpayer relies upon the following excerpt from S. Rep. No. 1622, 83d Cong., 2d Sess. 201:

> "The salvage value is not deducted from the basis prior to applying the rate, since under this method at the expiration of useful life there remains an undepreciated balance which represents salvage value."

The regulation is consistent with the first part of the sentence, for salvage value is not deducted from the basis prior to the application of the rate. But petitioner contends that the regulation is contrary to the second part of the sentence which appears to equate salvage value under the declining balance method with the mathematical residue which must always exist under the system. This, it appears to us, is but recognition that under this method there is some theoretical salvage value always left. But it only "represents salvage value" and when true salvage value exceeds this amount, the latter controls. Moreover, the regulation can only carry out the fundamental concept of depreciation—that it is

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[2] "SEC. 1.167(c)–1. LIMITATIONS ON METHODS OF COMPUTING DEPRECIATION UNDER SECTION 167(b) (2), (3), and (4)

* * * * * * *

"(c) *Election to use methods.*—Subject to the limitations set forth in paragraph (a) of this section, the methods of computing the allowance for depreciation specified in section 167(b) (2), (3), and (4) may be adopted without permission and no formal election is required. In order for a taxpayer to elect to use these mehods for any property described in paragraph (a) of this section, he need only compute depreciation thereon under any of these methods for any taxable year ending after December 31, 1953, in which the property may first be depreciated by him. The election with respect to any property shall not be binding with respect to acquisitions of similar property in the same year or subsequent year which are set up in separate accounts. If a taxpayer has filed his return for a taxable year ending after December 31, 1953, for which the return is required to be filed on or before September 15, 1956, an election to compute the depreciation allowance under any of the methods specified in section 167(b) or a change in such an election may be made in an amended return or claim for refund filed on or before September 15, 1956."

allowable only in such amount, together with salvage value, as will effectuate the recovery of cost over the period of useful life. Furthermore, the House Report said that, "The changes made by your committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property." [3] Senator Humphrey stated that under the declining balance method "[t]he total deduction over the life of the property will not be increased and only the same total sum will be given as a tax deduction * * *." Hearings before the Senate Committee on Finance, 83d Cong., 2d Sess., Pt. 1, 95. Both of these statements clearly support the regulation, since, if the taxpayer prevailed, it would be able to take a greater total amount of depreciation under the declining balance method than under the straight-line method, even if salvage value under the latter method were limited to scrap value.

Petitioner also seems to rely on administrative interpretation. He cites a footnote to what is known as Form 2106, issued by the Commissioner. This footnote No. 41 reads, "Salvage value is estimated resale or trade in value of the vehicle, determined at the time of purchase. If declining balance method of depreciation is used, disregard salvage value in computing depreciation." Petitioner says this is a direct instruction to "disregard salvage value" entirely since it is built into the equation. However, we are not inclined to give the footnote such weighty consideration. The form is but a worksheet and the footnote appears to refer to the fact that salvage value is disregarded at the outset of the application of the depreciation equation, as provided by the Code. We likewise place no weight in the remaining peripheral arguments of the petitioner that salvage must be ignored altogether in the application of the declining balance method.

The judgment is

Affirmed.

MR. JUSTICE DOUGLAS dissents.

MR. JUSTICE HARLAN, whom MR. JUSTICE WHITTAKER, and MR. JUSTICE STEWART join, concurring, in a separate opinion.

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26 CFR 1.167(e)-1: Change in method.

Adjustments to basis for pre-1913 depreciation required by taxpayer's change from the retirement method of computing depreciation to another method of computing depreciation. See Rev. Rul. 60-390, page 463.

SECTION 170.—CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS

26 CFR 1.170-1: Charitable, etc., contributions and gifts; allowance of deduction. Rev. Rul. 60-367

(Also Sections 2055, 2522; 20.2055-1, 25.2522(a)-1.)

Contributions made to a college for the purpose of acquiring or constructing a housing facility for use by a designated fraternity, under certain terms and conditions, constitute allowable deductions by the donors in computing their taxable income in the manner and to the extent provided in section 170 of the Internal Revenue Code of 1954. It is further held that the amount of all bequests, devises, legacies, and transfers to the college for such purposes will be deductible from the gross estates of decedents for Federal estate tax purposes; and the amount of all gifts to the college for such purposes will be deductible from the amount of gross gifts made by donors during a calendar year for Federal gift tax purposes.

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[3] H.R. Rep. No. 1337, 83d Cong., 2d Sess. 25.
Senator Millikin made a similar statement on the floor of the Senate, but preceded it with the observation that depreciation cannot exceed the cost of the asset. The way in which the Senator presented the matter suggests that he did not mean that total depreciation taken could not be greater under the declining balance method of depreciation than under the other accepted methods. However, no such qualification limits the impact of the statement in the House Report.

Advice has been requested whether gifts made to a university or college (hereinafter referred to as college) for the purpose of acquiring or constructing a housing facility for a designated fraternity, title to which will be in the college, are deductible for Federal income tax purposes under section 170 of the Internal Revenue Code of 1954 and are also deductible for estate and gift tax purposes under sections 2055 and 2522, respectively, of the Code.

X college has an enrollment of about 600 students. For many years housing for these students has been principally furnished either through college-owned dormitories or by fraternities. The college-owned dormitories accommodate approximately 115 students and the fraternities accommodate approximately 350 students. The remainder of the students either live at home or rent rooms in private homes in the college town.

Over the past several years increasing difficulty has been encountered by the fraternities in properly maintaining their houses and in establishing any program of new construction to replace inadequate and deteriorated facilities. Accordingly, in a number of instances the presently existing fraternity houses are in a physical condition which does not measure up to the standards desirable for the housing of college students. Recognizing the importance of fraternity houses to the overall student housing problem and to student recruitment and enrollment, the college trustees have adopted an official policy of improving and providing proper housing for all fraternity members as a part of the college's activity or function of seeing that all its students are properly housed.

A number of prospective donors have indicated an interest in making gifts to the college for the purpose of improving the housing conditions of the fraternity members. The proposed gifts will be used by the college for the construction of housing for fraternity members or, in the event that the college had acquired ownership of existing fraternity housing, for the reconstruction and remodeling of such houses. None of the funds will be expended on improvements owned by any one other than the college.

It is anticipated that various donors may desire to designate the use of part or all of their gifts for housing to be occupied by members of particular fraternities. It will be the policy of the college to allow such designation and to honor the designation so long as this is consistent with the policy, needs, and activities of the college, but it will accept gifts with such designation only with the understanding that the designation is not to restrict or limit the full ownership rights of the college in the property acquired by use of the gift, or the future uses which the college may determine to make of the property.

It is the expectation and declared policy of the college trustees that all fraternities will ultimately be treated alike by administrative control over the types of gifts accepted. Some fraternities, by reason of donor designation of gifts, may have their housing conditions improved sooner than others, but it is the policy of the college that ultimately all fraternities shall be on a comparable basis. It is the policy of the college that the amounts spent on a fraternity house, the size, the character and architecture of the accommodations will be controlled and determined by the college and will be consistent with the college's policy in respect of nonfraternity housing.

The contemplated housing will be owned by the college and will be rented to fraternity members either as fraternity groups or as individual students, but leases will be for short-term periods. The rentals in either case will be substantially equivalent to the rentals charged for comparable housing facilities in the college dormitories.

Section 170(a)(1) of the Code states that there shall be allowed as a deduction any charitable contribution (as defined in subsection (c)), payment of which is made within the taxable year. Charitable contributions as described in subsection (c) include contributions or gifts to or for the use of a corporation organized and operated exclusively for educational purposes. Sections 2055(a) and 2522 of the Code provide, respectively, deductions for Federal estate tax and gift tax purposes for bequests and gifts to or for the use of corporations organized and operated exclusively for educational purposes.

The *X* college is a corporation organized and operated exclusively for educational purposes. A gift to the college for the educational purposes of the college would be deductible under section 170(a) of the Code. On the other hand, a gift to a social fraternity for the purposes of the fraternity would not be a gift to a corporation organized and operated exclusively for educational purposes and would not be deductible. See G.C.M. 5952, C.B. VIII–1, 172 (1929), and Rev. Rul. 56–329, C.B. 1956–2, 125.

A college might properly adopt as incident to its educational activities a program to assist in the housing of all its students by providing dormitories, by providing an information or rental office to obtain accommodations for its students in private homes, by exercising control over housing for its students, by purchasing or constructing, owning and operating houses for fraternity students, or by a combination of such activities. The furnishing of housing for fraternity members would not cease to be a college activity because the college participated in or undertook plans to have the whole or a part of the cost of a fraternity house defrayed by gifts from alumni of a particular fraternity. In order, however, for the gift to be deductible as a gift to the college, it must in reality be a gift to the college and must not be a gift to the fraternity by using the college as a conduit.

The effect of designation by a donor as to the fraternity house for which his gift is to be used must not be such that his gift is for the benefit of the fraternity rather than for the benefit of the college. Therefore, the college must, as the result of the gift, have the attributes of ownership in respect of the donated property, and its rights as an owner must not, as a condition of the gift, be limited by conditions or restrictions which in effect make a private group the beneficiary of the donated property. The making and acceptance of a gift on conditions which confer substantial rights on a private group are inconsistent with a gift wholly to the college. The college should, as an owner, be free to use the property acquired with the gift as its future policy suggests or requires.

It is noted that it is the policy of the *X* college to permit donors to designate the fraternity for the housing of whose members they desire their gifts to be expended and to honor such designation insofar as possible, but that the college accepts such gifts only with the understanding that, although it may be the practice of the college to lease the house to the designated fraternity, the college will not be obli-

gated to such use of the house or to make such lease. It is noted that it is also the policy of the *X* college that the contemplated housing will be leased under short-term leases at rentals which are closely comparable to the rentals charged for comparable housing facilities in the college dormitories which in some cases may be less than commercial rentals. Such a policy is consistent with the concept that fraternity housing is merely an extension of the dormitory system and is consistent with rights of ownership in the college, just as the rental of dormitory rooms to students at less than commercial rentals is consistent with the college's ownership of the dormitory. However, an obligation or understanding that the property will be leased to a designated fraternity under a long-term lease may be inconsistent with full ownership rights in the college.

It is the policy of the *X* college that arrangements regarding construction, maintenance, and operation of the fraternity housing will be consistent with the pattern for other student housing, and the college will retain discretion and control with respect to the amount spent on a fraternity house and with respect to the size, character, and architecture of the accommodations.

To summarize:

(1) The *X* college has officially adopted a clearly defined policy of providing proper housing for all its students. A part of this official policy to which the college has committed itself is the improving and providing of appropriate housing for all fraternity members.

(2) In keeping with this policy, the college will accept gifts designated for improving or building a house for a designated fraternity and will honor such designation so long as this is consistent with the policy, needs, and activities of the college, but the terms of the gift and the acceptance make it clear that the designation does not restrict or limit the full ownership rights of the college in the property acquired by use of the gift or future uses which the college may determine to make of the property.

(3) The college retains and presumably will exercise discretion and control with respect to the amount spent on a fraternity house and with respect to its size, character, and architecture, which will be consistent with the standards and pattern of the college for other student housing and consistent with the expressed housing policy of the college. No part of the gift will be spent on improvements owned by any one other than the college.

(4) The policy of the college is that leases will be for short-term periods and rentals will be closely comparable to the rentals charged for comparable housing facilities in the college dormitories.

In view of the foregoing, it is held that contributions or gifts made to the *X* college, under the circumstances outlined above, for the purpose of acquiring or constructing fraternity houses which will be owned by the college, constitute allowable deductions by donors in computing their taxable income in the manner and to the extent provided in section 170 of the Code.

It is further held that the amount of all bequests, devises, legacies and transfers to the *X* college for the purpose and under the circumstances outlined will be deductible, under section 2055(a) of the Code, from the gross estates of decedents in computing the value of the

taxable estate for Federal estate tax purposes; and the amount of all gifts to the X college for these purposes and under the outlined circumstances will be deductible, under section 2522 of the Code, from the amount of gross gifts in computing taxable gifts made by donors during a calendar year for Federal gift tax purposes.

(Also Sections 2055, 2522; 20.2055–2, 25.2522 (a)–2.) Rev. Rul. 60–385

Where a trust instrument provides that the trust income shall be paid to a life tenant, that the corpus may be invested in stock of regulated investment companies, and that dividends received by the trustee which represent capital gains realized from the sale of securities owned by such companies shall be treated as corpus and held for the benefit of a charitable remainderman, then the charitable remainder interest is severable from the noncharitable interest, and its present worth may be ascertained. The present worth of such a charitable remainder is deductible for income, estate, and gift tax purposes in the manner and to the extent provided in sections 170, 2055, and 2522 of the Internal Revenue Code of 1954.

However, if the trust instrument provides that dividends representing capital gains realized as aforesaid shall (or, in the trustee's discretion, may) be treated as income and paid to the life tenant, or if the instrument could be so construed under applicable local law, then the charitable interest is not severable from the noncharitable interest since no known formula has been advanced for ascertaining the value of the charitable interest. Therefore, no deduction for income, estate, or gift tax purposes is allowable with respect to the transfer.

Revenue Ruling 55–620, C.B. 1955–2, 56, revoked.

Advice has been requested concerning the amount of allowable charitable deduction in a case where the charitable remainder interest in a trust may or may not be severable from the noncharitable interest, depending upon whether the capital gains received are added to the trust income or corpus.

A taxpayer transferred property to an irrevocable trust, with directions to pay the trust income to his son for life and on the son's death to deliver the trust corpus to a charitable organization which meets the requirements of section 170 (income tax), section 2055 (estate tax) and section 2522 (gift tax) of the Internal Revenue Code of 1954. The trust instrument provides that the corpus of the trust may be invested in stock of regulated investment companies and that dividends received by the trustee which represent capital gains realized from the sale of securities owned by such companies shall be treated as corpus and held for the benefit of the charitable remainderman.

I.T. 3707, C.B. 1945, 114, holds that where a taxpayer creates an irrevocable trust, reserving the income to himself for life with remainder to a charitable organization which meets the requirements of section 23(o) of the Internal Revenue Code of 1939 (corresponding to section 170 of the 1954 Code), the present value of the remainder interest is deductible in the manner and to the extent provided in such section.

Section 20.2055–2 of the Estate Tax Regulations and section 25.2522(a)–2 of the Gift Tax Regulations provide, in part, that where a trust is created or property transferred for both a charitable and a private purpose, a deduction may be taken only insofar as the charitable interest is presently ascertainable and hence severable from the noncharitable interest.

Accordingly, it is held that where, as under the present facts, the charitable remainder interest is severable from the noncharitable interest, its present worth may be ascertained by multiplying the fair market value of the transferred property by the appropriate actuarial remainder factor from Table I of section 25.2512–5 of the Gift Tax Regulations or Table I or II of section 20.2031–7 of the Estate Tax Regulations, whichever is applicable. The present worth so determined is deductible for income, estate or gift tax purposes in the manner and to the extent provided in sections 170, 2055, and 2522 of the Code.

However, if the trust instrument provides that dividends representing capital gains realized as aforesaid shall (or, in the trustee's discretion, may) be treated as income and paid to the life tenant, or if the instrument could be so construed under applicable local law, then the charitable interest is not severable from the non-charitable interest since no known formula has been advanced for ascertaining the value of the charitable interest. Therefore, no deduction for income, estate, or gift tax purposes is allowable with respect to the transfer.

In view of the position taken in Revenue Ruling 55–620 and pursuant to authority contained in section 7805(b) of the Internal Revenue Code of 1954, the latter conclusion above, relating to capital gains treated as income to the life tenant, will not be applied in the case of contributions and gifts made before January 1, 1961.

Revenue Ruling 55–620, C.B. 1955–2, 56, holds that the present worth of the remainder interest in an irrevocable trust passing to a charity, where the trust corpus is to be invested in stock of a regulated investment company and trust income is to be paid to the donor for life, is deductible by the donor in the manner and to the extent provided by section 170 of the Code, irrespective of whether the capital gain dividends received by the trustee are distributed as income to the donor or added to the corpus of the trust. Because Revenue Ruling 55–620 is contrary to the above-stated position, it is hereby revoked.

Transfer of limited partnership interest to charitable organization. See Rev. Rul. 60–352, page 208.

SECTION 172.—NET OPERATING LOSS DEDUCTION

26 CFR 1.172: Statutory provisions; net operating loss deduction. T. D. 6486 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER 1, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under section 172 of the Internal Revenue Code of 1954, relating to net operating loss deduction, amended.

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

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

On January 9, 1960, notice of proposed rulemaking with respect

[1] The publication of this Treasury Decision in 25 F.R. 7733, dated August 13, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 178, dated January 9, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

to the amendment of the Income Tax Regulations (26 CFR Part 1) under section 172 of the Internal Revenue Code of 1954 (relating to the net operating loss deduction) to reflect the changes made by sections 14 and 64(b) of the Technical Amendments Act of 1958 (72 Stat. 1611 and 1656) and section 203 of the Small Business Tax Revision Act of 1958 (72 Stat. 1678) [P.L. 85-866, C.B. 1958-3, 254] was published in the Federal Register (25 F.R. 178). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendment of the regulations is hereby adopted.

PARAGRAPH 1. Section 1.172 is revised to read as follows:

§ 1.172 STATUTORY PROVISIONS; NET OPERATING LOSS DEDUCTION.

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) DEDUCTION ALLOWED.—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) NET OPERATING LOSS CARRYBACKS AND CARRYOVERS.—

(1) YEARS TO WHICH LOSS MAY BE CARRIED.—A net operating loss for any taxable year ending after December 31, 1957, shall be—

(A) A net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss, and

(B) A net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(2) AMOUNT OF CARRYBACKS AND CARRYOVERS.—Except as provided in subsection (i), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the 8 taxable years to which (by reason of subparagraphs (A) and (B) of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other 7 taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—

(A) With the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) By determining the amount of the net operating loss deduction without regard to the net operating loss for the loss year or for any taxable year thereafter,

and the taxable income so computed shall not be considered to be less than zero.

(c) NET OPERATING LOSS DEFINED.—For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) MODIFICATIONS.—The modifications referred to in this section are as follows:

(1) NET OPERATING LOSS DEDUCTION.—No net operating loss deduction shall be allowed.

(2) CAPITAL GAINS AND LOSSES OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation—

(A) The amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets; and

(B) The deduction for long-term capital gains provided by section 1202 shall not be allowed.

(3) DEDUCTION FOR PERSONAL EXEMPTIONS.—No deduction shall be allowed under section 151 (relating to personal exemptions). No deducation in lieu of any such deduction shall be allowed.

(4) NONBUSINESS DEDUCTIONS OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

(A) Any gain or loss from the sale or other disposition of—

(i) Property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

(ii) Real property used in the trade or business, shall be treated as attributable to the trade or business;

(B) The modifications specified in paragraphs (1), (2)(B), and (3) shall be taken into account; and

(C) Any deduction allowable under section 165(c)(3) (relating to casualty losses) shall not be taken into account.

(5) SPECIAL DEDUCTIONS FOR CORPORATIONS.—No deduction shall be allowed under section 242 (relating to partially tax-exempt interest) or under section 922 (relating to Western Hemisphere trade corporations).

(6) COMPUTATION OF DEDUCTION FOR DIVIDENDS RECEIVED, ETC.—The deductions allowed by sections 243 (relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) (relating to limitation on aggregate amount of deductions); and the deduction allowed by section 247 (relating to dividends paid on certain preferred stock of public utilities) shall be computed without regard to subsection (a)(1)(B) of such section.

(e) LAW APPLICABLE TO COMPUTATIONS.—In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

(f) TAXABLE YEARS BEGINNING IN 1953 AND ENDING IN 1954.—In the case of a taxable year beginning in 1953 and ending in 1954—

(1) In lieu of the amount specified in subsection (c), the net operating loss for such year shall be the sum of—

(A) That portion of the net operating loss for such year computed without regard to this subsection which the number of days in the loss year after December 31, 1953, bears to the total number of days in such year, and

(B) That portion of the net operating loss for such year computed under section 122 of the Internal Revenue Code of 1939 as if this section had not been enacted which the number of days in the lost year before January 1, 1954, bears to the total number of days in such year.

(2) The amount of any net operating loss for such year which shall be carried to the second preceding taxable year is the amount which bears the same ratio to such net operating loss as the number of days in the loss year after December 31, 1953, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the reduction for the second taxable year preceding the loss year shall not exceed the portion of the net operating loss which is carried to the second preceding taxable year.

(3) The net operating loss deduction for such year shall be, in lieu of the amount specified in section 122(c) of the Internal Revenue Code of 1939, the sum of—

(A) That portion of the net operating loss deduction for such year, computed as if subsection (a) of this section were applicable to the taxable year, which the number of days in such year after December 31, 1953, bears to the total number of days in such year, and

(B) That portion of the net operating loss deduction for such year, computed under section 122(c) of the Internal Revenue Code of 1939 as if this paragraph had not been enacted, which the number of days in such year before January 1, 1954, bears to the total number of days in such year.

(4) For purposes of the second sentence of subsection (b)(2), the taxable income for such year shall be the sum of—

(A) That portion of the net income for such year, computed without regard to this paragraph, which the number of days in such year before January 1, 1954, bears to the total number of days in such year, and

(B) That portion of the net income for such year, computed—

(i) Without regard to paragraphs (1) and (2) of section 122(d) of the Internal Revenue Code of 1939, and

(ii) By allowing as a deduction an amount equal to the sum of the credits provided in subsections (b) and (h) of section 26 of such Code.

which the number of days in such year after December 31, 1953, bears to the total number of days in such year.

(g) SPECIAL TRANSITIONAL RULES.—

(1) LOSSES FOR TAXABLE YEARS ENDING BEFORE JANUARY 1, 1954.—For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried, shall be made under the Internal Revenue Code of 1939.

(2) LOSSES FOR TAXABLE YEARS ENDING AFTER DECEMBER 31, 1953.—For purposes of section 122 of the Internal Revenue Code of 1939—

(A) The determination of the taxable years ending before January 1, 1954, to which a net operating loss for any taxable year ending after December 31, 1953, may be carried shall be made under subsection (b)(1)(A) of this section; and

(B) In determining the amount of the carryback to the first taxable year preceding the first taxable year ending after December 31, 1953, the portion of the net operating loss carried to such year shall be such net operating loss reduced by—

(i) The net income for the second preceding taxable year computed as if the second sentence of section 122(b)(2)(B) of the Internal Revenue Code of 1939 applied, or

(ii) If smaller, the portion of the net operating loss which by reason of subsection (f) of this section is carried to the second preceding taxable year.

(3) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953, AND ENDING BEFORE AUGUST 17, 1954.—In the case of a taxable year which begins after December 31, 1953, and ends before August 17, 1954—

(A) The net operating loss deduction for such year shall be computed as if subsection (a) of this section applied to such taxable year, and

(B) For purposes of the second sentence of subsection (b)(2), the taxable income for such taxable year shall be the net income for such taxable year, computed—

(i) Without regard to paragraphs (1) and (2) of section 122(d) of the Internal Revenue Code of 1939, and

(ii) By allowing as a deduction an amount equal to the sum of the credits provided in subsections (b) and (h) of section 26 of such Code.

(4) EXCESS PROFITS TAX NOT AFFECTED.—For purposes of subchapter D of chapter 1 of the Internal Revenue Code of 1939, excess profits net income shall be computed as if this section had not been enacted and as if section 122 of such Code continued to apply to taxable years to which this subtitle applies.

(h) DISALLOWANCE OF NET OPERATING LOSS OF ELECTING SMALL BUSINESS CORPORATIONS.—In determining the amount of the net operating loss deduction under subsection (a) of any corporation, there shall be disregarded the net operating loss of such corporation for any taxable year for which such corporation is an electing small business corporation under subchapter S.

(i) CARRYBACK OF NET OPERATING LOSS FOR TAXABLE YEARS BEGINNING IN 1957 AND ENDING IN 1958.—In the case of a taxable year beginning in 1957 and ending in 1958, the amount of any net operating loss for such year which shall be carried to the third preceding taxable year is the amount which bears the same ratio to such net operating loss as the number of days in the loss year after December 31, 1957, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the reduction for the third taxable year preceding the loss year shall not exceed the portion of the net operating loss which is carried to the third preceding taxable year.

(j) CROSS REFERENCES.—

(1) For treatment of net operating loss carryovers in certain corporate acquisitions, see section 381.

(2) For special limitation on net operating loss carryovers in case of a corporate change of ownership, see section 382.

[Sec. 172 as amended by secs. 14 and 64(b), Technical Amendments Act 1958 (72 Stat. 1611, 1656); sec. 203, Small Business Tax Revision Act 1958 (72 Stat. 1678)]

PAR. 2. Section 1.172–1 is amended as follows:

(A) By striking out paragraph (e) (2) thereof and inserting in lieu thereof the following:

(2) *Special transitional rules.*—See section 172(a) for special transitional rules with respect to (i) net operating losses sustained in taxable years ending before January 1, 1954, (ii) net operating losses sustained in taxable years ending after December 31, 1953, and (iii) the net operating loss deduction for taxable years beginning after December 31, 1953, and ending before August 17, 1954.

(B) By revising paragraph (f) thereof to read as follows:

(f) *Taxable years subject to 1939 Code.*—(1) *In general.*—For the computation of the net operating loss deduction for any taxable year (other than the taxable years described in subparagraphs (2) and (3) of this paragraph) which is subject to the 1939 Code, see § 39.122–5 of Regulations 118 (26 CFR (1939) 39.122–5) or the corresponding section of prior applicable regulations.

(2) *Taxable years beginning in 1953 and ending in 1954.*—The net operating loss deduction for a taxable year beginning in 1953 and ending in 1954, shall be, in lieu of the amount specified in section 122(c) of the 1939 Code and in § 39.122–5 of Regulations 118 (26 CFR (1939) 39.122–5), the sum of—

(i) That portion of the net operating loss deduction for such taxable year, computed in accordance with paragraph (b) of this section as though section 172(a) of the 1954 Code applied to such taxable year, which the number of days in such taxable year after December 31, 1953, bears to the total number of days in such taxable year, and

(ii) That portion of the net operating loss deduction for such taxable year, computed in accordance with section 122(c) of the 1939 Code and as though section 172(f)(3) of the 1954 Code had not been enacted, which the number of days in such taxable year before January 1, 1954, bears to the total number of days in such taxable year.

(3) *Taxable years beginning after December 31, 1953, and ending before August 17, 1954.*—In the case of a taxable year which begins after December 31, 1953, and ends before August 17, 1954, the net operating loss deduction shall be computed in accordance with paragraph (b) of this section as though section 172(a) of the 1954 Code applied to such taxable year.

(4) *Statute of limitations, etc.; interest.*—If a refund or credit of any overpayment resulting from the application of subparagraph (2) or (3) of this paragraph is prevented on September 2, 1958, or within six months after such date, by the operation of any law or rule of law other than section 3760 of the 1939 Code or section 7121 of the 1954 Code, relating to closing agreements, and other than section 3761 of the 1939 Code or section 7122 of the 1954 Code, relating to compromises, refund or credit of such overpayment may, neverthe-

less, be made or allowed if claim therefor is filed on or before March 2, 1959. No interest shall be paid or allowed on any overpayment resulting from the application of subparagraph (2) or (3) of this paragraph. See section 14(c) of the Technical Amendments Act of 1958 (72 Stat. 1611).

(C) By adding the following new paragraphs at the end thereof:

(g) *Electing small business corporations.*—In determining the amount of the net operating loss deduction of any corporation, there shall be disregarded the net operating loss of such corporation for any taxable year for which such corporation was an electing small business corporation under subchapter S (section 1371 and following), chapter 1 of the Code. In applying section 172(b)(1) and (2) to a net operating loss sustained in a taxable year in which the corporation was not an electing small business corporation, a taxable year in which the corporation was an electing small business corporation is counted as a taxable year to which such net operating loss is carried back or over. However, the taxable income for such year as determined under section 172(b)(2) is treated as if it were zero for purposes of computing the balance of the loss available to the corporation as a carryback or carryover to other taxable years in which the corporation is not an electing small business corporation. See section 1374 and the regulations thereunder for allowance of a deduction to shareholders for a net operating loss sustained by an electing small business corporation.

(h) *Husband and wife.*—The net operating loss deduction of a husband and wife shall be determined in accordance with this section, but subject also to the provisions of § 1.172–7.

PAR. 3. Section 1.172–2 is amended as follows:

(A) By striking "243" in subparagraph (2)(i) of paragraph (a) thereof and inserting in lieu thereof "243(a)".

(B) By striking "243" in the second sentence of the example in paragraph (b) thereof and inserting in lieu thereof "243(a)".

PAR. 4. Section 1.172–4 is amended as follows:

(A) By revising paragraph (a)(1) and adding paragraph (a)(8) which read as follows:

(a) *General provisions.*—(1) *Years to which loss may be carried.*—(i) *In general.*—In order to compute the net operating loss deduction the taxpayer must first determine the part of any net operating losses for any preceding or succeeding taxable years which are carryovers or carrybacks to the taxable year in issue.

(ii) *Loss for taxable years ending after December 31, 1957.*—A net operating loss sustained in a taxable year ending after December 31, 1957, shall be carried back to the three preceding taxable years and carried over to the five succeeding taxable years.

(iii) *Loss for taxable years ending after December 31, 1953, and before January 1, 1958.*—A net operating loss sustained in a taxable year ending after December 31, 1953, and before January 1, 1958, shall be carried back to the two preceding taxable years and carried over to the five succeeding taxable years; this rule shall apply even though the loss year is otherwise subject to the 1939 Code.

(iv) *Loss for taxable years beginning after December 31, 1949, and ending before January 1, 1954.*—A net operating loss sustained in a taxable year beginning after December 31, 1949, and ending before January 1, 1954, shall be carried back to the first preceding taxable year and carried over to the five succeeding taxable years.

* * * * * * *

(8) *Electing small business corporations.*—For special rule applicable to corporations which were electing small business corporations under subchapter S (section 1371 and following), chapter 1 of the Code, during one or more of the taxable years described in section 172(b)(1), see paragraph (g) of § 1.172–1.

(B) By adding the following new subparagraph (2–a) after paragraph (b)(2) thereof:

(2–a) *Taxable years beginning in 1957 and ending in 1958.*—(i) Notwithstanding subparagraph (1) of this paragraph, in the case of a net operating loss

sustained in a taxable year which begins in 1957 and ends in 1958, the amount of such loss which shall be carried back to the third preceding taxable year is the amount which bears the same ratio to such net operating loss (as determined under section 172(c)) as the number of days in the loss year after December 31, 1957, bears to the total number of days in such year.

(ii) To determine the portion of the net operating loss for such a taxable year ending in 1958 which shall be carried to any taxable year subsequent to such third preceding taxable year there shall be substituted, in the application of subparagraph (1)(ii) of this paragraph, for the taxable income of such third preceding taxable year an amount equal to the portion of the net operating loss which is carried back to such third preceding taxable year in accordance with this subparagraph, if such amount is smaller than the taxable income of such third preceding taxable year as computed under paragraph (a) of § 1.172–5.

(C) By striking example (2) in paragraph (b)(4) thereof and inserting in lieu thereof the following new example:

Example (2). (i) A taxpayer who makes his tax return on the basis of a fiscal year ending June 30 has a net operating loss (computed as provided in section 172(c)) for the taxable year which begins July 1, 1957, and ends June 30, 1958. The amount of the carryback from such taxable year to the taxable year ending June 30, 1955, the third preceding taxable year, is 181/365ths of the net operating loss. If such amount is not less than the taxable income (computed as provided in § 1.172–5) for the taxable year ending June 30, 1955, the amount of the carryback to the taxable year ending June 30, 1956, is the excess of the net operating loss over the taxable income so computed for the taxable year ending June 30, 1955; and the amount of the carryback to the taxable year ending June 30, 1957, is the excess of the net operating loss over the aggregate of the taxable incomes so computed for the taxable years ending June 30, 1955, and 1956. The amount of the carryovers to the taxable years ending June 30, 1959, 1960, 1961, 1962, and 1963 is the excess of the net operating loss over the aggregate of the taxable incomes (computed as provided in § 1.172–5) for the taxable years ending June 30, 1955, 1956, and 1957; 1955, 1956, 1957, and 1959; 1955, 1956, 1957, 1959, and 1960; 1955, 1956, 1957, 1959, 1960, and 1961; and 1955, 1956, 1957, 1959, 1960, 1961, and 1962, respectively.

(ii) If, however, the taxable income (computed as provided in § 1.172–5) for the taxable year ending June 30, 1955, exceeds the amount of the carryback to such taxable year (181/365ths of the net operating loss for the loss year), then the amount of the carryback to the taxable year ending June 30, 1956, is the excess of the net operating loss over the amount of the carryback to the taxable year ending June 30, 1955. The amount of the carryback to the taxable year ending June 30, 1957, is the excess of the net operating loss over the sum of the amount of the carryback to the taxable year ending June 30, 1955, and the taxable income (computed as provided in § 1.172–5) for the taxable year ending June 30, 1956. The amount of the carryovers to the taxable years ending June 30, 1959, 1960, 1961, 1962, and 1963 is the excess of the net operating loss over the sum of the amount of the carryback to the taxable year ending June 30, 1955, and the aggregate of the taxable incomes (computed as provided in § 1.172–5) for the taxable years ending June 30, 1956, and 1957; 1956, 1957, and 1959; 1956, 1957, 1959, and 1960; 1956, 1957, 1959, 1960, and 1961; and 1956, 1957, 1959, 1960, 1961, and 1962, respectively.

PAR. 5. Section 1.172–5 is amended by adding paragraph (a)(4) and revising paragraph (b) which read as follows:

(4) *Electing small business corporations.*—For special rule applicable to corporations which were electing small business corporations under subchapter S (section 1371 and following), chapter 1 of the Code, during one or more of the taxable years described in section 172(b)(1), see paragraph (g) of § 1.172—1.

(b) *Taxable year subject to 1939 Code.*—(1) *In general.*—For the computation of the net income for any taxable year (other than the taxable years described in subparagraphs (2) and (3) of this paragraph) subject to the 1939 Code which is subtracted from the net operating loss for any other taxable year to determine the portion of such loss which is a carryback or a carryover to a particular taxable year, see § 39.122–4(c) of Regulations 118 (26 CFR (1939) 39.122–4(c)) or the corresponding section of prior applicable regulations.

(2) *Taxable years beginning in 1953 and ending in 1954.*—The net income for any taxable year beginning in 1953 and ending in 1954 which is subtracted

from the net operating loss for any other taxable year to determine the portion of such net operating loss which is a carryback or a carryover to a particular taxable year shall be the sum of—

(i) That portion of the net income for such taxable year, computed as provided in clauses (i) and (ii) of the first sentence of section 122(b)(2)(B) of the 1939 Code, which the number of days in such taxable year before January 1, 1954, bears to the total number of days in such taxable year, and

(ii) That portion of the net income for such taxable year, computed—

(*a*) As provided in clauses (i) and (ii) of the first sentence of section 122(b)(2)(B) of the 1939 Code but without regard to the modifications provided in section 122(d) (1) and (2) of such Code, and

(*b*) By allowing as a deduction an amount equal to the sum of the credits allowable for such taxable year under section 26(b) (relating to credit for dividends received) and section 26(h) (relating to credit for dividends paid on certain preferred stock) of the 1939 Code in determining normal-tax net income,

which the number of days in such taxable year after December 31, 1953, bears to the total number of days in such taxable year.

(3) *Taxable years beginning after December 31, 1953, and ending before August 17, 1954.*—The net income for any taxable year beginning after December 31, 1953, and ending before August 17, 1954, which is subtracted from the net operating loss for ony other taxable year to determine the portion of such net operating loss which is a carryback or a carryover to a particular taxable year shall be the net income for such taxable year, computed—

(i) As provided in clauses (i) and (ii) of the first sentence of section 122(b)(2)(B) of the 1939 Code but without regard to the modifications provided in section 122(d) (1) and (2) of such Code, and

(ii) By allowing as a deduction an amount equal to the sum of the credits allowable for such taxable year under section 26(b) (relating to the credit for dividends received) and section 26(h) (relating to the credit for dividends paid on certain perferred stock) of the 1939 Code in determining normal-tax net income.

(4) *Statute of limitations, etc.; interest.*—If a refund or credit of any overpayment resulting from the application of subparagraph (2) or (3) of this paragraph is prevented on September 2, 1958, or within six months after such date, by the operation of any law or rule of law other than section 3760 of the 1939 Code or section 7121 of the 1954 Code, relating to closing agreements, and other than section 3761 of the 1939 Code or section 7122 of the 1954 Code, relating to compromises, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed on or before March 2, 1959. No interest shall be paid or allowed on any overpayment resulting from the application of subparagraph (2) or (3) of this paragraph. See section 14 (c) of the Technical Amendments Act of 1958 (72 Stat. 1611).

PAR. 6. Section 1.172–6 is revised to read as follows:

§ 1.172–6 ILLUSTRATION OF NET OPERATING LOSS CARRYBACKS AND CARRYOVERS.—The application of § 1.172–4 may be illustrated by the following example:

(a) *Facts.*—The books of the taxpayer, whose return is made on the basis of the calendar year, reveal the following facts:

Taxable year	*Taxable income*	*Net operating loss*
1954	$15,000	----------
1955	30,000	----------
1956	------	($75,000)
1957	20,000	----------
1958	------	(150,000)
1959	30,000	----------
1960	35,000	----------
1961	75,000	----------
1962	17,000	----------
1963	53,000	----------

The taxable income thus shown is computed without any net operating loss deduction. The assumption is also made that none of the other modifications prescribed in § 1.172–5 apply. There are no net operating losses for 1950, 1951, 1952, 1953, 1964, 1965, or 1966.

(b) *Loss sustained in 1956.*—The portions of the $75,000 net operating loss for 1956 which shall be used as carrybacks to 1954 and 1955 and as carryovers to 1957, 1958, 1959, 1960, and 1961 are computed as follows:

(1) *Carryback to 1954.*—The carryback to this year is $75,000, that is, the amount of the net operating loss.

(2) *Carryback to 1955.*—The carryback to this year is $60,000, computed as follows:

Net operating loss		$75,000
Less:		
Taxable income for 1954 (computed without the deduction of the carryback from 1956)		15,000
Carryback		60,000

(3) *Carryover to 1957.*—The carryover to this year is $30,000, computed as follows:

Net operating loss		$75,000
Less:		
Taxable income for 1954 (computed without the deduction deduction of the carryback from 1956)	$15,000	
Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958)	30,000	
		45,000
Carryover		30,000

(4) *Carryover to 1958.*—The carryover to this year is $10,000, computed as follows:

Net operating loss		$75,000
Less:		
Taxable income for 1954 (computed without the deduction deduction of the carryback from 1956)	$15,000	
Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958)	30,000	
Taxable income for 1957 (computed without the deduction of the carryover from 1956 or the carryback from 1958)	20,000	
		65,000
Carryover		10,000

(5) *Carryover to 1959.*—The carryover to this year is $10,000, computed as follows:

Net operating loss		$75,000
Less:		
Taxable income for 1954 (computed without the deduction of the carryback from 1956)	$15,000	
Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958)	30,000	
Taxable income for 1957 (computed without the deduction of the carryover from 1956 or the carryback from 1958)	20,000	
Taxable income for 1958 (a year in which a net operating loss was sustained)	0	
		65,000
Carryover		10,000

(6) *Carryover to 1960.*—The carryover to this year is $0, computed as follows:

Net operating loss		$75,000
Less:		
Taxable income for 1954 (computed without the deduction of the carryback from 1956)	$15,000	
Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958)	30,000	

Taxable income for 1957 (computed without the deduction of the carryover from 1956 or the carryback from 1958)	$20,000	
Taxable income for 1958 (a year in which a net operating loss was sustained)	0	
Taxable income for 1959 (computed without the deduction of the carryover from 1956 or the carryover from 1958)	30,000	
		$95,000
Carryover		0

(7) *Carryover to 1961.*—The carryover to this year is $0, computed as follows:

Net operating loss		$75,000
Less:		
Taxable income for 1954 (computed without the deduction of the carryback from 1956)	$15,000	
Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958)	30,000	
Taxable income for 1957 (computed without the deduction of the carryover from 1956 or the carryback from 1958)	20,000	
Taxable income for 1958 (a year in which a net operating loss was sustained)	0	
Taxable income for 1959 (computed without the deduction of the carryover from 1956 or the carryover from 1958)	30,000	
Taxable income for 1960 (computed without the deduction of the carryover from 1956 or the carryover from 1958)	35,000	
		130,000
Carryover		0

(c) *Loss sustained in 1958.*—The portions of the $150,000 net operating loss for 1958 which shall be used as carrybacks to 1955, 1956, and 1957 and as carryovers to 1959, 1960, 1961, 1962, and 1963 are computed as follows:

(1) *Carryback to 1955.*—The carryback to this year is $150,000, that is, the amount of the net operating loss.

(2) *Carryback to 1956.*—The carryback to this year is $150,000, computed as follows:

Net operating loss		$150,000
Less:		
Taxable income for 1955 (the $30,000 taxable income for such year reduced by the carryback to such year of $60,000 from 1956, the carryback from 1958 to 1955 not being taken into account)		0
Carryback		150,000

(3) *Carryback to 1957.*—The carryback to this year is $150,000, computed as follows:

Net operating loss		$150,000
Less:		
Taxable income for 1955 (the $30,000 taxable income for such year reduced by the carryback to such year of $60,000 from 1956, the carryback from 1958 to 1955 not being taken into account)	$0	
Taxable income for 1956 (a year in which a net operating loss was sustained)	0	
		0
Carryback		150,000

(4) *Carryover to 1959.*—The carryover to this year is $150,000, computed as follows:

Net operating loss		$150,000
Less:		
Taxable income for 1955 (the $30,000 taxable income for such year reduced by the carryback to such year of $60,000 from 1956, the carryback from 1958 to 1955 not being taken into account)	$0	
Taxable income for 1956 (a year in which a net operating loss was sustained)	0	
Taxable income for 1957 (the $20,000 taxable income for such year reduced by the carryover to such year of $30,000 from 1956, the carryback from 1958 to 1957 not being taken into account)	0	
		0
Carryover		150,000

(5) *Carryover to 1960.*—The carryover to this year is $130,000, computed as follows:

Net operating loss		$150,000
Less:		
Taxable income for 1955 (the $30,000 taxable income for such year reduced by the carryback to such year of $60,000 from 1956, the carryback from 1958 to 1955 not being taken into account)	$0	
Taxable income for 1956 (a year in which a net operating loss was sustained	0	
Taxable income for 1957 (the $20,000 taxable income for such year reduced by the carryover to such year of $30,000 from 1956, the carryback from 1958 to 1957 not being taken into account)	0	
Taxable income for 1959 (the $30,000 taxable income for such year reduced by the carryover to such year of $10,000 from 1956, the carryover from 1958 to to 1959 not being taken into account)	20,000	
		20,000
Carryover		130,000

(6) *Carryover to 1961*—The carryover to this year is $95,000, computed as follows:

Net operating loss		$150,000
Less:		
Taxable income for 1955 (the $30,000 taxable income for such year reduced by the carryback to such year of $60,000 from 1956, the carryback from 1958 to 1955 not being taken into account)	$0	
Taxable income for 1956 (a year in which a net operating loss was sustained	0	
Taxable income for 1957 (the $20,000 taxable income for such year reduced by the carryover to such year of $30,000 from 1956, the carryback from 1958 to 1957 not being taken into account)	0	
Taxable income for 1959 (the $30,000 taxable income for such year reduced by the carryover to such year of $10,000 from 1956, the carryover from 1958 to 1959 not being taken into account)	20,000	
Taxable income for 1960 (the $35,000 taxable income for such year reduced by the carryover to such year of $0 from 1956, the carryover from 1958 to 1960 not being taken into account)	35,000	
		55,000
Carryover		95,000

(7) *Carryover to 1962*—The carryover to this year is $20,000, computed as follows:

Net operating loss		$150,000
Less:		
Taxable income for 1955 (the $30,000 taxable income for such year reduced by the carryback to such year of $60,000 from 1956, the carryback from 1958 to 1955 not being taken into account)	$0	
Taxable income for 1956 (a year in which a net operating loss was sustained)	0	
Taxable income for 1957 (the $20,000 taxable income for such year reduced by the carryover to such year of $30,000 from 1956, the carryback from 1958 to 1957 not taken into account)	0	
Taxable income for 1958 (the $30,000 taxable income for such year reduced by the carryover to such year of $10,000 from 1956, the carryover from 1958 to 1959 not being taken into account)	20,000	
Taxable income for 1960 (the $35,000 taxable income for such year reduced by the carryover to such year of $0 from 1956, the carryover from 1958 to 1960 not being taken into account)	35,000	
Taxable income for 1961 (the $75,000 taxable income for such year reduced by the carryover to such year of $0 from 1956, the carryover from 1958 to 1961 not being taken into account)	75,000	
		130,000
Carryover		20,000

(8) *Carryover to 1963.*—The carryover to this year is $3,000, computed as follows:

Net operating loss		$150,000
Less:		
Taxable income for 1955 (the $30,000 taxable income for such year reduced by the carryback to such year of $60,000 from 1956, the carryback from 1958 to 1955 not being taken into account)	$0	
Taxable income for 1956 (a year in which a net operating loss was sustained)	0	
Taxable income for 1957 (the $20,000 taxable income for such year reduced by the carryover to such year of $30,000 from 1956, the carryback from 1958 to 1957 not being taken into account)	0	
Taxable income for 1959 (the $30,000 taxable income for such year reduced by the carryover to such year of $10,000 from 1956, the carryover from 1958 to 1959 not being taken into account)	20,000	
Taxable income for 1960 (the $35,000 taxable income for such year reduced by the carryover to such year of $0 from 1956, the carryover from 1958 to 1960 not being taken into account)	35,000	
Taxable income for 1961 (the $75,000 taxable income for such year reduced by the carryover to such year of $0 from 1956, the carryover from 1958 to 1961 not being taken into account)	75,000	
Taxable income for 1962 (computed without the deduction of the carryover from 1958)	17,000	
		147,000
Carryover		3,000

(d) *Determination of net operating loss deduction for each year.*—The carryovers and carrybacks computed under paragraphs (b) and (c) of this section

are used as a basis for the computation of the net operating loss deduction in the following manner:

Taxable year	Carryover		Carryback		Net operating loss deduction
	From 1956	From 1958	From 1956	From 1958	
1954			$75,000		$75,000
1955			60,000	$150,000	210,000
1957	$30,000			150,000	180,000
1959	10,000	$150,000			160,000
1960	0	130,000			130,000
1961	0	95,000			95,000
1962		20,000			20,000
1963		3,000			3,000

PAR. 7. Section 1.172–7 is amended as follows:

(A) By striking the last sentence of paragraph (f) thereof and inserting in lieu thereof the following new sentence:

If the husband and wife also file joint returns for the calendar years 1957, 1958, and 1959, having joint taxable income in 1957 and 1958 and a joint net operating loss in 1959, the joint net operating loss carrybacks to 1956, 1957, and 1958 from 1959 are computed on the basis of the joint net operating loss for 1959, since separate returns were not made for any taxable year involved in the computation of such carrybacks.

(B) By striking "it is assumed that reference to the modifications prescribed in § 1.172–5 is unnecessary", in the first sentence of paragraph (g) thereof, and inserting in lieu thereof "it is assumed that there are no items of adjustment under section 172(b)(2)(A)".

(C) By striking "but has a net operating loss of $200 for the fiscal year February 1, 1957, to January 31, 1958", in subdivision (i) of example (4) of paragraph (g) thereof, and inserting in lieu thereof "or for the fiscal year February 1, 1957, to January 31, 1958, but has a net operating loss of $200 for the fiscal year February 1, 1958, to January 31, 1959".

(D) By striking subdivision (iv) of example (4) of paragraph (g) thereof and inserting in lieu thereof the following new subdivision:

(iv) The net operating loss carryover of W from the fiscal year beginning February 1, 1958, to her next fiscal year is $200, that is, her net operating loss of $200 for the fiscal year beginning February 1, 1958, reduced by the sum of her $0 taxable income for 1956, her $0 taxable income for the taxable year January 1, 1957, to January 31, 1957 (a year in which she had neither income nor loss), and her $0 taxable income for the fiscal year February 1, 1957, to January 31, 1958 (also a year in which she had neither income nor loss). The $0 taxable income for 1956 is computed as follows:

(E) By striking "February 1, 1957" in subdivision (v) of example (4) of paragraph (g) thereof and inserting in lieu thereof "February 1, 1958".

DANA LATHAM,
Commissioner of Internal Revenue.

Approved August 9, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 12, 1960, 8:48 a.m. and published in the issue of the Federal Register for August 13, 1960, 25 F.R. 7733)

SECTION 179.—ADDITIONAL FIRST-YEAR DEPRECIATION ALLOWANCE FOR SMALL BUSINESS

26 CFR 1.179: Statutory provisions; additional first-year depreciation allowance T.D. 6507 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations prescribed under section 179 of the Internal Revenue Code of 1954.

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

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

On September 3, 1960, a notice of proposed rulemaking regarding the regulations under section 179 of the Internal Revenue Code of 1954, relating to additional first-year depreciation allowance, effective for taxable years ending after June 30, 1958, and certain amendments to the Income Tax Regulations (26 CFR Part 1) to conform to the rules relating to additional first-year depreciation allowance was published in the Federal Register (25 F.R. 8554). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. Such regulations supersede § 18.1–3 of Treasury Decision 6335 (26 CFR Part 18), approved November 13, 1958 (23 F.R. 8981) [C.B. 1958–2, 1112].

PARAGRAPH 1. The following regulations are hereby prescribed under section 179 of the Internal Revenue Code of 1954:

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§ 1.179 STATUTORY PROVISIONS; ADDITIONAL FIRST-YEAR DEPRECIATION ALLOWANCE.

SEC. 179. ADDITIONAL FIRST-YEAR DEPRECIATION ALLOWANCE FOR SMALL BUSINESS.

(a) GENERAL RULE.—In the case of section 179 property, the term "reasonable allowance" as used in section 167(a) may, at the election of the taxpayer, include an allowance, for the first taxable year for which a deduction is allowable under section 167 to the taxpayer with respect to such property, of 20 percent of the cost of such property.

(b) DOLLAR LIMITATION.—If in any one taxable year the cost of section 179 property with respect to which the taxpayer may elect an allowance under subsection (a) for such taxable year exceeds $10,000, then subsection (a) shall apply with respect to those items selected by the taxpayer, but only to the extent of an aggregate cost of $10,000.

[1] The publication of this Treasury Decision in 25 F.R. 12340, dated December 2, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 8554, dated September 3, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

In the case of a husband and wife who file a joint return under section 6013 for the taxable year, the limitation under the preceding sentence shall be $20,000 in lieu of $10,000.

(c) ELECTION.—

(1) IN GENERAL.—The election under this section for any taxable year shall be made within the time prescribed by law (including extensions thereof) for filing the return for such taxable year. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe.

(2) ELECTION IRREVOCABLE.—Any election made under this section may not be revoked except with the consent of the Secretary or his delegate.

(d) DEFINITIONS AND SPECIAL RULES.—

(1) SECTION 179 PROPERTY.—For purposes of this section, the term "section 179 property" means tangible personal property—

(A) Of a character subject to the allowance for depreciation under section 167,

(B) Acquired by purchase after December 31, 1957, for use in a trade or business or for holding for production of income, and

(C) With a useful life (determined at the time of such acquisition) of 6 years or more.

(2) PURCHASE DEFINED.—For purposes of paragraph (1), the term "purchase" means any acquisition of property, but only if—

(A) The property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267 (b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants),

(B) The property is not acquired by one member of an affiliated group from another member of the same affiliated group, and

(C) The basis of the property in the hands of the person acquiring it is not determined—

(i) In whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(ii) Under section 1014(a) (relating to property acquired from a decendent).

(3) COST.—For purposes of this section, the cost of property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the person acquiring such property.

(4) SECTION NOT TO APPLY TO TRUSTS.—This section shall not apply to trusts.

(5) ESTATES.—In the case of an estate, any amount apportioned to an heir, legatee, or devisee under section 167(g) shall not be taken into account in applying subsection (b) of this section to section 179 property of such heir, legatee, or devisee not held by such estate.

(6) DOLLAR LIMITATION OF AFFILIATED GROUP.—For purposes of subsection (b) of this section—

(A) All members of an affiliated group shall be treated as one taxpayer, and

(B) The Secretary or his delegate shall apportion the dollar limitation contained in such subsection (b) among the members of such affiliated group in such manner as he shall by regulations prescribe.

(7) AFFILIATED GROUP DEFINED.—For purposes of paragraphs (2) and (6), the term "affiliated group" has the meaning assigned to it by section 1504, except that, for such purposes, the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1504(a).

(8) ADJUSTMENT TO BASIS; WHEN MADE.—In applying section 167(f), the adjustment under section 1016(a)(2) resulting by rea-

son of an election made under this section with respect to any section 179 property shall be made before any other deduction allowed by section 167(a) is computed.

(e) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section.

[Sec. 179 as added by sec. 204, Small Business Tax Revision Act of 1958 (72 Stat. 1679) [P.L. 85-866, C.B. 1958-3, 324]]

§ 1.179-1 ADDITIONAL FIRST-YEAR DEPRECIATION ALLOWANCE.—(a) *In general.*—For taxable years ending after June 30, 1958, in the case of "section 179 property" acquired by purchase after December 31, 1957, a taxpayer (other than a trust) may elect for the first taxable year for which a deduction with respect to such property is allowable under section 167 to the taxpayer to include as part of the "reasonable allowance" allowable under section 167(a) an additional allowance of 20 percent of the cost or of a portion of the cost of such property. A trust is not eligible for the additional depreciation allowance under section 179. The allowance under section 179 is in addition to the depreciation allowable under section 167 computed on the balance of the unrecovered cost of the property after adjustment for the allowance under this section. For application of the dollar limitations of section 179(b), see § 1.179-2. For a definition of the term "section 179 property" and for special rules, see § 1.179-3. For the time and manner of making the election under this section, see § 1.179-4.

(b) *Proration not required.*—The allowance under section 179 is determined without any proration based on the period of time the section 179 property has been in service during the taxable year. For example, taxpayer *A*, who makes his income tax returns on the calendar year basis, purchased and placed in service on August 7, 1958, section 179 property costing $8,000. *A* elects to claim the additional first-year depreciation on the total cost of $8,000. *A* is entitled to a deduction of $1,600 (20 percent of $8,000) under this section for 1958, without proration for the number of days in 1958 during which the property was in service.

(c) *Amount subject to allowance.*—The allowance under section 179 is equal to 20 percent of the cost, or portion of the cost, of section 179 property selected by the taxpayer. Thus, all or a part of the cost of one item of property, or all or parts of the cost of several items of property, may be selected, subject to the dollar limitations of section 179(b) and § 1.179-2. For example, *B*, who makes his income tax returns on the basis of the calendar year, purchased section 179 property costing $9,000 in March 1959. *B* elects to claim the additional first-year depreciation allowance, but only with respect to $3,000 of the cost of the property. *B*'s allowance under section 179 for 1959 is $600 (20 percent of $3,000).

(d) *Salvage.*—The allowance under section 179 is computed without regard to any salvage value which is estimated will be realizable upon the sale or other disposition of the section 179 property when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. But see paragraph (a) and (c) of § 1.167(a)-1 for rules relating to salvage in computing the depreciation allowance under section 167 on the unrecovered cost of the section 179 property after the allowance of the deduction under section 179.

(e) *When allowance is available.*—(1) (i) The term "the first taxable year for which a deduction is allowable under section 167 to the taxpayer with respect to such property" means the first taxable year for which depreciation is allowable under section 167 on such property. See paragraph (b) of § 1.167(a)–10. The provisions of this subdivision may be illustrated by the following examples:

Example (1). *M* Corporation, which makes its income tax returns on the calendar year basis, purchases section 179 property costing $10,000 on December 27, 1960, places it in service on the same date, and does not use an averaging convention in determining the depreciation allowance. Since depreciation is allowable for the December 27–31, 1960, period, *M* Corporation may elect to claim the additional first-year depreciation allowance of $2,000 (20 percent of $10,000) for 1960.

Example (2). *N* Corporation, which files its income tax returns on the calendar year basis, purchases section 179 property costing $10,000 on August 10, 1960, and places it in service on the same date. *N* Corporation places the section 179 property in a multiple asset account under which it is assumed, for purposes of computing depreciation, that all additions and retirements during the first half of the taxable year were made on the first day of that year, and that all additions and retirements during the second half of the taxable year were made on the first day of the following year. Under these circumstances, *N* Corporation is entitled to elect the additional first-year depreciation allowance under section 179 on such property only for 1961, since that is the first year for which a deduction is allowable under section 167 on such property.

(ii) In the case of an emergency facility which the taxpayer elects to amortize under the provisions of section 168, and which facility also qualifies as section 179 property, the additional first-year depreciation allowance is not available (except as hereafter provided) unless the taxpayer elects under § 1.168–2 to begin the amortization deductions under section 168 with the succeeding taxable year. If the taxpayer elects under § 1.168–2 to begin the amortization deductions under section 168 with the month following the month in which the facility was completed or acquired, and the facility qualifies as section 179 property, the additional first-year allowance is available only with respect to the portion of the facility which is not certified in accordance with section 168(e). If 100 percent of the facility is certified in accordance with section 168(e) and the taxpayer elects under § 1.168–2 to begin the amortization deductions under section 168 with such following month, no additional first-year allowance is available with respect to any portion of the facility.

(2) The additional first-year depreciation allowance on section 179 property is not available if the cost of such property is to be recovered through amortization deductions under section 162 and the regulations thereunder instead of through depreciation allowances under section 167(a).

§ 1.179–2 Dollar Limitation.—(a) *Maximum amount subject to election.*—(1) In any one taxable year the maximum amount of the cost of section 179 property with respect to which the taxpayer may elect to take an allowance under section 179 is $10,000, except that in the case of a husband and wife who file a joint income tax return

under section 6013(a) for the taxable year the limitation is $20,000. But see paragraph (e) of this section. If the section 179 property purchased by the taxpayer exceeds the $10,000 or $20,000 limitation, as the case may be, the taxpayer may select the cost or portion of the cost of section 179 property to which his election is to apply. For example, *X* Corporation purchased five new delivery trucks in February 1959 at a cost of $5,000 each. The trucks qualify as section 179 property. *X* may select $2,000 of the cost of each truck to be subject to the allowance under § 1.179–1, or the total cost of $5,000 for each of any two trucks, or *X* may allocate the $10,000 maximum cost among some or all of the trucks in any other manner it chooses. The selection of property made by *X* is irrevocable unless *X* obtains consent of the Commissioner to change. See paragraph (b) of § 1.179–4.

(2) The dollar limitations of section 179 apply to each taxpayer, and not to each trade or business in which the taxpayer has an interest. For example, *G* is a single individual who makes his income tax returns on the calendar year basis. *G* operates two separate businesses on his own account and is a member of a partnership engaged in business. During 1960, *G* purchased section 179 property costing $8,000 for one of his businesses and section 179 property costing $6,000 for the other. In addition, *G*'s distributive share of the partnership's section 179 allowance for 1959 is $300. The maximum allowance available to *G* under section 179 for 1960, including his $300 distributive share from the partnership is $2,000 (20 percent of $10,000). See, however, paragraph (b) of this section.

(b) *Amount apportioned by an estate.*—The maximum amount of the cost of section 179 property with respect to which an estate may elect to take an allowance under section 179 is $10,000. The maximum allowance available to an estate under section 179 is $2,000 reduced, however, by any such section 179 allowance apportioned to an heir, legatee, or devisee. The amount of the allowance under section 179 apportioned from an estate to an heir, legatee, or devisee shall not be taken into account by such heir, legatee, or devisee in determining his $10,000 or $20,000 limitation (as provided in paragraph (a) of this section). See section 179(d)(5). For example, *D*, a single individual who makes his income tax return on the basis of the calendar year, purchases section 179 property costing $12,000 in December 1960 for use in his business. *D* elects to claim the additional first-year depreciation allowance on the maximum allowable cost, $10,000, and claims a deduction under section 179 for $2,000 (20 percent of $10,000). *D* is also a legatee of the *XYZ* estate, and in 1960 is allocated income of $1,500 from the estate, $500 as his share of the estate's additional first-year depreciation allowance, and $200 as his share of the estate's depreciation allowance under section 167. The net income of $800 ($1,500 minus $700) received by *D* from the estate will be included in *D*'s income tax return for 1960. The $500 additional first-year depreciation allowance allocated to him by the estate will not affect his right to the allowance of $2,000 under section 179.

(c) *Affiliated group.*—Taxpayers which constitute an affiliated group, as defined in paragraph (e) of § 1.179–3, shall be treated as one taxpayer in applying the $10,000 limitation of this section. The allowance may be taken by any one such member or allocated among

the several members in any manner, pursuant to allocation by the common parent corporation if a consolidated return is filed, or in accordance with an agreement entered into by the members of the group if separate returns are filed. The amount of the allowance allocated to any member, however, shall not exceed 20 percent of the cost of section 179 property actually purchased by the member in the taxable year. If a consolidated return is filed, the common parent corporation shall file a statement in accordance with § 1.179–4. If separate returns are filed, the statement shall be filed by each member of an affiliated group to which is allocated any part of the deduction under section 179. Such statement shall include, in addition to the information required by § 1.179–4, the names of all the members of the affiliated group, the taxable year of the common parent corporation, and a description of the manner in which the deduction under section 179 has been divided among them. An allocation among the members of an affiliated group of the allowance under section 179 shall not, if a consolidated return is filed, be revoked after the due date of the return (including extensions of time) of the common parent corporation for a taxable year for which an election to take the allowance is made. If the members of an affiliated group do not file a consolidated return for a taxable year for which an election to take the allowance is made, the allocation as to all members of the group shall not be revoked after the due date of the return (including extensions of time) of the common parent corporation. For the purpose of the preceding sentence, the taxable years of the other members of the affiliated group ending with or within the taxable year of the common parent shall be considered as corresponding to the taxable year of the common parent. Thus, where a common parent's taxable year ends November 30, 1960, the allowance will apply with respect to section 179 property purchased in August 1959 by an affiliated corporation whose taxable year ends June 30, 1960 (a taxable year ending within the taxable year of the parent).

(d) *Partnership.*—(1) In the case of a partnership, the election under section 179 with respect to section 179 property of the partnership shall be made by the partnership. See section 703(b). However, the amount of the section 179 allowance shall be determined separately as to each partner. The amount of the section 179 allowance available to a partner with respect to the cost of the section 179 property selected by the partnership is 20 percent of the maximum amount of the cost of such property allocable to the partner for the purpose of computing such allowance. This maximum is the individual partner's share of the total cost of the section 179 property (but not in excess of $10,000 or $20,000, whichever is applicable) computed by applying to the total cost of such property the percentage or fraction used in determining each partner's distributive share of the partnership's depreciation allowance under section 167 for the taxable year on such property. The partner's distributive share of the partnership's depreciation allowance under section 167 shall be determined in accordance with the provisions of section 704 and the regulations thereunder. The maximum amount of the allowance permitted under section 179 to the partnership shall be the aggregate of the maximum amounts allowable to the separate partners. The basis of the partnership's section 179 property must be adjusted to

reflect the amount of the section 179 allowance to the partnership. See paragraph (f) of § 1.179–3. A trust's share of partnership property shall not be taken into account in determining the amount of the section 179 allowance of a partnership. In no event is a partner entitled to a section 179 allowance of more than $2,000 or $4,000, as the case may be, whether the allowance is in respect of section 179 property of the partnership or in respect of section 179 property which he acquired separately, or both. See, however, paragraph (b) of this section. Any allocation among the partners of the section 179 allowance shall not be modified after the due date of the partnership return (without regard to extensions of time) for the year for which the election under section 179 is made.

(2) The principles of this paragraph may be illustrated by the following examples:

Example (1). Partnership *ABCD* is composed of partner *A* who is married and files a joint income tax return, and partners *B*, *C*, and *D* who are single. Under the terms of the partnership agreement, the allocation of each partner's distributive share of depreciation under section 167 is 30 percent to *A*, 20 percent to *B*, 45 percent to *C*, and 5 percent to *D*. In 1960, the partnership purchases $100,000 of section 179 property. The partnership elects to claim the additional first-year depreciation allowance under § 1.179–1 with respect to the maximum allowable amount of the cost of section 179 property. The partnership is entitled in 1960 to an additional first-year depreciation allowance of $9,000 computed as follows:

	1 Distributive share of depreciation under section 167	2 Allocable share of total cost of section 179 property ($100,000× col. 1)	3 Maximum amount subject to election (lesser of col. 2 or ($10,000 or $20,000, as the case may be))	4 Section 179 allowance (20%×col. 3)
Partner *A*	30%	$30,000	$20,000	$4,000
Partner *B*	20%	20,000	10,000	2,000
Partner *C*	45%	45,000	10,000	2,000
Partner *D*	5%	5,000	5,000	1,000
Total partnership allowance				9,000

In the foregoing example, the portion of the cost of the property selected by the partnership is $45,000, the total of column 3. The basis of the section 179 property of the partnership must be adjusted to reflect the $9,000 section 179 allowance. Such adjustment to the partnership's basis is required even though a partner may not be entitled to deduct the amount or a portion of the amount of the section 179 allowance available to him from such partnership for the reason that the aggregate of the section 179 allowances available to him from such partnership and from other partnerships or sole proprietorships exceed the appropriate limitation provided by section 179(b). If the partnership desired to elect only with respect to one-half of the maximum allowable amount, the entries in columns 3 and 4 with respect to each partner would be reduced by one-half. In such case, the portion

of the cost of the property selected would be $22,500, the total section 179 allowance would be $4,500, and the basis would be adjusted accordingly.

Example (*2*). Partnership *EFT* is composed of partners *E* and *F* who are married and file joint income tax returns, and partner *T* which is a trust. Under the terms of the partnership agreement, the allocation of each partner's distributive share of depreciation under section 167 is 40 percent to *E*, 40 percent to *F*, and 20 percent to *T*. In 1960 the partnership purchases $50,000 of section 179 property. The partnership may not select a cost of section 179 property in excess of $40,000, which is the total of column 3 in the following computation:

	1 Distributive share of depreciation under section 167	2 Allocable share of total cost of section 179 property ($50,000× col. 1)	3 Maximum amount subject to election (lesser of col. 2 or ($10,000 or $20,000, as the case may be))	4 Section 179 allowance (20%×col. 3)
Partner *E*	40%	$20, 000	$20, 000	$4, 000
Partner *F*	40%	20, 000	20, 000	4, 000
Partner *T*	20%	0	0	0
Total partnership allowance				8, 000

Since partner *T* is a trust, its share of partnership property may not be taken into account in determining the section 179 allowance of the partnership. Also, partner *T* is not entitled to any portion of the additional first-year depreciation allowance under section 179. The partnership is entitled in 1960 to an additional first-year depreciation allowance of $8,000.

(e) *Joint returns.*—In the case of a husband and wife who file a joint income tax return under section 6013(a), the maximum amount of the cost of section 179 property with respect to which the taxpayer may elect an allowance under section 179 is $20,000, regardless of which spouse purchased the property. However, in the case of a husband and wife who elect under section 6013(b) to file a joint income tax return for a taxable year after the time prescribed by law for filing the return for such taxable year has expired, the dollar limitation under section 179 shall be the aggregate allowable dollar amount of section 179 property for which the election was made on their separate income tax returns. For example, *H*, who purchased section 179 property costing $18,000 in November 1960, filed a separate income tax return for 1960 on April 1, 1961, in which he elected to claim the additional first-year depreciation allowance on $10,000 of the cost of such property used in his separate business. *W*, who purchased section 179 property costing $7,000 in October 1960 for use in her separate business, filed a separate income tax return in March 1961 in which she elected to claim the additional first-year depreciation allowance on only $5,000 of the cost of such property. After the due

date of the return, *H* and *W* elect under section 6013(b) to file a joint income tax return for 1960. Although *H* and *W* purchased section 179 property costing $25,000 in 1960, the maximum amount with respect to which the additional first-year depreciation allowance may be claimed in their joint income tax return is $15,000, the aggregate of the amounts elected on their separate income tax returns.

§ 1.179–3 DEFINITIONS AND SPECIAL RULES.—The following definitions and special rules apply for purposes of section 179, §§ 1.179–1, 1.179–2, 1.179–4, and this section.

(a) *Section 179 property.*—The term "section 179 property" means any tangible personal property, new or used, of a character subject to the allowance for depreciation under section 167, acquired by purchase after December 31, 1957, for use in the taxpayer's trade or business or in the production of his income, and which has an estimated useful life (determined at the time of acquisition) of 6 years or more. For purposes of determining the estimated useful life of section 179 property, the provisions of paragraph (b) of § 1.167(a)–1 shall be applied. For definition of the term "purchase", see paragraph (c) of this section.

(b) *Tangible personal property.*—Local law definitions will not be controlling for purposes of determining the meaning of the term "tangible personal property" as it is used in section 179 and the regulations thereunder. For purposes of section 179, the term "tangible personal property" includes any tangible property except land, and improvements thereto, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). Assets accessory to the operation of a business, such as machinery, printing presses, transportation or office equipment, refrigerators, individual air conditioning units, grocery counters, etc., generally constitute tangible personal property for purposes of section 179, even though such assets may be termed fixtures under local law. The term does not include, for example, the wiring in a building, plumbing systems, nor central heating or central air conditioning machinery, pipes, or ducts or other items, which are structural components of a building or other permanent structure, nor does the term include trademarks, goodwill, or other intangibles.

(c) *Purchase.*—(1) The term "purchase" means any acquisition of property after December 31, 1957, but only if all the requirements of subdivisions (i), (ii), and (iii) of this subparagraph are satisfied.

(i) The property is not acquired by purchase if it is acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b). In applying the rules of section 267(b) and (c), section 267(c)(4) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants. For example, a purchase of property from a corporation by a taxpayer who owns, directly or indirectly, more than 50 percent in value of the outstanding stock of such corporation does not qualify as a "purchase" under section 179(d)(2), nor does the purchase of property by a husband from his wife. However, the purchase of section 179 property by a tax-

payer from his brother or sister does qualify as a purchase for purposes of section 179(d)(2).

(ii) The property is not acquired by purchase if acquired from any one member of an affiliated group (as defined in paragraph (e) of this section) by another member of the same affiliated group.

(iii) The property is not required by purchase if the basis of the property in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or under section 1014(a), relating to property acquired from a decedent. For example, property acquired by gift or bequest does not qualify as property acquired by purchase, for purposes of section 179(d)(2), nor does property received in a corporate distribution the basis of which is determined under section 301(d)(2)(B), property acquired by a corporation in a transaction to which section 351 applies, property acquired by a partnership through contribution (section 723), nor property received in a partnership distribution which has a carryover basis under section 732(a)(1).

(2) If property is in the process of construction, reconstruction, or erection on December 31, 1957, the term "purchase" will apply only to that part of the cost of such property which is attributable to such construction, reconstruction, or erection after December 31, 1957. The portion of the cost of such property attributable to construction, reconstruction, or erection after December 31, 1957, consists of all costs of the property allocable to the period after that date, including the cost or other basis of materials entering into such property. It is not necessary that such materials be acquired after December 31, 1957, or that their estimated useful lives independently determined be 6 years or more provided, however, that the property constructed, reconstructed, or erected has an estimated useful life of 6 years or more.

(d) *Cost.*—The cost of section 179 property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the taxpayer. For example, *N* Corporation purchases a new drill press costing $9,000 in November 1960 which qualifies as section 179 property, and is granted a trade-in allowance of $2,000 on its old drill press. The old drill press had a basis of $1,200. Under the provisions of sections 1012 and 1031(d), the basis of the new drill press is $8,200 ($1,200 basis of old drill press plus cash expended of $7,000). However, only $7,000 of the basis of the new drill press qualifies as cost for purposes of the allowance under § 1.179–1; the remaining $1,200 is not part of the cost because it is determined by reference to the basis of the old drill press.

(e) *Affiliated group.*—For purposes of section 179, the term "affiliated group" has the meaning assigned to it by section 1504 and paragraph (b) of § 1.1502–2, except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in those sections.

(f) *Adjustment to basis.*—A taxpayer who elects the additional first-year depreciation allowance under section 179 must make the necessary adjustment to basis of the section 179 property, as required by section 179(d)(8), in the records he is required to keep under

paragraph (c) of § 1.167(a)–7, before any other deduction allowable by section 167(a) is computed. For example, *M* Corporation which makes its return on the basis of the calendar year and uses the straight-line method of depreciation, purchases a $15,000 machine on July 1, 1960, which qualifies as section 179 property, and elects to claim the additional first-year depreciation allowance. The machine has an estimated 10-year life and an estimated salvage value of $1,000. For 1960, *M* Corporation is entitled to an allowance of $2,000 (20 percent of $10,000) under section 179. The cost basis of $15,000 must be adjusted by the $2,000 allowance before any other deduction under section 167 is computed. The adjusted basis of $13,000, less $1,000 salvage, or $12,000 may then be depreciated over the 10-year useful life of the machine in accordance with the provisions of section 167 and the regulations thereunder. Since *M* Corporation uses the straight-line method of depreciation for the machine, it will be entitled to a total deduction of $2,600 in 1960; that is $2,000 for additional first-year depreciation plus $600 ($12,000×10 percent×6 mos.) depreciation on the balance of $12,000.

§ 1.179–4 Time and Manner of Making Election.—(a) *Election.*—A separate election must be made for each taxable year in which an additional first-year depreciation allowance is claimed with respect to section 179 property. The election under section 179 and § 1.179–1 to claim an additional first-year depreciation allowance on section 179 property shall be made in a statement attached to the taxpayer's income tax return for the taxable year to which the election applies. The return and statement must be filed not later than the time prescribed by law (including extensions thereof) for filing the return for such taxable year. The statement shall indicate that the taxpayer elects under section 179 to claim an additional first-year depreciation allowance for section 179 property, and shall set forth the following information with respect to the property selected:

(1) Description of property (truck, printing press, etc.).

(2) Date property acquired (after December 31, 1957).

(3) Total cost of each item of property with respect to which the election is made.

(4) Portion of cost of property selected.

(5) Estimated useful life at date of acquisition (at least 6 years).

(6) Additional first-year depreciation.

The taxpayer shall maintain records which permit specific identification of section 179 property and reflect how and from whom such property was acquired. Except as provided in paragraph (d)(1) of this section, an election will not be valid unless the statement is submitted at the time and in the manner prescribed herein. The election to claim an additional first-year depreciation allowance under this section with respect to any property is irrevocable and shall be binding on the taxpayer with respect to such property for the taxable year for which the election is made and for all subsequent taxable years, unless the Commissioner gives his consent to revoke the election. Similarly, the selection of section 179 property by the taxpayer to be subject to the additional first-year depreciation allowance must be adhered to in

computing the taxpayer's taxable income for the taxable year for which the selection is made and for all subsequent taxable years, unless consent to change the selection of property is given by the Commissioner.

(b) *Revocation.*—A request to revoke an election under section 179 and § 1.179–1 or to change the property selected for the additional first-year depreciation allowance shall be in writing and shall be addressed to the Commissioner of Internal Revenue, Washington 25, D.C. The request shall include the name and address of the taxpayer and shall be signed by the taxpayer or his duly authorized representative. It must be filed no later than 6 months after the date prescribed by law (without regard to extensions of time) for filing the income tax return for the year in which the allowance under § 1.179–1 was claimed, shall be accompanied by a statement showing the year and property involved, and shall set forth in detail the reasons for the request to revoke the election or to change the selection of property. Ordinarily, a request for consent to revoke the election or to change the selection of property will not be granted if it appears from all the facts and circumstances that the only reason for the desired change is to obtain a tax advantage.

(c) *Effective date.*—The provisions of this section apply only to income tax returns and statements filed after the date of publication of these regulations in the Federal Register as a Treasury decision. Elections made under the provisions of Treasury Decision 6335 (26 CFR 18.1–3), approved November 13, 1958 (23 F.R. 8979) continue in effect.

(d) *Special rules.*—(1) If the taxpayer has exercised the election by claiming the additional allowance on his income tax return for any taxable year, but failed to attach the statement required by paragraph (a) of this section or by § 18.1–3(b) of Treasury Decision 6335 and the last day prescribed by law (including extensions of time) for filing the return falls on or before the ninetieth day after the date the regulations under section 179 are published in the Federal Register as a Treasury decision, the election will not be invalid, provided that on or before such ninetieth day the required statement is submitted to the district director for the district in which his income tax return for such year was filed.

(2) If the last day prescribed by law (including extensions of time) for filing an income tax return for any taxable year ending after June 30, 1958, falls on or before the ninetieth day after the date the regulations under section 179 are published in the Federal Register as a Treasury decision, consent is hereby given to the taxpayer to revoke his election under section 179 and Treasury Decision 6335 for such taxable year or to change his previous selection of property subject to the additional first-year depreciation allowance, provided that on or before such ninetieth day he submits to the district director for the district in which his income tax return for such year was filed a statement showing the new selection of property or that the election for such taxable year is being revoked. Amended income tax returns for the year of revocation or change and for any other taxable year affected, or treated as affected, by the revocation or by the change in the selection of property must accompany such statement.

PAR. 2. Paragraphs (a) and (c) of § 1.167(a)–1 are amended to read as follows:

§ 1.167(a)–1 DEPRECIATION IN GENERAL.—(a) *Reasonable allowance.*—Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(f) and § 1.167(f)–1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. See paragraph (c) below for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value. See section 179 and § 1.179–1 for a further description of the term "reasonable allowance."

* * * * * * *

(c) *Salvage.*—Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b), salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value. Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, paragraph (a) of § 1.167(b)–2 for the treatment of salvage under the declining balance method, and § 1.179–1 for the treatment of salvage in computing the additional first-year depreciation allowance. The taxpayer may use either salvage or net salvage in determining depreciation allowances but such practice must be consistently followed and the treatment of the costs of removal must be consistent with the practice adopted. For specific treatment of salvage value see §§ 1.167(b)–1, 2, and 3. When an asset is retired or disposed of, appropriate adjustments shall be made in the asset and depreciation reserve accounts. For example, the amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 29, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

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PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

SECTION 212.—EXPENSES FOR PRODUCTION OF INCOME

26 CFR 1.212–1: Nontrade or nonbusiness expenses. Rev. Rul. 60–359

(Also Sections 162, 263; 1.162–1, 1.263(a)–1.)

Amounts paid by investors or traders in securities with respect to stock dividends or liquidating dividends on stock they have borrowed incident to a short sale are capital expenditures and are not deductible as nonbusiness expenses under section 212 of the Internal Revenue Code of 1954 or as business expenses under section 162 of the Code.

I.T. 3989, C.B. 1950–1, 34, distinguished.

The Internal Revenue Service has been asked whether I.T. 3989, C.B. 1950–1, 34, permits the deduction of amounts paid by investors or traders in securities with respect to stock borrowed in connection with a short sale, in either of the following situations: (a) a stock dividend is distributed in respect of the borrowed shares while the loan is outstanding and the borrower, in covering his short position, purchases shares equal to the number distributed in addition to the number originally borrowed; or (b) a liquidating dividend is distributed in respect of the borrowed shares while the loan is outstanding and the borrower reimburses the lender for the amount of such dividend.

I.T. 3989 holds that amounts equal to dividends paid by an investor with respect to stock borrowed to cover short sales are allowable deductions under section 23(a)(2) of the Internal Revenue Code of 1939, new section 212 of the Internal Revenue Code of 1954. That ruling also holds that the deductibility of amounts paid in connection with stock borrowed under such conditions should be determined by the same standards whether the taxpayer is a trader or an investor.

The rule of I.T. 3989 is applicable only to amounts paid by the borrower with respect to ordinary cash dividends on the borrowed stock and does not apply to expenditures made with respect to stock dividends on such stock.

In the cases of *Commissioner* v. *Norbert H. Wiesler*, 161 Fed. (2d) 997, certiorari denied 332 U.S. 842, and *Commissioner* v. *F. A. Wilson*, 163 Fed. (2d) 680, certiorari denied 332 U.S. 842, cited in I.T. 3989 as authority for the position stated therein, payments with respect to ordinary cash dividends were likened to interest on indebtedness. A stock or liquidating dividend, however, brings about a diminution of the capital represented by each of the shares to be returned. Moreover, either form of dividend affects the borrower's obligation to make the lender whole in respect of the borrowed stock regardless of the duration of the borrowing transaction. The stock dividend increases the number of shares which must be returned; the liquidating dividend requires the borrower to compensate the lender for the reduction in the capital represented by each share returned.

The additional shares purchased in the first situation and the compensating payment in the second situation are each in the nature of a repayment of principal. The amount paid in either case is part of the

cost of replacing the borrowed stock and is, hence, a capital expenditure.

Accordingly, it is held that amounts paid by investors or traders in securities with respect to stock dividends or liquidating dividends on stock they have borrowed incident to a short sale are capital expenditures and are not deductible as nonbusiness expenses under section 212 of the Code or as business expenses under section 162 of the Code.

Deductibility of North Carolina primary filing fee as a nontrade or nonbusiness expense. See Rev. Rul. 60–366, page 63.

SECTION 213.—MEDICAL, DENTAL, ETC., EXPENSES

26 CFR 1.213–1: Medical, dental, etc., expenses. Rev. Rul. 60–255
(Also Sections 152, 262; 1.152–2, 1.262–1.)

> The amount paid by an adopting parent for medical services rendered directly to a child before its placement in the adopting parents' home constitutes a medical expense, provided that (1) the child qualifies as a dependent of the adopting parent at the time the medical services are rendered or at the time the expenses therefor are paid, (2) the medical expenses are paid by the adopting parent, or his agent, for the medical care of the particular child and are not paid merely as reimbursement for expenses incurred and paid by the adoption agency or other persons prior to adoption negotiations between the agency and the adopting parent, and (3) the adopting parent can clearly substantiate that any deduction claimed is directly attributable to the medical care of the child. Revenue Ruling 56–401, C.B. 1956–2, 169, modified.

Revenue Ruling 56–401, C.B. 1956–2, 169, has been reconsidered insofar as it relates to the deductibility of medical expenses attributable to the medical care of a child prior to its adoption by a taxpayer.

Revenue Ruling 56–401 states, "No part of the expenses, such as doctor or hospital bills and legal or agency fees, paid by a taxpayer in connection with, and for the purpose of, adopting a child are deductible by the individual as a charitable contribution or as a medical expense. Such payments are personal expenses of the taxpayer, the deduction of which is prohibited by section 262 of the Internal Revenue Code of 1954."

Section 213 of the Code allows as a deduction (subject to certain limitations) expenses paid during the taxable year, not compensated for by insurance or otherwise, for the medical care of the taxpayer, his spouse, and his dependents, as defined in section 152 of the Code.

Section 1.213–1(e)(3) of the Income Tax Regulations provides, in part, that in the case of medical expenses for the care of a person who is the taxpayer's spouse or dependent, the deduction under section 213 is allowable if the status of such person as "spouse" or "dependent" of the taxpayer exists either at the time the medical services were rendered or at the time the expenses were paid.

For taxable years beginning prior to January 1, 1959, section 152 of the Code includes within the definition of the term "dependent" a child of the taxpayer, a child legally adopted by the taxpayer, and an individual who, for the taxable year of the taxpayer, has as his

principal place of abode the home of the taxpayer and is a member of the taxpayer's household. For taxable years beginning after December 31, 1958, section 152(b)(2) of the Code was amended by Public Law 86–376, 86th Cong., 73 Stat. 699, C.B. 1959–2, 707, to enlarge the definition of the term "dependent" by, in effect, waiving the requirement that a child reside as a member of a taxpayer's household for the entire taxable year, if the child were placed with the taxpayer by an authorized placement agency for legal adoption by such taxpayer, and the child is a member of the individual's household. See H.R. Report No. 816, 86th Cong., C.B. 1959–2, 901.

In view of the provisions of the foregoing sections of the Code and the regulations, it is held that the amount paid by an adopting parent for medical services rendered directly to a child before its placement in the adopting parents' home constitutes a medical expense under section 213 of the Code, provided that the child qualifies as a dependent of the adopting parent, under section 152 of the Code, at the time the medical services are rendered or at the time the expenses therefor are paid and the medical expenses are paid by the adopting parent, or his agent, for the medical care of the particular child and are not paid merely as reimbursement for expenses incurred and paid by the adoption agency or other persons prior to adoption negotiations between the agency and the adopting parent. If the medical expenses are paid by the adoption agency or other agent of the adopting parent, pursuant to an agency agreement made prior to such payment, reimbursement therefor by the adopting parent is considered a payment by him of medical expenses. However, the adopting parent must clearly substantiate that any deduction claimed is directly attributable to medical care of the child.

Revenue Ruling 56–401 is accordingly modified to remove the conclusion that no part of the expenses, such as doctor or hospital bills, paid by a taxpayer in connection with adopting a child are deductible by the individual as a medical expense.

SECTION 215.—ALIMONY, ETC., PAYMENTS

26 CFR 1.215–1: Periodic alimony, etc., payments.

Treatment of support payments paid by a husband under a decree entered prior to March 1, 1954, which was later modified. See Rev. Rul. 60–238, page 17.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 262.—PERSONAL, LIVING, AND FAMILY EXPENSES

26 CFR 1.262–1: Personal, living, and family expenses.

Hospital expenses of a child paid by its adopting parents. See Rev. Rul. 60–255, page 105.

SECTION 263.—CAPITAL EXPENDITURES

26 CFR 1.263(a)-1: Capital expenditures; in general. Rev. Rul. 60-386

(Also Sections 162, 167; 1.162-1, 1.167(a)-1.)

Amounts expended by a taxpayer for the construction of sea walls, dikes, bulkheads, pumps and drainage systems, to counteract the effect of land subsidence, constitute capital expenditures. The amount of these expenditures may be recovered over the useful life of the facilities.

The Internal Revenue Service has been requested to set forth the proper treatment for Federal income tax purposes of expenditures made by a taxpayer to counteract the effects of land subsidence.

The taxpayer owns a tract of land along the western coastal plain of the United States. Numerous oil and gas wells have been drilled on this tract of land. Originally, the land on which the operations are conducted was a barrier to the sea. Several years ago, however, it became evident that the land was subsiding, a situation which still continues.

In order to prevent the property from becoming inundated, the taxpayer has spent large sums of money to erect sea walls which now constitute a barrier to the sea. In addition to the construction of such sea walls and related bulkheads, the taxpayer has elevated the top of many of its wells and other facilities.

As circumstances required, sea walls were raised and further seawall construction was undertaken to counteract the effects of the continued subsidence. The location of the strengthened sea walls in all cases overlay the existing sea walls so that none of the older facilities were removed or abandoned but used to the fullest extent through incorporation into the later construction. Drainage systems, comprising pipes, pumps and related facilities, to dispose of surface and seepage water have been constructed. In addition, the taxpayer has been required to rearrange and move various parts of his equipment and drainage facilities.

Section 162 of the Internal Revenue Code of 1954 provides for the allowance as a deduction of all the ordinary and necessary expenses incurred during the taxable year in carrying on any trade or business.

However, under the provisions of section 263 of the Code, no deductions shall be allowed for (1) any amounts paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate or for (2) any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

Section 167 of the Code provides for the allowance as a depreciation deduction of a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business, or of property held for the production of income.

It is evident that certain expenditures as, for instance, repairs, maintenance and moving costs occasioned by subsidence, constitute ordinary and necessary business expenses currently deductible under section 162 of the Code. On the other hand, expenditures for sea walls, dikes, and bulkheads, as well as pumps and drainage systems,

the benefits of which are to be derived by the taxpayer over more than one taxable year, are nondeductible capital expenditures subject to an allowance for depreciation under section 167 of the Code.

There are many cases in which expenditures were made necessary which did not extend the life of the property or increase its value. The expenditures provided protection against future damage, or adapted buildings or operations to new surroundings, or created something new or better by substitution of different materials or structures, or where the expenditures made the property more valuable from either a monetary point of view or for use in the business.

In *Parkersburg Iron and Steel Company* v. *Burnet*, 48 Fed. (2d) 163, Ct.D. 360, C.B. X–2, 357 (1937), the taxpayer was the recipient of Government contracts. Army engineers, upon inspection of the plant, suggested that certain physical changes be made therein. The taxpayer complied with these suggestions and, for Federal income tax purposes, contended that the changes constituted ordinary and necessary business expenses on the ground that they did not increase either the productivity, the efficiency, or the value of the plant. The court held that the expenditures were made for permanent improvements and as such had to be capitalized. See also *Hotel Sulgrave, Inc.* v. *Commissioner*, 21 T.C. 619, and *R.K.O. Theatres, Inc.* v. *United States*, 163 Fed. Supp. 598.

Revenue Ruling 79, C.B. 1953–1, 41, holds that amounts expended for the construction of protective works or for moving houses to prevent storm losses to property abutting the Great Lakes are not allowable deductions but constitute capital expenditures. See also Revenue Ruling 54–191, C.B. 1954–1, 68, relating to the construction of earthen terraces on farm land for the prevention of soil erosion, and Revenue Ruling 57–30, C.B. 1957–1, 109, relating to capitalization and amortization of costs of sheet piling the side of a dock.

On the other hand, in the case of *Illinois Merchants Trust* v. *Commissioner*, 4 B.T.A. 103, acquiescence, C.B. V–2, 2 (1926), a sudden lowering of the water level in the south branch of the Chicago River left the upper ends of certain wood piles, upon which the taxpayer's building rested, exposed to the air, causing that part of the piles to decay from dry rot. As a consequence, the wall on the river side of the taxpayer's building settled to a point where it was likely that the entire building would collapse. In order to maintain the building in serviceable condition, it was necessary to saw off the rotted piles at a point below the new water level and to insert concrete supports between the ends of the submerged piles and the floor of the building, thus raising the river wall. This wall was also considerably shored up. The United States Board of Tax Appeals (now the Tax Court of the United States) held that the taxpayer was entitled to deduct the cost of this work as a business expense for repairs since the work did not extend the life of the property or increase its value.

In the instant case, a portion of the taxpayer's lands, which have been a natural barrier to the Pacific Ocean, has been irretrievably lost by subsiding into the ocean. Consequently, new barriers and drainage systems had to be constructed. This construction represents entirely new assets and a complete substitution of structures, utilizing different materials, which adapt the properties to changed surroundings,

provide protection from future damage and make the properties more valuable for use in the taxpayer's business.

Accordingly, it is held that expenditures made by the taxpayer in the instant case for sea walls, dikes, and bulkheads, as well as pumps and drainage systems, to counteract the effect of land subsidence constitute capital expenditures within the purview of section 263 of the Code. The cost of the sea wall, dikes, and bulkheads, as well as drainage systems, may be recovered over the expected useful life thereof, depending upon its construction and the rate of subsidence to which it may be subject, through an allowance for depreciation as provided in section 167 of the Code.

Costs incurred by a corporation in issuing a stock dividend. See Rev. Rul. 60–254, page 42.

Amounts equal to dividends paid with respect to stock borrowed to cover short sales. See Rev. Rul. 60–359, page 104.

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26 CFR 1.263(a)–2: Examples of capital expenditures.

Legal expenses incurred to establish the fact that a municipal ordinance does not prohibit the operation of the taxpayer's business within the municipal limits. See Rev. Rul. 60–261, page 42.

SECTION 265.—EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME

26 CFR 1.265–1: Expenses relating to tax-exempt income. Rev. Rul. 60–236

(Also Sections 164, 337; 1.164–1, 1.337–1.)

> State income taxes paid by a corporation upon gains realized on the sale of all of its assets, pursuant to a plan of complete liquidation under section 337(a) of the Internal Revenue Code of 1954, are not deductible as "taxes" under section 164 of the Code in view of the limitation imposed by section 265 of the Code on the deductibility of "expenses" allocable to tax exempt income.

Advice has been requested whether state income taxes paid by a corporation upon gains realized on the sale of all its assets, pursuant to a plan of complete liquidation under section 337(a) of the Internal Revenue Code of 1954, are deductible as "taxes" under section 164 of the Code in view of the limitation imposed by section 265 of the Code on the deductibility of "expenses" allocable to tax-exempt income.

Having adopted a plan of complete liquidation under section 337 of the Code, the taxpayer corporation sold all of its property and distributed the proceeds thereof to its shareholders. The gains realized on these sales were subject to a state income tax which the taxpayer paid during the taxable year of liquidation.

Section 337(a) of the Code provides that, in prescribed circumstances, no gain or loss shall be recognized to a corporation on the sale or exchange of its property during a 12-month period preceding

the complete liquidation of the corporation. Thus, the gains realized by the taxpayer in the instant cases were not recognized for Federal income tax purposes.

Section 161 of the Code provides, in substance, that, in computing taxable income, there shall be allowed as a deduction those items specified in section 161 to section 179 of the Code, subject to the exceptions provided in section 261 to section 273 of the Code.

The pertinent provision of section 164 of the Code reads as follows:

(a) * * * Except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Section 261 of the Code provides that, in computing taxable income, no deduction shall in any case be allowed in respect of the items specified in section 262 to 273 of the Code.

The pertinent provision of section 265 of the Code reads as follows:

No deduction shall be allowed for—

(1) EXPENSES.—Any amount otherwise allowable as a deduction which is allocable to one or more classes of income * * * wholly exempt from the taxes imposed by this subtitle.

Section 1.265–1(b)(1) of the Income Tax Regulations provides that a class of income wholly exempt from Federal income tax includes any class of income which is wholly excluded from gross income under any provision subtitle A of the Code or wholly exempt from Federal income tax under the provision of any other law.

In *Hawaiian Trust Company, Limited* v. *United States*, 178 Fed. Supp. 637, the taxpayer, hereinafter referred to as "Refiners," was a corporation organized under the laws of Hawaii and principally engaged in the manufacture and sale of petroleum products and the distribution of butane. During the taxable year 1955, Refiners sold all of its assets pursuant to a plan of complete liquidation and was formally dissolved in 1956. Pursuant to section 337 of the Code, no gain or loss was recognized to Refiners for Federal income tax purposes upon the sale of its assets.

In its Federal income tax return for 1955, Refiners claimed a deduction for accrued Territorial net income taxes. These taxes were imposed upon Refiners' net income reportable for Territorial net income tax purposes. This income included the gains realized by Refiners upon the sale of its assets in 1955. The Commissioner of Internal Revenue disallowed that portion of the Territorial net income tax allocable to the gain from the sale of Refiners' assets as a deduction for Federal income tax purposes on the grounds that section 265 of the Code prohibited the deduction of expenses allocable to income exempt from Federal income tax. The court, in holding that the Commissioner correctly disallowed the claimed deduction for Territorial taxes paid, cited section 265(1) of Code and section 1.265–1(b) of the regulations and stated, in part, as follows:

From the foregoing, it is apparent that there are only two classes of income involved; taxable income and exempt income, the latter being defined as that which is not required to be included in gross income.

As we have seen, it is agreed that "No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas," under the provisions of Section 337 of the Code of 1954. Accordingly, it must qualify as exempt income. Since the gain is not included in Refiners' income, it follows that there is no basis for allowing a deduction for the expenses—that is to say, the Territorial tax—related to such income.

Accordingly, it is held that gains not recognized under 337(a) of the Code constitute wholly exempt income for purposes of section 265 of the Code and, hence, state income taxes allocable to such income represent "expenses" which are not deductible as "taxes" under section 164 of the Code.

The holding in the instant case is distinguishable from the decision in the case of *Cotton States Fertilizer Company* v. *Commissioner*, 28 T.C. 1169, acquiescence, C.B. 1958–1, 4. In that case the taxpayer's fertilizer plants were destroyed by fire. To collect the insurance proceeds, it was necessary for the taxpayer to employ an architect and a contractor to recreate the plans and specifications of the destroyed plants. The insurance proceeds exceeded the adjusted basis of the destroyed property and were expended for replacement property, the cost of which exceeded the proceeds. The taxpayer elected under section 112(f)(3)(A) of the Internal Revenue Code of 1939 (now section 1033(a) of the 1954 Code) not to report the gain. The Tax Court of the United States held that section 24(a)(5) of the 1939 Code (now section 265 of the 1954 Code) was not applicable because nonrecognized gain under section 112(f)(3)(A) of the 1939 Code was not a class of exempt income. The court stated, in effect, that the gain was not exempt from Federal income taxation but the tax was merely postponed. Moreover, section 113(a)(9) of the 1939 Code operates to reduce the basis of the replacement property by the amount of the gain which was not recognized under 112(f)(3)(A) of the 1939 Code. In the instant case, the net effect of section 337(a) of the 1954 Code is to release items of corporate gain completely from Federal income taxation.

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATIONS

Subpart A.—Effects on Recipients

SECTION 305.—DISTRIBUTIONS OF STOCK AND STOCK RIGHTS

26 CFR 1.305–2: Election of shareholders as to medium of payment. (Also Section 312; 1.312–11.) T. D. 6476 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under sections 305(b)(2) and 312 of the Internal Revenue Code of 1954 amended.

DEPARTMENT OF THE TREASURY,
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, 1956, notice of proposed rulemaking regarding amendments to § 1.305–2 and paragraph (a) of § 1.312–11 of the Income Tax

[1] 25 F.R. 6183.

Regulations (26 CFR Part 1), prescribed under sections 305(b)(2) and 312 of the Internal Revenue Code of 1954, relating to distributions by corporations, was published in the Federal Register (21 F.R. 5104). After consideration of all such relevant matters as were presented by interested persons regarding the rules proposed, the following amendments to the regulations are hereby adopted. The amendments adopted do not include regulations pertaining to the election of shareholders as to the medium of the payment of a dividend and the nature of an election, as set forth in proposed paragraphs (a) and (b) of § 1.305–2 of the aforesaid notice of proposed rule making. Paragraph (a), except the last sentence in subparagraph (1) thereof, and paragraph (b) of § 1.305–2 continue in effect under notice of proposed rule making and will be given further consideration before final action is taken thereon.

PARAGRAPH 1. Section 1.305–2 is amended by providing a heading for paragraph (a), reserving paragraph (b), and revising existing paragraph (b) and redesignating such paragraph as paragraph (c). These amended provisions read as follows:

§ 1.305–2 ELECTION OF SHAREHOLDERS AS TO MEDIUM OF PAYMENT.—(a) *General.* * * *

(b) [Reserved]

(c) *Amount of distribution.*—(1) Where a distribution of stock or rights to acquire stock of a corporation is treated as a distribution of property to which section 301 applies by reason of section 305(b)(2), the amount of the distribution, in accordance with section 301(b) and § 1.301–1, is the fair market value of such stock or rights on the date of distribution. Accordingly, where a corporation makes a distribution, to which section 305(b)(2) is applicable, which is payable either in property or in its own stock or rights to acquire its stock the amount distributed with respect to all shareholders receiving stock or rights is the fair market value, on the date of distribution, of the stock or rights received. The amount distributed with respect to shareholders receiving property is the fair market value, on the date of distribution, of such property received or, in the case of corporate distributees, the adjusted basis of such property in the hands of the distributing corporation if less than its fair market value. Where a corporation which regularly distributes its earnings and profits, such as a regulated investment company, declares a dividend pursuant to which the shareholders may elect to receive either money or stock of the distributing corporation of equivalent value and, on a date shortly before the distribution, there is a determination of the amount of stock to be distributed to those shareholders who elect to receive stock equal in value to the amount of money that could be received instead, the amount of the distribution of the stock received by any shareholder will be considered to equal the amount of the money which could have been received instead.

(2) The application of section 305(b) may be illustrated by the following examples:

Example (1). (i) Corporation X declared a dividend payable in additional shares of its common stock to the holders of its outstanding common stock on the basis of two additional shares for each share held on the record date but with the provision that, at the election of any shareholder made within a specified period prior to the distribution date, he may receive one additional share for each share held on the record date plus $12 principal amount of securities of Corporation Y owned by Corporation X. The fair market value of the stock of Corporation X on the distribution date was $10 per share. The fair market value of the $12 principal amount of securities of Corporation Y on the distribution date was $11 but such securities had a cost basis to Corporation X of $9.

(ii) The distribution to all shareholders of one additional share of stock of Corporation X (with respect to which no election applies) for each share outstanding is not a distribution to which section 301 applies.

(iii) The distribution of the second share of stock of Corporation X to those shareholders who do not elect to receive securities of Corporation Y is a distribution of property to which section 301 applies, whether such shareholders

are individuals or corporations. The amount of the distribution to which section 301 applies is $10 per share of stock of Corporation X held on the record date (the fair market value of the stock of Corporation X on the distribution date).

(iv) The distribution of securities of Corporation Y in lieu of the second share of stock of Corporation X to the shareholders of Corporation X, whether individuals or corporations, who elect to receive such securities, is also a distribution of property to which section 301 applies.

(v) In the case of the individual shareholders of Corporation X who elect to receive such securities, the amount of the distribution to which section 301 applies is $11 per share of stock of Corporation X held on the record date (the fair market value of the $12 principal amount of securities of Corporation Y on the distribution date).

(vi) In the case of the corporate shareholders of Corporation X electing to receive such securities, the amount of the distribution to which section 301 applies is $9 per share of stock of Corporation X held on the record date (the basis of the securities of Corporation Y in the hands of Corporation X).

Example (2). On January 10, 1960, Corporation X, a regulated investment company, declared a dividend of $1 per share on its common stock payable on February 11, 1960, in cash or in stock of Corporation X of equivalent value determined as of January 22, 1960, at the election of the shareholder made on or before January 22, 1960. The amount of the distribution to which section 301 applies is $1 per share whether the shareholder elects to take cash or stock and whether the shareholder is an individual or a corporation. Such amount will also be used in determining the dividend paid deduction of Corporation X and the reduction in earnings and profits of Corporation X.

PAR. 2. The title of § 1.312–11 and paragraph (a) of that section are amended to read as follows:

§ 1.312–11 EFFECT ON EARNINGS AND PROFITS OF CERTAIN OTHER TAX-FREE EXCHANGES. TAX-FREE DISTRIBUTIONS AND TAX-FREE TRANSFERS FROM ONE CORPORATION TO ANOTHER.—(a) If property is transferred by one corporation to another, and, under the law applicable to the year in which the transfer was made, no gain or loss was recognized (or was recognized only to the extent of the property received other than that permitted by such law to be received without the recognition of gain), then proper adjustment and allocation of the earnings and profits of the transferor shall be made as between the transferor and the transferee. Transfers to which the preceding sentence applies include contributions to capital, transfers under section 351, transfers in connection with reorganizations under section 368, transfers in liquidations under section 332 and intercompany transfers during a period of affiliation. However, if, for example, property is transferred from one corporation to another in a transaction under section 351 or as a contribution to capital and the transfer is not followed or preceded by a reorganization, a transaction under section 302(a) involving a substantial part of the transferor's stock, or a total or partial liquidation, then ordinarily no allocation of the earnings and profits of the transferor shall be made. For specific rules as to allocation of earnings and profits in certain reorganizations under section 368 and in certain liquidations under section 332 see section 381 and the regulations thereunder. For allocation of earnings and profits in certain corporate separations see section 312(i) and § 1.312–10.

* * * * * * *

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805)).

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved June 28, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 30, 1960, 8:51 a.m., and published in the issue of the Federal Register for July 1, 1960, 25 F.R. 6183)

Subpart B.—Effects on Corporation

SECTION 312.—EFFECT ON EARNINGS AND PROFITS

26 CFR 1.312.11: Effect on earnings and profits of certain other tax-free exchanges, tax-free distributions and tax-free transfers from one corporation to another.

Amended regulations relating to the allocation of earnings and profits in certain tax-free transfers. See T.D. 6476, page 111.

Subpart C.—Definitions; Constructive Ownership of Stock

SECTION 316.—DIVIDEND DEFINED

26 CFR 1.316–1; Dividends.

Distributions made by a corporation to its shareholders. See Rev. Rul. 60–322, page 118.

PART II.—CORPORATE LIQUIDATIONS

Subpart A.—Effects on Recipients

SECTION 332.—COMPLETE LIQUIDATIONS OF SUBSIDIARIES

26 CFR 1.332–1: Distributions in liquidation of subsidiary corporation—General.

Purchase by a corporation of all of the capital stock of another "going business" corporation, followed by the complete liquidation of the latter into the former. See Rev. Rul. 60–262, below.

SECTION 334.—BASIS OF PROPERTY RECEIVED IN LIQUIDATIONS

26 CFR 1.334–1: Basis of property received in liquidations. Rev. Rul. 60–262
(Also Section 332; 1.332–1.)

A new corporation was organized in 1955 by an individual for the purpose of acquiring the going business of another corporation. The following month, the new corporation purchased all the capital stock of the "going business" corporation, which had no stock connections with the above individual prior to the sale. Within two years after such purchase, the acquiring corporation (parent) liquidated its wholly-owned subsidiary in a transaction to which section 332 of the Internal Revenue Code of 1954 applies. The continuing corporation, under the provisions of section 334(b)(2) of the Code,

computed a new "stepped-up" basis for the assets acquired upon the liquidation of its subsidiary, based upon the consideration paid by it for the capital stock of the subsidiary. *Held*, under these circumstances, since the continuing corporation fulfilled all the requirements of section 334(b)(2) of the Code, it is entitled to the benefits of that section. The fact that the continuing corporation was originally organized by an individual for the purpose of obtaining a "going business" would not operate to deny it the benefits of section 334(b)(2) of the Code.

In similar circumstances the purchase of stock by a new corporation to acquire a "going business" was considered in substance a purchase of assets under the Internal Revenue Code of 1939. See Revenue Ruling 60–246, page 462, this Bulletin, announcing that the Internal Revenue Service will follow the decision of the United States Court of Appeals for the Fifth Circuit in *United States* v. *M. O. J. Corporation*, 274 Fed. (2d) 713.

In this connection, the formal steps themselves are significant under the 1954 Code and the element of purpose or intent is immaterial. Accordingly, the continuing corporation is entitled to a "stepped-up" basis in the assets received, equal to the adjusted basis to it of the capital stock of the "purchase" subsidiary corporation. See section 1.334–1(c) of the Income Tax Regulations.

Subpart B.—Effects on Corporations

SECTION 337.—GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS

26 CFR 1.337–1: General.

State income taxes paid by a corporation on sales of its property in a section 337 liquidation. See Rev. Rul. 60–236, page 109.

Subpart D.—Definition

SECTION 346.—PARTIAL LIQUIDATION DEFINED

26 CFR 1.346–1: Partial liquidation. Rev. Rul. 60–232

> Where the termination of all or part of one business of a corporation resulted in a genuine contraction of the corporate business, a distribution by the corporation in redemption of a portion of its capital stock constituted a distribution in partial liquidation within the meaning of section 346(a) of the Internal Revenue Code of 1954, to the extent that the distribution did not exceed the net proceeds from the sale of the business assets plus that portion of the working capital reasonably attributable to the terminated business activities and no longer required in the operation of the continuing business activities.
>
> Revenue Ruling 55–373, C.B. 1955–1, 363, modified.

Advice has been requested whether a distribution of certain property by a corporation to its shareholders in redemption of a portion

of its stock qualifies as a distribution in partial liquidation of the corporation within the meaning of section 346(a) of the Internal Revenue Code of 1954.

The instant corporation was engaged principally in the business of repairing contractors' equipment. The corporation also bought, sold and traded used contractors' equipment. It had an inventory of such equipment which it rented to contractors. The corporation owns the building in which the business was conducted.

The above-described business was actively conducted until the date of its recent sale in an arm's-length transaction, the buyer having no business connection with the corporation and its stockholders. The assets sold consisted of rental equipment, all miscellaneous inventory, all work in process and a service truck. The buyer leased the real estate of the corporation and also other property, consisting of shop equipment, machines, tools, office furniture and fixtures and storage equipment. The corporation thereafter was engaged only in the business of leasing such property to the buyer.

The termination of the foregoing business made advisable the partial liquidation of the corporation. Accordingly, pursuant to a plan of partial liquidation, the corporation distributed an amount in cash and securities equal to the net proceeds from the sale of the business assets plus that portion of the working capital (cash, accounts receivable, etc.) attributable to the business activity terminated by the sale. This distribution was pro rata to the stockholders and each stockholder turned in for cancellation and redemption a portion of his stock in the corporation.

The issue is whether the amount of the distribution which is treated as in partial liquidation within the purview of section 346(a) of the Code may exceed the net proceeds realized from the sale of the business assets.

Revenue Ruling 55–373, C.B. 1955–1, 363, holds that where there is a genuine contraction of the corporate business activity, a distribution by a corporation in redemption of a portion of its capital stock is treated as in partial liquidation to the extent that the distribution does not exceed the net proceeds derived by the corporation from the bulk sales of its inventories, but that any excess distribution is taxable as a dividend under sections 115 (a) and (g) of the Internal Revenue Code of 1939.

Section 346(a)(2) of the 1954 Code states, in part, that a distribution shall be treated as in partial liquidation of a corporation if the distribution is not essentially equivalent to a dividend, is in redemption of a part of the stock of the corporation pursuant to a plan, and occurs within the taxable year in which the plan is adopted or within the succeeding taxable year.

Section 346(b) of the 1954 Code states, in part, that a distribution shall be treated as a distribution within the meaning of the general rule of subsection (a)(2), if it is "* * * attributable to the corporation's ceasing to conduct, or consists of the assets of, a trade or business which has been actively conducted throughout the 5-year period immediately before the distribution * * *."

It does not appear that prior case law, as developed under the 1939 Code, prohibited the distribution of working capital in addition to the proceeds of the sale of assets in situations where there was a genuine contraction of corporate activity.

The amount of working capital utilized in the operation of a terminated business would clearly be "attributable to" that business, as it was necessary to the conduct of the terminated business. Since section 346(b) of the Code merely defines one type of distribution which is included in the general rule set forth in section 346(a), the same result obtains under the general rule and, therefore, the amount distributable in partial liquidation may include that portion of the working capital which is reasonably attributable to the business activity terminated.

In view of the foregoing, the Service holds that, in general, the amount which may be properly distributed as a partial liquidation includes not only the net proceeds derived from the sale of operating assets, or the assets themselves, but also includes that portion of the working capital (including cash) reasonably attributable to the business activity terminated.

In determining the amount of working capital reasonably attributable to the operation of the business activity terminated, the Service will take into consideration all pertinent factors. The amount of working capital actually used in the business activity just prior to its termination will be the primary consideration. However, an unusual or abnormal increase just prior to the distribution in the size of inventories, work in process, accounts receivable, cash accounts, or other items, may indicate an attempt to secure partial liquidation treatment of a distribution involving an amount of working capital in excess of that normally required in the operation of the business terminated. The amount of cash and other liquid assets is never in itself an indication of the amount of working capital attributable to a business activity since a corporation may retain liquid assets in excess of the needs of its business. Because the determination of the amount of working capital attributable to any business activity is a factual matter, a specific determination on this point will be made by the Service only after an examination of the income tax return of the corporation making the distribution in partial liquidation.

Under the facts set forth in the instant case, it is held that the distribution by the corporation, limited in amount to the net proceeds from the sales of assets related to the contractor's equipment business plus that portion of the working capital reasonably attributable to the terminated business activity and no longer required in the operation of the continuing business activities, constitutes a partial liquidation within the meaning of section 346(a) of the Code.

Revenue Ruling 55–373, *supra*, is modified to the extent it holds that, in the situation there concerned, any excess of the amount distributed over the net proceeds from the bulk sale of inventories, regardless of the portion of the working capital reasonably attributable to the terminated business activities, was taxable as a dividend under section 115 (a) and (g) of the 1939 Code.

(Also Section 316, 1.316–1.) Rev. Rul. 60–322

Where a corporation, which has substantial accumulated earnings but, due to the steady decline in the demand for its products, distributes cash, realized from the sale of portfolio bonds and excess inventories, to its shareholders in redemption of a part of its stock, such distribution does not constitute a partial liquidation within the purview of section 346 of the Internal Revenue Code of 1954. Such distribution will represent a dividend under section 301 of the Code.

Advice has been requested relative to the tax consequences of a proposed distribution by a corporation of cash, realized from the sale of United States Government bonds and excess inventories, to its stockholders under the circumstances described below.

M corporation has 3,800 shares of common stock, par value of $10x$ dollars per share, of which 200 shares are held in the treasury. The balance sheet indicates accumulated earnings of $1{,}500x$ dollars.

The corporation was engaged in the business of buying raw skins and tanning and selling the leather to a certain segment of the leather trade. It showed consistent profits until two years ago when the demand therefor suffered a serious, if not a permanent, decline. In an effort to revitalize the business, the corporation changed over to buying raw skins of another kind and tanning and selling the leather to another segment of the leather trade. However, the situation did not improve with the result that continuing losses were incurred and a large inventory of $5{,}000x$ dollars was accumulated.

Early in the year under consideration, *M* corporation determined that further purchases should be curtailed and inventories liquidated. Pursuant to this policy, the inventory was reduced to $3{,}000x$ dollars. In doing so, the corporation had sustained substantial operating losses. However, in view of the depressed state of the market and the grim future prospects, the process of liquidating its inventory is expected to be continued and the operations will be carried on at a modified basis with purchases kept at a minimum. In this manner, it is felt that the operating losses can be minimized and if the business decline continues, then a complete liquidation will eventually be voted by the stockholders. Accordingly, the *M* corporation proposes to redeem a portion of its stock with cash from the sale of United States Series G bonds and from the proceeds of the inventories being liquidated in the ordinary course of business.

Section 331 of the Internal Revenue Code of 1954, relative to gain or loss to share holders in a corporate liquidation, provides in part as follows:

(a) GENERAL RULE.—

* * * * * * *

(2) PARTIAL LIQUIDATION.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

Section 346 of such Code provides in part as follows:

(a) IN GENERAL.—For purposes of this subchapter, a distribution shall be treated as in partial liquidation of a corporation if—

* * * * * * *

(2) the distribution is not essentially equivalent to a dividend, is in redemption of a part of the stock of the corporation pursuant to a plan, and

occurs within the taxable year in which the plan is adopted or within the succeeding taxable year, including (but not limited to) a distribution which meets the requirements of subsection (b). * * *

Where a corporation has earnings available, in order for the distribution of assets by it to its shareholders to be treated as a partial liquidation, the distribution must result from a genuine contraction of the business of the corporation. See *Joseph W. Imler* v. *Commissioner*, 11 T.C. 836, acquiescence, C.B. 1949–1, 2. See also Rev. Rul. 59–240, C.B. 1959–2, 112, and Rev. Rul. 60–232, page 115, this Bulletin. In the instant case, the earnings and profits of prior years were retained in the corporation and resulted in building up a large inventory and investment of funds in Government bonds.

Under the foregoing set of facts, it is held that neither the sale of investments nor the sale of a large part of the inventory in the ordinary course of business constitutes a genuine contraction of the business of the corporation. Accordingly, the proposed distribution of cash for the portion of the stock of *M* corporation to be redeemed will not constitute a distribution in partial liquidation within the purview of section 346 of the code. The provisions of section 301 will apply to this distribution and, accordingly, the distribution will be taxed as a dividend to the extent provided in section 316.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

Subpart A.—Corporate Organizations

SECTION 351.—TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR

26 CFR 1.351–2: Receipt of property.

A transfer of depreciable property by an individual to a corporation controlled by the transferor. See Rev. Rul. 60–302, page 223.

Subpart B.—Effects on Shareholders and Security Holders

SECTION 357.—ASSUMPTION OF LIABILITY

26 CFR 1.357–2: Liabilities in excess of basis.

A transfer of depreciable property to a new corporation controlled by the transferor in which the amount of the liability to which the property is subject exceeds the total of the adjusted basis of the property transferred. See Rev. Rul. 60–302, page 223.

PART V.—CARRYOVERS

SECTION 381.—CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS

26 CFR 1.381(a): Statutory provisions; carryovers in certain corporate acquisitions; general rule. T. D. 6480 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations prescribed under section 381 (a), (b), and (c)(1) of the Internal Revenue Code of 1954.

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

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

On January 29, 1960, notice of proposed rulemaking regarding the regulations under section 381 (a), (b), and (c) (1) of the Internal Revenue Code of 1954, relating to net operating loss carryovers in certain corporate acquisitions, was published in the Federal Register (25 F.R. 756). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. Except as otherwise specifically provided therein, such regulations shall be applicable to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

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AUTHORITY: §§ 1.381(a) to 1.381(c)(1)–2, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

[1] The publication of this Treasury Decision in 25 F.R. 6555, dated July 13, 1960, contains (1) instructions for modifying the notice of proposed rule making published in 25 F.R. 756, dated January 29, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

CARRYOVERS

§ 1.381(a) STATUTORY PROVISIONS; CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS; GENERAL RULE.

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) GENERAL RULE.—In the case of the acquisition of assets of a corporation by another corporation—

(1) In a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) In a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

§ 1.381(a)–1 GENERAL RULE RELATING TO CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.—(a) *Allowance of carryovers.*—Section 381 provides that a corporation which acquires the assets of another corporation in certain liquidations and reorganizations shall succeed to, and take into account, as of the close of the date of distribution or transfer, the items described in section 381(c) of the distributor or transferor corporation. These items shall be taken into account by the acquiring corporation subject to the conditions and limitations specified in sections 381 and 382(b) and the regulations thereunder.

(b) *Determination of transactions and items to which section 381 applies.*—(1) *Qualified transactions.*—Except to the extent provided in section 381(c)(20), relating to the carryover of unused pension trust deductions in certain liquidations, the items described in section 381(c) are required by section 381 to be carried over to the acquiring corporation (as defined in subparagraph (2) of this paragraph) only in the following liquidations and reorganizations:

(i) The complete liquidation of a subsidiary corporation upon which no gain or loss is recognized in accordance with the provisions of section 332, but only if the basis of the assets distributed to the acquiring corporation is not required by section 334(b)(2) to be the adjusted basis of the stock with respect to which the distribution is made;

(ii) A statutory merger or consolidation qualifying under section 368(a)(1)(A) to which section 361 applies;

(iii) A reorganization qualifying under section 368(a)(1)(C);

(iv) A reorganization qualifying under section 368(a)(1)(D) if the requirements of section 354(b)(1) (A) and (B) are satisfied; and

(v) A mere change in identity, form, or place of organization qualifying under section 368(a)(1)(F).

(2) *Acquiring corporation defined.*—(i) Only a single corporation may be an acquiring corporation for purposes of section 381 and the regulations thereunder. The corporation which acquires the as-

sets of its subsidiary corporation in a complete liquidation to which section 381(a)(1) applies is the acquiring corporation for purposes of section 381. Generally, in a transaction to which section 381(a)(2) applies, the acquiring corporation is that corporation which, pursuant to the plan of reorganization, ultimately acquires, directly or indirectly, all of the assets transferred by the transferor corporation. If, in a transaction qualifying under section 381(a)(2), no one corporation ultimately acquires all of the assets transferred by the transferor corporation, that corporation which directly acquires the assets so transferred shall be the acquiring corporation for purposes of section 381 and the regulations thereunder, even though such corporation ultimately retains none of the assets so transferred. Whether a corporation has acquired all of the assets transferred by the transferor corporation is a question of fact to be determined on the basis of all the facts and circumstances.

(ii) The application of this subparagraph may be illustrated by the following examples:

Example (1). Y Corporation, a wholly-owned subsidiary of X Corporation, directly acquired all the assets of Z Corporation solely in exchange for voting stock of X Corporation in a transaction qualifying under section 368(a)(1)(C). Y Corporation is the acquiring corporation for purposes of section 381.

Example (2). X Corporation acquired all the assets of Z Corporation solely in exchange for voting stock of X Corporation in a transaction qualifying under section 368(a)(1)(C). Thereafter, pursuant to the plan of reorganization X Corporation transferred all the assets so acquired to Y Corporation, its wholly-owned subsidiary (see section 368(a)(2)(C)). Y Corporation is the acquiring corporation for purposes of section 381.

Example (3). X Corporation acquired all the assets of Z Corporation solely in exchange for the voting stock of X Corporation in a transaction qualifying under section 368(a)(1)(C). Thereafter, pursuant to the plan of reorganization X Corporation transferred one-half of the assets so acquired to Y Corporation, its wholly-owned subsidiary, and retained the other half of such assets. X Corporation is the acquiring corporation for purposes of section 381.

Example (4). X Corporation acquired all the assets of Z Corporation solely in exchange for voting stock of X Corporation in a transaction qualifying under section 368(a)(1)(C). Thereafter, pursuant to the plan of reorganization X Corporation transferred one-half of the assets so acquired to Y Corporation, its wholly-owned subsidiary, and the other half of such assets to M Corporation, another wholly-owned subsidiary of X Corporation. X Corporation is the acquiring corporation for purposes of section 381.

(3) *Transactions and items not covered by section 381.*—(i) Section 381 does not apply to partial liquidations, divisive reorganizations, or other transactions not described in subparagraph (1) of this paragraph. Moveover, section 381 does not apply to the carryover of an item or tax attribute not specified in subsection (c) thereof. In a case where section 381 does not apply to a transaction, item, or tax attribute by reason of either of the preceding sentences, no inference is to be drawn from the provisions of section 381 as to whether any

item or tax attribute shall be taken into account by the successor corporation.

(ii) If, pursuant to the provisions of subparagraph (2) of this paragraph, a corporation is considered to be the acquiring corporation even though a part of the acquired assets is transferred to one or more corporations controlled by the acquiring corporation, or all the acquired assets are transferred to two or more corporations controlled by the acquiring corporation, then the carryover of any item described in section 381(c) to such controlled corporation or corporations shall be determined without regard to section 381. Thus, for example, if a parent corporation is the acquiring corporation for purposes of section 381 notwithstanding the fact that, pursuant to the plan of reorganization, it transferred to its wholly-owned subsidiary property acquired from the transferor corporation which the transferor corporation had elected to inventory under the last-in first-out method, then the question whether the subsidiary corporation shall continue to use the same method of inventorying with respect to that property shall be determined without regard to section 381.

(c) *Foreign corporations.*—A foreign corporation may be a distributor, transferor, or acquiring corporation for purposes of section 381. Thus, for example, the net operating loss carryovers of a foreign corporation, determined under the provisions of section 172 and subchapter N, chapter 1 of the Code, may be carried over to a domestic acquiring corporation if the domestic corporation acquires the assets of the foreign corporation in a liquidation or reorganization described in section 381(a) and the requirements of § 1.367–1, if applicable, have been complied with.

(d) *Internal Revenue Code of 1939.*—Any reference in the regulations under section 381 to any provision of the Internal Revenue Code of 1954 shall, where appropriate, be deemed also to refer to the corresponding provision of the Internal Revenue Code of 1939.

§ 1.381(b) STATUTORY PROVISIONS; CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS; OPERATING RULES.

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS. * * *

(b) OPERATING RULES.—Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)—

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

(2) For purposes of this section, the date of distribution or transfer shall be the day on which the distribution or transfer is completed; except that, under regulations prescribed by the Secretary or his delegate, the date when substantially all of the property has been distributed or transferred may be used if the distributor or transferor corporation ceases all operations, other than liquidating activities, after such date.

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

§ 1.381(b)–1 OPERATING RULES APPLICABLE TO CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.—(a) *Closing of taxable year.*—

(1) *In general.*—Except in the case of a reorganization qualifying under section 368(a)(1)(F), the taxable year of the distributor or transferor corporation shall end with the close of the date of distribution or transfer.

(2) *Reorganizations under section 368(a)(1)(F).*—In the case of a reorganization qualifying under section 368(a)(1)(F) (whether or not such reorganization also qualifies under any other provision of section 368(a)(1)), the acquiring corporation shall be treated (for purposes of section 381) just as the transferor corporation would have been treated if there had been no reorganization. Thus, the taxable year of the transferor corporation shall not end on the date of transfer merely because of the transfer; a net operating loss of the acquiring corporation for any taxable year ending after the date of transfer shall be carried back in accordance with section 172(b) in computing the taxable income of the transferor corporation for a taxable year ending before the date of transfer; and the tax attributes of the transferor corporation enumerated in section 381(c) shall be taken into account by the acquiring corporation as if there had been no reorganization.

(b) *Date of distribution or transfer.*—(1) The date of distribution or transfer shall be that day on which are distributed or transferred all those properties of the distributor or transferor corporation which are to be distributed or transferred pursuant to a liquidation or reorganization described in paragraph (b)(1) of § 1.381(a)-1. If the distribution or transfer of all such properties is not made on one day, then, except as provided in subparagraph (2) of this paragraph, the date of distribution or transfer shall be that day on which the distribution or transfer of all such properties is completed.

(2) If the distributor or transferor and acquiring corporations file the statements described in subparagraph (3) of this paragraph, the date of distribution or transfer shall be that day as of which (i) substantially all of the properties to be distributed or transferred have been distributed or transferred, and (ii) the distributor or transferor corporation has ceased all operations (other than liquidating activities). Such day also shall be the date of distribution or transfer if the completion of the distribution or transfer is unreasonably postponed beyond the date as of which substantially all the properties to be distributed or transferred have been distributed or transferred and the distributor or transferor corporation has ceased all operations other than liquidating activities. A corporation shall be considered to have distributed or transferred substantially all of its properties to be distributed or transferred even though it retains money or other property in a reasonable amount to pay outstanding debts or preserve the corporation's legal existence. A corporation shall be considered to have ceased all operations, other than liquidating activities, when it ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance of its money or other properties to its shareholders.

(3) The statements referred to in subparagraph (2) of this paragraph shall specify the day considered to be the date of distribution or transfer and shall specify, as of such date, (i) the nature and amount of the total assets which were distributed or transferred and

the dates so distributed or transferred, (ii) the nature and amount of the assets not distributed or transferred and the purpose for which they were retained, and (iii) the date on which the distributor or transferor corporation ceased all operations other than liquidating activities. Such statements shall be attached to the timely filed income tax return of the distributor or transferor corporation for its taxable year ending with such date of distribution or transfer and to the timely filed income tax return of the acquiring corporation for its first taxable year ending after such date, except that, with respect to any income tax return filed before October 11, 1960, any such statement shall be filed before October 11, 1960, with the district director with whom such return is filed.

(4) If—

(i) The last day of the acquiring corporation's taxable year is a Saturday, Sunday, or legal holiday, and

(ii) The day specified in subparagraph (1) or (2) of this paragraph as the date of distribution or transfer is the last business day before such Saturday, Sunday, or holiday,

then the last day of the acquiring corporation's taxable year shall be the date of distribution or transfer for purposes of section 381(b) and this section. For purposes of this subparagraph, the term "business day" means a day which is not a Saturday, Sunday, or legal holiday, and also means a Saturday, Sunday, or legal holiday if the date of distribution or transfer determined under subparagraph (1) or (2) of this paragraph is such Saturday, Sunday, or holiday.

(c) *Return of distributor or transferor corporation.*—The distributor or transferor corporation shall file an income tax return for the taxable year ending with the date of distribution or transfer described in paragraph (b) of this section. If the distributor or transferor corporation remains in existence after such date of distribution or transfer, it shall file an income tax return for the taxable year beginning on the day following the date of distribution or transfer and ending with the date on which the distributor or transferor corporation's taxable year would have ended if there had been no distribution or transfer.

(d) *Carryback of net operating losses.*—For provisions relating to the carryback of net operating losses of the acquiring corporation, see paragraph (b) of § 1.381(c)(1)–1.

§ 1.381(c)(1) STATUTORY PROVISIONS; CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS; ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION; NET OPERATING LOSS CARRYOVERS.

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS. * * *

(c) ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION.—The items referred to in subsection (a) are:

(1) NET OPERATING LOSS CARRYOVERS.—The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer.

(B) In determining the net operating loss deduction, the portion of such deduction attributable to the net operating

loss carryovers of the distributor or transferor corporation to the first taxable year of the acquiring corporation ending after the date of distribution or transfer shall be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of the acquiring corporation in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

(C) For the purpose of determining the amount of the net operating loss carryovers under section 172(b)(2), a net operating loss for a taxable year (hereinafter in this subparagraph referred to as the "loss year") of a distributor or transferor corporation which ends on or before the end of a loss year of the acquiring corporation shall be considered to be a net operating loss for a year prior to such loss year of the acquiring corporation. For the same purpose, the taxable income for a "prior taxable year" (as the term is used in section 172(b)(2)) shall be computed as provided in such section; except that, if the date of distribution or transfer is on a day other than the last day of a taxable year of the acquiring corporation—

(i) Such taxable year shall (for the purpose of this subparagraph only) be considered to be 2 taxable years (hereinafter in this subparagraph referred to as the "pre-acquisition part year" and the "post-acquisition part year");

(ii) The pre-acquisition part year shall begin on the same day as such taxable year begins and shall end on the date of distribution or transfer;

(iii) The post-acquisition part year shall begin on the day following the date of distribution or transfer and shall end on the same day as the end of such taxable year;

(iv) The taxable income for such taxable year (computed with the modifications specified in section 172(b)(2)(A) but without a net operating loss deduction) shall be divided between the pre-acquisition part year and the post-acquisition part year in proportion to the number of days in each;

(v) The net operating loss deduction for the pre-acquisition part year shall be determined as provided in section 172(b)(2)(B), but without regard to a net operating loss year of the distributor or transferor corporation; and

(vi) The net operating loss deduction for the post-acquisition part year shall be determined as provided in section 172(b)(2)(B).

§ 1.381(c)(1)-1 NET OPERATING LOSS CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.—(a) *Carryover requirement.*—(1) Section 381(c)(1) requires the acquiring corporation to succeed to, and take into account, the net operating loss carryovers of the distributor or transferor corporation. To determine the amount of these carryovers as of the close of the date of distribution or transfer, and to integrate them with any carryovers and carrybacks of the acquiring corporation for purposes of determining the taxable income of the acquiring corporation for taxable years ending after the date of distribution or transfer, it is necessary to apply the provisions of section 172 in accordance with the conditions and limitations of section 381(c)(1) and this section. See also section 382(b) and the regulations thereunder.

(2) The net operating loss carryovers and carrybacks of the acquiring corporation determined as of the close of the date of distribution

or transfer shall be computed without reference to any net operating loss of a distributor or transferor corporation. The net operating loss carryovers of a distributor or transferor corporation as of the close of the date of distribution or transfer shall be determined without reference to any net operating loss of the acquiring corporation.

(b) *Carryback of net operating losses.*—A net operating loss of the acquiring corporation for any taxable year ending after the date of distribution or transfer shall not be carried back in computing the taxable income of a distributor or transferor corporation. However, a net operating loss of the acquiring corporation for any such taxable year shall be carried back in accordance with section 172(b) in computing the taxable income of the acquiring corporation for a taxable year ending on or before the date of distribution or transfer. If a distributor or transferor corporation remains in existence after the date of distribution or transfer, a net operating loss sustained by it or any taxable year beginning after such date shall be carried back in accordance with section 172(b) in computing the taxable income of such corporation for a taxable year ending on or before that date, but may not be carried back or over in computing the taxable income of the acquiring corporation. This paragraph may be illustrated by the following examples:

Example (1). On December 31, 1954, X Corporation merged into Y Corporation in a statutory merger to which section 361 applies, and the charter of Y Corporation continued after the merger. Y Corporation sustained a net operating loss for the calendar year 1955. Y Corporation's net operating loss for 1955 may not be carried back in computing the taxable income of X Corporation but shall be carried back in computing the taxable income of Y Corporation.

Example (2). On December 31, 1954, X Corporation and Y Corporation transferred all their assets to Z Corporation in a statutory consolidation to which section 361 applies. Z Corporation sustained a net operating loss for the calendar year 1955. Z Corporation's net operating loss for 1955 may not be carried back in computing the taxable income of X Corporation or Y Corporation.

Example (3). On December 31, 1954, X Corporation ceases all operations (other than liquidating activities) and transferred substantially all its properties to Y Corporation in a reorganization qualifying under section 368(a)(1)(C). Such properties comprised all of X Corporation's properties which were to be transferred pursuant to the reorganization. In the process of liquidating its assets and winding up its affairs, X Corporation sustained a net operating loss for its taxable year beginning on January 1, 1955. This net operating loss of X Corporation shall be carried back in computing the taxable income of that corporation but may not be carried back or over in computing the taxable income of Y Corporation.

(c) *First taxable year to which carryovers apply.*—(1) The net operating loss carryovers available to the distributor or transferor corporation as of the close of the date of distribuiton or transfer shall first be carried to the first taxable year of the acquiring corporation ending after that date. This rule applies irrespective of whether the date of distribution or transfer is on the last day, or any other day, of the acquiring corporation's taxable year. Thus, such net operating loss carryovers shall first be used by the acquiring corporation with

respect to the computation of its net operating loss deduction under section 172(a), and its taxable income determined under the provisions of section 172(b)(2), for such first taxable year. However, see paragraph (f) of this section.

(2) The net operating loss carryovers available to the distributor or transferor corporation as of the close of the date of distribution or transfer shall be carried to the acquiring corporation without diminution by reason of the fact that the acquiring corporation does not acquire 100 percent of the assets of the distributor or transferor corporation. Thus, if a parent corporation owning 80 percent of all classes of a stock of its subsidiary corporation were to acquire its share of the assets of the subsidiary corporation upon a complete liquidation described in paragraph (b)(1)(i) of § 1.381(a)–1, then, subject to the conditions and limitations of this section, 100 percent of the net operating loss carryovers available to the subsidiary corporation as of the close of the date of distribution would be carried over to the parent corporation.

(d) *Limitation on net operating loss deduction for first taxable year ending after date of distribution or transfer.*—(1) That part of the acquiring corporation's net operating loss deduction, determined in accordance with sections 172(a) and 381(c)(1), for its first taxable year ending after the date of distribution or transfer which is attributable to the net operating loss carryovers of the distributor or transferor corporation, is limited by section 381(c)(1)(B) and this paragraph to an amount equal to the acquiring corporation's postacquisition part year taxable income. Such postacquisition part year taxable income is the amount which bears the same ratio to the acquiring corporation's taxable income for the first taxable year ending after the date of distribution or transfer (determined under section 63 without regard to any net operating loss deduction but taking into account other items to which the acquiring corporation succeeds under section 381) as the number of days in such first taxable year which follow the date of distribution or transfer bears to the total number of days in such taxable year. Thus, if the date of distribution or transfer is the last day of the acquiring corporation's taxable year, the net operating loss carryovers of the distributor or transferor are allowed in full in computing under section 172(a) the net operating loss deduction of the acquiring corporation for its first taxable year ending after that date. In such instance, the number of days in the first taxable year which follow the date of distribution or transfer is the total number of days in such taxable year.

(2) The limitation provided by section 381(c)(1)(B) applies solely for the purpose of computing the net operating loss deduction of the acquiring corporation under section 172(a) for the acquiring corporation under section 172(a) for the acquiring corporation's first taxable year ending after the date of distribution or transfer. The limitation does not apply for purposes of determining the portion of any net operating loss (whether of the distributor, transferor, or acquiring corporation) which may be carried to any taxable year of the acquiring corporation following its first taxable year ending after the date of distribution or transfer since such determination is made pursuant to section 172(b) and section 381(c)(1)(C). See paragraphs (e) and (f) of this section.

(3) The limitation provided by section 381(c)(1)(B) shall be applied to the aggregate of the allowable net operating loss carryovers of the distributor or transferor corporation without reference to the taxable years in which the net operating losses were sustained by such corporation. If the acquiring corporation has acquired the assets of two or more distributor or transferor corporations on the same date of distribution or transfer, then the limitation provided by section 381(c)(1)(B) shall be applied to the aggregate of the net operating loss carryovers from all of such distributor or transferor corporations.

(4) If the acquiring corporation succeeds to the net operating loss carryovers of two or more distributor or transferor corporations on two or more different dates of distribution or transfer within one taxable year of the acquiring corporation, the limitation to be applied under section 381(c)(1)(B) to the aggregate of such carryovers shall be governed by the rules prescribed in paragraph (b) of § 1.381(c)(1)-2.

(5) *Illustrations.*—The application of this paragraph may be illustrated by the following examples:

Example (1). (i) X Corporation and Y Corporation were organized on January 1, 1956, and make their returns on the calendar year basis. On December 16, 1957, X Corporation transferred all its assets to Y Corporation in a statutory merger to which section 361 applies. The net operating losses and taxable income (computed without the net operating loss deduction) of the two corporations are as follows, the assumption being made that none of the modifications specified in section 172(b)(2)(A) apply to any taxable year:

Taxable year	*X Corporation (transferor)*	*Y Corporation (acquirer)*
1956	($35,000)	($5,000)
Ending 12/16/57	(30,000)	xxx
1957	xxx	36,500

(ii) The aggregate of the net operating loss carryovers of X Corporation carried under section 381(c)(1)(A) to Y Corporation's taxable year ending December 31, 1957, is $65,000; but pursuant to section 381(c)(1)(B), only $1,500 of such aggregate amount ($36,500 x 15/365) may be used in computing the net operating loss deduction of Y Corporation for such taxable year under section 172(a). This limitation applies even though Y Corporation's own net operating loss carryover to such year is only $5,000, with the result that Y Corporation has taxable income under section 63 of $30,000 for its taxable year ending December 31, 1957, that is, $36,500 less the sum of $5,000 and $1,500.

(iii) For rules determining the portion of any given loss of X Corporation or Y Corporation which may be carried to a taxable year of Y Corporation following its taxable year ending December 31, 1957, see sections 172(b)(2) and 381(c)(1)(C) and paragraph (f) of this section.

Example (2). (i) X Corporation was organized on January 1, 1954, and Y Corporation was organized on January 1, 1956. Each corporation makes its return on the basis of the calendar year. On December 31, 1956, X Corporation transferred all its assets to Y Corporation in a statutory merger to which section 361 applies. The

net operating losses and the taxable income (computed without any net operating loss deduction) of the two corporations are as follows, the assumption being made that none of the modifications specified in section 172(b)(2)(A) apply to any taxable year:

Taxable year	*X Corporation (transferor)*	*Y Corporation (acquirer)*
1954	($5,000)	xxx
1955	(15,000)	xxx
1956	(10,000)	$20,000
1957	xxx	40,000

(ii) The aggregate of the net operating loss carryovers of X Corporation carried under section 381(c)(1)(A) to Y Corporation's taxable year 1957 is $30,000, and the full amount of such carryovers is allowed in such taxable year to Y Corporation as a deduction under section 172(a), since such amount does not exceed the limitation ($40,000 x 365/365) for such taxable year under section 381(c)(1)(B).

Example (3). (i) X Corporation, Y Corporation, and Z Corporation were organized on January 1, 1954, and each corporation makes its return on the basis of the calendar year. On September 30, 1956, X Corporation and Y Corporation transferred all their assets to Z Corporation in a statutory merger to which section 361 applies. The net operating loses and the taxable income (computed without any net operating loss deduction) of the three corporations are as follows, the assumption being made that none of the modifications specified in section 172(b)(2)(A) apply to any taxable year:

Taxable year	*X Corporation (transferor)*	*Y Corporation (transferor)*	*Z Corporation (acquirer)*
1954	($5,000)	($3,000)	($40,000)
1955	(4,000)	(2,000)	10,000
Ending 9/30/56	(1,000)	(9,000)	xxx
1956	xxx	xxx	73,200

(ii) The aggregate of the net operating loss carryovers of X Corporation and Y Corporation carried under section 381(c)(1)(A) to Z Corporation's taxable year 1956 is $24,000; but, pursuant to section 381(c)(1)(B), only $18,400 of such aggregate amount ($73,200 x 92/366) may be used in computing the net operating loss deduction of Z Coporation for such taxable year under section 172(a). For this purpose, Z Corporation may not use the total of the aggregate carryovers ($10,000) from X Corporation plus the aggregate carryovers ($14,000) from Y Corporation, even though each such aggregate of carryovers is separately less than the limitation ($18,400) applicable under section 381(c)(1)(B) and this section.

(iii) For rules determining the portion of any given loss of X Corporation, Y Corporation, or Z Corporation which may be carried to a taxable year of Z Corporation following its taxable year ending December 31, 1956, see sections 172(b)(2) and 381(c)(1)(C) and paragraph (f) of this section.

(e) *Computation of carryovers and carrybacks; general rule.*—(1) *Sequence for applying losses and computation of taxable income.*—The portion of any net operating loss which is carried back or carried over to any taxable year is the excess, if any, of the amount of the loss over the sum of the taxable income for each of the prior taxable years to which the loss may be carried under sections 172(b)(1) and

381. In determining the taxable income for each such prior taxable year for this purpose, the various net operating loss carryovers and carrybacks to such prior taxable year are considered to be applied in reduction of the taxable income in the order of the taxable years in which the net operating losses are sustained, beginning with the loss for the earliest taxable year. The application of this rule to the taxable income of the acquiring corporation for any taxable year ending after the date of distribution or transfer involves the use of carryovers of the distributor or transfer corporation, and of carryovers and carrybacks of the acquiring corporation. In such instance, the sequence for the use of the loss years remains the same, and the requirement is to begin with the net operating loss of the earliest taxable year, whether or not it is a loss of the distributor, transferor, or acquiring corporation. The taxable income of the acquiring corporation for any taxable year ending after the date of distribution or transfer shall be determined in the manner prescribed by section 172(b)(2), except that, if the date of distribution or transfer is on a day other than the last day of a taxable year of the acquiring corporation, the taxable income of such corporation for the taxable year which includes such date shall be computed in the special manner prescribed by section 381(c)(1)(C) and paragraph (f) of this section.

(2) *Loss year of transferor or distributor considered prior taxable year.*—Section 381(c)(1)(C) provides that, for the purpose of determining the net operating loss carryovers under section 172(b)(2), a net operating loss for a loss year of a distributor or transferor corporation which ends on or before the last day of a loss year of the acquiring corporation shall be considered to be a net operating loss for a year prior to such loss year of the acquiring corporation. In a case where the acquiring corporation has acquired the assets of two or more distributor or transferor corporations on the same date of distribution or transfer, the loss years of the distributor or transferor corporations shall be taken into account in the order in which such loss years terminate; if any one of the loss years of a distributor or transferor corporation ends on the same day as the loss year of another distributor or transferor corporation, either loss year may be taken into account before the other.

(3) *Years to which losses may be carried.*—The taxable years to which a net operating loss shall be carried back or carried over are prescribed by section 172(b)(1). Since the taxable year of the distributor or transferor corporation ends with the close of the date of distribution or transfer, such taxable year and the first taxable year of the acquiring corporation which ends after that date shall be considered two separate taxable years to which a net operating loss of the distributor or transferor corporation for any taxable year ending before that date may be carried over. This rule applies even though the taxable year of the distributor or transferor corporation which ends on the date of distribution or transfer is a period of less than twelve months. However, for the purpose of determining under section 173(b)(1) the taxable years to which a net operating loss of the acquiring corporation is carried over or carried back, the first taxable year of the acquiring corporation which ends after the date of distribution or transfer shall be treated as only one taxable year even though

such taxable year is considered under section 381(c)(1)(C) and paragraph (f)(2) of this section as two taxable years. The application of this subparagraph may be illustrated by the following example:

Example. X Corporation was organized on January 1, 1954, and thereafter it sustained net operating losses in its calendar years 1954, 1955, and 1956. On June 30, 1957, X Corporation transferred all its assets to Y Corporation, which was organized on January 1, 1955, in a statutory merger to which section 361 applies. In its taxable year ending June 30, 1957, X Corporation sustained a net operating loss. Y Corporation sustained net operating losses in its calendar years 1955, 1956, and 1958, but had taxable income for the year 1957. The years to which these losses of X Corporation and Y Corporation shall be carried, and the sequence in which carried, are as follows:

Loss Year	
X 1954	X 1955, X 1956, X 6/30/57, Y 1957, Y 1958.
X 1955	X 1954, X 1956, X 6/30/57, Y 1957, Y 1958, Y 1959.
Y 1955	Y 1956, Y 1957, Y 1958, Y 1959, Y 1960.
X 1956	X 1954, X 1955, X 6/30/57, Y 1957, Y 1958, Y 1959, Y 1960.
Y 1956	Y 1955, Y 1957, Y 1958, Y 1959, Y 1960, Y 1961.
X 6/30/57	X 1955, X 1956, Y 1957, Y 1958, Y 1959, Y 1960, Y 1961.
Y 1958	Y 1955, Y 1956, Y 1957, Y 1959, Y 1960, Y 1961, Y 1962, Y 1963.

(4) *Computation of carryover in a case where the date of distribution or transfer occurs on last day of acquiring corporation's taxable year.*—The computation of the net operating loss carryovers from the distributor or transferor corporation and from the acquiring corporation in a case where the date of distribution or transfer occurs on the last day of a taxable year of the acquiring corporation may be illustrated by the following example:

Example. X Corporation and Y Corporation were organized on January 1, 1955, and each corporation makes its return on the basis of the calendar year. On December 31, 1956, X Corporation transferred all its assets to Y Corporation in a statutory merger to which section 361 applies. The net operating losses and the taxable income (computed without any net operating loss deduction) of the two corporations are as follows, the assumption being made that none of the modifications specified in section 172(b)(2)(A) apply to any taxable year:

Taxable year	*X Corporation (transferor)*	*Y Corporation (acquirer)*
1955	($2,000)	($11,000)
1956	(3,000)	10,000
1957	xxx	(15,000)

The sequence in which the losses of X Corporation and Y Corporation are applied, and the computation of the carryovers to Y Corporation's calendar year 1958, may be illustrated as follows:

(i) *X Corporation's 1955 loss.*—The carryover to 1958 is $2,000, computed as follows:

Net operating loss		$2,000
Less:		
X's 1956 taxable income	$0	
Y's 1957 taxable income	0	
		0
Carryover		2,000

(ii) *Y Corporation's 1955 loss.*—The carryover to 1958 is $1,000, computed as follows:

Net operating loss		$11,000
Less:		
Y's 1956 taxable income	$10,000	
Y's 1957 taxable income	0	
		10,000
Carryover		1,000

(iii) *X Corporation's 1956 loss.*—The carryover to 1958 is $3,000, computed as follows:

Net operating loss		$3,000
Less:		
X's 1955 taxable income	$0	
Y's 1957 taxable income	0	
		0
Carryover		3,000

(iv) *Y Corporation's 1957 loss.*—The carryover to 1958 is $15,000, computed as follows:

Net operating loss			$15,000
Less:			
Y's 1955 taxable income		$0	
Y's 1956 taxable income before net operating loss deduction	$10,000		
Minus Y's 1956 net operating loss deduction (i.e., Y's 1955 carryover)	11,000		
			0
		0	
Carryover			15,000

(v) *Summary of carryovers to 1958.*—The aggregate of the net operating loss carryovers to 1958 is $21,000, computed as follows:

X's 1955 loss	$2,000
Y's 1955 loss	1,000
X's 1956 loss	3,000
Y's 1957 loss	15,000
Total	21,000

(f) *Computation of carryovers and carrybacks when date of distribution or transfer is not on last day of acquiring corporation's taxable year.*—(1) *General rule.*—Pursuant to the provisions of section 381(c)(1)(C), the taxable income of the acquiring corporation for its taxable year which is a prior taxable year for purposes of section 172(b)(2) and paragraph (e) of this section shall be determined in the manner prescribed in this paragraph, if the date of distribution or transfer occurs within, but not on the last day of, such taxable year.

(2) *Taxable year considered as two taxable years.*—Such taxable year of the acquiring corporation shall be considered as though it were two taxable years, but only for the limited purpose of applying section 172(b)(2). The first of such two taxable years shall be referred to in this section as the preacquisition part year; the second, as the post-acquisition part year. For purposes of section 172(b)(2), a net op-

erating loss of the acquiring corporation shall be carried to the preacquisition part year and then to the postacquisition part year, whereas a net operating loss of a distributor or transferor corporation shall be carried to the postacquisition part year and then to the acquiring corporation's subsequent taxable years. In determining under section 172(b)(2) and this paragraph the portion of any net operating loss of a distributor or transferor corporation which is carried to any taxable year of the acquiring corporation ending after the postacquisition part year, the taxable income (as determined under this paragraph) of the postacquisition part year shall be taken into account but the taxable income of the preacquisition part year (as so determined) shall not be taken into account. Though considered as two separate taxable years for purposes of section 172(b)(2), the preacquisition part year and the postacquisition part year are treated as one taxable year in determining the years to which a net operating loss is carried under section 172(b)(1). See paragraph (e)(3) of this section.

(3) *Preacquisition part year.*—The preacquisition part year shall begin with the beginning of such taxable year of the acquiring corporation and shall end with the close of the date of distribution or transfer.

(4) *Postacquisition part year.*—The postacquisition part year shall begin with the day following the date of distribution or transfer and shall end with the close of such taxable year of the acquiring corporation.

(5) *Division of taxable income.*—The taxable income for such taxable year (computed with the modifications specified in section 172(b)(2)(A) but without any net operating loss deduction) of the acquiring corporation shall be divided between the preacquisition part year and the postacquisition part year in proportion to the number of days in each. Thus, if in a statutory merger to which section 361 applies Y Corporation acquires the assets of X Corporation on June 30, 1960, and Y Corporation has taxable income (computed in the manner so prescribed) of $36,600 for its calendar year 1960, then the preacquisition part year taxable income would be $18,200 ($36,600 x 182/366) and the postacquisition part year taxable income would be $18,400 ($36,600 x 184/366).

(6) *Net operating loss deduction.*—After obtaining the taxable income of the preacquisition part year and of the postacquisition part year in the manner described in subparagraph (5) of this paragraph, it is necessary to compute the net operating loss deduction for each such part year. This deduction shall be determined in the manner prescribed by section 172(b)(2)(B) but subject to the provisions of this subparagraph. The net operating loss deduction for the preacquisition part year shall, for purposes of section 172(b)(2) only, be determined in the same manner as that prescribed by section 172(b)(2)(B) but shall be computed without taking into account any net operating loss of the distributor or transferor corporation. Therefore, only net operating loss carryovers and carrybacks of the acquiring corporation to the preacquisition part year shall be taken into account in computing the net operating loss deduction for such part year. The net operating loss deduction for the postacquisition part year shall, for purposes of section 172(b)(2) only, be determined in

the same manner as that prescribed by section 172(b)(2)(B) and shall be computed by taking into account all the net operating loss carryovers available to the distributor or transferor corporation as of the close of the date of distribution or transfer, as well as the net operating loss carryovers and carrybacks of the acquiring corporation to the postacquisition part year. The sequence in which the net operating losses of the two corporations shall be applied for purposes of this subparagraph shall be determined in the manner prescribed in paragraph (e) of this section.

(7) *Limitation on taxable income.*—In no case shall the taxable income of the preacquisition part year or the postacquisition part year, as computed under this paragraph, be considered to be less than zero.

(8) *Cross reference.*—If the acquiring corporation succeeds to the net operating loss carryovers of two or more distributor or transferor corporations on two or more dates of distribution or transfer during the same taxable year of the acquiring corporation, the determination of the taxable income of the acquiring corporation for such year pursuant to section 381(c)(1)(C) shall be governed by the rules prescribed in paragraph (c) of § 1.381(c)(1)-2.

(9) *Illustration.*—The application of this paragraph may be illustrated by the following example:

Example. (i) *Facts.*—X Corporation was organized on January 1, 1955, and Y Corporation was organized on January 1, 1954. Each corporation makes its return on the basis of the calendar year. On June 30, 1956, X Corporation transferred all its assets to Y Corporation in a statutory merger to which section 361 applies. The net operating losses and the taxable income (computed without any net operating loss deduction) of the two corporations are as follows, the assumption being made that none of the modifications specified in section 172(b)(2)(A) apply to any taxable year:

Taxable year	*X Corporation (transferor)*	*Y Corporation (acquirer)*
1954	xxx	($5,000)
1955	($65,000)	(20,000)
Ending 6/30/56	1,000	xxx
1956	xxx	36,600

(ii) *Y Corporation's 1954 loss.*—The carryover to 1957 is $0, computed as follows:

Net operating loss		$5,000
Less:		
Y's 1955 taxable income		0
Carryover to Y's preacquisition part year		5,000
Less:		
Y's preacquisition part year taxable income computed under subparagraph (5) of this paragraph ($36,600 x 182/366)	$18,200	
Minus Y's net operating loss deduction for preacquisition part year	xxx	18,200
Carryover to Y's postacquisition part year and also to Y 1957		0

(iii) *X Corporation's 1955 loss.*—The carryover to 1957 is $45,600, computed as follows:

Net operating loss		$65,000
Less:		
X's 6/30/56 year taxable income		1,000
Carryover to Y's postacquisition past year		64,000
Less:		
Y's postacquisition part year taxable income computed under subparagraph (5) of this paragraph ($36,600 x 184/366)	$18,400	
Minus Y's net operating loss deduction for postacquisition part year (i.e., Y's 1954 carryover of $0 to such part year)	0	
		$18,400
Carryover to Y 1957		45,600

(iv) *Y Corporation's 1955 loss.*—The carryover to 1957 is $6,800, computed as follows:

Net operating loss		$20,000
Less:		
Y's 1954 taxable income		0
Carryover to Y's preacquisition part year		20,000
Less:		
Y's preacquisition part year taxable income computed under subparagraph (5) of this paragraph	$18,200	
Minus Y's net operating loss deduction for preacquisition part year (i.e., Y's 1954 carryover to such part year)	5,000	
		13,200
Carryover to Y's postacquisition part year		6,800
Less:		
Y's postacquisition part year taxable income computed under subparagraph (5) of this paragraph	$18,400	
Minus Y's net operating loss deduction for postacquisition part year (i.e., Y's 1954 carryover of $0, and X's 1955 carryover of $64,000, to such part year)	64,000	
		0
Carryover to Y 1957		$6,800

(v) *Summary of carryovers to 1957.*—The aggregate of the net operating loss carryovers to 1957 is $52,400, determined as follows:

Y's 1954 loss	$0
X's 1955 loss	45,600
Y's 1955 loss	6,800
Total	52,400

(g) *Successive acquiring corporations.*—An acquiring corporation which, in a distribution or transfer to which section 381(a) applies, acquires the assets of a distributor or transferor corporation which previously acquired the assets of another corporation in a transaction to which section 381(a) applies, shall succeed to and take into account, subject to the conditions and limitations of sections 172 and 381, the net operating loss carryovers available to the first acquiring corporation under sections 172 and 381.

(h) *Illustration.*—The application of this section may be further illustrated by the following example:

Example. (1) *Facts.*—X Corporation was organized on January 1, 1954, and Y Corporation was organized on January 1, 1955. Each corporation makes its return on the basis of the calendar year. On August 31, 1957, X Corporation transferred all its assets to Y Corporation in a statutory merger to which section 361 applies. The net operating losses and the taxable income of the two corporations for the taxable years involved are set forth in the tabulation below. The taxable income so shown is computed without the modifications required by section 172(b)(2)(A) and without the benefit of any net operating loss deduction. In its calendar year 1957, Y Corporation had a deduction of $365 which is disallowed by section 172(b)(2)(A).

Taxable year	*X Corporation (transferor)*	*Y Corporation (acquirer)*
1954	($7,000)	xxx
1955	(10,000)	($10,000)
1956	(25,000)	(15,000)
Ending 8/31/57	1,000	xxx
1957	xxx	54,750
1958	xxx	(5,000)
1959	xxx	50,000

(2) *Computation of carryovers and carrybacks.*—The sequence in which the losses of X Corporation and Y Corporation are applied and the computation of the carryovers to Y Corporation's calendar year 1959 may be illustrated as follows:

(i) *X Corporation's 1954 loss.*—The carryover to 1958, which is the last year to which this loss may be carried, is $0, computed as follows:

Net operating loss		$7,000
Less:		
X's 1955 taxable income	$0	
X's 1956 taxable income	0	
		0
Carryover to X's 8/31/57-year		7,000
Less:		
X's 8/31/57-year taxable income		1,000
Carryover to Y's postacquisition part year		6,000
Less:		
Y's postacquisition part year taxable income computed under paragraph (f)(5) of this section (($54,750+$365) x 122/365)	$18,422	
Minus Y's net operating loss deduction for postacquisition part year	xxx	
		18,422
Carryover to Y 1958		0

(ii) *X Corporation's 1955 loss.*—The carryover to 1959 is $0, computed as follows:

Net operating loss		$10,000
Less:		
X's 1954 taxable income	$0	
X's 1956 taxable income	0	0
Carryover to X's 8/31/57-year		10,000

Less:		
X's 8/31/57-year taxable income before net operating loss deduction	$1,000	
Minus X's net operating loss deduction for 8/31/57-year (i.e., X's 1954 carryover)	7,000	0
Carryover to Y's postacquisition part year		10,000
Less:		
Y's postacquisition part year taxable income computed under paragraph (f)(5) of this section	$18,422	
Minus Y's net operating loss deduction for postacquisition part year (i.e., X's 1954 carryover to such part year)	6,000	12,422
Carryover to Y 1958 and Y 1959		0

(iii) *Y Corporation's 1955 loss.*—The carryover to 1959 is $0, computed as follows:

Net operating loss		$10,000
Less:		
Y's 1956 taxable income		0
Carryover to Y's preacquisition part year		10,000
Less:		
Y's preacquisition part year taxable income computed under paragraph (f)(5) of this section (($54,750 +$365) x 243/365)	$36,693	
Minus Y's net operating loss deduction for preacquisition part year	xxx	36,693
Carryover to Y's postacquisition part year, to Y 1958, and to Y 1959		0

(iv) *X Corporation's 1956 loss.*—The carryover to 1959 is $22,578, computed as follows:

Net operating loss			$25,000
Less:			
X's 1954 taxable income		$0	
X's 1955 taxable income		0	
X's 8/31/57-year taxable income before net operating loss deduction	$1,000		
Minus X's net operating loss deduction for 8/31/57-year (i.e., X's 1954 carryover of $7,000 and X's 1955 carryover of $10,000)	17,000	0	0
Carryover to Y's postacquisition part year			25,000
Less:			
Y's postacquisition part year taxable income computed under paragraph (f)(5) of this section		$18,422	
Minus Y's net operating loss deduction for postacquisition part year (i.e., X's 1954 carryover of $6,000, X's 1955 carryover of $10,000 and Y's 1955 carryover of $0, to such part year)		16,000	2,422
Carryover to Y 1958			22,578
Less:			
Y's 1958 taxable income			0
Carryover to Y 1959			22,578

(v) *Y Corporation's 1956 loss.*—The carryover to 1959 is $0, computed as follows:

Net operating loss		$15,000
Less:		
Y's 1955 taxable income		0
Carryover to Y's preacquisition part year		15,000
Less:		
Y's preacquisition part year taxable income computed under paragraph (f)(5) of this section	$36,693	
Minus Y's net operating loss deduction for preacquisition part year (i.e., Y's 1955 carryover to such part year)	10,000	26,693
Carryover to Y's postacquisition part year, to Y 1958, and to Y 1959		0

(vi) *Y Corporation's 1958 loss.*—The carryover to 1959 is $0, computed as follows:

Net operating loss		$5,000
Less:		
*Y's 1955 taxable income	$0	
Y's 1956 taxable income	0	0
Carryback to Y's preacquisition part year		5,000
Less:		
Y's preacquisition part year taxable income computed under paragraph (f)(5) of this section	$36,693	
Minus Y's net operating loss deduction for preacquisition part year (i.e., Y's 1955 carryover of $10,000, and Y's 1956 carryover of $15,000, to such part year)	25,000	11,693
Carryback to Y's postacquisition part year and carryover to Y 1959		0

(vii) *Summary of carryovers to 1959.*—The aggregate of the net operating loss carryovers to 1959 is $22,578, computed as follows:

X's 1955 loss	$0
Y's 1955 loss	0
X's 1956 loss	22,578
Y's 1956 loss	0
Y's 1958 loss	0
Total	22,578

(3) *Net operating loss deduction for 1957.*—(i) The net operating loss deduction available to Y Corporation under section 172(a) for the calendar year 1957, determined in accordance with paragraph (d) of this section, is $48,300, computed as follows:

Aggregate of the net operating loss carryovers available to the transferor corporation as of the close of August 31, 1957, but limited by paragraph (d) of this section to $18,300 (Y's 1957 taxable income of $54,750, computed without any net operating loss deduction, multiplied by 122/365)		
Carryover of X's 1954 loss	$6,000	
Carryover of X's 1955 loss	10,000	
Carryover of X's 1956 loss	25,000	
	41,000	
Aggregate of carryovers, limited as above		$18,300
Carryover of Y's 1955 loss		10,000
Carryover of Y's 1956 loss		15,000
Carryback of Y's 1958 loss		5,000
Net operating loss deduction		48,300

*3-year carryback in case of loss years ending after December 31, 1957.

(ii) The taxable income under section 63 for 1957 is $6,450, computed as follows:

Taxable income determined without any net operating loss deduction	$54,750
Less:	
Net operating loss deduction for 1957, as determined under subdivision (i) of this subparagraph	48,300
Taxable income under section 63	6,450

(4) *Net operating loss deduction for 1959.*—The taxable income under section 63 for 1959 is $27,422, computed as follows:

Taxable income determined without any net operating loss deduction	$50,000
Less:	
Net operating loss deduction for 1959 (i.e., the aggregate carryovers determined under subparagraph (2)(vii) of this paragraph)	22,578
Taxable income under section 63	27,422

(5) *Years to which losses may be carried.*—The taxable years to which the losses of X Corporation and Y Corporation may be carried, and the sequence in which carried, are as follows:

Loss year	*Carried to*
X 1954	X 1955, X 1956, X 8/31/57, Y 1957, Y 1958.
X 1955	X 1954, X 1956, X 8/31/57, Y 1957, Y 1958, Y 1959.
Y 1955	Y 1956, Y 1957, Y 1958, Y 1959, Y 1960.
X 1956	X 1954, X 1955, X 8/31/57, Y 1957, Y 1958, Y 1959, Y 1960.
Y 1956	Y 1955, Y's 1957, Y 1958, Y 1959, Y 1960, Y 1961.
Y 1958	Y 1955, Y 1956, Y 1957, Y 1959, Y 1960, Y 1961, Y 1962, Y 1963.

§ 1.381(c)(1)–2 NET OPERATING LOSS CARRYOVERS; TWO OR MORE DATES OF DISTRIBUTION OR TRANSFER IN THE TAXABLE YEAR.—(a) *In general.*—If the acquiring corporation succeeds to the net operating loss carryovers of two or more distributor or transferor corporations on two or more dates of distribution or transfer within one taxable year of acquiring corporation, the limitation to be applied under section 381(c)(1)(B) to the aggregate of the net operating loss carryovers to that taxable year from all of the distributor or transferor corporations shall be determined by applying the rules prescribed in paragraph (b) of this section, and the taxable income of the acquiring corporation for that taxable year under sections 381(c)(1)(C) and 172(b)(2) shall be determined by applying the rules prescribed in paragraph (c) of this section. For purposes of this section, the term "postacquisition income" means postacquisition part year taxable income determined under paragraph (d)(1) of § 1.381(c)(1)–1 by treating the first date of distribution or transfer as though it were the only date of distribution or transfer during the taxable year of the acquiring corporation.

(b) *Determination of limitation under section 381(c)(1)(B).*—(1) *In general.*—If the acquiring corporation succeeds to the net operating loss carryovers of two or more distributor or transferor corporations on two or more dates of distribution or transfer during the same taxable year of the acquiring corporation, and if the amount of the net operating loss carryovers acquired on the first date of distribution or transfer equals or exceeds the postacquisition income, then the limitation under section 381(c)(1)(B) shall be an amount equal to such postacquisition income. If the amount of the net operating loss

carryovers acquired on the first date of distribution or transfer is less than such postacquisition income, then the limitation under section 381(c)(1)(B) shall be determined as provided in subparagraphs (2) through (5) of this paragraph.

(2) *Allocation of postacquisition income among partial postacquisition years.*—That part of the taxable year of the acquiring corporation beginning on the day following the first date of distribution or transfer and ending with the close of the taxable year of the acquiring corporation shall be divided into the same number of partial postacquisition years as the number of dates of distribution or transfer on which the acquiring corporation succeeds to net operating loss carryovers during its taxable year. The first partial postacquisition year shall begin with the day following the first date of distribution or transfer and shall end with the close of the second date of distribution or transfer. The second and succeeding partial postacquisition years shall begin with the day following the close of the preceding such partial year and shall end with the close of the succeeding date of distribution or transfer, or, if there is no such succeeding date, then with the close of the taxable year of the acquiring corporation. The postacquisition income of the acquiring corporation shall be allocated among the partial postacquisition years in proportion to the number of days in each such partial year.

(3) *Two dates of distribution or transfer.*—If the acquiring corporation succeeds to the net operating loss carryovers of two distributor or transferor corporations on two dates of distribution or transfer during the same taxable year of the acquiring corporation, and if the amount of the net operating loss carryovers acquired on the first date equals or exceeds the income for the first partial postacquisition year, the limitation provided by section 381(c)(1)(B) shall be the amount of the postacquisition income. If the income for the first partial postacquisition year exceeds the net operating loss carryovers acquired on the first date of distribution or transfer, the limitation provided by section 381(c)(1)(B) shall be the amount of the postacquisition income reduced by the amount of such excess. The application of this subparagraph may be illustrated by the following example:

Example. (i) X Corporation has taxable income (computed without any net operating loss deduction) of $36,500 for its calendar year 1955. During 1955, X Corporation acquires the assets of Y and Z Corporations in statutory mergers to each of which section 361 applies, the dates of transfer being January 1 and December 1, respectively. The net operating loss carryovers of each transferor corporation and the income for each partial postacquisition year are:

Corporation	*Carryovers*	*Income for partial years*	*Reduction*
Y	$1,000	$33,400 ($36,500 x 334/365)	$32,400
Z	50,000	3,000 ($36,500 x 30/365)	0
	51,000	36,400	32,400

(ii) The limitation provided by section 381(c)(1)(B) equals the postacquisition income of $36,400 reduced by $32,400, the excess of the income for the first partial year ($33,400) over the net operating loss carryovers acquired on the first date of transfer ($1,000). Accordingly, the limitation is $4,000 ($36,400 minus $32,400). Therefore, although X Corporation acquired carryovers aggregating $51,000

during 1955, it can utilize only $4,000 of such carryovers in computing its net operating loss deduction for 1955.

(4) *Three dates of distribution or transfer.*—If the acquiring corporation succeeds to the net operating loss carryovers of three distributor or transferor corporations on three dates of distribution or transfer during the same taxable year of the acquiring corporation, and if the amount of the net operating loss carryovers acquired on the first date equals or exceeds the income for the first and second partial postacquisition years, the limitation provided by section 381(c)(1)(B) shall be the amount of the postacquisition income. If the amount of the carryovers acquired on the first date equals or exceeds the income for the first partial postacquisition year but does not equal or exceed the income for the first and second partial postacquisition years, the limitation shall be the amount of the postacquisition income reduced by the excess of the income for the first and second partial postacquisition years over the amount of carryovers acquired on the first and second dates of distribution or transfer. If the income for the first partial postacquisition year exceeds the carryovers acquired on the first date, the limitation shall be the postacquisition income reduced by the sum of the amount of such excess plus the amount, if any, by which the income for the second partial postacquisition year exceeds the carryovers acquired on the second date. This subparagraph may be illustrated by the following examples:

Example (1). (i) X Corporation has taxable income (computed without any net operating loss deduction) of $36,500 for its calendar year 1955. During 1955, X Corporation acquires the assets of M, N, and Z Corporations in statutory mergers to each of which section 361 applies, the dates of transfer being January 1, January 31, and December 1, respectively. The net operating loss carryovers of each transferor corporation and the income for each partial postacquisition year are:

Corporation	*Carryovers*	*Income for partial years*	*Reduction*
M	$4,000	$3,000 ($36,500 x 30/365)	$23,400
N	6,000	30,400 ($36,500 x 304/365)	
Z	50,000	3,000 ($36,500 x 30/365)	0
	60,000	36,400	23,400

(ii) Since the carryovers of $4,000 acquired on the first date of transfer exceed the income for the first partial year ($3,000), the limitation provided by section 381(c)(1)(B) is the amount of the postacquisition income ($36,400) reduced by the excess of the income for the first and second partial years ($33,400) over the carryovers acquired on the first and second dates of transfer ($10,000). Therefore, the limitation is $13,000 ($36,400 less $23,400).

Example (2). (i) Assume the same facts as in example (1) except that the amount of the net operating loss carryovers acquired from M Corporation is $1,000. The net operating loss carryovers of each transferor corporation and the income for each partial postacquisition year are:

Corporation	*Carryovers*	*Income for partial years*	*Reduction*
M	$1,000	$3,000 ($36,500 x 30/365)	$2,000
N	6,000	30,400 ($36,500 x 304/365)	24,400
Z	50,000	3,000 ($36,500 x 30/365)	0
	57,000	36,400	26,400

(ii) Since the income for the first partial year ($3,000) exceeds the $1,000 of carryovers acquired on the first date by $2,000, the limitation provided by section 381(c)(1)(B) is the postacquisition income of $36,400 reduced by such excess and also reduced by the excess of the income for the second partial year ($30,400) over the carryovers acquired on the second date of transfer ($6,000). Therefore, the limitation is $10,000 ($36,400 less the sum of $2,000 and $24,400).

Example (3). (i) Assume the same facts as in example (2) except that the carryovers acquired from N Corporation are $75,000. The net operating loss carryovers of each transferor corporation and the income for each partial postacquisition year are:

Corporation	*Carryovers*	*Income for partial years*	*Reduction*
M	$1,000	$3,000 ($36,500 x 30/365)	$2,000
N	75,000	30,400 ($36,500 x 304/365)	0
Z	50,000	3,000 ($36,500 x 30/365)	0
	126,000	36,400	2,000

(ii) Since the income for the first partial year ($3,000) exceeds the $1,000 of carryovers acquired on the first day by $2,000, the limitation provided by section 381(c)(1)(B) is the postacquisition income of $36,400 reduced by $2,000, or $34,400. No further reduction is made since the income for the second partial year ($30,400) does not exceed the carryovers of $75,000 acquired on the second date of transfer.

(5) *Four or more dates of distribution or transfer.*—If the acquiring corporation succeeds to the net operating loss carryovers of four or more distributor or transferor corporations on four or more dates of distribution or transfer during the same taxable year of the acquiring corporation, the limitation provided by section 381(c)(1)(B) shall be determined consistently with the methods prescribed in subparagraphs (3) and (4) of this paragraph. The application of this subparagraph may be illustrated by the following example:

Example. (i) X Corporation has taxable income (computed without any net operating loss deduction) of $36,500 for its calendar year 1955. During 1955, X Corporation acquired the assets of M, N, O, Y, and Z Corporations in statutory mergers to each of which section 361 applied, the dates of transfer being, respectively, January 1, January 31, March 3, April 2, and December 1. The net operating loss carryovers of each transferor corporation and the income for each partial postacquisition year are:

Corporation	*Carryovers*	*Income for partial years*	*Reduction*
M	$1,000	$3,000 ($36,500 x 30/365)	$2,000
N	4,000	3,100 ($36,500 x 31/365)	1,100
O	1,000	3,000 ($36,500 x 30/365)	
Y	10,000	24,300 ($36,500 x 243/365)	14,300
Z	20,000	3,000 ($36,500 x 30/365)	0
	36,000	36,400	17,400

(ii) The limitation provided by section 381(c)(1)(B) equals the postacquisition income of $36,400 reduced by the sum of (*a*) the $2,000 excess of the income for the first partial year ($3,000) over the carryovers acquired from M Corporation ($1,000), (*b*) the $1,100 excess of the income for the second and third partial years ($6,000) over the carryovers acquired from N and O Corporations ($5,000), and (*c*) the $14,300 excess of the income for the fourth partial

year ($24,300) over the carryovers acquired from Y Corporation ($10,000). Accordingly, the limitation is $19,000 ($36,400 minus $17,400). Therefore, although X Corporation acquired carryovers aggregating $36,000 during 1955, it can utilize only $19,000 of such carryovers in computing its net operating loss deduction for 1955.

(c) *Determination of taxable income of acquiring corporation under section 381(c)(1)(C).*—(1) *In general.*—If the acquiring corporation succeeds to the net operating loss caryovers of two or more distributors or transferor corporations on two or more dates of distribution or transfer within one taxable year of the acquiring corporation, then pursuant to section 381(c)(1)(C) the taxable income of the acquiring corporation for its taxable year which is a prior taxable year for purposes of section 172(b)(2) and paragraph (e) of § 1.381(c)(1)-1 shall be determined as provided in this paragraph.

(2) *Division of taxable income.*—The taxable income of the acquiring corporation (computed with the modifications specified in section 172(b)(2)(A) but without any net operating loss deduction) shall be allocated proportionately on a daily basis among a preacquisition part year (determined under paragraph (f)(3) of § 1.381(c)(1)-1 by treating the first date of distribution or transfer as though it were the only date of distribution or transfer during the taxable year of the acquiring corporation) and two or more partial postacquisition years (determined as provided in paragraph (b)(2) of this section). The preacquisition part year and each partial postacquisition year shall be considered a separate taxable year, but only for the limited purpose of applying sections 172(b)(2) and 381(c)(1)(C).

(3) *Net operating loss deduction.*—The net operating loss deduction of the preacquisition part year and the partial postacquisition years shall be determined consistently with the manner described in paragraph (f)(6) of § 1.381(c)(1)-1 but by taking into account, in the case of any partial postacquisition year, only the net operating loss carryovers and carrybacks of the acquiring corporation and those net operating loss carryovers from a distributor or transferor corporation which become available to the acquiring corporation as of the close of those dates of distribution or transfer which occur before the beginning of that specific partial postacquisition year. The sequence in which the net operating losses of the distributor or transferor and acquiring corporations shall be applied for this purpose shall be determined in the manner described in paragraph (e) of § 1.381(c)(1)-1. Subject to the preceding sentence, the net operating loss carryovers to any specific partial postacquisition year, whether from a distributor, transferor, or acquiring corporation, shall be taken into account in the order of the taxable years in which the net operating losses arose, beginning with the loss for the earliest taxable year.

(4) *Illustration.*—The application of this paragraph may be illustrated by the following example.

Example. (i) *Facts.*—X Corporation, which was organized on January 1, 1957, sustained a net operating loss of $20,000 for its calendar year 1957 and had taxable income (computed without any net operating loss deduction) of $36,500 for its calendar year 1958. During 1958, X Corporation acquired the assets of Y and Z Corporations in statutory mergers to each of which section 361 applied, the

dates of transfer being June 30 and September 30, respectively. None of the modifications specified in section 172(b)(2)(A) apply to any of the corporations for any taxable year. The taxable income (computed without any net operating loss deduction) and net operating losses of Y and Z Corporations (which were organized on January 1, 1957, and January 1, 1954, respectively) are set forth below:

Taxable year	*Acquiring Corporation X*	*Transferor Corporation Y*	*Transferor Corporation Z*
1954	xxx	xxx	($30, 000)
1955	xxx	xxx	1, 000
1956	xxx	xxx	1, 000
1957	($20, 000)	($25, 000)	1, 000
Ending 6/30/58	xxx	1, 000	xxx
Ending 9/30/58	xxx	xxx	1, 000
1958	36, 500	xxx	xxx

The sequence in which the losses of the acquiring corporation and the transferor corporations are applied and the computation of the carryovers to X Corporation's calendar year 1959 are illustrated in the following subdivisions of this example.

(ii) *Computation of taxable income.*—X Corporation's taxable income, determined in the manner described in subparagraph (2) of this paragraph, for the preacquisition part year and for the partial postacquisition years is as follows:

Year	*Taxable income*	*Computation*
Preacquisition part year	$18, 100	$36, 500 x 181/365
Partial #1	9, 200	$36, 500 x 92/365
Partial #2	9, 200	$36, 500 x 92/365

(iii) *Z Corporation's 1954 loss.*—The carryover to 1959 is $0, computed as follows:

Net operating loss	$30, 000
Less:	
Z's 1955, 1956, 1957, and 9/30/58-year income	4, 000
Net operating loss carryover to Partial #2 year	26, 000
Less:	
Partial #2 year taxable income	9, 200
	16, 800

The balance of $16,800 is not carried over to 1959 since X Corporation's taxable year 1958 is the last of the five years to which Z's 1954 loss may be carried under section 172(b)(1).

(iv) *Y Corporation's 1957 loss.*—The carryover to 1959 is $14,800, computed as follows:

Net operating loss		$25, 000
Less:		
Y's 6/30/58-year income		1, 000
Net operating loss carryover to Partial #1 year		24, 000
Less:		
Partial #1 year taxable income		9, 200
Carryover to Partial #2 year		14, 800
Less:		
X's Partial #2 year taxable income	$9, 200	
Minus X's net operating loss deduction for Partial #2 year (i.e., Z's 1954 carryover of $26,000 to such partial year)	26, 000	0
Carryover to 1959		14, 800

(v) *X Corporation's 1957 loss.*—The carryover to 1959 is $1,900, computed as follows:

Net operating loss		$20,000
Less:		
X's preacquisition part year taxable income		18,100
Carryover to Partial #1 year		1,900
Less:		
Partial #1 year taxable income	$9,200	
Minus X's net operating loss deduction for Partial #1 year (i.e., Y's 1957 carryover of $24,000 to such partial year)	24,000	0
Carryover to Partial #2 year		1,900
Less:		
Partial #2 year taxable income	$9,200	
Minus X's net operating loss deduction for Partial #2 year (i.e., Z's 1954 carryover of $26,000, and Y's 1957 carryover of $14,800, to such partial year)	40,800	0
Carryover to 1959		1,900

(vi) *Summary of carryovers to 1959.*—The aggregate of the net operating loss carryovers to 1959 is $16,700, computed as follows:

Z's 1954 loss	xxx
Y's 1957 loss	$14,800
X's 1957 loss	1,900
Total	16,700

DANA LATHAM,
Commissioner of Internal Revenue.

Approved July 7, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

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SUBCHAPTER D.—DEFERRED COMPENSATION, ETC.

PART I.—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

SECTION 401.—QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS

26 CFR 1.401–1: Qualified pension, profit-sharing and stock bonus plans. Rev. Rul. 60–281

An employees' contributory pension plan does not fail of qualification under section 401(a) of the Internal Revenue Code of 1954 merely because it grants a participant the right to withdraw his contributions, together with an amount which represents the increment actually earned on the participant's own contributions, on discontinuance of participation prior to the termination of his employment. However, a pension plan, which permits the withdrawal of employee contributions plus amounts, in lieu of simple or compound interest thereon, computed according to a graduated

formula up to a maximum of 20 percent after ten years of service, would result in the payment of an amount in excess of that actually earned and would, therefore, cause the plan to fail of qualification.

The Internal Revenue Service has been requested to state its position with respect to the qualification, under section 401(a) of the Internal Revenue Code of 1954, of an employees' pension plan which grants participants the right to withdraw, in addition to their contributions, an amount representing interest thereon.

A provision of an employees' contributory pension plan provides that without terminating his service with the company, a participant may elect to withdraw from the plan, in which event he shall receive, in lieu of all other benefits under the plan, a cash payment equal to the total of his contributions, accumulated with interest at two percent, compounded annually, to the first day of the month in which such withdrawal occurs. Under the plan, this payment is limited to the employee's own contributions and amounts actually earned thereby. The plan was amended to provide that an employee is entitled to withdraw at any time, in addition to his aggregate contributions to date, an amount, in lieu of interest, which would increase in graduated steps from two percent of such contributions after the first year of participation to a maximum of 20 percent after ten years and thereafter.

Revenue Ruling 57–163, C.B. 1957–1, 128, states in Part 2(c)(2) at page 131, that a pension plan may provide incidental benefits prior to normal retirement, such as disability and death benefits, but if it permits participants, prior to severance of employment or termination of the plan, to withdraw all or a part of the funds accumulated on their behalf, except their own contributions on discontinuance of participation, in times of financial need or otherwise, it will fail of qualification under section 401(a) of the Code.

It is the opinion of the Internal Revenue Service that a recognition of an employee's right to withdraw his own contributions carries with it a right to receive any increment actually earned on his contributions to the plan. Thus, under Part 2(c)(2) of Revenue Ruling 57–163, a participant may receive interest actually earned on his own contributions which he withdraws upon termination of his participation in the plan prior to the termination of his employment. However, the amendment to the plan would produce amounts other than those actually earned on the employee's own contributions and would, in effect, constitute a distribution of the employer's contributions. See Rev. Rul. 56–693, C.B. 1956–2, 282.

Accordingly, it is held that an employees' contributory pension plan does not fail of qualification under section 401(a) of the Code merely because it permits a participant to withdraw, upon discontinuance of participation prior to termination of employment, an amount, in addition to his contributions, which represents the increment actually earned on the participant's own contributions. But, it is further held that an employees' pension plan which permits a participant to withdraw, upon discontinuance of participation prior to termination of employment, an amount, in lieu of simple or compound interest, computed by a graduated formula to a maximum of 20 percent after ten years of service, would fail of qualification under section 401(a) of the Code.

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An employees' pension plan will not be denied qualification because it contains provisions permitting participants to withdraw their voluntary contributions which are made in addition to their compulsory contributions, where such withdrawals do not affect the member's participation in the plan, the employer's past or future contributions on his behalf, the basic benefits provided by both the participant's and the employer's nonwithdrawable contributions, and no interest is allowable with respect to the contributions withdrawn either at the time of withdrawal or in computing benefits at retirement.

Revenue Ruling 56–693, C.B. 1956–2, 282, and Part 2(c)(2) of Revenue Ruling 57–163, C.B. 1957–1, 128, modified.

Advice has been requested concerning the effect of a provision, in an otherwise qualified employees' pension plan, permitting the participants to withdraw their voluntary contributions which are made in addition to their compulsory contributions.

A retirement plan for the benefit of the employees of a life insurance company is funded under a deposit administration type of arrangement with the employer company acting as insurer. Under the terms of the plan, the employer contributes an amount equal to five percent of each participant's earnings and each participant must contribute four percent of his earnings. The participants may also make additional contributions of from one to six percent of their earnings on a voluntary basis.

The combined contributions by the employer and the employee participants are set aside in a separate fund to which interest of not less than two percent is added annually. This fund represents the reserve for benefits provided for under the plan and is maintained in accordance with applicable state insurance laws to which the employer is subject as a life insurance company. Upon retirement the accumulated employee and employer contributions then standing to a member's credit are applied to provide him with an annuity.

The plan has been held to qualify under section 401(a) of the Internal Revenue Code of 1954.

An amendment to the plan permits any member who has not commenced receiving a retirement benefit under the plan to withdraw his voluntary contributions in amounts of not less than $1,000, without interest. According to the plan, the interest accumulated on any such withdrawn contributions will be forfeited forever by the participant.

Part 2(c)(2) of Revenue Ruling 57–163, C.B. 1957–1, 128, refers to Revenue Ruling 56–693, C.B. 1956–2, 282, and holds that although a pension plan may provide incidental benefits prior to normal retirement, such as disability and death benefits, it will fail of qualifications if it permits participants, prior to severance of employment or termination of the plan, to withdraw all or part of the funds accumulated on their behalf, except their own contributions on discontinuance of participation.

Under the terms of the plan in question, when a participant exercises the right to withdraw his voluntary contributions, it shall in no way affect his participation in the plan, the employer's past or future contributions on his behalf, or the basic benefits provided by both the participant's and the employer's nonwithdrawable contributions. Further, no interest is allowable with respect to the contributions

withdrawn either at the time of withdrawal or in computing benefits at retirement.

Accordingly, it is held that, under the facts of the present plan, the provision permitting participants to withdraw their own voluntary contributions will not, of itself, disqualify the otherwise qualified plan.

Revenue Ruling 56–693, C.B. 1956–2, 282, and Part 2(c)(2) of Revenue Ruling 57–163, C.B. 1957–1, 128, are hereby modified to the extent that a pension plan will not be denied qualifications because it contains provisions permitting a participant to withdraw his voluntary contributions which are made in addition to his compulsory contributions, where such withdrawals do not affect the member's participation in the plan, the employer's past or future contributions on his behalf, the basic benefits provided by both the participant's and the employer's compulsory contributions, and, under the provisions of the plan, no interest is allowable with respect to the contributions withdrawn either at the time of withdrawal or in computing benefits at retirement.

Rev. Rul. 60–338

A cooperative corporation purchases merchandise for its members. The cooperative adds an "overcharge" to the cost price charged the members. The "overcharge" is used to pay operating expenses of the cooperative. *Held*, such "overcharge" constitutes "profits" for purposes of qualifying a profit-sharing plan under section 401(a) of the Internal Revenue Code of 1954.

Advice has been requested whether "overcharges" of a cooperative corporation constitute "profit" for purposes of qualifying a profit sharing plan under section 401(a) of the Internal Revenue Code of 1954.

In the instant case, a cooperative corporation has as its principal purpose the purchase of groceries and other merchandise exclusively for its stockholder members. In addition to charging its members the cost price of the merchandise purchased for them, the cooperative is permitted by its by-laws to "charge" them an additional amount known as "overcharges" or "markup" to provide funds from which to pay operating expenses such as compensation (current and deferred), rent, interest, taxes, etc.

The amount of the "overcharge" or "markup" is placed in a fund denominated "overcharges" and is handled in the nature of a trust fund on the theory that the whole thereof, after deducting operating expenses, was and is property of the stockholder members. Therefore, the entire amount of markup is either expended as operating expenses or returned to the members. The corporation has a profit-sharing plan for its employees.

Section 1.401–1(b)(1)(ii) of the Income Tax Regulations provides, in part, that a profit-sharing plan is a plan established and maintained by an employer to provide for the participation in his profits by his employees or their beneficiaries.

The cooperative's contributions to its profit-sharing plan are made only from its "mark up" or "overcharge" receipts; that is to say, from the total amount of such receipts remaining with the company after deducting therefrom its total operating costs.

A profit sharing contribution constitutes deferred compensation. The fact that in the instant case the compensation is paid from funds which otherwise would be distributed to members makes no difference since the members of the cooperative get no more or less whether the compensation is paid currently or under a profit-sharing plan.

Accordingly, it is held that the "overcharges" of the instant cooperative corporation constitute "profits" for purposes of qualifying a profit-sharing plan under section 401(a) of the Code.

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26 CFR 1.401–2: Impossibility of diversion under the trust instrument. Rev. Rul. 60–276 [1]

A provision in a newly established pension, profit sharing, stock bonus, or annuity plan provides for the return of employer contributions made prior to the initial determination as to qualification, only in the event that in such determination the Commissioner of Internal Revenue rules that such plan is not qualified. *Held*, such a provision will not, of itself, prevent qualification of the plan and trust under section 401 or the exemption of the trust under section 501(a) of the Internal Revenue Code of 1954.

Revenue Ruling 59–309, C.B. 1959–2, 117, superseded.

Advice has been requested whether the initial qualification of an otherwise qualified employees' pension plan and trust will be affected by a provision calling for the return of the employer's contributions to the plan in the event the plan should fail to qualify.

An employer established an employees' pension plan setting forth in definite terms the benefits to be provided, the method of funding such benefits, and all other provisions necessary to the operation of the plan. Plan costs are to be borne entirely by the employer and the participants' interests in the employer contributions are to be fully vested after a reasonable waiting period. It further provides, "This trust instrument is based upon the condition precedent that it shall be approved and qualified by the Internal Revenue Service * * * as meeting the requirements of the Federal Internal Revenue Code and regulations issued thereunder with respect to employees' trusts so as to permit the employer to deduct for income tax purposes the amounts of its contributions to the trustee for the payment of premiums on the policies of insurance procured by it, and so that such premiums will not be taxable to the employees as income."

Section 401(a)(2) of the Code provides, as one of the requirements for exemption, that the trust instrument must make it absolutely impossible to use or divert any part of the trust corpus or income for purposes other than for the exclusive benefit of employees or their beneficiaries.

Section 1.401–2(a)(2) of the Income Tax Regulations holds, in part, that the trust instrument must definitely and affirmatively make it impossible for the nonexempt diversion or use to occur, whether by the happening of a contingency or by any other means.

The issue raised herein pertaining to contributions and benefits made conditional upon the Commissioner's initial ruling with respect to the

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[1] In the publication of Revenue Ruling 59–309, C.B. 1959–2, 117, the words "in a plan, calling for the return of employer contributions" were omitted from the penultimate paragraph. The ruling, therefore, is corrected and restated in its entirety.

plan has been decided by the court decision in the case of *Meldrum and Fewsmith, Inc.* v. *Commissioner*, 20 T.C. 790, acquiescence C.B. 1954–2, 5. In that case it was decided that the employer's contribution to the trust was irrevocable, since the employer could not recover its contribution if the trust was qualified. Since the employees' respective interests were not nonforfeitable at the time the contribution was made, it must be inferred that the court decided that the plan qualified under section 165(a) of the 1939 Code (corresponding to section 401(a) of the 1954 Code). The Commissioner acquiesced in this decision insofar as the issue of deductibility of the contribution is concerned.

Assuming that a provision in a plan, calling for the return of employer contributions in the event that the plan is held not to be qualified, would not of itself prevent qualification, it is apparent that no diversion of trust corpus or income is possible by reason of such provision if the plan is otherwise qualified.

Accordingly, in the instant case, the newly established employees pension plan and trust will not fail to qualify initially merely because it contains a provision that, if the Commissioner rules that such plan is not qualified, the employer could recover contributions which have been made prior to the initial determination as to qualification. This conclusion is equally applicable to profit sharing, stock bonus, or annuity plans.

Revenue Ruling 59–309, C.B. 1959–2, 117, is hereby superseded.

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26 CFR 1.401–3: Requirements as to coverage. Rev. Rul. 60–337

A trusteed pension plan involving integration with social security benefits will not meet the requirements for integration, if it contains no limitation on the amount of excess earnings of the trust which may be credited to a participant's account.

Advice has been requested whether a trusteed pension plan involving integration with social security benefits will meet the requirements for integration, if the plan contains no limitation on the amount of excess earnings of the trust which may be credited to a participant's account.

An employer established a self-insured, trusteed pension plan. The plan provides for a normal retirement benefit, payable for ten years certain and life thereafter, equal to 35 percent of compensation (averaged over the period of participation in the plan, but not taking into account changes in compensation occurring after attaining age 55), offset by 90 percent of the primary social security benefit. Normal retirement is at age 65, or the tenth anniversary of becoming a participant, if later. The amount in an employee's account will be paid in the event of death before retirement.

In case of early retirement, disability retirement, or other termination of employment prior to normal retirement date, the benefit paid will be that which can be provided by a stated percentage (not to exceed 100 percent) of the amount in the employee's account. The employees do not contribute to the plan.

The employer's contributions are made on the assumption that the trust will earn a return of three percent per year. However, the plan will provide "variable" benefits, since the actual earnings (realized and unrealized) of the trust will be credited proportionately to the

individual accounts, whether such earnings are greater or less than three percent.

Section 401(a) of the Internal Revenue Code of 1954 provides, in part, that a trust created or organized in the United States and 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 constitute a qualified trust if the trust does not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

Section 401(a)(5) of the Code provides, however, that a classification shall not be considered discriminatory merely because all employees whose annual remuneration constitutes "wages" under section 3121(a)(1) (for purposes of the Federal Insurance Contributions Act) are excluded from the plan. This provision is intended to permit the qualification of plans which supplement the old-age and survivors insurance benefits under the Social Security Act, as amended.

Section 1.401–3(e) of the Income Tax Regulations establishes the general basis for integration of pension, annuity, profit-sharing, and stock bonus plans, which limit participation to employees earning in excess of $4800 a year, or which base contributions or benefits only on compensation in excess of that amount, with the benefits provided by the Social Security Act, as amended.

Section 1.401–3(e)(2) of the regulations provides that in determining whether a plan is properly integrated with the Social Security Act, the total old-age and survivor insurance benefits with respect to an employee are considered to be 150 percent of the employee's old-age insurance benefits under such Act, and the proportion of such total benefits which is attributable to employee contributions is considered to be approximately 22 percent of such total benefits.

It follows from this provision of the regulations that the part of the total benefits under the Social Security Act not attributable to employee contributions is deemed to be equivalent in value to a straight-life annuity beginning at age 65 (or subsequent retirement) equal to 117 percent (78 percent of 150 percent) of the primary old-age insurance benefit. In a plan providing death benefits before retirement equal to the reserve, and a ten-year certain and life annuity, such as in the instant case, the 117 percent limit should be reduced to 93.6 percent (117 percent times 8/9 times 90 percent), in accordance with the rules set forth in Mimeograph 6641, C.B. 1951–1, 41.

The operation of the variable feature (i.e., crediting excess earnings to the employees' accounts) of this plan can result in the 93.6 percent limit being exceeded.

In view of this, it is held that the pension plan in the instant case does not meet the requirements for integration with Social Security Act benefits.

However, such a plan may meet the requirements for integration if it is amended so as to contain limits to insure that the crediting of the amount of excess earnings of the trust fund will not cause the actual benefits paid to exceed integration limits. This may be done by providing that in no case will the amount to be credited to a participant's account at any time exceed 104 percent (93.6 percent divided by 90 percent) of the amount that would have been credited

to such account had the earnings of the fund (realized or unrealized) always been at the assumed rate of three percent. Any excess earnings which, in any year, cannot be credited to a participant's account because of such limitation, should be used to reduce the employer's contributions for that year.

As an alternative to limiting the amount of earnings that may be credited to a participant's account, it would be acceptable to amend the plan to provide that any earnings in excess of three percent will be allocated on a basis which does not involve integration with Social Security, for example, by allocating such excess earnings in proportion to "compensation" as defined in the plan or in proportion to total "compensation" since becoming a participant. (See Rev. Rul. 185, C.B. 1953–2, 202.)

SECTION 402.—TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST

26 CFR 1.402(a)–1: Taxability of beneficiary under a trust which meets the requirements of section 401(a). Rev. Rul. 60–292

> The amount standing to the credit of an employee in a qualified employees' trust at the date of his separation from the service of the employer and the amount of any increment credited thereon after such date are not made available to him prior to the time the amounts are actually distributed if the withdrawal of such amounts would subject the employee to a loss of all prior service credits upon subsequent reemployment.
>
> A distribution of the qualified trust to the employee in one taxable year of the total amount standing to his credit at the date of termination of service will be accorded long-term capital gain treatment to the extent it exceeds the employee's own contributions.
>
> Any increment credited to the employee's account subsequent to the date of his termination of service is taxable to him as ordinary income in the year of distribution.
>
> However, where the delay in distribution is occasioned by administrative problems of the plan and the total amount of the distribution (amount standing to the credit of the employee at the time of separation and any increment accruing from that date to date of payment) is made in one taxable year of the employee as soon as administratively feasible after separation, the Internal Revenue Service will, in the interest of convenience in administration, consider such an amount in excess of his contributions as a long-term capital gain.

Advice has been requested whether the amount standing to the credit of an employee in a qualified employees' pension trust is made available to him where, upon termination of service, a withdrawal of such amount would subject the employee to a loss of all prior service credits upon later reemployment; and whether a total distribution of such amount several years after the employee's termination of service may be treated as a long-term capital gain to the extent of the excess over the employee's contribution.

An employer established a retirement plan for the benefit of his employees. The plan meets the requirements of section 401(a) of the Internal Revenue Code of 1954 and the trust forming a part thereof is exempt from income tax under section 501(a) of the Code. Under the terms of the plan, an employee-participant who terminates

his service prior to becoming eligible for benefits has the right (1) to take a lump-sum distribution of the amount standing to his credit in the trust fund at the date of separation from service or (2) to leave such amount standing to his credit, at interest, for a period up to five years. Should the separated employee elect not to withdraw the amount due him upon separation and then, within five years, reenter the employer's service, he would be entitled to receive credit toward retirement for all prior service. However, should he withdraw the amount to his credit, he would forfeit the right to any prior service credits upon reemployment.

Under these circumstances, an employee-participant severed his connection with the employer. He elected not to withdraw the amounts accumulated in his account in the trust fund when he separated from service. Four years later he requested a withdrawal and was paid a lump-sum total distribution consisting of his own contributions plus the interest accrued thereon before and after the date of his separation from service.

Paragraph (1) of section 402(a) of the Code provides, in effect, that the amount actually distributed or made available to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities) except that section 72(e)(3) (relating to the treatment of certain lump sums) shall not apply.

Paragraph (2) of section 402(a) provides in substance that if the total distributions payable, under such an exempt trust, are paid to the distributee within one taxable year of the distributee on account of the employee's death or other separation from the service or on account of the employee's death after such separation from service, the amount of such distribution, to the extent exceeding the amount contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

Revenue Ruling 55–423, C.B. 1955–1, 41, holds that a participant's interest under an exempt employees' trust is not made available to him within the purview of section 402(a)(1) of the Code if there are substantial conditions or restrictions on his right of withdrawal.

Under the instant plan, a participant who withdraws the amount accumulated to his account in the trust fund (participant's contributions plus interest theron) at the time of his separation from service immediately suffers a loss of all prior service credits to which he was theretofore entitled. This, in the presence of such facts, constitutes a substantial condition. Therefore, in accordance with the above cited Ruling, neither the amount to the credit of an employee in a qualified employees' trust at the date of his separation from the service of the employer nor the amount of any increment credited thereon after such date is made available to him prior to the time the amounts are actually distributed to him if the withdrawal of such amounts would subject the employee to a loss of all prior service credits to which he was theretofore entitled.

As will be noted from the provisions of section 402(a)(2) of the Code, if everything to which the employee is entitled under the trust, at the time of separation from service, is paid within one taxable year of the employee, the amount so paid is treated as a long-term capital

gain to the extent of the excess of the amount received over the employee's contributions. Thus, even though the participant here under consideration did not receive a distribution of the amount to his credit under the trust fund until four years after his separation from service, he did receive everything to which he was entitled at the date of his separation from service in one taxable year.

Accordingly, it is held that a distribution by the qualified trust to the employee in one taxable year of the total amount standing to his credit at the date of termination of service will be accorded long-term capital gain treatment to the extent it exceeds the employee's own contributions. Any increment credited to the employee's account subsequent to the date of his termination of service is taxable to him as ordinary income in the year of distribution since it is not a part of the balance to the credit of the employees account which becomes payable on account of his separation from the service. (See section 402(a)(3)(c) of the Code.)

However, where the delay in distribution is occasioned by administrative problems of the plan and the total amount of the distribution (amount standing to the credit of the employee at the time of separation and any increment accruing from that date to date of payment) is made in one taxable year of the employee as soon as administratively feasible after such separation, the Internal Revenue Service will, in the interest of convenience in administration, consider such an amount in excess of his contributions as a long-term capital gain. Whether any delay in distribution is occasioned by administrative problems of the plan and whether the distribution is made "as soon as administratively feasible" are to be determined on the basis of the facts and circumstances in each particular case.

SECTION 403.—TAXATION OF EMPLOYEE ANNUITIES

26 CFR 1.403(b)-1: Taxability of beneficiary under a nonqualified annuity.

Exemption of wholly-owned state or municipal instrumentalities under section 501(c)(3) of the Internal Revenue Code of 1954. See Rev. Rul. 60-384, page 172.

SECTION 404.—DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN

26 CFR 1.404(a)-2: Information to be furnished by employer claiming deductions.

Information filed with the Department of Labor pursuant to the Welfare and Pension Plans Disclosure Act may be used in partial satisfaction of the requirement, of the regulations relating to information to be furnished by an employer claiming deductions under section 404 of the Code. See Rev. Proc. 60-14, page 939.

26 CFR 1.404(a)-9: Contributions of an employer to an employees' profit-sharing or stock bonus trust that meets the requirements of section 401(a); application of section 404(a)(3)(A). Rev. Rul. 60-379

A corporation has a qualified profit-sharing plan which permits continued eligibility and participation by employees assigned temporarily to various joint ventures into which the corporation enters. *Held*, in computing the limitation on deductible contributions provided in section 404(a)(3)(A) of the Internal Revenue Code of 1954, the corporation may take into account its distributive share of compensation paid by a joint venture, in which it is participating, to employees covered by the corporation's profit-sharing plan.

Advice has been requested whether a taxpayer, in computing its deductible limit for contributions to a profit-sharing trust, is entitled to take into account its distributive share of the compensation paid by a joint venture, in which it is participating, to employees covered by the taxpayer's profit-sharing plan.

The taxpayer corporation is a general contractor having a qualified profit-sharing plan for its employees. Occasionally, the taxpayer enters into a joint venture with some other contractor for the construction of a specific project. Some of the taxpayer's key employees may be assigned to perform duties for such a joint venture and during their temporary assignment the wages of these employees are paid by the joint venture rather than by the taxpayer. Nevertheless, the profit-sharing plan provides that for purposes of participation in the plan, services performed while temporarily assigned to a joint venture shall be considered as employment by the taxpayer. The plan also provides that compensation paid by the joint venture shall, for the purpose of allocating the taxpayer's annual contributions under the plan, be considered as compensation of a participating employee, that is, compensation paid by the taxpayer.

Section 404(a)(3) of the Internal Revenue Code of 1954 and section 1.404(a)-9 of the Income Tax Regulations prescribe limits for the deductibility of employer contributions under a qualified profit-sharing plan. The primary limitation is that the deduction shall not exceed 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the profit-sharing plan.

The percentage limitations of section 404(a)(3)(A) of the Code apply to compensation otherwise paid or accrued during the taxable year to all employees under a qualified profit-sharing plan. In order to meet the qualification requirements of section 401(a) of the Code, a plan must be the plan of an employer for the exclusive benefit of his employees or their beneficiaries. It follows that the percentage limitations of section 404(a)(3)(A) apply to the compensation paid or accrued by a particular employer to his employees.

Pension, profit-sharing or stock bonus plans intended to qualify under section 401(a) of the Code may provide for continued employee participation in the event of a leave of absence for a specified purpose, provided all participants under similar circumstances are treated alike. See Part 4(b) of Rev. Rul. 57-163, C.B. 1957-1, 128, at 140. The same principle applies to employees who are loaned to another organization, such as a joint venture. In this latter case the employer-employee relationship, once established, does not terminate

by reason of the employee's temporary absence from duty. However, the mere fact that a temporary absence or transfer does not terminate the employer-employee relationship, and does not disturb the employee's eligibility or participation, does not result in the conclusion that compensation paid by the actual employer (in this case, the joint venture) during such period is considered as paid by the lending employer. In determining what, if any, portion of the compensation paid by a joint venture of which the lending employer is a member may be included as compensation paid by the lending employer, in computing the deduction limitation under section 404(a)(3)(A), one must consider the provisions of subchapter K of the Code, relating to partners and partnerships.

The term "partnership" is defined in section 761(a) as including a joint venture. Accordingly, section 702 of the Code would be applicable in computing the taxpayer's income tax liability with respect to its participation in the joint venture. Section 702(a)(8) provides that, among other things, a taxpayer shall take into account its distributive share of the partnership items of deduction to the extent provided by regulations.

Section 1.702–1(a)(8)(ii) of the regulations provides, in part, that each partner must take into account separately his distributive share of any partnership item which, if separately taken into account by any partner, would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately.

Section 702(b) of the Code provides that the character in the hands of a partner of any item of income, gain, loss, deduction, or credit described in section 702(a) (1) through (8) shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Thus, a taxpayer's distributive share of the compensation paid by the joint venture should be taken into account by it separately, having the same character with respect to the taxpayer as it has with respect to the joint venture, if it will have the effect of permitting the taxpayer an additional deduction for contributions to its qualified profit-sharing plan by increasing is deductible limit as prescribed in section 404(a)(3)(A) of the Code. If an employee of the partnership is considered to be also an employee of the individual partners, section 702(a)(8) and section 702(b) will have the effect of permitting the taxpayer to take its distributive share of compensation paid by the joint venture into account in computing its deduction limitation for contributions to the profit-sharing plan under section 404(a)(3)(A). The sole question, therefore, is whether, for purposes of computing that limit, an employee of the partnership of which the taxpayer is a member should be considered also an employee of the taxpayer with respect to the services rendered to the partnership.

Employment, for pension trust, profit-sharing and stock bonus plan purposes, means the same, generally, as employment for other purposes, including coverage for social security or similar public programs. See Part 2(i) of Rev. Rul. 57–163, *supra*. Although Revenue Ruling 57–163 deals with guides for qualification of a plan, the same

considerations enter into the question of the deductibility of contributions. In the instant case, for Federal employment tax purposes, an employee temporarily assigned to the joint venture is an employee of the partnership rather than an employee of the partners with respect to the services rendered to the joint venture. See Rev. Rul. 54–369, C.B. 1954–2, 364. Nevertheless, once the requisite employment relationship is established as between the partnership and the individuals to whom the compensation in question is being paid, it is established also as between the individual partners and such employees for purposes of sections 401–404 of the Code. This position is consistent with the view that the partnership itself is not, for purposes of income tax liability, a taxable entity but rather is merely the aggregate of the constituent partners, each of whom is liable for income tax only in his individual capacity.

This conclusion does not encroach upon the view that "employment" for pension trust, profit-sharing and stock bonus plan purposes is the same as employment for such public programs as the Federal Unemployment Tax Act, since the essential relationship must still exist between the partnership and the individual to whom the compensation is being paid. The sole effect of this conclusion is to attribute to the individual partners the employment relationship which exists between the partnership and the individuals.

Accordingly, it is held, in the instant case, the taxpayer is entitled to take into account, in computing its deductible limit for contributions to the profit-sharing trust under section 404(a)(3)(A) of the Code, its distributive share of the compensation paid by a joint venture, in which it is participating, to employees covered by the taxpayer's profit-sharing plan.

PART II.—MISCELLANEOUS PROVISIONS

SECTION 421.—EMPLOYEE STOCK OPTIONS

26 CFR 1.421–1: Meaning and use of certain terms. Rev. Rul. 60–242 (Also Section 7805.)

In order to make certain that an employee stock option qualifies as a restricted stock option for purposes of section 421 of the Internal Revenue Code of 1954, some companies have been attempting to meet the 85-percent-of-fair-market-value price requirement of the statute by including in the option agreement a provision that if the Commissioner of Internal Revenue (or the Treasury Department or the Internal Revenue Service) should determine that the option price was less than 85 percent of the fair market value of the stock at the time of the granting of the option, the employee would pay the employer the additional amount necessary to satisfy that condition of the statute.

Revenue Ruling 59–243, C.B. 1959–2, 123, issued July 20, 1959, holds that the Commissioner need not comply with a provision which seeks to require the Treasury Department to assume the function of making determinations of fair market value for the purpose of fixing an option price; that, since the Commissioner could in no event make such a determination on the date of grant of an option, an agreement containing such a provision does not provide a price fixed or deter-

minable at that time within the meaning of the regulations; and that an agreement containing such provision does not qualify as a restricted stock option under section 421(d)(1).

However, since the provision in question had been included in option agreements by many companies acting in good faith, a retroactive application of the Revenue Ruling invalidating such options would result in undue hardship in cases where the options would otherwise qualify but for such price redetermination provision. Accordingly, under the authority of section 7805(b) of the Code, Revenue Ruling 59–243 will be applied without retroactive effect to options granted prior to July 20, 1959, the date of its issuance.

Specifically, the Commissioner will not comply with a provision in any stock option that seeks to require him (or the Treasury Department or the Internal Revenue Service) to make a price redetermination so as to allow taxpayers, in accordance with such redetermination, to take action to qualify the option as a restricted stock option. However, if an option which was granted prior to July 20, 1959, otherwise qualifies as a restricted stock option and, without regard to the price redetermination provision, the 85-percent-of-fair-market-value price requirement of the statute has been met, the inclusion of the provision will not prevent the option from qualifying as a restricted stock option.

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26 CFR 1.421–6: Options to which section 421 does not apply. T. D. 6481 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Amendment of Income Tax Regulations under section 421 of the Internal Revenue Code of 1954 relating to employee stock options.

DEPARTMENT OF THE TREASURY,
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 revise the definition of the term "employee," "employment," and "employer" in the Income Tax Regulations (26 CFR Part 1) under section 421 of the Internal Revenue Code of 1954, relating to options to which section 421 does not apply, such regulations are amended as set forth below, effective with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

Further consideration is being given to the applicability of the rules in § 1.421–6 to situations not involving the employer-employee relationship.

Paragraph (b)(2) of § 1.421–6 is amended to read as follows:

§ 1.421–6 OPTIONS TO WHICH SECTION 421 DOES NOT APPLY.

* * * * * * *

(b) Meaning and use of certain terms. * * *

(2) As used in this section, the terms "employee", "employment", and "employer" have reference to the legal and bona fide relationship of employer and

[1] 25 F.R. 6621.

employee. For rules applicable to the determination whether the employer-employee relationship exists, see section 3401(c) and the regulations thereunder.

Because this Treasury Decision amends § 1.421–6 to restore the substance of the rule relating to the employer-employee relationship which was contained in the notice of proposed rule making, published in the Federal Register (21 F.R. 8774), November 10, 1956, and because further consideration is being given to the applicability of the rules in § 1.421–6 to situations not involving the employer-employee relationship, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved July 8, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 8, 1960, 8:49 a.m., and published in the issue of the Federal Register for July 14, 1960, 25 F.R. 6621)

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART I.—ACCOUNTING PERIODS

SECTION 443.—RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS

26 CFR 1.443–1: Returns for periods of less than 12 months.

Period for which a return is filed when a partner concurrently changes to the taxable year (annual accounting period) a newly formed partnership adopts. See Rev. Rul. 60–268, page 206.

PART II.—METHODS OF ACCOUNTING

Subpart A.—Methods of Accounting in General

SECTION 446.—GENERAL RULE FOR METHODS OF ACCOUNTING

26 CFR 1.446–1: General rule for methods of accounting. Rev. Rul. 60–243
(Also Section 471; 1.471–1.)

A change to the "sale and repurchase" method of accounting for bottles, by a taxpayer engaged in bottling and selling soft drink

beverages, from the method of requiring a deposit for the bottles with a refund of the deposit upon their return, constitutes a change in method of accounting for which the prior consent of the Commissioner of Internal Revenue is required. Under the circumstances, the Commissioner will not consent to such a change because the "sale and repurchase" method of accounting for bottles does not clearly reflect income.

Advice has been requested whether a change to the "sale and repurchase" method of accounting for bottles by a taxpayer engaged in bottling and selling soft drink beverages, from its present method of requiring a deposit for the bottles with a refund of the deposit upon their return, constitutes a change in the method of accounting within the meaning of section 446(e) of the Internal Revenue Code of 1954 for which the prior consent of the Commissioner of Internal Revenue is required.

The taxpayer is franchised to bottle and sell a soft drink beverage. It markets its product through returnable glass bottles packed twenty-four to a case. Business is conducted both through salesmen and company maintained routes selling direct to retailers. A deposit is required from its salesmen and customers for each bottle and/or case. Full credit is granted upon the return of the container and/or case. Invoices are issued for sales which contain a statement that title to the cases and bottles is vested in the company and that the deposits required do not constitute a sale.

The taxpayer employs the accrual method of accounting for Federal income tax purposes. Its books of account reflect the bottles at cost as a noncurrent, nondepreciable, asset. However, cases are depreciated over their useful life. The bottle account is adjusted annually to provide a deduction for bottles lost or broken. Therefore, the deductible expense for bottles in each taxable year, under the taxpayer's present method of accounting for bottles, represents the cost of bottles no longer available for use.

The taxpayer proposes to remove the title retention clause in invoices and to conduct its business through the composite "sale" of bottles and beverage with the expectation, based upon trade practice, that the bottles "sold" would be reacquired to the same extent as under present circumstances. Under the proposed method of accounting for bottles, the taxpayer would include the cost of each bottle in the cost of merchandise sold. Where the bottles are reacquired they would be included in inventory at cost of reacquisition which, as proposed, would be substantially less than the original cost.

In the taxpayer's type of business, a substantial investment in bottles in which to distribute its product is necessary, and profitable operations depend upon the return of a very large portion of the bottles.

The taxpayer's present method of accounting for bottles has been consistently employed by it for several years. Its income is clearly reflected by the use of such method.

Section 446(e) of the Code provides that a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary of the Treasury or his delegate.

The striking of the title retention clause in invoices does not in and of itself constitute merely a change in business practice as contended

by the taxpayer as opposed to a change of accounting method requiring the prior consent of the Commissioner.

Section 1.446–1(e)(2) of the Income Tax Regulations provides, in part, that a change in the method of accounting includes a change in the over-all method of accounting for gross income or deductions, or a change in the treatment of a material item. Consent must be secured whether or not a taxpayer regards the method from which he desires to change to be proper. Thus, a taxpayer may not compute his taxable income under a method of accounting different from that previously used by him unless such consent is secured.

Without any change in its business practice, under the proposed method of accounting, the taxpayer would in effect reduce taxable income, at the time new bottles are placed into use, by the difference between the original cost and a much lower so-called sale price. Also, in the year of change the taxpayer would reduce taxable income further by valuing each bottle in closing inventory at the cost of reacquiring the bottles from its customers and salesmen.

In view of the above, it is concluded that a change to the proposed method of accounting for bottles by a taxpayer engaged in bottling and selling soft drink beverages from its prior method of requiring a deposit for the bottles with a refund of the deposit upon their return, is a material change. See *Advertisers Exchange, Inc.* v. *Commissioner*, 25 T.C. 1086, affirmed per curiam, 240 Fed. (2d) 958. Therefore, such a change would require the prior consent of the Commissioner in accordance with the provisions of section 446 of the Code and the regulations thereunder.

A further question to be considered is whether, under the circumstances, the Commissioner will consent to a change to the "sale and repurchase" method of accounting for bottles described above.

Section 471 of the Code provides that wherever the use of inventories is necessary in order to clearly determine the income of any taxpayer, inventories shall be taken into account by such taxpayer in determining gross income.

Section 1.471–1 of the regulations provides in part, as follows:

> The inventory should include all finished or partly finished goods and, in the case of raw materials and supplies only those which have been *acquired for sale* or which physically become a part of *merchandise intended for sale*, in which class fall containers, such as kegs, bottles, and cases, whether returnable or not, if title thereto will pass to the purchaser of the product to be sold therein. Merchandise should be included in the inventory only if title thereto is vested in the taxpayer. Accordingly, the *seller* should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory *goods sold (including containers)*, title to which has passed to the purchaser. (Italics supplied.)

The foregoing regulations make it clear that, in order to be included in the cost of goods sold, bottles must be acquired for sale, or must become part of the merchandise intended for sale and must actually be sold.

The question then resolves itself whether under the foregoing circumstances there would be a disposition of bottles. The taxpayer must establish that the substance rather than the form of the transaction constitutes a sale.

In the usual case where a taxpayer claims a loss from the sale of property, the loss must be actual and real. See *Evelyn F. Gregory*

v. *Helvering*, 293 U.S. 465, Ct.D. 911, C.B. XIV–1, 193 (1935). The general requirements that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test. See *Lucas* v. *American Code Co., Inc.*, 280 U.S. 445, Ct.D. 168, C.B. IX–1, 314 (1930). The general rule as to this issue was expressed in *Sydney M. Shoenberg* v. *Commissioner*, 77 Fed. (2d) 446, certiorari denied, 296 U.S. 586, Ct.D. 1051, C.B. XIV–2, 180 (1935). The court stated as follows:

A loss as to particular property is usually realized by a sale thereof for less than it cost. However, where such sale is made as part of a plan whereby substantially identical property is to be reacquired and that plan is carried out, the *realization* of loss is not genuine and substantial—it is not real, This is true because the taxpayer has not actually changed his position and is no poorer than before the sale. The particular transaction may be real but the entire transaction prevents the loss from being actually suffered. Taxation is concerned with realities and no loss is deductible which is not real.

Where as part of a composite plan which includes, as in the instant case, an expectation, based upon trade practice, that the property will be reacquired, and such expectation is realized, the inclusion of the container cost in cost of goods sold would not be consistent with the requirements of section 1.471–1 of the regulations.

Since it is unrealistic as a matter of economic substance to believe that the taxpayer could profitably engage in a business requiring the sale of all new bottles at a price substantially less than cost, it is clear that there has been no real change in the taxpayer's position, because it must rely, in order to stay in business, on the practical certainty that it will continue to reacquire most of the bottles "sold."

Based upon the foregoing facts, it is held that the "sale and repurchase" method, in the instant case, does not clearly reflect income within the meaning of section 446 of the Code and the Commissioner will not consent to a change to such method.

Subpart B.—Taxable Year for Which Items of Gross Income Included

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SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

26 CFR 1.451–1: General rule for taxable year of inclusion.

Accrual of an increase in the per diem charge for rental of railroad freight cars by an accrual method taxpayer who has contested such increase. See Rev. Rul. 60–237, page 164.

SECTION 453.—INSTALLMENT METHOD

26 CFR 1.453–1: Installment method of reporting income. (Also Part II, Section 44; Regulations 118, Section 39.44–1.) Rev. Rul. 60–293 [1]

[1] Based on Technical Information Release 247, dated August 23, 1960.

The Internal Revenue Service will not follow the decision of the United States District Court for the District of Massachusetts in *Consolidated Dry Goods Company* v. *United States*, 180 Fed. Supp. 878.

The District Court held that the taxpayer's Cycle Budget Account Plan was fairly embraced within the meaning of the words "installment plan" as used in section 453(a) of the Internal Revenue Code of 1954 and section 44(a) of the Internal Revenue Code of 1939 and that, accordingly, taxpayer was entitled to report *all* of such sales on the installment method.

Under the Cycle Budget Account Plan, a customer was extended credit of a specified amount, was permitted to purchase goods up to his credit limit, and was required to pay each month the smaller of the balance in his account or a fixed amount representing a fraction of the maximum amount of credit which would be extended to him under the plan.

The taxpayer's Cycle Budget Account Plan in this case appears to be fairly typical of "revolving credit" plans adopted by a considerable number of taxpayers within the past few years.

However, it is the position of the Revenue Service that the fact that sales are made pursuant to a revolving credit plan is not determinative of whether such sales are to be regarded as installment sales. A study is now under way as to whether workable standards can be formulated for determining what part of revolving credit sales qualify as sales "on the installment plan" under the statutory provisions mentioned above.

Partnership installment obligations receivable transferred to charity. See Rev. Rul. 60–352, page 208.

Subpart C.—Taxable Year for Which Deductions Taken

SECTION 461.—GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION

26 CFR 1.461–1: General rule for taxable year of deduction. Rev. Rul. 60–237

(Also Section 451; 1.451–1.)

> An accrual method taxpayer, who has contested an increase in the per diem charge for the rental of railroad freight cars, is not entitled to accrue the amount in dispute until the controversy is resolved. This manner of accounting treatment is equally applicable for the purpose of determining the taxable year of the inclusion of the contested amount in gross income where the right thereto is in dispute.

Advice has been requested as to when an accrual method taxpayer, who has contested an increase in the per diem charge for the rental of railroad freight cars, is entitled to accrue and deduct the amount in dispute for Federal income tax purposes.

A railroad company using the freight cars of another railroad company is required to make per diem rental payments for such

cars at a stated rate. When the rate was increased, the taxpayer, employing the accrual method of accounting, contested the increase. However, in accruing charges for the rental of the freight cars, the taxpayer accrued such charges at the increased rate but declined to pay the increases.

The general rule applicable to taxpayers who keep their accounts and file their returns on the accrual method is that expenses should be accrued and deducted in the year in which all the events have occurred which determine the fact of the liability of the taxpayer and the amount thereof can be determined with reasonable accuracy. See section 1.461–1(a)(2) of the Income Tax Regulations; and *Continental Tie and Lumber Co.* v. *United States*, 286 U.S. 290, Ct.D. 494, C.B. XI–1, 260 (1932).

Where the item depends upon a contingency or future events, it is not accruable until the contingency or events have occurred. Where the liability is substantially in controversy, accrual of income or deduction must await the resolution of the controversy. *Lucas* v. *American Code Co., Inc.*, 280 U.S. 445, Ct.D. 168, C.B. IX–1, 314 (1930); *Security Flour Mills* v. *Commissioner*, 321 U.S. 281, Ct.D. 1603, C.B. 1944, 526.

Revenue Ruling 57–105, C.B. 1957–1, 193, holds that, where a taxpayer disagrees with the determination of an additional liability through a contest by litigation, the amount in dispute does not constitute a deductible expense when employing the accrual method of accounting as long as the outcome is unsettled.

In the instant case, the increase in the rental of railroad freight cars has been contested. Accordingly, under the well established principle that a taxpayer cannot accrue an amount with respect to which he denies liability and contests payment, it is held that the railroad company contesting the issue is not entitled to accrue and deduct the amount in dispute until the controversy is resolved. This manner of accounting treatment is equally applicable for the purpose of determining the taxable year of the inclusion of the contested amount in gross income where the right thereto is in dispute. See section 1.451–1(a) of the regulations.

Subpart D.—Inventories

SECTION 471.—GENERAL RULE FOR INVENTORIES

26 CFR 1.471–1: Need for inventories.

Accounting for bottles by a taxpayer engaged in bottling and selling soft drink beverage. See Rev. Rul. 60–243, page 160.

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26 CFR 1.471–5: Inventories by dealers in securities.

Inventories by "specialists" in securities. See Rev. Rul. 60–321, page 166.

SECTION 472.—LAST-IN, FIRST-OUT INVENTORIES

26 CFR 1.472–1: Last-in, first-out inventories. Rev. Rul. 60–321
(Also Section 471; 1.471–5.)

A "specialist" in securities, a qualified member of a stock exchange who accepts orders in selected securities from other members of the exchange for execution, is a dealer in respect to such securities and is entitled to inventory such unsold securities for Federal income tax purposes. See *Helvering* v. *Albert Fried, et al.*, 299 U.S. 175, Ct. D. 1184, C.B. XV–2, 199 (1936).

Such a dealer who, in his books and accounts, regularly inventories securities on hand in the manner prescribed in section 1.471–5 of the Income Tax Regulations may, as provided in section 1.472–1(a) of the regulations, elect to use the last-in, first-out (LIFO) method of valuing his inventory of unsold securities in which he is a "specialist" and which he holds for sale to customers in the ordinary course of business, provided he files the required application for the adoption and use of the elective inventory method provided by section 472 of the Internal Revenue Code of 1954, Form 970, with his Federal income tax return for the taxable year as of the end of which the method is first used, and otherwise complies with all of the requirements and conditions of section 472 of the Code and the regulations thereunder.

Determinations regarding the application to adopt the LIFO inventory method and the propriety of all computations incident to the adoption and the continued use of such method are subject to the approval of the Internal Revenue Service upon examination of the taxpayer's income tax returns.

Rev. Rul. 60–349

Price indexes for July 1960, published by the Bureau of Labor Statistics on September 1, 1960, for use by department stores employing the retail inventory and last-in, first-out inventory methods.

The following price indexes for July 1960, published by the Bureau of Labor Statistics on September 1, 1960, for use by department stores employing the retail inventory and last-in, first-out inventory methods, are accepted by the Internal Revenue Service pursuant to section 1.472–1(k) of the Income Tax Regulations and Mimeograph 6244, C.B. 1948–1, 21, for appropriate application to inventories for taxable years of 12 months ended June 30, 1960, and July 31, 1960.

Indexes are given on a national basis for store total, for 20 major groups of departments, and for two special group combinations—soft and durable goods. The store total index includes all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wall paper, as well as contract departments.

Bureau of Labor Statistics, Department Store Inventory Price Indexes, By Department Groups

[January 1941=100]

	Department group	July 1960	July 1959	Percent change* from July 1959 to July 1960
I	Piece goods	203. 3	199. 5	1. 9
II	Domestics and draperies	201. 8	198. 0	1. 9
III	Women's and children's shoes	262. 8	255. 6	2. 8
IV	Men's and boys' shoes	253. 5	246. 2	3. 0
V	Infant's wear	175. 6	175. 2	. 2
VI	Women's underwear	177. 0	177. 8	—. 4
VII	Women's and girls' hosiery	157. 4	158. 6	—. 8
VIII	Women's and girls' accessories	182. 3	179. 9	1. 3
IX	Women's outerwear and girls' wear	185. 9	183. 0	1. 6
X	Men's clothing	219. 6	213. 8	2. 7
XI	Men's furnishings	200. 0	198. 1	1. 0
XII	Boys' clothing and furnishings	209. 4	205. 8	1. 7
XIII	Jewelry	177. 6	174. 7	1. 7
XIV	Notions	166. 7	165. 3	. 8
XV	Toilet articles and drugs	196. 5	196. 1	. 2
XVI	Furniture and bedding	224. 8	223. 6	. 5
XVII	Floor covering	194. 7	192. 9	. 9
XVIII	Housewares	230. 0	225. 3	2. 1
XIX	Major appliances	131. 1	134. 9	—2. 8
XX	Radios and television sets	130. 7	130. 7	0
	Groups I–XV: Soft goods	200. 1	197. 3	1. 4
	Groups XVI–XX: Durable goods	197. 1	195. 8	. 7
Store total:		199. 5	197. 0	1. 3

*Absence of a minus sign before percent change in this column signifies a price increase.

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26 CFR 1.472–2: Requirements incident to adoption and use of LIFO inventory method. (Also Section 631; 1.631–1.) Rev. Rul. 60–244

A taxpayer, who elects to treat the cutting of timber as a sale or exchange under section 631(a) of the Internal Revenue Code of 1954 and who adopts the last-in, first-out, inventory method under section 472 of the Code, may use, in financial statements to shareholders and for credit purposes, an inventory reserve reflecting the difference between the fair market value of the timber cut and the adjusted cost basis of such timber, determined without reference to such fair market value.

Advice has been requested whether a taxpayer, who elects to treat the cutting of timber as a sale or exchange under section 631(a) of the Internal Revenue Code of 1954 and adopts the last-in, first-out, inventory method under section 472 of the Code, may use, in financial statements to shareholders and for credit purposes, an inventory reserve reflecting the difference between the fair market value of the timber cut and the adjusted cost basis of such timber, determined without reference to such fair market value.

The taxpayer has extensive timber holdings from which substantial quantities of timber are cut each year for use in its manufacturing

operations. It elected to treat the cutting of timber as a sale or exchange under section 631(a) of the Code. It also adopted the last-in, first-out (LIFO), inventory method described in section 472 of the Code.

Section 631(a) of the Code provides that a taxpayer may elect on its return for a taxable year to treat the cutting of timber during the taxable year as a sale or exchange. If such an election is made, gain or loss to the taxpayer is recognized in an amount equal to the difference between the fair market value of the timber cut during the taxable year and the adjusted basis for depletion of such timber in the hands of the taxpayer. For this purpose, the fair market value is the fair market value as of the first day of the taxable year in which the timber is cut and shall be treated as the cost of such timber to the taxpayer for all purposes for which such cost is a necessary factor.

Section 472(b) of the Code provides that in inventorying goods specified in an application to use the LIFO method, the taxpayer shall:

> (1) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof; and second, those acquired in the taxable year;
> (2) Inventory them at cost; and
> (3) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

Section 472(c) of the Code provides that the elective method shall apply only if the taxpayer establishes to the satisfaction of the Secretary of the Treasury or his delegate that the taxpayer has used no procedure other than that specified in paragraphs (1) and (3) of subsection (b) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in subsection (b) is to be used, for the purpose of a report or statement covering such taxable year (1) to shareholders, partners, or other proprietors, or to beneficiaries, or (2) for credit purposes. Also see section 1.472–2(e) of the Income Tax Regulations. Section 472(e)(2) of the Code contains similar provisions for subsequent taxable years under which the Secretary or his delegate may determine that the taxpayer has used some procedure other than that specified in paragraph (1) of subsection (b). Also see section 1.472–2(g) of the regulations.

The taxpayer keeps its books, records, and accounts in conformity with the last-in, first-out, inventory method, using cost for timber cut as distinguished from section 631(a) fair market value, and reflecting such cost in the LIFO inventories shown on financial statements. For both Federal income tax returns and financial statements, inventories of cut timber (logs, pulpwood, etc.) are treated as being, first, the cut timber included in the opening inventory of the taxable year to the extent thereof and, second, the timber cut during the taxable year. The fair market value as of the beginning of the taxable year of the standing timber cut during the year is used in lieu of the actual cost of such timber in computing the closing inventory of cut timber for such year and the opening inventory for the succeeding year.

In financial statements to shareholders and for credit purposes, the taxpayer reflects in its inventory the fair market value of the tim-

ber cut to which section 631(a) applies but provides an inventory reserve to eliminate the excess of such fair market value over the adjusted cost basis of the cut timber included in inventory. The reserve is shown on the balance sheet as a deduction from inventories, but is not an allowable deduction for Federal income tax purposes. The net effect of such treatment is to reflect, in the inventory of timber cut under the provisions of section 631(a) on the financial statements and credit reports, the adjusted cost basis of such timber.

The specific question is whether such treatment of inventories in the taxpayer's financial reports to shareholders and for credit purposes is consistent with the provisions of sections 472(c) and 472(e) of the Code.

Under the circumstances described in the instant case, it is held that the indicated treatment of LIFO inventories in reports to shareholders and for credit purposes is consistent with the provisions of and the principles underlying sections 472(c) and 472(e) of the Code. Accordingly, a taxpayer, who elects to treat the cutting of timber in a taxable year as a sale or exchange under section 631(a) of the Code, and who adopts the last-in, first-out, inventory method may, in financial statements to shareholders and for credit purposes, use an inventory reserve reflecting the difference between the fair market value of the timber cut and its adjusted cost basis, determined without reference to such fair market value.

PART III.—ADJUSTMENTS

SECTION 481.—ADJUSTMENTS REQUIRED BY CHANGES IN METHOD OF ACCOUNTING

26 CFR 1.481–2: Limitation on tax.

Amendment to the regulations with respect to adjustments, including dealer reserve adjustments, required in the case of a change in method of accounting by an electing small business corporation. See T.D. 6490, page 481.

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

SECTION 501.—EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

26 CFR 1.501(c)(3)–1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. Rev. Rul. 60–351

A corporation is organized and operated on a non-profit basis. It publishes a foreign language magazine containing fiction, poetry,

book reviews and articles alleged to be of a literary, scientific and educational character. The magazine is available to the general public through regular paid subscriptions. *Held*, since the sale activity of the corporation is the publishing and public sale of a magazine it is not exempt from Federal income tax under section 501(c) (3) of the Internal Revenue Code of 1954.

Advice has been requested whether a corporation is exempt from Federal income tax under section 501(c) (3) of the Internal Revenue Code of 1954 under the circumstances described below.

A corporation is organized and operated on a non-profit basis. It publishes a foreign language magazine containing fiction, poetry, book reviews and articles which it states is of a literary, scientific and educational character. The magazine is available to the general public through regular paid subscriptions.

The corporation's stated purposes as set out in its articles of incorporation are to receive and administer funds and other property exclusively for charitable, scientific, literary and educational purposes and, in furtherance thereof, to publish a magazine or other material in a specified foreign language. The articles of incorporation also state that the magazine or other material is to provide a vehicle for the creative activity of writers and scholars emigrating from a certain foreign country to the United States and to acquaint other immigrants from that country with American life and help them to become integrated in the American way of life.

The activities of the corporation are devoted solely to publishing the magazine and making it available to the general public through the corporation or subscription agencies at regular subscription rates. The corporation's income is derived mainly from subscriptions and sales of individual copies of the publication, and some is from advertising and contributions. Its expenditures consist of fees paid to authors for their works, salaries, printing, advertising, shipping packing, postage and other operating costs incurred in the publication of the magazine. The corporation is organized on a non-profit basis.

Section 501 of the Code provides as follows:

(a) EXEMPTION FROM TAXATION.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504.

* * * * * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

* * * * * * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, * * *.

Section 1.501(c) (3)–1 of the Income Tax Regulations provides, in part, that in order to be exempt as an organization described in section 501(c) (3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

An organization is not "organized exclusively" for one or more exempt purposes if its articles expressly empower it to carry on, other-

wise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3) of the Code. Thus, an organization that is empowered by its articles "to engage in a manufacturing business," or "to engage in the operation of a social club," does not meet the required organizational test for such exemption regardless of the fact that its articles may state that such organization is created "for charitable purposes within the meaning of section 501(c)(3) of the Code." Section 1.501(c)(3)–(b)(iii) of the regulations.

An organization will be regarded as "operated exclusively" for one or more of such exempt purposes only if it engages primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Section 1.501(c)(3)–1(c)(1) of the regulations.

Consideration of the corporation's charter power, in the light of the actual operations, indicates that the corporation is organized for the primary purpose of publishing a magazine. It is true that there is language in the articles of incorporation which, standing alone, indicates charitable, scientific, literary and educational purposes. The corporation, however, has a specific power to publish a magazine, the use or distribution of which is not distinctly required to accomplish any of such purposes. This power, as construed and exercised by the corporation, shows that the corporate assets are not dedicated to charitable, scientific, literary or educational purposes and that they are not impressed with a trust which may be enforced for such purposes by the state in which it is incorporated or by an interested person. Materials may be selected and purchased for publication, and other operations in publishing and distributing the magazine may be undertaken, at the discretion of the corporate officers and without regard on their part to the fiduciary responsibilities that ordinarily attach to funds and assets definitely committed to charitable, scientific, literary or educational uses.

In this case, the corporate activities, which presumably are within the charter powers, are, *per se*, business activities. They are devoted to publishing a magazine and selling it to the general public in accordance with ordinary commercial publishing practices. The corporate assets are subjected to the usual business risks incident to such activities. Although the magazine is printed in a foreign language and may provide some materials unlike those in other magazines, there is no showing that the operations fulfill a corporate role which in and of itself is exclusively charitable, scientific, literary or educational. The mere fact that the corporation is not organized for the profit of its members does not remove the necessity for the corporation to bear its burden of proof to a right to exemption.

In view of the above, it is held that the instant corporation is not an exempt charitable, scientific, literary or educational organization within the meaning of section 501(c)(3) of the Code.

(Also Section 403; 1.403(b)–1.) Rev. Rul. 60–384 [1]

A wholly-owned state or municipal instrumentality which is a separate entity and which is organized and operated exclusively for purposes described in section 501(c)(3) of the Internal Revenue Code of 1954 may qualify for exemption from Federal income tax under section 501(a) as an organization described in section 501(c)(3) of the Code.

Rev. Rul. 55–319, C.B. 1955–1, 119, amplified.

The Internal Revenue Service has given further consideration to the position expressed in Revenue Ruling 55–319, C.B. 1955–1, 119, that a wholly-owned state instrumentality may in some circumstances qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

As indicated in Revenue Ruling 55–319, an organization which is a wholly-owned state or municipal instrumentality may seek exemption as a section 501(c)(3) organization so that the benefit of a particular feature may be extended to its employees, as for example, the exception provided by section 403 of the Code which depends on exemption under section 501(a) of an employer described in section 501(c)(3).

Section 403 of the Code reads, in part, as follows:

* * * * * * *

(b) TAXABILITY OF BENEFICIARY UNDER ANNUITY PURCHASED BY SECTION 501(c)(3) ORGANIZATION.—

(1) GENERAL RULE.—If—

(A) an annuity contract is purchased for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a),

(B) such annuity contract is not subject to subsection (a), and

(C) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums,

then amounts contributed by such employer for such annuity contract on or after such rights become nonforfeitable shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such amounts does not exceed the exclusion allowance for such taxable year. The employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities) except that section 72(e)(3) shall not apply.

(2) EXCLUSION ALLOWANCE.—For purposes of this subsection, the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of—

(A) the amount determined by multiplying (i) 20 percent of his includible compensation by (ii) the number of years of service, over

(B) the aggregate of the amounts contributed by the employer for annuity contracts and excludable from the gross income of the employee for any prior taxable year.

Section 501(c) of the Code describes certain organizations exempt from income tax under section 501(a) and reads, in part, as follows:

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

[1] Also released as Technical Information Release 276, dated December 13, 1960.

Revenue Ruling 55–319 holds, in part, that where an organization desires to have the benefit of a particular tax feature extended to its employees, such as the exemption provided by section 403 of the Code, which depends on exemption under section 501(a) of an employer described in section 501(c)(3), and the particular organization meets the statutory requirements for exemption under section 501(c)(3) of the Code, it may be granted exemption thereunder, regardless of the fact that it also qualifies as a wholly-owned state instrumentality and, as such, would not be subject to Federal income tax.

Thus, such an organization may be exempt under section 501(c)(3) of the Code if it is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

A state or municipality itself, however, would not qualify as an organization described in section 501(c)(3) since its purposes are clearly not exclusively those described in section 501(c)(3) of the Code. See for example, *Estate of John C. F. Slayton* v. *Commissioner*, 3 B.T.A. 1343. It follows, therefore, that where the particular branch or department under whose jurisdiction the activity in question is being conducted is an integral part of a state or municipal government the provisions of section 501(c)(3) would not be applicable. For example, where a public school, college, university or hospital is an integral part of a local government, it could not meet the requirements for exemption under section 501(c)(3) of the Code.

On the other hand a wholly-owned state or municipal instrumentality which is a counterpart of an organization described in section 501(c)(3) of the Code such as a separately organized school, college, university, or hospital may qualify for exemption under section 501(c)(3) of the Code. If the organization conducting the activity, although a separate entity, is clothed with powers other than those described in section 501(c)(3) it would not be a clear counterpart of a section 501(c)(3) organization. For example, where a wholly-owned state or municipal instrumentality exercises enforcement or regulatory powers in the public interest such as health, welfare, or safety, it would not be a clear counterpart of an organization described in section 501(c)(3) of the Code even though separately organized since it has purposes or powers which are beyond those described in section 501(c)(3).

In order for a wholly-owned instrumentality to establish an exemption under section 501(c)(3) of the Code, it is necessary to file an application on Form 1023, Application for Exemption, with the District Director of Internal Revenue for the internal revenue district in which is located the principal place of business or principal office of the organization. See section 1.501(a)–1 of the Income Tax Regulations.

Revenue Ruling 55–319, C.B. 1955–1, 119, is hereby amplified.

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26 CFR 1.501(c)(7)–1: Social clubs. Rev. Rul. 60–324

A social club which has been granted exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 may lose its exemption if it makes its club facilities avail-

able to the general public on a regular, recurring, basis since it may then no longer be considered to be organized and operated exclusively for its exempt purpose.

Advice has been requested as to the extent to which a social club, which has been granted exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954, may make its club facilities available to outside organizations and groups and still retain its exemption.

In the instant case, an organization was formed for the purpose of operating a social club on a nonprofit basis for the pleasure and recreation of its members and their guests. The club's bylaws provide for the admission of guests only when accompanied by members. Members are responsible for the conduct of their guests on club premises

The club had been granted exemption from Federal income tax as a social and recreational club under section 101(9) of the Internal Revenue Code of 1939 (now section 501(c)(7) of the 1954 Code).

Among other facilities provided for the pleasure and convenience of its members and their guests, the club has a regular club dining room and bar; a private dining room suitable for cocktail parties, small or medium sized parties or luncheons, small wedding receptions or similar private parties; and a ballroom which, when not used for the club's dances, is available for private use by members for larger parties, such as wedding receptions, banquets, debutante dances, and the like.

A considerable number of functions are held at the club which involve the use of the private dining room and the ballroom. Such functions include civic and business club meetings, employee parties by business firms, school and alumni banquets and parties, and similar non-club activities. In such cases, negotiations for the use of club facilities by an organization or group are made with the particular club member sponsoring the organization or group. The member's name is entered on the club records as the party responsible for the behavior of his guests and the protection of club property. He is billed for the expenses of the function and it is apparent that he, in turn, is reimbursed therefor by the particular organization or group which he sponsored. If a particular member is entertaining a business, professional, or civic group, the name of the organization or group is listed on the club's daily function sheet. That sheet serves as a guide to the day's activities and assists in directing persons to the proper rooms when arriving for private parties and functions.

A financial analysis submitted by the club showing its banquet sales over a seven-year period indicates that the income from sales on behalf of outside organizations and groups ranged from 12 to more than 17 percent of total income from all sources, including dues, in each of the years involved. In one of the years, gross profits from these outside activities amounted to $41x$ dollars compared to $166x$ dollars of gross profit from all club operations, or 25 percent of the total gross profit for the year. In that same year, the amount of net profit from these outside activities was $25x$ dollars. The number of such outside functions totalled over 200 during the year.

The number of major functions for outside organizations and groups conducted on club facilities during each year of the seven-year period

covered in the financial analysis is very substantial, in fact, exceeding 40 percent of the total number of major functions conducted on club facilities in one of those years. Moreover, the availability of club facilities to outside organizations and groups under the ready sponsorship of club members serves to indicate that the club is catering to the general public and places it in competition with other business enterprises in the community for such business or activities.

The report of an independent survey conducted in recent years by the club's accounting firm concluded that, in the opinion of that firm, if these functions for outside organizations and groups were to be discontinued, a substantial increase in the amount of annual dues from club members would be necessary. Consequently, the outside functions have not been discontinued, although the amount of dues was recently increased because of rising costs.

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

> (7) 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 1.501(c)(7)–1 of the Income Tax Regulations, relating to the requirements for exemption of such clubs under section 501(a), reads in part as follows:

> (a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue *from members* through the use of club facilities or in connection with club activities.
>
> (b) A club which engages in business, *such as making its social and recreational facilities available to the general public* or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a). * * *. [Italics supplied.]

While these regulations indicate that a club may lose its exempt status if it makes its facilities available to the general public, this does not mean that any dealings with outsiders will automatically cause a club to lose its exemption. A club will not lose its exemption merely because it receives some income from the general public, that is, persons other than members and their bona fide guests, or because the general public may occasionally be permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income therefrom does not inure to members. See the discussion in Revenue Ruling 58–589, C.B. 1958–2, 266, and the court decisions cited therein.

In the instant case, the club is making its facilities available for the use of outside organizations and groups through the member-sponsorship arrangement. Any member may invite other organizations and groups to use the club's facilities for their activities.

The club is permitting, if not actually inviting, the general public to use its facilities through its member-sponsoring arrangement for

outside groups to a degree that will not permit the club to retain its exempt status.

An analysis of the club's transactions with outside organizations and groups demonstrates that such outside activities are of such magnitude and recurrence as to constitute engaging in business. Thus, the participation in the use of club facilities by the general public is not considered to be merely incidental or in furtherance of the general club purposes.

Accordingly, on the basis of the facts and circumstances herein described, it is concluded that the instant club by making its social facilities available to the general public through its member-sponsorship arrangement can not be treated as being operated exclusively for pleasure, recreation or other nonprofitable purposes. Accordingly, it is held that the club no longer qualifies for exemption from Federal income tax under section 501(c)(7) of the Code.

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26 CFR 1.501(c)(14): Statutory provisions; exemption from tax on corporations, certain trusts, etc.; credit unions.

Regulations under the Internal Revenue Code of 1954 relating to the exemption from tax on mutual deposit guarantee funds organized up to September 1, 1957. See T.D. 6493, below.

SECTION 503.—REQUIREMENTS FOR EXEMPTION

26 CFR 1.503(h): Statutory provisions; requirements for exemption; special rules relating to lending by section 401(a) trusts to certain persons. (Also Section 501; 1.501(c)(14).) T. D. 6493[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Amendment of the Income Tax Regulations under section 501(c)(14), relating to credit unions and mutual insurance funds, and under section 503, relating to certain loans by employees' trusts.

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

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

On April 9, 1960, notice of proposed rulemaking with respect to the amendments of the Income Tax Regulations (26 CFR Part 1) under section 503 of the Internal Revenue Code of 1954 to reflect the changes made by section 30 of the Technical Amendments Act of 1958 (72 Stat. 1629) [C.B. 1958–3, 254] was published in the Federal Register

[1] The publication of this Treasury Decision in 25 F.R. 9215, dated September 27, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 3075, dated April 9, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

(25 F.R. 3075). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments of the regulations as so published are hereby adopted. In addition, in order to reflect the change made by the Act of April 22, 1960 (Public Law 86–428, 74 Stat. 54) [C.B. 1960–1, 788], the paragraphs 4 and 5 are included in the Treasury Decision and the amendments contained therein are adopted.

PARAGRAPH 1. Section 1.503(c)–1 is amended—

(A) By revising paragraph (b)(2)(iv) to read as follows:

(iv) December 1, 1958, for debentures which were purchased before November 9, 1956, and held after December 1, 1958.

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

(3) *Certain exceptions to section 503(c)(1).*—See section 503(h) and §§ 1.503(h)–1, 1.503(h)–2, and 1.503(h)–3 for special rules providing that certain obligations acquired by an employees' trust described in section 401(a) shall not be treated as loans made without the receipt of adequate security for purposes of section 503(c)(1). See section 503(i) and § 1.503(i)–1 for an exception to the application of section 503(c)(1) for certain loans made by employees' trusts described in section 401(a).

(C) By striking the first sentence of paragraph (c) and inserting in lieu thereof the following sentences:

The following examples illustrate the operation of section 503(c)(1) with regard to organizations described in section 501(c)(3). The examples are also illustrative of the operation of section 503(c)(1) with respect to employees' trusts described in section 401(a), to the extent that section 503 (h) or (i) is not applicable.

(D) By revising the fourth sentence of example (6) in paragraph (c) to read as follows:

If the organization purchased the debenture on or before November 8, 1956, and holds it after December 1, 1958, the debenture must be adequately secured on December 2, 1958, or it will be then considered as a prohibited transaction.

PAR. 2. Section 1.503(g)–1 is amended to read as follows:

§ 1.503(g)–1 CROSS REFERENCES.—For provisions relating to loans by a trust described in section 401(a), see § 1.503(c)–1 and section 503 (h) and (i) and the regulations thereunder.

PAR. 3. There are inserted immediately after § 1.503(g)–1 the following new sections:

§ 1.503(h) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; SPECIAL RULES RELATING TO LENDING BY SECTION 401(a) TRUSTS TO CERTAIN PERSONS.

SEC. 503. REQUIREMENTS FOR EXEMPTION * * *

(h) SPECIAL RULES RELATING TO LENDING BY SECTION 401(A) TRUSTS TO CERTAIN PERSONS.—For purposes of subsection (c)(1), a bond, debenture, note, or certificate or other evidence of indebtedness (hereinafter in this subsection referred to as "obligation") acquired by a trust described in section 401(a) shall not be treated as a loan made without the receipt of adequate security if—

(1) Such obligation is acquired—

(A) On the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the trust than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) From an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) Directly from the issuer, at a price not less favorable to the trust than the price paid currently for a substantial portion of the same issue by persons independent of the issuer;

(2) Immediately following acquisition of such obligation—

(A) Not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the trust, and

(B) At least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer; and

(3) Immediately following acquisition of the obligation, not more than 25 percent of the assets of the trust is invested in obligations of persons described in subsection (c).

[Sec. 503(h) as added by sec. 30(a), Technical Amendments Act 1958 (72 Stat. 1629)]

SEC. 30. DENIAL OF EXEMPTION TO ORGANIZATIONS ENGAGED IN PROHIBITED TRANSACTIONS [TECHNICAL AMENDMENTS ACT OF 1958 (72 STAT. 1629)]. * * *

(c) EFFECTIVE DATE. * * *

(2) EXCEPTIONS.—Nothing in subsection (a) shall be construed to make any transaction a prohibited transaction which, under announcements of the Internal Revenue Service made with respect to section 503(c)(1) of the Internal Revenue Code of 1954 before the date of the enactment of this Act, would not constitute a prohibited transaction. In the case of any bond, debenture, note, or certificate or other evidence of indebtedness acquired before the date of the enactment of this Act [September 2, 1958] by a trust described in section 401(a) of such Code which is held on such date, paragraphs (2) and (3) of section 503(h) of such Code shall be treated as satisfied if such requirements would have been satisfied if such obligation had been acquired on such date of enactment.

§ 1.503(h)–1 CERTAIN LOANS BY EMPLOYEES' TRUSTS.—(a) *In general.*—(1) Section 503(h) provides that the acquisition by an employees' trust described in section 401(a) of a bond, debenture, note, or certificate or other evidence of indebtedness shall not be treated as a loan made without the receipt of adequate security for purposes of section 503(c)(1), relating to loans made without the receipt of adequate security and a reasonable rate of interest, if certain requirements are met. Those requirements are described in § 1.503(h)–2.

(2) Section 503(h) does not affect the requirement in section 503(c)(1) of a reasonable rate of interest. Thus, although the acquisition of a certificate of indebtedness which meets all of the requirements of section 503(h) and of § 1.503(h)–2 will not be considered as a loan made without the receipt of adequate security, the acquisition of such an indebtedness does constitute a prohibited transaction if the indebtedness does not bear a reasonable rate of interest.

(3) The provisions of section 503(h) do not limit the effect of section 401(a) and § 1.401–2, relating to use or diversion of corpus or income of an employees' trust, or the effect of any of the provisions of section 503 other than section 503(c)(1). Consequently, although a loan made by an employees' trust described in section 401(a) meets all the requirements of section 503(h) and therefore is not treated as a loan made without the receipt of adequate security, an employees' trust making such a loan will lose its exempt status if the loan is not considered as made for the exclusive benefit of the employees or their beneficiaries. Similarly, a loan which meets the requirements of section 503(h) will constitute a prohibited transaction within the meaning of section 503(c)(6) if it results in a substantial diversion of the trust's income or corpus to a person described in section 503(c).

(b) *Definitions.*—For purposes of section 503(h)—

(1) The term "obligation" means bond, debenture, note, or certificate or other evidence of indebtedness.

(2) The term "issuer' includes any person described in section 503(c) who issues an obligation.

(3) (i) The term "person independent of the issuer" means a person who is not related to the issuer by blood, by marriage, or by reason of any substantial business interests. Persons who will be considered not to be independent of the issuer include but are not limited to—

(*a*) The spouse, ancestor, lineal descendant, or brother or sister (whether by whole or half blood) of an individual who is the issuer of an obligation;

(*b*) A corporation controlled directly or indirectly by an individual who is the issuer, or directly or indirectly by the spouse, ancestor, lineal descendant, or brother or sister (whether by whole or half blood) of an individual who is the issuer;

(*c*) A corporation which directly or indirectly controls, or is controlled by, a corporate issuer;

(*d*) A controlling shareholder of a corporation which is the issuer, or which controls the issuer;

(*e*) An officer, director, or other employee of the issuer, of a corporation controlled by the issuer, or of a corporation which controls the issuer;

(*f*) A fiduciary of any trust created by the issuer, by a corporation which controls the issuer, or by a corporation which is controlled by the issuer; or

(*g*) A corporation controlled by a person who controls a corporate issuer.

(ii) For purposes of subdivision (i) of this subparagraph, the term "control" means, with respect to a corporation, direct or indirect ownership of 50 percent or more of the total combined voting power of all voting stock or 50 percent or more of the total value of shares of all classes of stock. If the aggregate amount of stock in a corporation owned by an individual and by the spouse, ancestors, lineal descendants, brothers and sisters (whether by whole or half blood) of the individual is 50 percent or more of the total combined voting power of all voting stock or is 50 percent or more of the total value of all classes of stock, then each of these persons shall be considered as the controlling shareholder of the corporation.

(iii) In determining family relationships for purposes of subdivision (i) of this subparagraph, a legally adopted child of an individual shall be treated as a child of such individual by blood.

(4) The term "issue" means all the obligations of an issuer which are offered for sale on substantially the same terms. Obligations shall be considered offered for sale on substantially the same terms if such obligations would, at the same time and under the same circumstances, be traded on the market at the same price. On the other hand, if the terms on which obligations are offered for sale differ in such manner as would cause such obligations to be traded on the market at different prices, then such obligations are not part of the same issue. The following are examples of terms which, if different, would cause obligations to be traded on the market at different prices:

(i) Interest rate;
(ii) Maturity date;
(iii) Collateral; and
(iv) Conversion provisions.

The fact that obligations are offered for sale on different dates will not preclude such obligations from being part of the same issue if they all mature on the same date and if the terms on which they are offered for sale are otherwise the same, since such obligations would, at the same time and under the same conditions, be traded on the market at the same price. Obligations shall not be considered part of the same issue merely because they are part of the same authorization or because they are registered as part of the same issue with the Securities and Exchange Commission.

§ 1.503(h)-2 REQUIREMENTS.—(a) *In general.*—The requirements which must be met under section 503(h) for an obligation not to be treated as a loan made without the receipt of adequate security for purposes of section 503(c)(1) are described in paragraphs (b), (c), and (d) of this section.

(b) *Methods of acquisition*—(1) *In general.*—The employees' trust described in section 401(a) must acquire the obligation on the market, by purchase from an underwriter, or by purchase from the issuer, in the manner described in subparagraph (2), (3), or (4) of this paragraph.

(2) *On the market.*—(i) An obligation is acquired on the market when it is purchased through a national securities exchange which is registered with the Securities and Exchange Commission, or when it is purchased in an over-the-counter transaction. For purposes of the preceding sentence, securities purchased through an exchange which is not a national securities exchange registered with the Securities and Exchange Commission shall be treated as securities purchased in an over-the-counter transaction.

(ii) (*a*) If the obligation is listed on a national securities exchange registered with the Securities and Exchange Commission, it must be purchased through such an exchange or in an over-the-counter transaction at a price not greater than the price of the obligation prevailing on such an exchange at the time of the purchase by the employees' trust.

(*b*) For purposes of section 503(h), the price of the obligation prevailing at the time of the purchase means the price which accurately reflects the market value of the obligation. In the case of an obligation purchased through a national securities exchange which is registered with the Securities and Exchange Commission, the price paid for the obligation will be considered the prevailing price of the obligation. In the case of an obligation purchased in an over-the-counter transaction, the prevailing price may be the price at which the last sale of the obligation was effected on such national securities exchange immediately before the trust's purchase of such obligation on the same day or may be the mean between the highest and lowest prices at which sales were effected on such exchange on the same day or on the immediately preceding day or on the last day during which there were sales of such obligation or may be a price determined by any other method which accurately reflects the market value of the obligation.

(iii) (*a*) If the obligation is not listed on a national securities exchange which is registered with the Securities and Exchange Commission, it must be purchased in an over-the-counter transaction at a price not greater than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer.

(*b*) For purposes of section 503(h), the offering price for the obligation at the time of the purchase means the price which accurately reflects the market value of the obligation. The offering price may be the price at which the last sale of the obligation to a person independent of the issuer was effected immediately before the trust's purchase of such obligation on the same day or may be the mean between the highest and lowest prices at which sales to persons independent of the issuer were effected on the same day or on the immediately preceding day or on the last day during which there were sales of such obligation or may be a price determined by any other method which accurately reflects the market value of the obligation. The offering price for an obligation must be a valid price for the amount of the obligations which the employees' trust is purchasing. For example, if an employees' trust purchases 1,000 bonds of the employer corporation at the offering price established by current prices for a lot of 10 such bonds, such offering price may not be a valid price for 1,000 bonds and the purchase may therefore not meet the requirements of this subdivision. For a purchase of an obligation to qualify under this subdivision, there must be sufficient current prices quoted by persons independent of the issuer to establish accurately the current value of the obligation. Thus, if there are no current prices quoted by persons independent of the issuer, an over-the-counter transaction will not qualify under this subparagraph although the obligation was purchased in an arm's length transaction from a person independent of the issuer.

(iv) For purposes of this section, an over-the-counter transaction is one not executed on a national securities exchange which is registered with the Securities and Exchange Commission. An over-the-counter transaction may be made through a dealer or an exchange which is not such a national securities exchange or may be made directly from the seller to the purchaser.

(3) *From an underwriter.*—An obligation may be purchased from an underwriter, if it is purchased at a price not greater than—

(i) The public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, or

(ii) The price at which a substantial portion of the issue including such obligation is acquired by persons independent of the issuer,

whichever is the lesser price. For purposes of this subparagraph, a portion of the issue will be considered substantial if the purchases of such portion by persons

independent of the issuer are sufficient to establish the fair market value of the obligations included in such issue. In determining whether the purchases are sufficient to establish the fair market value, all the surrounding facts and circumstances will be considered, including the number of independent purchasers, the aggregate amount purchased by each such independent purchaser, and the number of transactions. In the case of a large issue, purchases of a small percentage of the outstanding obligations may be considered purchases of a substantial portion of the issue; whereas, in the case of a small issue, purchases of a larger percentage of the outstanding obligations will ordinarily be required. The requirement in subdivision (ii) of this subparagraph contemplates purchase of the obligations by persons independent of the issuer contemporaneously with the purchase by the employees' trust. If a substantial portion has been purchased at different prices, the price of the portion may be based on the average of such prices, and if several substantial portions have been sold to persons independent of the issuer, the price of any of the substantial portions may be used for purposes of this subparagraph.

(4) *From the issuer.*—An obligation may be purchased directly from the issuer at a price not greater than the price paid currently for a substantial portion of the same issue by persons independent of the issuer. This requirement contemplates purchase of a substantial portion of the same issue by persons independent of the issuer contemporaneously with the purchase by the employees' trust. For purposes of this subparagraph, a portion of the issue will be considered substantial if the purchases of such portion by persons independent of the issuer are sufficient to establish the fair market value of the obligations included in such issue. In determining whether the purchases are sufficient to establish the fair market value, all the surrounding facts and circumstances will be considered, including the number of independent purchasers, the aggregate amount purchased by each such independent purchaser, and the number of transactions. In the case of a large issue, purchases of a small percentage of the outstanding obligations may be considered purchases of a substantial portion of the issue; whereas, in the case of a small issue, purchases of a larger percentage of the outstanding obligations will ordinarily be required. The price paid for a substantial portion of the issue may be determined in the manner provided in subparagraph (3) of this paragraph.

(c) *Limitations on holdings of obligations.*—(1) Immediately following acquisitions of the obligation by the employees' trust—

(i) Not more than 25 percent of the aggregate amount of the obligations issued in such issue and outstanding immediately after acquisition by the trust may be held by the trust, and

(ii) At least 50 percent of such aggregate amount must be held by persons independent of the issuer.

(2) (i) For purposes of subparagraph (1) of this paragraph, an obligation is not considered as outstanding if it is held by the issuer. For example, if an obligation which has been issued and outstanding is repurchased and held by the issuer, without cancellation or retirement, such an obligation is not considered outstanding.

(ii) For purposes of subparagraph (1) of this paragraph, the amounts of the obligations held by the employees' trust and by persons independent of the issuer shall be computed on the basis of the face amount of the obligations.

(d) *Limitation on amount invested in obligations.*—(1) (i) Immediately following acquisition of the obligation, not more than 25 percent of the assets of the trust may be invested in all obligations of all persons described in section 503(c). For purposes of determining the amount of the trust's assets which are invested in obligations of persons described in section 503(c) immediately following acquisition of the obligation, those obligations shall be valued as follows:

(*a*) Those obligations included in the acquisition in respect of which the percentage test in the first sentence of this subdivision is being applied shall be valued at their adjusted basis, as provided in section 1011, relating to adjusted basis for determining gain or loss; and

(*b*) All other obligations of persons described in section 503(c) which were part of the trust's assets immediately before the acquisition of the obligations described in (*a*) of this subdivision shall be valued at their fair market value on the day that the obligations described in (*a*) of this subdivision were acquired.

For purposes of determining the total amount of the assets of the trust (including obligations of persons described in section 503(c)), there shall be used the fair market value of those assets on the day the obligation is acquired.

(ii) The application of the rules in subdivision (i) of this subparagraph may be illustrated by the following example:

Example. On February 1, 1960, an exempt employees' trust described in section 401(a) purchases unsecured debentures issued by the employer corporation for $1,000. At the time of this purchase, such debentures have a fair market value of $1,200. Immediately after the purchase of such unsecured debentures, the assets of the trust consist of the following:

	Cost	*Fair Market Value on Feb. 1 1960*
(*a*) Assets other than obligations of persons described in section 503(c)	$5,000	$7,800
(*b*) Obligations of persons described in section 503(c) acquired before February 1, 1960	500	1,000
(*c*) Unsecured debentures of employer purchased on February 1, 1960	1,000	1,200

Immediately following acquisition of the unsecured debentures by the trust, the percent of the assets of the trust that are invested in all obligations of all persons described in section 503(c) is computed as follows:

(*1*) Obligations of persons described in section 503(c) acquired before February 1, 1960 (valued at fair market value)	$1,000
(*2*) Unsecured debentures of employer purchased on February 1, 1960 (valued at cost)	1,000
(*3*) Total amount of trust's assets invested in obligations of persons described in section 503(c) ((*1*) plus (*2*))	2,000
(*4*) Assets of the trust other than obligations of persons described in section 503(c) (valued at fair market value on February 1, 1960)	7,800
(*5*) Obligations of persons described in section 503(c) acquired before February 1, 1960 (valued at fair market value on February 1, 1960)	1,000
(*6*) Unsecured debentures of employer purchased on February 1, 1960 (valued at fair market value on February 1, 1960)	1,200
(7) Total assets of the trust valued at fair market value on February 1, 1960 (sum of (*4*), (*5*), and (*6*))	10,000
(*8*) Percent of assets of the trust invested in all obligations of all persons described in section 503(c) immediately following purchase of unsecured debentures on February 1, 1960 ((*3*) ÷ (7), that is, $2,000 ÷ $10,000)	20%

(2) In determining for purposes of subparagraph (1) of this paragraph the amount invested in obligations of persons described in section 503(c), there shall be included amounts invested in any obligations issued by any such person, irrespective of whether the obligation is secured, and irrespective of whether the obligation meets the conditions of section 503(h) or section 503(i). Obligations of persons described in section 503(c) other than the issuer of the obligation to which section 503(h) applies are also included within the 25-percent limitation. For example, if on February 19, 1959, an exempt employees' trust described in section 401(a) purchases unsecured debentures issued by the employer corporation in a transaction effected on the New York Stock Exchange, and if immediately after the purchase 10 percent of the trust's assets is invested in such debentures and 20 percent of its assets is invested in a loan made with adequate security on January 12, 1959, to the wholly-owned subsidiary of the employer corporation, then the purchase of the employer's debentures will not qualify under section 503(h), since 30 percent of the trust's assets are then invested in obligations of persons described in section 503(c).

(e) *Change of terms of an obligation.*—A change in the terms of an obligation is considered as the acquisition of a new obligation. If such new obligation is not adequately secured, the requirements of section 503(h) must be met at the time the terms of the obligation are changed for such section to be applicable to such new loan.

§ 1.503(h)-3 EFFECTIVE DATES.—(a) Section 503(h) and §§ 1.503(h)-1 and 1.503(h)-2 are effective for taxable years ending after March 15, 1956. Thus, if during a taxable year ending before March 16, 1956, an employees' trust made

a loan which meets the requirements of section 503(h), such loan will not be treated as made without the receipt of adequate security and will not cause loss of exemption for taxable years ending after March 15, 1956, although such loan was not considered adequately secured when made.

(b)(1) In the case of obligations acquired by the trust before September 2, 1958, which were held on that date, the requirements described in paragraphs (c) and (d) of § 1.503(h)-2 which were not satisfied immediately following the acquisition shall be treated as satisfied at that time if those requirements would have been satisfied had the obligations been acquired on September 2, 1958. For example, on January 3, 1955, an employees' trust described in section 401(a) purchased through the New York Stock Exchange unsecured debentures issued by the employer corporation. Under section 503(h) the acquisition of such debentures by the trust will not be treated for taxable years ending after March 15, 1956, as a loan made without the receipt of adequate security if the debentures were held by the trust on September 2, 1958, and if the requirements of paragraphs (c) and (d) of § 1.503(h)-2 which were not met on January 3, 1955, were met on September 2, 1958, as if that date were the date of acquisition.

(2) In the case of obligations acquired before September 2, 1958, which were not held by the trust on that date, only the requirement described in paragraph (b) of § 1.503(h)-2 must be satisfied for section 503(h) to be applicable to such acquisition. For example, if on December 5, 1956, an employees' trust lent money to the employer corporation by purchasing a debenture issued by the employer and if the trust sold the debenture on August 1, 1958, such loan would not be treated as made without the receipt of adequate security if the requirement described in paragraph (b) of § 1.503(h)-2 was met on December 5, 1956.

(c) See paragraph (b)(2) of § 1.503(c)-1 for the effective dates for the application of the definition of adequate security.

§ 1.503(i) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; LOANS WITH RESPECT TO WHICH EMPLOYERS ARE PROHIBITED FROM PLEDGING CERTAIN ASSETS.

SEC. 503. REQUIREMENTS FOR EXEMPTION. * * *

(i) LOANS WITH RESPECT TO WHICH EMPLOYERS ARE PROHIBITED FROM PLEDGING CERTAIN ASSETS.—Subsection (c)(1) shall not apply to a loan made by a trust described in section 401(a) to the employer (or to a renewal of such a loan or, if the loan is repayable upon demand, to a continuation of such a loan) if the loan bears a reasonable rate of interest, and if (in the case of a making or renewal)—

(1) The employer is prohibited (at the time of such making or renewal) by any law of the United States or regulation thereunder from directly or indirectly pledging, as security for such a loan, a particular class or classes of his assets the value of which (at such time) represents more than one-half of the value of all his assets;

(2) The making or renewal, as the case may be, is approved in writing as an investment which is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and no other such trustee had previously refused to give such written approval; and

(3) Immediately following the making or renewal, as the case may be, the aggregate amount loaned by the trust to the employer, without the receipt of adequate security, does not exceed 25 percent of the value of all the assets of the trust.

For purposes of paragraph (2), the term "trustee" means, with respect to any trust for which there is more than one trustee who is independent of the employer, a majority of such independent trustees. For purposes of paragraph (3), the determination as to whether any amount loaned by the trust to the employer is loaned without the receipt of adequate security shall be made without regard to subsection (h).

[Sec. 503(i) as added by sec. 30(b), Technical Amendments Act 1958 (72 Stat. 1630)]

§ 1.503(i)-1 LOANS BY EMPLOYERS WHO ARE PROHIBITED FROM PLEDGING ASSETS.—(a) *In general.*—(1) Section 503(i) provides that section 503(c)(1) shall not apply to a loan made to the employer by an employees' trust described in section 401(a) if the loan bears a reasonable rate of interest and certain

conditions are met. Section 503(i) also applies to the renewal of loans to the employer and, in the case of demand loans, to the continuation of such loans.

(2) The provisions of section 503(i) do not limit the effect of section 401(a) and § 1.401–2, relating to use or diversion of corpus or income of an employees' trust, or the effect of any of the provisions of section 503 other than section 503(c)(1). Consequently, although a loan made by an employees' trust described in section 401(a) meets all the requirements of section 503(i) and therefore is not treated as a loan made without the receipt of adequate security, an employees' trust making such a loan will lose its exempt status if the loan is not considered as made for the exclusive benefit of the employees or their beneficiaries. Similarly, a loan which meets the requirements of section 503(i) will constitute a prohibited transaction within the meaning of section 503(c)(6) if it results in a substantial diversion of the trust's income or corpus to a person described in section 503(c).

(b) *Conditions.*—(1) Section 503(i) applies to a loan only if, with respect to the making or renewal of the loan, the conditions described in subparagraphs (2), (3), and (4) of this paragraph are met. For purposes of this paragraph, the mere continuance of a demand loan is not considered as the making or renewal of such a loan.

(2) The employer must be prohibited (at the time of the making or renewal of the loan) by any law of the United States or regulations thereunder from directly or indirectly pledging, as security for such a loan, a particular class or classes of his assets the value of which (at such time) represents more than one-half of the value of all his assets. If a loan is made or renewed when the employer is prohibited by a law of the United States (or the regulations thereunder) from pledging a class of his assets, the qualification of such a loan under section 503(i) will not be affected by a subsequent change in such law or regulations permitting the employer to pledge such assets, unless such loan is renewed after such change. See section 8(a) of the Securities Exchange Act of 1934, as amended (48 Stat. 888, 49 Stat. 704; 15 U.S.C. 78h(a)), which prohibits certain persons from pledging a class of assets as security for loans, and section 5(a) of Regulation T issued thereunder by the Board of Governors of the Federal Reserve System (12 CFR 220.5(a)).

(3) The making or renewal, as the case may be, must be approved in writing as an investment which is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and such written approval must not have been previously refused by any other such trustee. A trustee is independent of the employer, for purposes of this subparagraph, if he is entirely free of influence or control by the employer. For example, if the employer is a partnership, then a partner in such partnership, or a member of a partner's family would not be considered independent of the employer. Similarly, an employee of the employer would not be considered independent of the employer. For purposes of this subparagraph, the term "trustee" means, with respect to any trust for which there are two trustees who are independent of the employer, both of such trustees and, with respect to any trust for which there are more than two such independent trustees, a majority of the trustees independent of the employer.

(4)(i) Immediately following the making or renewal, as the case may be, the aggregate amount lent by the trust to the employer, without the receipt of adequate security, must not exceed 25 percent of the value of all the assets of the trust.

(ii) For purposes of subdivision (i) of this subparagraph, the determination as to whether any amount lent by the trust to the employer is a loan made without the receipt of adequate security shall be made without regard to section 503(h). Thus, if an employees' trust makes a loan on January 2, 1959, to the employer without adequate security (but which loan is not considered as made without adequate security under section 503(h)), and if immediately after making such loan 10 percent of the value of all its assets is invested in such loan, then the trust may on that day invest not more than an additional 15 percent of its assets in a loan which would be considered made without adequate security if it were not for the provisions of section 503(i).

(iii) For purposes of subdivision (i) of this subparagraph, in determining the value of all the assets of the trust, there shall be used the fair market value of those assets on the day of the making or renewal.

(c) *Reasonable rate of interest.*—Section 503(i) only applies if, in addition to meeting the conditions described in paragraph (b) of this section, the loan

bears a reasonable rate of interest when it is made, renewed, or, in the case of demand loans, during the period of its existence.

(d) *Change of terms of loan.*—A change in the terms of a loan (including a reduction in the security for a loan) is considered as the making of a new loan. If such a new loan is not adequately secured, the requirements of section 503(i) must be met at the time the terms of the loan are changed for such section to be applicable to such new loan.

(e) *Effective date.*—(1) this section and section 503(i) are effective for taxable years ending after September 2, 1958, but only with respect to periods after such date. Thus, if a loan was made on or before September 2, 1958, without the receipt of adequate security and if, when such loan was made, it met all of the requirements of section 503(i) and this section then the loan is not subject to section 503(c)(1) after September 2, 1958, and would not constitute a prohibited transaction after that date because of a lack of adequate security.

(2) See paragraph (b)(2) of § 1.503(c)–1 for the effective dates for application of the definition of adequate security.

PAR. 4. Section 1.501(c)(14) is amended (A) by striking out "1951" in section 501(c)(14) and inserting in lieu thereof "1957" and (B) by adding a historical note at the end thereof. Section 1.501(c)(14), as amended, reads as follows:

§ 1.501(c)(14) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; CREDIT UNIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

* * * * * * *

(14) Credit unions without capital stock organized and operated for mutual purposes and without profit; and corporations or associations without capital stock organized before September 1, 1957, 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.

[Sec. 501(c)(14) as amended by Act of April 22, 1960 (Pub. Law 86–428, 74 Stat. 54)]

PAR. 5. Section 1.501(c)(14)–1 is amended by adding a new sentence at the end thereof. The amended section reads as follows:

§ 1.501(c)(14)–1 CREDIT UNIONS AND MUTUAL INSURANCE FUNDS.—Credit unions (other than Federal credit unions described in section 501(c)(1)) without capital stock, organized and operated for mutual purposes and without profit, are exempt from tax under section 501(a). Corporations or associations without capital stock organized before 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 7701(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 also exempt from tax under section 501(a). In addition, corporations or associations of the type described in the preceding sentence which were organized on or after September 1, 1951, but before September 1, 1957, are exempt from tax under section 501(a) for taxable years beginning after December 31, 1959.

Because the amendments to the regulations under section 501(c)(14) contained in this Treasury Decision do not prescribe new or different

substantive rules but merely reflect the provisions of the Act of April 22, 1960 (Public Law 86–428, 74 Stat. 54), which change the date relating to when an organization must be organized in order to qualify for exemption under such section 501(c)(14), it is found that it is unnecessary to issue these amendments 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 section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved September 22, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 26, 1960, 8:49 a.m., and published in the issue of the Federal Register for September 27, 1960, 25 F.R. 9215)

SUBCHAPTER G.—CORPORATIONS USED TO AVOID INCOME TAX ON SHAREHOLDERS

PART II.—PERSONAL HOLDING COMPANIES

SECTION 542.—DEFINITION OF PERSONAL HOLDING COMPANY

26 CFR 1.542–2: Gross income requirement. Rev. Rul. 60–344
(Also Section 61; 1.61–3.)

> In the case of oil and gas producing properties, "lifting costs" constitute a portion of the cost of producing the oil and gas and must be subtracted from gross sales in computing gross income for the purpose of determining whether personal holding company income, as defined in section 543 of the Internal Revenue Code of 1954, is at least 80 percent of the corporation's total gross income for a taxable year.

Advice has been requested whether "lifting costs" constitute a part of production costs in the determination of "gross income" from oil production under the provisions of section 61(a) of the Internal Revenue Code of 1954, relating to the definition of gross income, and section 542(a) of the Code, relating to the definition of a personal holding company.

Section 542(a) of the Code defines a personal holding company and provides, in part, that a corporation is a personal holding company, if at least 80 percent of the corporation's total gross income for the taxable year is personal holding income as defined in section 543 of the Code. Thus, in order to determine whether the percentage requirement is satisfied, the total gross income must be determined. Section 1.542–2 of the Income Tax Regulations refers to the provisions of section 61 of the Code and the regulations thereunder for the defini-

tion of "gross income" and states that under such provisions gross income is not necessarily synonymous with gross receipts.

Section 61(a) of the Code provides, in part, that gross income includes gross income derived from business. Section 1.61–3 of the regulations defines gross income in the case of manufacturing, merchandising, or mining business as total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining gross income, a subtraction should not be made for depletion allowances based on a percentage of income, selling expenses, losses, or other items not ordinarily used in computing cost of goods sold. However, a taxpayer may elect to subtract for depreciation or depletion based on cost incurred in connection with the production of goods or materials in determining gross income. See Rev. Rul. 141, C.B. 1953–2, 101.

In the case of oil and gas wells, drilling ends and operation begins when drilling is completed, casing set and the necessary equipment is installed. Operation ends and transportation and processing begin when the oil is removed from the storage tanks and/or gas is removed, usually from the well head. If gas and/or water drive is sufficient to bring oil to the surface, no pumping equipment is installed at the time of completion of the drilling. No pumping equipment is necessary with respect to a well which produces gas only. In the case of an oil well, pumping equipment, if not installed initially, is usually installed later. Regardless of the time of installation of pumping equipment, lines, lease tanks, and usually separators, are installed to care for oil production.

The term "lifting costs," as used in the oil and gas producing industry, is usually considered to be synonymous with "operating costs" and consists of those deductible costs incurred in the production of oil and gas after completion of drilling and before its removal from the property for sale or transportation. Such costs consist of labor, superintendence, supplies, repairs and assets having a life not in excess of one year, maintenance, applicable overhead costs, as well as those items properly includible in the computation of gross income under the provisions of Revenue Ruling 141. Compare *Woodside Acres, Inc.* v. *Commissioner*, 46 B.T.A. 1124, affirmed, 134 Fed. (2d) 793, wherein it was held that the gross income of a dairy, for the purpose of the personal holding company income percentage requirements, is determined by deducting the cost of production from the gross sales of dairy products. The cost of feed for the cows and wages of employees who take care of and milk the cows and prepare the dairy products for market are included in the cost of production. Under the facts in that case, the corporation was determined to be a personal holding company. See also *Garrett Holding Corporation* v. *Commissioner*, 9 T.C. 1029, acquiescence, C.B. 1948–1, 2.

Accordingly, in the case of oil and gas producing properties, "lifting costs" constitute a portion of the cost of producing oil and gas and must be subtracted from gross sales in computing gross income for the purpose of determining whether personal holding company income, as defined in section 543 of the Code, is at least 80 percent of the corporation's total gross income for a taxable year.

SECTION 545.—UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME

26 CFR 1.545-2: Adjustments to taxable income.

Allowance of deduction for percentage depletion in computing undistributed personal holding company income. See Rev. Rul. 60-283, page 201.

SECTION 547.—DEDUCTION FOR DEFICIENCY DIVIDENDS

26 CFR 1.547-2: Requirements for deficiency dividends. Rev. Rul. 60-287

(Also Sections 1313, 7121; 1.1313(a)-3, 301.7121-1.)

(Also Part II, Section 506; Regulations 118, 39.506-1.)

A determination of a taxpayer's liability for personal holding company tax made in an informal agreement entered into between the taxpayer and the Commissioner of Internal Revenue, as described in section 547(c)(3) of the Internal Revenue Code of 1954, does not have the effect of a final closing agreement under section 7121 of the Code.

Advice has been requested whether a determination of a taxpayer's liability for personal holding company tax made in an informal agreement entered into between the taxpayer and the Commissioner of Internal Revenue, as described in section 547(c)(3) of the Internal Revenue Code of 1954, has the same effect as a similar determination made by a final closing agreement under section 7121 of the Code.

A District Director of Internal Revenue classified a corporation as a personal holding company and proposed an assessment of personal holding company tax. The taxpayer executed Form 2198, Determination of Liability for Personal Holding Company Tax, seeking to offset this assessment by the timely payment of deficiency dividends.

Section 547 of the Code provides, in part, as follows:

(a) GENERAL RULE.—If a determination (as defined in subsection (c)) with respect to a taxpayer establishes liability for personal holding company tax imposed by section 541 (or by a corresponding provision of a prior income tax law) for any taxable year, a deduction shall be allowed to the taxpayer for the amount of deficiency dividends (as defined in subsection (d)) for the purpose of determining the personal holding company tax for such year, but not for the purpose of determining interest, additional amounts, or assessable penalties computed with respect to such personal holding company tax.

* * * * * * *

(c) DETERMINATION.—For purposes of this section, the term determination means—

(1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;

(2) a closing agreement made under section 7121; or

(3) under regulations prescribed by the Secretary or his delegate, an agreement signed by the Secretary or his delegate and by, or on behalf of, the taxpayer relating to the liability of such taxpayer for personal holding company tax.

Section 7121 of the Code reads as follows:

(a) AUTHORIZATION.—The Secretary or his delegate is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period.

(b) FINALITY.—If such agreement is approved by the Secretary or his delegate (within such time as may be stated in such agreement, or later agreed to) such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—

(1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and

(2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

Under both section 506 of the Internal Revenue Code of 1939 and section 547 of the 1954 Code, the allowance of the adjustment in question is dependent upon a prior "determination" of tax liability. However, section 506 of the 1939 Code permits relief only where a determination as to personal holding company tax has been established either by a court decision or in a closing agreement. The use of an informal agreement to serve as a "determination" was added by section 547(c)(3) of the 1954 Code in order to avoid the cumbersome and time-consuming closing agreement procedure ordinarily employed by taxpayers to secure elimination of a personal holding company tax deficiency. Form 2198 was designed for this purpose.

Sections 1311 to 1315 of the 1954 Code, relating to the mitigation of the effect of the statute of limitations, provide, under certain circumstances, for adjustments of errors involving closed years. Section 1313 of the 1954 Code is similar to section 547(c)(3) of the Code in that it provides for a "determination" by an informal agreement. A determination by an informal agreement under section 1313 becomes final when the tax liability for the open taxable year to which the determination relates becomes final. However, during the period when a deficiency may be assessed or a refund or credit allowed for such year, either the taxpayer or the Commissioner may attempt to secure a modification of such tax liability and, in so doing, may treat the item that was the subject of the adjustment in a manner different from the way in which it was treated in the agreement.

Accordingly, it is held that a determination of a taxpayer's liability for personal holding company tax made in an informal agreement entered into between the taxpayer and the Commissioner, as described in section 547(c)(3) of the Code, does not have the effect of a final closing agreement under section 7121 of the Code.

(Also Section 61; 1.61-9.) Rev. Rul. 60-331

Individuals, the sole owners of the capital stock of a personal holding company, are considered to have constructively received a dividend for Federal income tax purposes where, subsequent to receiving information relating to personal holding company tax liability, but before the distribution of a deficiency dividend under section 547 of the Internal Revenue Code of 1954, the individuals transfer their stock in the personal holding company to another wholly-owned corporation and there is no showing that that transfer

was made for reasons other than that of minimizing Federal income taxes. Such dividends are includible in the individuals' gross incomes under section 61 of the Code.

Advice has been requested regarding the treatment for Federal income tax purposes of a "deficiency dividend" paid by a personal holding company under the circumstances described below.

A and his wife organized and were the sole stockholders of corporation *M* and corporation *N*. Both companies operated farm properties. In addition, corporation *M* received income from oil royalties and corporation *N* held a working interest in oil properties.

An examination was conducted, by an internal revenue agent, of the Federal income tax returns filed by corporation *M* for its taxable years 1956 and 1957. The examination resulted in a determination of liability for personal holding company tax under section 541 of the Internal Revenue Code of 1954, and the individual shareholders in their capacity as corporate officers were so informed on August 5, 1958. On August 13, 1958, the entire capital stock of corporation *M* was transferred by the individual stockholders to corporation *N* in exchange for stock of that company. An agreement to the proposed deficiency in tax liability was later secured from the taxpayer and an agreement on Form 2198, Determination of Liability For Personal Holding Company Tax, was executed on behalf of the taxpayer and for the Commissioner of Internal Revenue on August 20, 1958.

Section 547 of the Code provides, in part, that in the absence of fraud or willful failure to file an income tax return, a corporation may be relieved of the payment of a deficiency in personal holding company tax determined with respect to a taxable year by making a deficiency dividend distribution. Certain conditions, however, must be met. They are: (1) There must be a determination of liability for personal holding company tax under section 547(c) of the Code; (2) the deficiency dividend must be paid within 90 days after the date of determination; (3) a claim, Form 976, Credit For Deficiency Dividend Deduction, or Credit or Refund under section 547 of the Internal Revenue Code of 1954, must be filed after the deficiency dividend has been paid and within 120 days after the date of determination; and (4) the dividend must be of such a nature as would have permitted its inclusion in the computation of a dividends-paid deduction had it been distributed during the year for which the deficiency is determined. Also, see section 1.547–2 of the Income Tax Regulations.

Corporation *M* clearly fulfilled the conditions required by section 547 of the Code for relief of the payment of the deficiency in personal holding company tax liability. Personal holding company tax liability was established under the agreement, Form 2198, signed on behalf of the taxpayer and for the Commissioner on August 20, 1958. This constitutes the date of determination and the full amount of the deficiency dividend was distributed by corporation *M* to its corporate stockholder, corporation *N*, on September 10, 1958, within the 90-day period. A claim for the deficiency dividend deduction was filed on September 20, 1958, within the 120-day period. The dividend was of the character that would have been included in the computation of a dividends-paid deduction under section 561 of the Code had it been distributed during the years for which the deficiency was determined.

However, since the deficiency dividend was distributed to the present corporate shareholder rather than the original individual shareholders, substantially reducing the tax thereon due to the provisions of section 243(a) of the Code, which provides that a receiving corporation is allowed as a special deduction from gross income an amount equal to 85 percent of the amount received as dividends from domestic corporations, it becomes essential to carefully scrutinize the transaction between the corporation and its shareholders. In this case, the timing is significant. The controlling stockholders knew that the only way they could avoid the imposition of personal holding company tax was to declare a dividend. However, they wished to avoid the payment of individual income tax on such dividend. Therefore, before the deficiency dividends were paid, they transferred all of their stock in *M* to corporation *N*, which they also own, so that the dividend came, not directly to them but to the intervening corporate entity, *N*, which is entitled to a dividend received deduction under section 243 of the Code. There was no legitimate business purpose for such transfer other than the minimization of Federal income taxes.

The question in this case then is whether, under the facts as disclosed, the distribution to the corporate entity may be disregarded and the deficiency dividend, distributed by the personal holding company to avoid imposition of personal holding company tax, considered constructively received by the individual shareholders for Federal income tax purposes.

In the case of *Evelyn F. Gregory* v. *Guy T. Helvering*, 293 U.S. 465, Ct.D. 911, C.B. XIV–1, 193 (1935), it was contended on behalf of the taxpayer that since every element required by the statute involved was to be found in what was done, the tax result sought by the taxpayer had been effected, and that the motive of the taxpayer thereby to escape payment of a tax would not alter the result or make unlawful what the statute allowed. The Supreme Court of the United States pointed out that the whole undertaking, though conducted according to the terms of the statute, was in fact an elaborate and devious form of conveyance consummated solely for the purpose of tax avoidance. Accordingly, the Court ruled adversely to the taxpayer.

In a later case involving *Joseph T. Higgins* v. *John Thomas Smith*, 308 U.S. 473, Ct.D. 1434, C.B. 1940–1, 127, the Court stated that the United States Government may look at actualities in tax cases and, upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham, may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute. To hold otherwise would permit schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation.

Throughout the above-cited cases is an underlying theme that only bona fide business transactions having a legitimate business purpose in addition to the minimization of taxes will be recognized for tax purposes, and then only if the characterization the taxpayer places on the transactions is in reality what it purports to be in form. A transaction which has no purpose other than the avoidance or reduction of taxes, will be ignored for tax purposes.

In the instant case the motive for the transfer by the individual shareholders of their stock of corporation *M* in exchange for stock of

corporation *N* was that of minimizing Federal income taxes. Accordingly, it is held that the deficiency dividend distributed by the personal holding company is to be treated as having been constructively received by *A* and his wife, rather than by corporation *N*, and is includible in their gross incomes under section 61 of the Code.

SUBCHAPTER H.—BANKING INSTITUTIONS

PART I.—RULES OF GENERAL APPLICATION TO BANKING INSTITUTIONS

SECTION 582.—BAD DEBT AND LOSS DEDUCTION WITH RESPECT TO SECURITIES HELD BY BANKS

26 CFR 1.582–1: Bad debt and loss deduction with respect to securities held by banks.

Treatment of gains and losses resulting from sales by a bank of FHA and VA insured mortgages. See Rev. Rul. 60–346, page 217.

SECTION 584.—COMMON TRUST FUNDS

26 CFR 1.584–4: Admission and withdrawal of participants in the common trust fund. Rev. Rul. 60–240

> For Federal income tax purposes distributions of cash or securities to participants in two common trust funds, in order to eliminate fractional units of participation held by the participants upon the merger of the two funds, shall be treated as proceeds from the sale or exchange of such fractional units of participating interests. Revenue Ruling 55–299, C.B. 1955–1, 402 clarified.

Reconsideration has been given to Revenue Ruling 55–299, C.B. 1955–1, 402 since the holding therein, based on the facts presented, could be misinterpreted to mean that participants in two common trust funds realize no taxable gain or loss upon the merger of such funds even though they receive certain cash distributions upon the merger in order to eliminate fractional units of participation.

Revenue Ruling 55–299 dealt, in applicable part, with the question of whether the participants in two common trust funds or the funds themselves realized a gain or loss upon the merger of the two funds where there was no distribution of cash or securities to any participant remaining in the merged fund "with the exception of such small cash adjustment as was necessary to eliminate fractional units." The Revenue Ruling holds, in pertinent part, that no gain or loss is realized by the two funds or their participants upon the merger of such funds.

Section 584(e) of the Internal Revenue Code of 1954 provides, in part, that the withdrawal of any participating interest in a common trust fund by a participant shall be treated as a sale or exchange of such interest by the participant.

Section 1.584–4(a), of the Income Tax Regulations provides in part, that, if a participant withdraws the whole or any part of its participating interest from the common trust fund, such withdrawal

shall be treated as a sale or exchange by the participant of the participating interest or portion thereof which is so withdrawn. Section 1.584–4(b) of the regulations provides, in part, that, the participant's gain or loss upon withdrawal of its participating interests or portion thereof shall be measured by the difference between the amount received upon such withdrawal and the adjusted basis of the participating interest or portion thereof withdrawn.

Based on the foregoing, it is held that, for Federal income tax purposes, distributions of cash or securities to participants in two common trust funds, in order to eliminate fractional units of participation held by the participants upon the merger of the two funds, shall be treated as proceeds from the sale or exchange of such fractional units of participating interests. A participant's gain or loss with respect to such distributions shall be determined in accordance with the provisions of section 1.584–4 of the regulations.

Revenue Ruling 55–299, C.B. 1955–1, 402, is clarified to the extent that it could be misinterpreted to mean that participants in two common trust funds realize no taxable gain or loss upon the merger of such funds even though they receive cash distributions upon the merger in order to eliminate fractional units of participation.

Rev. Rul. 60–256

A transfer of units of participation in a common trust fund from one trust, of which the taxpayer is the sole beneficiary, to another trust, of which the taxpayer is also the sole beneficiary, does not constitute a "withdrawal" of a participating interest within the meaning of section 584(e) of the Internal Revenue Code of 1954, provided that no funds change hands, there is no surrender of indicia of ownership, nothing is received by the taxpayer, and the trustee of the two trusts is the same. Under such circumstances, the basis of the participating units in the hands of the transferee trust is the same as it was in the hands of the transferor trust on the date of the transfer.

Revenue Ruling 59–414, C.B. 1959–2, 156, superseded, and Revenue Ruling 57–335, C.B. 1957–2, 322, modified.

In view of the decision of the United States District Court for the District of Massachusetts in *Nancy Wiggin* v. *United States*, dated January 12, 1959, reconsideration has been given to Revenue Ruling 57–335, C.B. 1957–2, 322, which deals with the Federal income tax consequences of intertrust transfers of a participant's interest in a common trust fund.

In Revenue Ruling 57–335, two illustrative factual situations are set forth with respect to intertrust transfers of participating units in a common trust fund. In the first factual situation, *A* established a revocable living trust in 1949. The trust is entirely invested in a common trust fund, and the cost of the units of participation totals $30x$ dollars. *A* later establishes a new trust in the amount of $50x$ dollars which is invested in the same common trust fund. He revokes the first trust and directs the trustee to transfer the units of participation representing its principal to the second trust. At the time of revocation, such units have a market value of $40x$ dollars.

In the second factual situation, the corpus of a testamentary trust for the benefit of *A* is entirely invested in a common trust fund, and

the cost of the units of participation totals $30x$ dollars. Under its terms, the trust terminates when A becomes 21 years of age and the principal is then distributable to A. When A becomes 21, he creates a living trust the corpus of which is to be invested in the same common trust fund and directs the trustee to transfer to the new living trust the units or participation representing the principal of the terminated testamentory trust. At that time such units have a market value of $40x$ dollars.

In both of the foregoing factual situations, it was assumed that the intertrust transfers were to trusts created and used for bona fide fiduciary purposes and that such transfers did not violate the rules and regulations of the Board of Governors of the Federal Reserve System.

Revenue Ruling 57–335, *supra*, holds that the redemption of participating units in a common trust fund, or the intertrust transfer of units of participation representing a participant's interest in such fund, constitutes the withdrawal of a participating interest by a participant within the meaning of section 584(e) of the Internal Revenue Code of 1954, resulting in a recognized gain or loss to the participant for Federal income tax purposes. Thus, that ruling concludes that in each of the illustrative factual situations given, a gain of $10x$ dollars would be realized.

The rationale behind the holding in Revenue Ruling 57–335 is that since the "trusts" in each of the stated factual situations were the "participants" in the common trust funds, the trust beneficiary's direction to the trustee to transfer to another participant the units of participation representing the principal of a terminated participant constituted an assertion of direct dominion and control over the assets of the terminated participant, which the beneficiary had no legal right to exercise except on the theory that such action was the legal equivalent of a distribution to the beneficiary, and, therefore, constituted a withdrawal under section 584(e) of the Code.

In the *Wiggin* case, the taxpayer was the beneficiary of a testamentary trust referred to as the Avery Trust. Trust assets were composed almost entirely of units of participation in a common trust fund established by the National Shawmut Bank of Boston and were held by such bank as sole trustee. The Avery Trust was to terminate when the taxpayer reached 21 years of age. Upon reaching 21, the taxpayer created a revocable living trust, with herself as beneficiary and the same bank as sole trustee, and directed the bank to transfer most of the participating units in the common trust fund from the Avery Trust to the new trust. Units of participation in the common trust fund were represented by book entries only. There were no certificates or like indicia of ownership issued. The trustee, by a bookkeeping entry, transferred the specified units of participation from the Avery Trust to the new trust. The court, in holding that there was no recognizable gain realized by the taxpayer by virtue of such transfer, stated, in part, as follows:

An inter-trust transfer is not a withdrawal. No funds have changed hands, there has been no surrender of indicia of ownership, nothing has been received by the taxpayer. There has been nothing more than a bookkeeping entry made on the books of the trustee of the common trust fund. There has been no "income" within the meaning of *Eisner* v. *Macomber*, 252 U.S. 189, 206–207 * * *.

It is the position of the Internal Revenue Service that the decision in the *Wiggin* case is reasonable based on the factual situation there presented and that such decision will be followed in the disposition of other cases involving substantially the same facts as those in the *Wiggin* case. It follows that since intertrust transfers of units of participation in a common trust fund of the type involved in the *Wiggin* case are not considered withdrawals giving rise to recognized gain or loss, the basis of such units in the hands of the transferee trust will be the same as it would be in the hands of the transferor trust on the date of the transfer.

Accordingly, it is held that a transfer of units of participation in a common trust fund from one trust, of which the taxpayer is the sole beneficiary, to another trust, of which the taxpayer is also the sole beneficiary, does not constitute a "withdrawal" of a participating interest within the meaning of section 584(e) of the Code, provided that no funds change hands, there is no surrender of indicia of ownership, nothing is received by the taxpayer, and the trustee of the two trusts is the same. Under such circumstances, the basis of the participating units in the hands of the transferee trust is the same as it was in the hands of the transferor trust on the date of the transfer.

Revenue Ruling 57–335 is accordingly modified to remove the implication that "all" intertrust transfers of units of participation in a common trust fund constitute withdrawals of a participating interest within the meaning of section 584(e) of the Code.

Revenue Ruling 59–414, C.B. 1959–2, 156, is hereby superseded.

SUBCHAPTER I.—NATURAL RESOURCES

PART I.—DEDUCTIONS

SECTION 612.—BASIS FOR COST DEPLETION

26 CFR 1.612–3: Depletion; treatment of bonus and advanced royalty. Rev. Rul. 60–336

> Where a depletion deduction has been taken on a bonus received for the grant of a mineral lease and the entire mineral interest of the payee is transferred by sale, gift, devise, inheritance, or by any other means, prior to termination of the lease and prior to production, the bonus depletion is not required to be restored to income.

Advice has been requested whether depletion deductions taken on bonuses received for the granting of mineral leases must be restored to income in the year of expiration or termination of the leases in situations where the entire mineral interest had been transferred from the bonus recipient (lessor or sublessor) by sale, gift, devise or inheritance, or by other means, while the lease was in force and where production had not occurred.

Section 1.612–3(a)(2) of the Income Tax Regulations states as follows:

> If the grant of an economic interest in a mineral deposit or standing timber with respect to which a bonus was received expires, terminates, or is abandoned

before there has been any income derived from the extraction of mineral or cutting of timber, the payee shall adjust his capital account by restoring thereto the depletion deduction taken on the bonus and a corresponding amount must be returned as income in the year of such expiration, termination, or abandonment.

In *American National Realty Company* v. *Commissioner*, 47 B.T.A. 653, affirmed, 136 Fed. (2d) 486, the United States Board of Tax Appeals (now Tax Court of the United States) held that in computing the profit on a sale, the basis of the property sold must be reduced by depletion previously claimed and allowed where a bonus has been received on the granting of a lease and where prior to production from the lease, the land, including the mineral rights, is sold. This reduction of basis did not relate to the restoration of depletion, but to the requirement of the Internal Revenue Code that in computing gain or loss upon the sale or other disposition of property, the basis of the property must be adjusted for exhaustion, wear and tear, depletion, depreciation, amortization, etc. See section 1016(a)(2) of the 1954 Code and section 113(b)(1)(B) of the 1939 Code.

The courts have taken the position that depletion may be restored only upon the termination of the lease without production having been obtained, and then only by the taxable entity to whom or to which the bonus was paid. See *Estate of Emma L. G. Seeligson* v. *Commissioner*, 1 T.C. 736, acquiescence, C.B. 1944, 25, affirmed, 141 Fed. (2d) 358; *Lucile Welder et al.*, v. *Commissioner*, Tax Court Memorandum Opinion, entered January 22, 1944, affirmed, 148 Fed. (2d) 583; and *Estate of Robert Driscoll* v. *Commissioner*, Tax Court Memorandum Opinion, entered June 28, 1943.

In *Mary F. Waggoner and T. J. Waggoner* v. *Commissioner*, 47 B.T.A. 699, acquiescence, C.B. 1945, 7, the Board of Tax Appeals required the restoration of all the depletion taken on a lease bonus even though a one-half interest had been transferred prior to the expiration of the lease. In that case, the taxpayer had retained a one-half interest in the mineral property. The retention of this interest meant that the taxpayer retained a basis in the mineral property to which the amount of depletion taken could be restored. Had this taxpayer not retained the one-half interest with its basis, it appears that the Board would not have required the restoration of any part of the depletion deducted from income.

With regard to whether the depletion allowed on a bonus should in all cases be restored to income when it is established that there will be no production under the lease, the regulations do not expressly refer to the situation where the property is disposed of by the lessor before the lease expires, terminates or is abandoned. Indeed, the regulations seem to contemplate principally, if not entirely, the situation where the lease terminates before disposition, since they provide that the lessor's capital account shall be adjusted by restoring the depletion deduction taken on the bonus and "a corresponding amount" must be reported as income. If the lessor has previously disposed of the property and thus has no basis subject to adjustment, there is no "corresponding amount" which may be reported as income. Adjustment of the capital account is necessary because of the reduction of basis under section 1016(a)(2) of the 1954 Code or section 113(b)(1)(B) of the 1939 Code by the amount of the bonus depletion. If the depletion deduction were restored to income without a corresponding restoration to basis, there would be an overall inequity to the taxpayer. This is

especially true in those instances where the property has been sold by the taxpayer and gain has been computed by using the basis adjusted by the previously taken depletion deduction.

A somewhat special situation exists in states having community property laws, such as Texas and Louisiana. In these states, the community one-half interest held by the surviving spouse is a continuing interest. Where a lease bonus has been received by the community and one member of the community dies before the expiration of the lease, the interest held by the surviving spouse is not affected by the death of the other spouse. Consequently, the depletion deduction applicable to the surviving spouse's one-half interest must be reported as income in the year of expiration of the lease. The provisions of section 1014(b)(6) of the 1954 Code, requiring the adjustment of the basis to the fair market value of the property at the date of the decedent's death or alternate valuation date on property held by the surviving spouse, does not prevent the further adjustment of this basis as required by section 1.612–3(a)(2) of the regulations on the date of expiration of the lease.

Accordingly, it is held that the restoration of bonus depletion to income is not required where the recipient of the bonus has divested himself, by whatever means, of all of his interest in the minerals prior to the termination of the lease.

SECTION 613.—PERCENTAGE DEPLETION

26 CFR 1.613–3: Gross income from the property. Rev. Rul. 60–257

> In determining "gross income from the property" for percentage depletion purposes, the gross selling price should be reduced by the amount of any prepayment discount allowed by the taxpayer and utilized by the purchaser unless the discount is a cash discount which is, under all circumstances, substantially equivalent to a charge in the nature of interest for the use of the net amount paid in advance of the date when it was otherwise due and payable.
>
> Revenue Ruling 55–13, C.B. 1955–1, 285, superseded.

The Internal Revenue Service has reconsidered Revenue Ruling 55–13, C.B. 1955–1, 285, involving the determination of "gross income from the property" for percentage depletion purposes where the seller allows a prepayment discount.

Revenue Ruling 55–13, based on *Montreal Mining Company* v. *Commissioner*, 2 T.C. 688 (1943), acquiescence, C.B. 1944, 20, held that in determining gross income for percentage depletion purposes where the seller grants a prepayment discount to the purchaser, the gross sales price may be used without being reduced by the amount of the discount only if it is a cash discount, as opposed to a trade discount, and represents a fair interest rate.

Some difficulty has been encountered in defining a fair interest rate within the meaning of Revenue Ruling 55–13. In some instances it has been considered to mean only that the cash discount must be a reasonable one when tested against customary trade practices. If this is the only criterion, then percentage depletion will be allowed on amounts to which the taxpayer was never entitled and could not col-

lect. Notwithstanding the court's broad language in the *Montreal Mining Company* case, referring to the treatment of cash discounts under inventory accounting principles, percentage depletion clearly should not be allowed on such amounts.

The Internal Revenue Service is of the opinion that the result reached in the *Montreal Mining Company* case was correct in view of the facts presented in that case. There the discount allowed by the seller constituted, in substance, a payment by him to the buyer in consideration for the use of the net purchase price in advance of the date when it was otherwise due and payable. As such, the payment was a charge in the nature of interest, deductible from gross income in determining net income.

Among the factors which may point to the existence of a payment which is substantially equivalent to interest are the following:

(1) A discount rate which approximates the prevailing interest rate on bank loans.

(2) A provision for the reduction of the amount of discount as the period of prepayment decreases.

(3) A provision for the payment of an additional amount, depending upon the period of delay, if payment is delayed beyond the due date.

Accordingly, it is held that in determining "gross income from the property" for percentage depletion purposes the gross selling price should be reduced by the amount of any prepayment discount allowed by the taxpayer and utilized by the purchaser unless the discount is a cash discount and one that under all the circumstances is substantially equivalent to a charge in the nature of interest for the use of the net amount paid in advance of the date when it was otherwise due and payable.

Pursuant to the authority in section 7805(b) of the Internal Revenue Code of 1954, the provisions of this Revenue Ruling will not be applied to taxable years ending prior to January 1, 1960.

Revenue Ruling 55–13, C.B. 1955–1, 285, is superseded.

Rev. Rul. 60–320 [1]

The principles of the recent decision of the Supreme Court of the United States in *United States* v. *Cannelton Sewer Pipe Company*, 364 U.S. 76, Ct.D. 1849, page 452, this Bulletin, will be applied in the disposition of cases involving the definition of the term "mining" for purposes of percentage depletion. Also in view of this decision, certain revenue rulings, long in contest by many taxpayers and inconsistent with the position taken administratively and in litigation, will be revoked.

However, the principles of the *Cannelton* decision will not apply in the case of calcium carbonates or other minerals when used in making cement where a proper election is made under section 4 of P.L. 86–781, page 726, this Bulletin, approved September 14, 1960.

Cases previously examined and closed may be reopened only in accordance with the procedures outlined in Revenue Procedure 59–25, C.B. 1959–2, 938.

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[1] Based on Technical Information Release 257, issued September 23, 1960.

Percentage depletion in the case of an integrated miner-manufacturer of vitrified clay products. See Ct. D. 1849, page 452.

Rules for making the election regarding treatment processes for minerals used in making cement for taxable years prior to 1961. See T.D. 6492, page 497.

Method or formula for allocating costs and profits in computing gross income from mining by certain cement producers. See Rev. Rul. 60–319, page 501.

Action for recovery of refunds based on percentage depletion deductions from certain cement producers. See Rev. Rul. 60–375, page 407.

PART II.—EXCLUSIONS FROM GROSS INCOME

SECTION 621.—PAYMENTS TO ENCOURAGE EXPLORATION, DEVELOPMENT, AND MINING FOR DEFENSE PURPOSES

26 CFR 1.621–1: Payments to encourage exploration, development, and mining for defense purposes. Rev. Rul. 60–305

> Payments received as the purchase price of domestic manganese ore under the Domestic Manganese Purchase Program administered by the General Services Administration may not be excluded from gross income under section 621 of the Internal Revenue Code of 1954.
>
> This ruling also applies to payments received as the purchase price of other minerals or ores and concentrates under similar domestic purchase programs administered by the General Services Administration.

Advice has been requested whether payments received for domestic metallurgical grade manganese ores or concentrates under the Domestic Manganese Purchase Program administered by the General Services Administration may be excluded from gross income under section 621 of the Internal Revenue Code of 1954. Deliveries under the program having reached the total quantity provided for, the Program has ended.

The General Services Administration derived its authority for the administration of the Domestic Manganese Purchase Program from clause (1) of section 303(a) of the Defense Production Act of 1950, 64 Stat. 801, 50 U.S.C. 2093. Under that clause, the President of the United States is granted the authority, for the purpose of assisting and carrying out the objectives of the Act, to make provision "for purchases of or commitments to purchase metals, minerals or other materials for government use or resale." Pursuant to the delegation of this authority to the General Services Administration, that agency published regulations which interpreted and implemented that au-

thority. Such regulations, as amended, describe the Domestic Manganese Purchase Program.

The regulation establishing the program constituted a continuing offer by the General Services Administration to purchase, at specified prices, domestic metallurgical grade manganese ores or concentrates meeting the requirements of the regulation. The General Services Administration has advised the Internal Revenue Service that the regulation covering the program contains no provisions relating to any approval of projects for exploration, development or mining of manganese ores or for the contribution of money for any such projects. Neither could the General Services Administration require a participant to make an accounting for money received by the participant as the purchase price of ores or concentrates under the Domestic Manganese Purchase Program.

Under the Program the participant was merely a seller who offered to sell manganese ores or concentrates of certain chemical and physical specifications at the Program price. Any person desiring to participate in the Program was required to make application for a certificate of participation. This requirement was imposed solely for administrative purposes. The participant was not obligated in any way to obtain from the Government approval of any exploration, development or mining prior to starting such an undertaking or to give an accounting of expenditures made on any such project. Furthermore, a participant had the right to dispose, as it pleased, of funds received through the sale of manganese ores to the Government.

Section 621 of the Code reads as follows:

> There shall not be included in gross income any 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, or any forgiveness of discharge of any part 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 on 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.

Section 621 of the Code is applicable only to amounts which are paid to a taxpayer by the United States or an instrumentality of the United States (1) as a grant, gift, bounty, bonus, premium, incentive, subsidy, loan, or advance, (2) for the encouragement of exploration for, or the development of mining of, a critical and strategic mineral or metal, (3) pursuant to or in connection with an undertaking approved by the United States or by an agency or instrumentality thereof under certain terms and conditions, (4) for the expenditure of which the taxpayer has accounted, or is required to account, to an appropriate Government agency, and (5) which were received other than as a part of the purchase price of a critical and strategic mineral or metal, irrespective of whether such price is below, at, or above the currently prevailing market price. See section 1.621–1 of the Income Tax Regulations.

Since under the Domestic Manganese Purchase Program there was no provision for the making by General Services Administrations of any payments of money which fulfill the above conditions, the amounts received by the participants in the Program do not qualify thereunder.

For the purposes of section 621 of the Code, 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 merely because such payment is added to or included with the payment of the purchase price. However, the General Services Administration did not make, and the Program regulation did not provide for the making of, any payment to participants other than the purchase price for domestic manganese under the Program, and the participants in the Program received no sums designated as a payment for exploration or development or mining.

Even when a taxpayer does receive a sum from any governmental agency designated specifically as an exploration, development, or mining allowance, that sum must not only be in substance such an allowance but it must fulfill the conditions set forth above. See Rev. Rul. 55–47, C.B. 1955–1, 239.

It is held that section 621 of the Code does not apply to any amounts received from the General Services Administration under the Domestic Manganese Purchase Program. All payments received for domestic manganese ore or concentrates or both under this Program must be included in the taxpayer's gross income.

This ruling also applies to amounts paid for other minerals or ores and concentrates by the General Services Administration pursuant to similar domestic purchase Programs.

PART III.—SALES AND EXCHANGES

SECTION 631.—GAIN OR LOSS IN THE CASE OF TIMBER OR COAL

26 CFR 1.631–1: Election to consider cutting as sale or exchange.

Treatment of cut timber inventories in financial reports to shareholders and for credit purposes under the provisions of section 472 of the Code. See Rev. Rul. 60–244, page 167.

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26 CFR 1.631–3: Gain or loss upon the disposal of coal with a retained economic interest. (Also Section 545; 1.545–2.) Rev. Rul. 60–283

A corporation which computes its taxable income by taking into consideration the provisions of section 631(c) of the Internal Revenue Code of 1954, in computing gain or loss from the disposal of coal, is not entitled to a deduction for percentage depletion in determining its undistributed personal holding company income.

Advice has been requested whether a corporation is allowed a deduction for percentage depletion in determining its undistributed personal holding company income, in a case in which it computes its taxable income by taking into consideration the provisions of section 631(c) of the Internal Revenue Code of 1954 in computing gain or loss on the disposal of coal in which it has retained an economic interest.

A personal holding company owns coal bearing lands. The sole business activity of the corporation is the leasing of these coal lands. The taxable income reported for purposes of section 11 of the Code, relating to the income tax imposed upon corporations, is computed by taking into consideration the provisions of section 631(c).

Section 631(c) of the Code provides, in part, that in the case of the disposal of coal, held for more than six months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal, the difference between the amount realized from the disposal of such coal and the adjusted depletion basis thereof, plus the deductions disallowed for the taxable year under section 272, shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal. This subsection shall have no application for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 545(b)(5)).

Section 545(a) of subchapter G of the Code provides that the term "undistributed personal holding company income" means the taxable income of a personal holding company adjusted in the manner provided by subsection (b), minus the dividends paid deduction as defined in section 561. The term "taxable income" in section 545(a) is defined in section 63(a) of the Code, as it relates to corporations, as gross income minus the deductions allowed by chapter 1.

Taxable income defined in section 63(a) of the Code is a concept fashioned by Congress to provide the tax base on which the rate of ordinary income taxes is imposed. It is not separately and specially defined in the personal holding company sections of the Code, nor does it otherwise have a special meaning for purposes of these provisions of the Code. Accordingly, the starting point for determining taxable income in the computation of "undistributed personal holding company income" under section 545 of the Code is the income subject to the corporate income taxes imposed by section 11 of the Code.

In the case of a corporation computing gain or loss from the disposal of coal under section 631(c), a deduction for percentage depletion is not allowed in computing the taxable income subject to the taxes imposed by section 11 of the Code. Consequently, the absence of a deduction for percentage depletion for purposes of the computation of section 11 of the Code precludes the consideration of a lesser amount for the starting point of the undistributed personal holding company income computation under section 545 of the Code. Compare *Transportation Services Association* v. *Commissioner*, 149 Fed. (2d) 355, wherein it was held that amounts (interest and

salaries) properly disallowed as deductions for income tax purposes may not be deducted in computing income subject to the personal holding company surtax.

Section 545 of the Code provides for adjustments to be made to the taxable income of a personal holding company in order to arrive at the undistributed personal holding company income for purposes of the tax imposed on personal holding companies. The adjustments to such taxable income are limited to those particularly enumerated in subsection (b) of section 545. A deduction for percentage depletion is not therein enumerated.

Accordingly, it is held that a corporation computing its taxable income by taking into consideration the provisions of section 631(c) of the Code is not entitled to a deduction for percentage depletion in determining its undistributed personal holding company income.

SUBCHAPTER J.— ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

Subpart C.—Estates and Trusts Which May Accumulate Income or Which Distribute Corpus

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SECTION 662.—INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS

26 CFR 1.662(b)–1: Character of amounts, when no charitable contributions are made.

Trust income from tax-exempt securities paid to the secondary beneficiary. See Rev. Rul. 60–370, below.

Subpart E.—Grantors and Others Treated as Substantial Owners

SECTION 671.—TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS

26 CFR 1.671–1: Grantors and others treated as substantial owners; scope. Rev. Rul. 60–370 [1]

(Also Sections 662, 677; 1.662(b)–1, 1.677(a)–1.)

Where a taxpayer transfers appreciated securities or other property to a tax-exempt organization, as trustee, which is under an express or implied obligation to sell such property and invest the proceeds in tax-exempt securities, or exchange the transferred property for tax-exempt securities, and to pay the income therefrom to the transferor (and a secondary beneficiary for life, if any), with the trustee acquiring a remainder interest in the trust corpus, the

[1] Also Released as Technical Information Release 273, dated December 2, 1960.

gain from the sale or exchange of the transferred property by the trustee is includible in the gross income of the transferor. Tax-exempt income realized from trust investments and distributed by the trustee to the transferor beneficiary or to the secondary beneficiary retains its exempt status in their hands.

Advice has been requested as to the Federal income tax consequences of a transfer of appreciated securities or other property to a tax-exempt educational organization under the circumstances described below.

An individual irrevocably transferred in trust to a university securities and other property which had appreciated in value over their basis to the transferor. The trust instrument by its terms specifically imposes upon the university, as trustee, an obligation to sell the appreciated property and to invest the proceeds in tax-exempt securities, or exchange the property for tax-exempt securities. The net income of the trust is payable to the transferor for life and, after his death, to a secondary beneficiary for life. Gains from the sale or exchange of trust assets are to be added to corpus. After the death of the transferor and the secondary beneficiary, the trust will terminate and the trust corpus will pass to the university as remainderman of the trust.

During the taxable year the university either sold the transferred property pursuant to the terms of the trust instrument and invested the proceeds in tax-exempt securities, or exchanged the transferred property for tax-exempt securities which it had held in its own portfolio.

The specific questions presented in this case are (1) whether the transferor realized gain, includible in gross income, by reason of the sale or exchange by the trustee of the appreciated property transferred in trust, and (2) whether any tax-exempt income realized from tax-exempt securities which were acquired by the trustee through the sale or exchange, will remain tax-exempt in the hands of the transferor and, after his death, in the hands of the secondary beneficiary.

Section 677(a) of the Internal Revenue Code of 1954 provides, in part, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674 of the Code, whose income without the approval or consent of any adverse party, is, or in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor, or held or accumulated for future distribution to the grantor.

Section 671 of the Code provides the general rule that in cases where the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits those items of income, deductions, and credits against the tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income or credits against the tax of an individual.

Section 1.671–2(c) of the Income Tax Regulations provides that an item of income, deduction, or credit included in computing the taxable income and credits of a grantor or another person under section 671 of the Code is treated as if it had been received or paid directly by the grantor or other person.

Under the provisions of section 652(b) and 662(b) of the Code, the amounts to be included in gross income of a beneficiary under section 652(a) of the Code or section 662(a) of the Code, whichever is applicable, shall have the same character in the hands of the beneficiary as in the hands of the trust.

In the instant case, the university was under an express obligation to sell or exchange the appreciated property transferred and to purchase tax-exempt securities. Therefore, in substance, the transferor did not give the trustee appreciated property to hold in trust, but, rather, gave the trustee the proceeds of the sale or exchange of the property which the trustee was required to consummate.

Accordingly, it is held that the transferor realizes gain, includible in his gross income in the taxable year of the sale or exchange, to the extent that the proceeds from the sale or exchange by the trustee of the property transferred in trust exceed his basis for such property.

Since any income from trust investments is to be distributed to the transferor for life without the approval or consent of any adverse party, he is considered the owner of a portion of the trust in accordance with the provisions of section 677(a) of the Code. However, to the extent that the life income payable to the transferor by the trustee consists of interest which is excludable from gross income under the provisions of section 103 of the Code, such income is excludable from the gross income of the transferor, since it is treated as if it were received directly by him. See section 1.671–2 of the regulations.

Likewise, to the extent that the amounts distributed to the secondary beneficiary, after the death of the transferor, consist of interest which is excludable from gross income under section 103 of the Code, such amounts will be excludable from the gross income of the secondary beneficiary.

The trustee in the instant case was under an express obligation to sell or exchange the appreciated property transferred in trust. However, an obligation to sell or exchange the transferred property may also arise by implication. For example, a taxpayer may transfer appreciated property to an educational or charitable organization in reliance upon advertisements or brochures stating that the organization will sell such property and invest the proceeds in tax-exempt securities, or exchange the property for tax-exempt securities. Thus, where the trustee is under an obligation, either express or implied, to sell or exchange the transferred property and to purchase tax-exempt securities, it is held that the transferor has given the trustee not the appreciated property but, rather, the proceeds of the sale or exchange which he has required the trustee to consummate. Therefore, the gain from such sale or exchange is includible in the gross income of the transferor in the taxable year in which the sale or exchange is consummated.

Since it may be necessary to go beyond the trust instrument to determine whether there is an obligation, either express or implied, imposed upon the trustee to sell or exchange the transferred property and invest in tax-exempt securities, no advance rulings will be issued as to whether there is such an obligation to sell or exchange the transferred property and invest the proceeds in tax-exempt securities.

Pursuant to the authority contained in section 7805(b) of the Code, the principles announced in this ruling will be applied only to trans-

fers of property after December 2, 1960,[2] involving an investment of the proceeds of sale of the transferred property in tax-exempt securities or an exchange of the transferred property for tax-exempt securities. Any change in existing Internal Revenue Service position with respect to transfers of property not involving such sale or exchange, and reinvestment in tax-exempt securities, will be prospective only.

SECTION 677.—INCOME FOR BENEFIT OF GRANTOR

26 CFR 1.677(a)–1: Income for benefit of grantor; general rule.

Trust income from tax-exempt securities paid to the donor. See Rev. Rul. 60–370, page 203.

SUBCHAPTER K.—PARTNERS AND PARTNERSHIPS

PART I.—DETERMINATION OF TAX LIABILITY

SECTION 704.—PARTNER'S DISTRIBUTIVE SHARE

26 CFR 1.704–1: Partner's distributive share.

Items of indebtedness constituting liabilities in computing a partner's distributive share of a cash basis partnership. See Rev. Rul. 60–345, page 211.

SECTION 705.—DETERMINATION OF BASIS OF PARTNER'S INTEREST

26 CFR 1.705–1: Determination of basis of partner's interest.

Items of indebtedness constituting liabilities in computing a partner's distributive share of a cash basis partnership. See Rev. Rul. 60–345, page 211.

SECTION 706.—TAXABLE YEARS OF PARTNER AND PARTNERSHIP

26 CFR 1.706–1: Taxable years of partner and partnership. (Also Section 443; 1.443–1.) Rev. Rul. 60–268

Where a newly formed partnership adopts a taxable year (annual accounting period) which is different from the taxable year (annual accounting period) of the principal partners and to which they are concurrently changing, the partners' short taxable period required to effect the change shall end on the last day of the partnership's first taxable year (whether or not such taxable year is a year of 12 full calendar months).

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[2] Date this Revenue Ruling was released as Technical Information Release 273.

Advice has been requested as to the effective date of a change of accounting period by the principal partners to the accounting period of a newly formed partnership.

Two individuals, both of whom are on a calendar-year basis, formed a partnership on September 1, 1959. The taxpayers propose to close the books of the partnership on a fiscal-year basis to end August 31, 1960.

Section 706(b) of the Internal Revenue Code of 1954 relates to the adoption of a taxable year, or the change to a new taxable year, by a partnership or a partner. Under section 1.706–1(b)(1)(ii) of the Income Tax Regulations, a newly formed partnership may adopt a taxable year which is the same as the taxable year of all of its principal partners (or the same as the taxable year to which all of its principal partners are concurrently changing) without securing prior approval from the Commissioner of Internal Revenue.

Section 1.706–1(b)(2) of the regulations provides that a partner may not change his taxable year without securing prior approval from the Commissioner.

Under section 1.706–1(b) and section 1.442–1(b) of the regulations an application for a change in taxable year shall be filed on Form 1128. Application For Change In Accounting Period, with the Commissioner on or before the last day of the month following the close of the short period for which a return is required to effect the change of taxable year.

Section 1.706–1(b)(5)(i) of the regulations provides that a partner who changes his taxable year shall make his return for a short period in accordance with section 443 of the Code.

Section 443 of the Code provides, in part, as follows:

> (a) RETURNS FOR SHORT PERIOD.—A return for a period of less than 12 months (referred to in this section as "short period") shall be made under any of the following circumstances:
>
> (1) CHANGE OF ANNUAL ACCOUNTING PERIOD.—When the taxpayer with the approval of the Secretary or his delegate, changes his annual accounting period. In such a case, the return shall be made for the short period beginning on the day after the close of the former taxable year and ending at the close of the day before the day designated as the first day of the new taxable year.

Under section 1.706–1(b)(5)(ii)(b) of the regulations, a newly formed partnership is required to file with its first return either (1) a copy of the letter from the Commissioner approving the adoption of a partnership taxable year which is not the same as the taxable year of all its principal partners, or (2) a statement indicating that the taxable year it has adopted is the same as the taxable year of all its principal partners, or that all its principal partners are concurrently changing to a taxable year it has adopted, or (3) a statement that all its principal partners are not on the same taxable year and that it is adopting a calendar year without prior approval.

Since the instant partnership will adopt in its first year the taxable year ending August 31, 1960, changes by the partners to the taxable year of the partnership will be effective as of August 31, 1960, and the partners should, therefore, file individual returns for the short period from January 1, 1960, to August 31, 1960.

Accordingly, it is held that where a newly formed partnership adopts a taxable year (annual accounting period) which is different from the taxable year (annual accounting period) of the principal

partners and to which they are concurrently changing, the partners' short taxable period required to effect the change shall end on the last day of the partnership's first taxable year (whether or not such taxable year is a year of 12 full calendar months.)

PART II.—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

Subpart C.—Transfers of Interests in a Partnership

SECTION 741.—RECOGNITION AND CHARACTER OF GAIN OR LOSS ON SALE OR EXCHANGE

26 CFR 1.741–1: Recognition and character of gain or loss on sale or exchange.
(Also Sections 61, 170, 453, 751; 1.61–1, 1.170–1, 1.453–1, 1.751–1.)

Rev. Rul. 60–352

A transfer of a limited partner's interest in a partnership appurtenant to which is a right to share in unrealized partnership income reflected in partnership installment obligations receivable constitutes a transfer of a capital asset, coupled with a disposition of such installment obligations subject to the provisions of section 453(d) of the Internal Revenue Code of 1954. Where the transfer is by way of a charitable contribution, the transferor realizes gain taxable as ordinary income to the extent of the difference between the basis of the installment obligations receivable appertaining to his partnership interest and the fair market value of his share of the obligations at the time of the transfer. To the extent that the transaction constitutes a charitable contribution of that portion of the partnership interest which is regarded as a capital asset, no gain or loss is recognized.

Subject to the limitations prescribed by section 170 of the Code with respect to charitable contributions deductible by individuals, the fair market value, as of the date of the transfer, of that portion of the partnership interest which is regarded as a capital asset and the fair market value, as of such date, of the partnership installment obligations regarded as disposed of in the transfer constitute an allowable deduction, as a charitable contribution, to the taxpayer.

Advice has been requested with respect to the treatment, for Federal income tax purposes, of a contribution of an interest in a partnership to a charitable organization under the circumstances described below.

During the taxable years 1955 through 1958, the taxpayer was both a general and a limited partner in a partnership which was engaged in the purchase, subdivision, and sale of tracts of land. The partnership has consistently employed the installment method of accounting in reporting its gains on sales of subdivided property in accordance with the provisions of section 453(a) of the Internal Revenue Code of 1954.

In 1959, the taxpaper transferred, without receipt of consideration, all of his interest as a limited partner in the partnership to a charitable organization contributions to which are deductible under section 170 of the Code.

The specific question in this case is whether the taxpayer realized taxable income as a result of the transfer of his partnership interest to the charitable organization and, if so, whether it is taxable as capital gain or ordinary income.

Section 741 of the Code provides that in the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).

Section 751(a) of the Code provides, in part, that the amount of any money or the fair market value of any property received by a transferor partner in exchange for all or part of his interest in the partnership attributable to unrealized receivables, or inventory items of the partnership which have appreciated substantially in value, shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

Section 453(d) of the Code provides, in part, that if an installment obligation is distributed, transmitted, or disposed of, otherwise than by sale or exchange, gain or loss shall result to the extent of the difference between the basis of the obligation and the fair market value of the obligation at the time of the distribution, transmission, or disposition.

A transfer of an installment obligation by gift constitutes a "disposition" of such obligation resulting in a realization of gain by the donor to the extent of the difference between the basis of the obligation and its fair market at the time of such disposition. See I.T. 3293, C.B. 1939–1, 183; and Rev. Rul. 55–157, C.B. 1955–1, 293.

In G.C.M. 26379, C.B. 1950–1, 58, the Internal Revenue Service accepted the view of prevailing court decisions that, with stated qualifications, the sale of a partnership interest should be treated as a sale of a capital asset for Federal income tax purposes, rather than as a sale of the partner's undivided interest in each and every asset owned by the firm. This does not mean, however, that a partnership was thereafter treated as an entity for income tax purposes as is a corporation. On the contrary, it is still held that the members of a partnership, whether general or limited partners, jointly own all of the partnership assets, including items of gross income, even though the provisions of the Code enabling the partnership to adopt its own accounting period and accounting method for information return purposes might cause such items of partnership income to be reflected in the individual tax returns of the partners in years other than those in which they would have been reported if the partnership had not intervened.

Thus, while the partnership interest generally may be regarded as constituting a partner's interest in the profits and surplus of the partnership, the fundamental principles of Federal income taxation require that an interest in income earned by the partnership which has not been realized, or has not yet been subjected to taxation, be treated as distinct from any "partnership interest" which is recognized as a capital asset for income tax purposes. Therefore, unrealized or untaxed rights to partnership income may be transferred with, but not as a part of, the partnership interest which constitutes a capital asset.

In the case of *James M. Tunnell, Jr. et ux.* v. *United States*, 148 Fed. Supp. 689, affirmed, 259 Fed. (2d) 916, the taxpayer sold his one-half interest in a law partnership to the remaining partners. At the time of the sale, the partnership books showed accounts receivable in a

substantial amount. It was the taxpayer's contention that the entire proceeds of the sale represented proceeds from the sale of a capital asset, his partnership interest. The United States District Court held that the portion of the sale proceeds attributable to the taxpayer's share of the accounts receivable of the partnership was taxable as ordinary income, since it was in reality only a substitute for ordinary income which he would have received in the future. In affirming the decision of the District Court, the United States Court of Appeals for the Third Circuit stated, in part as follows:

> The payment of the purchase price, for which a part of the quid pro quo was taxpayer's right to receive this income, was as to that part essentially a substitute for what would otherwise be received at a future time as ordinary income. And as to that part, it was not appreciation in value of the capital assets, which would be capital gain, but income produced by the capital asset, which is ordinary income.

Based on the foregoing, it is held that a transfer of a limited partner's interest in a partnership appurtenant to which is a right to share in unrealized partnership income reflected in installment obligations receivable by the partnership constitutes a transfer of a capital asset coupled with a disposition of such installment obligations subject to the provisions of section 453(d) of the Code. To the extent that the transaction constitutes a disposition of installment obligations receivable, the gain is taxable to the transferor as ordinary income.

Therefore, the taxpayer realized ordinary income, includible in his gross income for the year 1959, to the extent of the difference between the basis of the installment obligations appertaining to his limited interest in the partnership and the fair market value of that portion of the obligations at the time of the transfer to the charitable organization. Insofar as the transfer to charity is attributable to the taxpayer's limited partnership interest, as such, exclusive of his share of the partnership's installment obligations receivable, no gain or loss is recognized since there was not a sale or exchange of such interest within the meaning of section 741 of the Code.

It is further held that, subject to the limitations prescribed by section 170 of the Code with respect to charitable contributions deductible by individuals, the fair market value, as of the date of the transfer, of that portion of the limited partnership interest which is regarded as a capital asset and the fair market value, as of such date, of the partnership installment obligations regarded as disposed of in the transfer constitute an allowable deduction, as a charitable contribution, to the taxpayer.

Subpart D.—Provisions Common to Other Subparts

SECTION 751.—UNREALIZED RECEIVABLES AND INVENTORY ITEMS

26 CFR 1.751–1: Unrealized receivables and inventory items.

Partnership installment obligations receivable transferred to charity. See Rev. Rul. 60–352, page 208.

SECTION 752.—TREATMENT OF CERTAIN LIABILITIES

26 CFR 1.752–1: Treatment of certain liabilities. Rev. Rul. 60–345
(Also Sections 704, 705; 1.704–1, 1.705–1.)

The taxpayer is a member of a partnership which uses the cash receipts and disbursements method of accounting. At the close of the partnership taxable year, there were outstanding partnership liabilities for the payment of certain trade accounts, notes, and accrued expenses, which liabilities were not recorded on the partnership books because of the method of accounting employed. *Held*, in computing the adjusted basis of taxpayer's interest in the partnership, for the purpose of determining the extent to which his distributive share of the partnership's loss for such year may be allowed under section 704(d) of the Internal Revenue Code of 1954, the term "liabilities," as used in section 752 of the Code, includes the partnership's obligations for the payment of outstanding trade accounts, notes, and accrued expenses, whether or not recorded on the partnership books under its accounting method.

SUBCHAPTER L.—INSURANCE COMPANIES

PART I.—LIFE INSURANCE COMPANIES

Subpart E.—Miscellaneous Provisions

SECTION 819.—FOREIGN LIFE INSURANCE COMPANIES

Percentage for purposes of declaration of estimated income tax by foreign life insurance companies for the taxable year 1960. See T.D. 6491, page 936.

PART III.—OTHER INSURANCE COMPANIES

SECTION 832.—INSURANCE COMPANY TAXABLE INCOME

26 CFR 1.832–1: Gross income. Rev. Rul. 60–306

> An insurance company, other than life or mutual, is not required to accrue discount on bonds owned by the company where the bonds were not issued with an original issue discount as defined in section 1232(b) of the Internal Revenue Code of 1954. The fact that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners provides for such an accrual is not controlling for Federal income tax purpose.

Advice has been requested whether an insurance company subject to the provisions of section 832 of the Internal Revenue Code of 1954 is required to include in gross income bond discount attributable to market fluctuations, where the requirements of the underwriting and investment exhibit of the annual statement approved by the National

Convention of Insurance Commissioners provides for the annual accrual of bond discount.

The taxpayer is an insurance company, but is neither a life nor a mutual insurance company. It is therefore subject to the provisions of section 832 of the Code. Among its investments are bonds purchased at a discount from their par value. The discounts are not "original issue discounts" as defined in section 1232(b)(1) of the Code, but are attributable to market fluctuations.

The taxpayer files with the insurance commissioners of the states in which it operates an annual statement using the form approved by the National Convention of Insurance Commissioners. That form requires that all discount on bonds be amortized over the life of the bonds and that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners show an accrual of income for the annual amount of this amortization.

Gross income of insurance companies subject to the provisions of section 832 of the Code is defined, in part, by section 832(b) of the Code as follows:

> GROSS INCOME.—The term "gross income" means the sum of—
>
> (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners.

Section 1.832–1 of the Income Tax Regulations provides that the underwriting and investment exhibit is presumed to reflect the true net income of the company, and insofar as it is not inconsistent with the provisions of the Internal Revenue Code of 1954 will be recognized and used as a basis for that purpose.

Ordinarily, bonds which are capital assets in the hands of a taxpayer would be subject to capital gain or loss treatment upon their retirement, sale, or exchange except to the extent that "original issue discount" is involved. The fact that the bonds were purchased at a discount is accounted for for the purpose of determining the basis for gain or loss upon the retirement, sale, or exchange of the bonds.

Sections 818(b)(1) (and corresponding sections of prior laws) and 822(d)(2) of the Code specifically require the accrual of bond discount by life insurance companies and mutual insurance companies. See Rev. Rul. 60–210, C.B. 1960–1, 473. However, there are no provisions in the Code or regulations specifically requiring such accrual for insurance companies, other than life or mutual, subject to section 832 of the Code, unless the reference in section 832(b)(1) of the Code to the annual statement approved by the National Convention of Insurance Commissioners implies such a result. That reference is to an "accounting method" on the basis of which investment income and underwriting income is to be computed and is meant to be used only as a guide in computing the income of insurance companies subject to the provisions of section 832 of the Code. See *Commissioner* v. *General Reinsurance Corp.*, 190 Fed. (2d) 148; and *Pacific Employers Insurance Co.* v. *Commissioner*, 89 Fed. (2d) 186. Thus, section 832 of the Code does not convert what would be a capital gain into ordinary income.

Accordingly, it is held that, with respect to bonds other than bonds issued with an original issue discount as defined in section 1232(b) of the Code, an insurance company, other than life or mutual, which is subject to the provision of section 832 of the Code, is not required to accrue bond discount for Federal income tax purposes, even though the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners provides for such accrual.

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART I.—DETERMINATION OF SOURCES OF INCOME

SECTION 863.—ITEMS NOT SPECIFIED IN SECTION 861 OR 862

26 CFR 1.863–1: Allocation of gross income under section 863(a).

Gain included in insurance proceeds received by a Western Hemisphere trade corporation. See Rev. Rul. 60–278, page 214.

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subpart C.—Miscellaneous Provisions

SECTION 894.—INCOME EXEMPT UNDER TREATY

26 CFR 1.894–1: Income exempt under treaty.

Taxability of income of residents of France who render personal services as public entertainers while temporarily in the United States. See Rev. Rul. 60–313, page 627.

PART III.—INCOME FROM SOURCES WITHOUT THE UNITED STATES

Subpart B.—Earned Income of Citizens of United States

SECTION 911.—EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

26 CFR 1.911–1: Earned income from sources without the United States.

Rules for determining whether an individual is an inhabitant of the Virgin Islands within the meaning of section 28(a) of the Revised Organic Act of the Virgin Islands. See Rev. Rul. 60–291, page 407.

Subpart C.—Western Hemisphere Trade Corporations

SECTION 921.—DEFINITION OF WESTERN HEMISPHERE TRADE CORPORATIONS

26 CFR 1.921–1: Definition of Western Hemisphere trade corporations. Rev. Rul. 60–278[1]
(Also Section 863, 1.863–1.)
(Also Part II, Sections 109, 119; Regulations 118, Sections 39.109–1, 39.119(a)–7; Regulations 111, Sections 29.109–1, 29.119–1.)

The situs of property lost in transit between the United States and another country in the Western Hemisphere determines whether any gain included in insurance proceeds received by a Western Hemisphere trade corporation as a result of the loss constitutes income from sources within or without the United States. The residence status of the insurer, whether domestic or foreign, is irrelevant.
I.T. 3902, C.B. 1948–1, 64, clarified.

The Internal Revenue Service was requested to clarify I.T. 3902, C.B. 1948–1, 64, which apparently has been misinterpreted by some taxpayers.

Specifically, the Service was asked to state whether the fact that the payer of insurance proceeds was a domestic insurance company had any significance in reaching the conclusion in I.T. 3902 that gain included in insurance proceeds received by a Western Hemisphere trade corporation as a result of the loss of goods in transit from the United States to Cuba constituted income from sources within the U.S.

For purposes of taxation of personal property, the general principle of law is that the situs of goods in transit remains at their original situs until they have acquired a permanent situs elsewhere. Therefore, since the situs of the property at the time of the loss determines the source of the gain included in the insurance proceeds, the residence status (domestic or foreign) of the insurance company is wholly immaterial to the determination of the source of such gain.

I.T. 3902, C.B. 1948–1, 64, is clarified.

(Also Section 922; 1.922–1.) Rev. Rul. 60–307

Greenland is considered a country in North America within the meaning of section 921 of the Internal Revenue Code of 1954.

SECTION 922.—SPECIAL DEDUCTION

26 CFR 1.922–1: Special deduction of Western Hemisphere trade corporation.

Section 922 deduction in the case of unrealized profits from transactions between members of an affiliated group of corporations which are taken into consideration in consolidated income tax returns. See Rev. Rul. 60–289, page 268.

[1] Based on Technical Information Release 241, dated July 18, 1960.

Greenland is considered to be a country in North America for purposes of the special deduction allowed a Western Hemisphere trade corporation. See Rev. Rul. 60–307, page 214.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART II.—BASIS RULES OF GENERAL APPLICATION

SECTION 1016.—ADJUSTMENTS TO BASIS

26 CFR 1.1016–4: Exhaustion, wear and tear, obsolescence, amortization, and depletion; periods during which income was not subject to tax.

Adjustments to basis for pre-1913 depreciation required by taxpayer's change from the retirement method of computing depreciation to another method of computing depreciation. See Rev. Rul. 60–390, page 463.

PART III.—COMMON NONTAXABLE EXCHANGES

SECTION 1037.—CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS

Rev. Rul. 60–371

Under authority of section 1037(a) of the Internal Revenue Code of 1954, the Secretary of the Treasury, in section 3 of Treasury Department Circular No. 1043 (1960), 25 F.R. 5247, declared that no gain or loss shall be recognized for Federal income tax purposes upon the exchange with the United States of the 2½ percent Treasury Bonds of 1961, due November 15, 1961, solely for the 3¾ percent Treasury Notes of Series D–1964.

Gain or loss, if any, upon the obligations surrendered in this exchange will be taken into account upon the disposition or redemption of the new obligations.

Rev. Rul. 60–372

Under authority of section 1037(a) of the Internal Revenue Code of 1954, the Secretary of the Treasury, in section 3 of Treasury Department Circular No. 1044 (1960), 25 F.R. 5248, declared that no gain or loss shall be recognized for Federal income tax purposes upon the exchange with the United States of the 2½ percent Treasury Bonds of 1961, due November 15, 1961, solely for the 3⅞ percent Treasury Bonds of 1968.

Gain or loss, if any, upon the obligations surrendered in this exchange will be taken into account upon the disposition or redemption of the new obligations.

Rev. Rul. 60-387

Under section 1037(a) of the Internal Revenue Code of 1954, gain or loss realized from the exchange of 2½ percent Treasury Bonds of 1962–67 solely for 3½ percent Treasury Bonds of 1980 will not be recognized.

The 3½ percent Treasury Bonds of 1980 which were offered by the Secretary of the Treasury in Treasury Department Circular No. 1050, dated September 12, 1960, 25 F.R. 8964, were issued in exchange for 2½ percent Treasury Bonds of 1962–67, dated May 5, 1942, due June 15, 1967.

The income derived from these bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds 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 possession of the United States, or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys. They may, upon death of the owner, be redeemed at par, plus accrued interest to date of payment, in payment of Federal estate taxes due from the deceased owner's estate.

Under the authority of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized for Federal income tax purposes upon the exchange with the United States of the 2½ percent Treasury Bonds of 1962–67 solely for the 3½ percent Treasury Bonds of 1980. D.C. No. 1050.

Gain or loss, if any, upon the obligations surrendered in this exchange will be taken into account upon the disposition or redemption of the new obligations.

Rev. Rul. 60-388

Under section 1037(a) of the Internal Revenue Code of 1954, gain or loss realized from the exchange of 2½ percent Treasury Bonds of 1963–68 solely for 3½ percent Treasury Bonds of 1990 will not be recognized.

The 3½ percent Treasury Bonds of 1990 which were offered by the Secretary of the Treasury in Treasury Department Circular No. 1051, dated September 12, 1960, 25 F.R. 8965, were issued in exchange for 2½ percent Treasury Bonds of 1963–68, dated December 1, 1942, due December 15, 1968.

The bonds issued pursuant to Treasury Department Circular No. 1051 were an addition to and formed a part of the series of 3½ percent Treasury Bonds of 1990 issued pursuant to Treasury Department Circular No. 1005, dated February 3, 1958, 23 F.R. 804.

The income derived from these bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds 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 possession of the United States, or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys. They may, upon death of the owner, be redeemed at par, plus accrued interest to date of payment, in payment of Federal estate taxes due from the deceased owner's estate.

Under the authority of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized for Federal income tax purposes upon the exchange with the United States of the 2½ percent Treasury Bonds of 1963–68 solely for the 3½ percent Treasury Bonds of 1990. D.C. No. 1051.

Gain or loss, if any, upon the obligations surrendered in this exchange will be taken into account upon the disposition or redemption of the new obligations.

Rev. Rul. 60–389

Under section 1037(a) of the Internal Revenue Code of 1954, gain or loss realized from the exchange of 2½ percent Treasury Bonds of 1964–69 solely for 3½ percent Treasury Bonds of 1998 will not be recognized.

The 3½ percent Treasury Bonds of 1998 which were offered by the Secretary of the Treasury in Treasury Department Circular No. 1052, dated September 12, 1960, 25 F.R. 8966, were issued in exchange for 2½ percent Treasury Bonds of 1964–69, dated April 15 and September 15, 1943, due June 15 and December 15, 1969.

The income derived from these bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds 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 possession of the United States, or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys, They may, upon death of the owner, be redeemed at par, plus accrued interest to date of payment, in payment of Federal estate taxes due from the deceased owner's estate.

Under the authority of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized for Federal income tax purposes upon the exchange with the United States of the 2½ percent Treasury Bonds of 1964–69 solely for the 3½ percent Treasury Bonds of 1998. D.C. No. 1052.

Gain or loss, if any, upon the obligations surrendered in this exchange will be taken into account upon the disposition or redemption of the new obligations.

SUBCHAPTER P.—CAPITAL GAINS AND LOSSES

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1221.—CAPITAL ASSET DEFINED

26 CFR 1.1221–1: Meaning of terms. (Also Section 582; 1.582–1.) Rev. Rul. 60–346

Gains or losses resulting from continuing and substantial sales by a bank of Federal Housing Administration and Veterans' Administration insured mortgages, for the purpose of obtaining additional funds with which to cover increasing demands for loans, are considered ordinary gains or losses rather than gains or losses from the sales of capital assets.

Advice has been requested whether gains and losses resulting from a bank's sales of mortgages, obligations of individuals which are insured or guaranteed by the Federal Housing Administration or Veterans' Administration (FHA and VA), under the circumstances described below, constitute ordinary gains and losses or gains and losses from the sale of capital assets.

The taxpayer, a bank, has for a period of ten years made mortgage loans, commonly referred to as FHA loans and VA loans, in considerable volume to qualified individuals. Annually, about 50 percent of the average outstanding volume of mortgages were sold, principally to other financial institutions and insurance companies, after being held approximately three months. Under the sales agreements, the taxpayer agreed to service and collect the outstanding mortgage loans for the purchasers. For this service the taxpayer received a fee based on the amount of the outstanding loans.

It is further shown that (1) the taxpayer does not ordinarily purchase mortgages; (2) the mortgage loans were made originally with the intention of an early sale thereof for the purpose of obtaining additional funds to cover an increasing demand for other loans of a more profitable nature; (3) the practice of selling these mortgages is a customary function of the taxpayer's banking business; and (4) the mortgages were sold at or near par value.

In some years, the taxpayer incurred losses in disposing of the mortgages. In other years, it was able to realize gains upon disposal of the mortgages.

Section 1221 of the Internal Revenue Code of 1954 provides, in pertinent part, that the term "capital asset" does not include property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Since (1) the taxpayer has consistently engaged in the practice of converting the mortgages it receives as security for loans it makes into liquid funds for the purpose of making additional loans to its customers, (2) the loans were made with the intention to sell the mortgages shortly after obtaining them, and (3) such practice is a necessary incident to the conduct of the taxpayer's business, it is held that the mortgages, the subject of the sales described above, constitute property held primarily for sale to customers in the ordinary course of trade or business rather than capital assets held for investment purposes. See *Kanawha Valley Bank* v. *Commissioner*, 4 TC 252, acquiescence, C.B. 1946–1, 3, and *Joe B. Fortson* v. *Commissioner*, 47 B.T.A. 158, acquiescence, C.B. 1942–2, 7. See also I.T. 3648, C.B. 1944, 268.

Accordingly, gains or losses resulting from sales by the bank of FHA and VA insured mortgages which are obligations of individuals, for the purpose of obtaining additional funds with which to cover increasing demands for loans, are considered ordinary gains or losses rather than gains or losses from the sales of capital assets.

Section 582(c) of the Code, dealing only with the tax treatment of losses of banks, provides specific rules governing bank losses applicable only to those instances where corporate or government obligations are sold. In this case, the mortgages are obligations of individuals and merely insured or guaranteed by Federal agencies. Consequently, section 582(c) is not applicable.

A sale of "goodwill" in connection with business or profession. See Rev. Rul. 60–301, page 15.

PART IV.—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1231.—PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS

26 CFR 1.1231–1: Gain and losses from the sale or exchange of certain property used in the trade or business.

Exchange of depreciable property between individual and a new corporation controlled by the transferor. See Rev. Rul. 60–302, page 223.

SECTION 1233.—GAINS AND LOSSES FROM SHORT SALES

26 CFR 1.1233: Statutory provisions; gains and losses from short sales. T. D. 6494 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Income Tax Regulations under section 1233 of the 1954 Code, relating to short sales, amended to conform to statutory amendments made by the 84th and 85th Congresses.

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

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

On August 12, 1959, notice of proposed rulemaking regarding the regulations under section 1233 of the Internal Revenue Code of 1954 relating to short sales, as amended by the Act of August 12, 1955 (Public Law 385, 84th Cong., 69 Stat. 717 [C.B. 1955–2, 772]), and section 52 of the Technical Amendments Act of 1958 (72 Stat. 1643) [P.L. 85–866, C.B. 1958–3, 254] was published in the Federal Register (24 F.R. 6501). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

PARAGRAPH 1. Section 1.1233 is amended by revising section 1233(a), by adding a new paragraph (4) to section 1233(e), by adding a new section 1233(g), and by revising the historical note. These revised and new provisions read as follows:

§ 1.1233 STATUTORY PROVISIONS; GAINS AND LOSSES FROM SHORT SALES.

SEC. 1233. GAINS AND LOSSES FROM SHORT SALES.

(a) CAPITAL ASSETS.—For purposes of this subtitle, gain or loss from the short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer.

* * * * * * *

[1] 25 F.R. 9372.

(e) RULES FOR APPLICATION OF SECTION.—* * *

(4) (A) In the case of a taxpayer who is a dealer in securities (within the meaning of section 1236)—

(i) If, on the date of a short sale of stock, substantially identical property which is a capital asset in the hands of the taxpayer has been held for not more than 6 months, and

(ii) If such short sale is closed more than 20 days after the date on which it was made,

subsection (b) (2) shall apply in respect of the holding period of such substantially identical property.

(B) For purposes of subparagraph (A)—

(i) The last sentence of subsection (b) applies; and

(ii) The term "stock" means any share or certificate of stock in a corporation, any bond or other evidence of indebtedness which is convertible into any such share or certificate, or any evidence of an interest in, or right to subscribe to or purchase, any of the foregoing.

* * * * * * *

(g) HEDGING TRANSACTIONS.—This section shall not apply in the case of a hedging transaction in commodity futures.

[Sec. 1233 as amended by sec. 1, Act of Aug. 12, 1955 (Pub. Law 385, 84th Cong., 69 Stat. 717); sec. 52, Technical Amendments Act 1958 (72 Stat. 1643)]

PAR. 2. Section 1.1233–1 is amended by revising paragraph (b), by inserting a new sentence at the end of paragraph (c) (1), by revising paragraph (c) (5),[1] and by adding paragraphs (e) and (f). The revised and new provisions read as follows:

§ 1.1233–1 GAINS AND LOSSES FROM SHORT SALES.

* * * * * * *

(b) *Hedging transactions.*—Under section 1233(g), the provisions of section 1233 and this section shall not apply to any bona fide hedging transaction in commodity futures entered into by flour millers, producers of cloth, operators of grain elevators, etc., for the purpose of their business. Gain or loss from a short sale of commodity futures which does not qualify as a hedging transaction shall be considered gain or loss from the sale or exchange of a capital asset if the commodity future used to close the short sale constitutes a capital asset in the hands of the taxpayer as explained in paragraph (a) of this section.

(c) *Special short sales.*—(1) *General.*—Section 1233 provides rules as to the tax consequences of a short sale of property if gain or loss from the short sale is considered as gain or loss from the sale or exchange of a capital asset under section 1233(a) and paragraph (a) of this section and if, at the time of the short sale or on or before the date of the closing of the short sale, the taxpayer holds property substantially identical to that sold short. The term "property" is defined for purposes of such rules to include only stocks and securities (including stocks and securities dealt with on a "when issued" basis) and commodity futures, which are capital assets in the hands of the taxpayer. Certain restrictions on the application of the section to commodity futures are provided in section 1233(e) and paragraph (d)(2) of this section. Section 1233(f) contains special provisions governing the operation of rule (2) in subparagraph (2) of this paragraph in the case of a purchase and short sale of stocks or securities in a transaction qualifying as an arbitrage operation. See paragraph (f) of this section for detailed rules relating to arbitrage operations in stocks and securities.

* * * * * * *

(e) *Special rule for short sales by dealers in securities under certain circumstances.*—In the case of a short sale of stock (as defined in subparagraph (3) of this paragraph) after December 31, 1957, by a dealer in securities, section 1233(e) (4) (A) provides that the holding period of substantially identical stock which he has held as an investment for not more than 6 months shall be determined in accordance with section 1233(b) (2) unless such short sale is closed

[1] The phrase in par. 2 "by revising paragraph (c) (5)," was erroneously included.

within 20 days of the date on which it was made. See rule (2) in paragraph (c)(2) of this section for the purpose of determining the holding period of such substantially identical stock. In addition, section 1233(e)(4)(B) provides that for the purpose of the special rule of section 1233(e)(4)(A), the acquisition of an option to sell property at a fixed price shall be considered a short sale, and the exercise or failure to exercise such option shall be considered a closing of such short sale. For purposes of this paragraph—

(1) Whether or not a taxpayer is a "dealer in securities" shall be determined in accordance with the meaning of the term for purposes of section 1236;

(2) Whether or not stock is "substantially identical" with other property shall be determined in accordance with the provisions of paragraph (d)(1) of this section; and

(3) The term "stock" means—

(i) Any share or certificate of stock,

(ii) Any bond or other evidence of indebtedness which is convertible into a share or certificate of stock, and

(iii) Any evidence of an interest in, or right to subscribe to or purchase, any of the items described in subdivision (i) or (ii) of this subparagraph.

(f) *Arbitrage operations in stocks and securities and holding periods.*—(1) *General rule.*—(i) In the case of a short sale entered into as part of an arbitrage operation, rule (2) of paragraph (c)(2) of this section shall apply first to substantially indentical property acquired for arbitrage operations and held by the taxpayer at the close of business on the day of the short sale. The holding period of substantially idential property not acquired for arbitrage operations shall be affected only to the extent that the amount of property sold short exceeds the amount of substantially identical property acquired for arbitrage operations and held by the taxpayer at the close of business on the day of the short sale.

(ii) If the substantially identical property acquired for arbitrage operations is disposed of without closing the short sale so that a net short position in assets acquired for arbitrage operations is created, a short sale in the amount of such net short position will be deemed to have been made on the day such net short position is created. Rule (2) of paragraph (c)(2) of this section will then apply to substantially identical property not acquired for arbitrage operations to the same extent as if the taxpayer, on the day such net short position is created, sold short an amount equal to the amount of the net short position in a transaction not entered into as part of an arbitrage operation.

(iii) The following examples illustrate the application of rule (2) of paragraph (c)(2) of this section to arbitrage operations:

Example (1). On August 13, 1957, A buys 100 bonds of X Corporation for purposes other than arbitrage operations. The bonds are convertible at the option of the bondholders into common stock of X Corporation on the basis of one bond for one share of stock. On November 1, 1957, A sells short 100 shares of common stock of X Corporation in a transaction identified and intended to be part of an arbitrage operation and on the same day buys another 100 bonds of X Corporation in a transaction identified and intended to be part of the same arbitrage operation. The bonds acquired on both August 13, 1957, and November 1, 1957, are, on the basis of all the facts and circumstances, substantially identical to the common stock of X Corporation. On December 1, 1957, A closes the short sale with 100 shares of common stock of X Corporation acquired on that day. The holding period of the bonds acquired on November 1, by application of rule (2) of paragraph (c)(2) of this section, will be deemed to begin on December 1 and the holding period of the bonds acquired on August 13 will be unaffected. If, instead of purchasing the 100 shares of common stock of X Corporation on December 1, 1957, A had converted the bonds acquired on November 1 into common stock and, on December 1, 1957, used the stock so acquired to close the short sale, rule (2) of paragraph (c)(2) of this section would similarly have no effect on the holding period of the bonds acquired on August 13.

Example (2). Assume the same facts as in example (1), except that A, on December 1, sells the bonds acquired on November 1 (or converts such bonds into common stock and sells the stock), but does not close the short sale. The sale of the bonds (or stock) creates a net short position in assets acquired for arbitrage operations which is deemed to be a short sale made on December 1. Accordingly, the holding period of the bonds acquired on August 13 will, by

application of rule (2) of paragraph (c)(2) of this section, begin on the date such short sale is closed or on the date of sale, gift, or other disposition of such bonds, whichever date occurs first.

(2) *Right to receive or acquire property.*—(i) For purposes of section 1233(f)(1) and (2) and subparagraph (1) of this paragraph, a taxpayer will be deemed to hold substantially identical property acquired for arbitrage operations at the close of any business day if, by virtue of the ownership of other property acquired for arbitrage operations (whether or not substantially identical) or because of any contract entered into by the taxpayer in an arbitrage operation, he then has the right to receive or acquire such substantially identical property.

(ii) The application of section 1233(f)(3) and subdivision (i) of this subparagraph may be illustrated by the following example:

Example. A acquires on August 13, 1957, 100 shares of common stock of X Corporation for purposes other than arbitrage operations. On November 1, A sells short, in a transaction identified and intended to be part of an arbitrage operation, 100 shares of X common stock. On the same day, in a transaction also identified and intended to be part of the same arbitrage operation, A contracts to purchase 100 shares of preferred stock of X. The preferred stock of X may be converted into common stock of X on the basis of one share of preferred stock for one share of common stock. The preferred stock is not actually delivered to A until November 3. Since A has contracted before the close of business on the date of the short sale, as part of an arbitrage operation, to purchase property by virtue of which he has the right to receive or acquire substantially identical property to that sold short, he will be deemed, for purposes of section 1233(f)(1) and (2), to hold such substantially identical property at the close of business on the date of the short sale. For purposes of this subparagraph, it is immaterial whether, on the basis of all the facts and circumstances, the preferred stock of X is substantially identical to the common stock of X. The short sale on November 1 does not affect the holding period of the 100 shares of X Corporation common stock purchased on August 13, 1957. Because of the operation of rule (2) of paragraph (c)(2) of this section, the holding period of the preferred stock acquired as the result of A's contract to purchase it as part of an arbitrage operation (or the common stock which A acquires by conversion of such preferred stock into common stock) will not begin until the short sale entered into in the arbitrage operation is closed.

(3) *Definition of arbitrage operations.*—For the purpose of section 1233(f), arbitrage operations are transactions involving the purchase and sale of property entered into for the purpose of profiting from a current difference between the price of the property purchased and the price of the property sold. Assets acquired for arbitrage operations include only stocks and securities and rights to acquire stocks and securities. The property purchased may be either identical to the property sold or, if not so identical, such that its acquisition will entitle the taxpayer to acquire property which is so identical. Thus, the purchase of bonds or preferred stock convertible, at the holder's option, into common stock and the short sale of the common stock which may be acquired therefor, or the purchase of stock rights and the short sale of the stock to be acquired on the exercise of such rights, may qualify as arbitrage operations. A transaction will qualify as an arbitrage operation under section 1233(f) only if the taxpayer properly identifies the transaction as an arbitrage operation on his records as soon as he is able to do so. Such identification must ordinarily be entered in the taxpayer's records on the day of the transaction. Property acquired in a transaction properly identified as part of an arbitrage operation is the only property which will be deemed acquired for an arbitrage operation. The provisions of section 1233(f) and this paragraph shall continue to apply to property acquired in a transaction properly identified as an arbitrage operation although, because of subsequent events, e.g., a change in the value of bonds so acquired or of stock into which such bonds may be converted, the taxpayer sells such property outright rather than using it to complete the arbitrage operation.

(4) *Effective date of section 1233(f).*—Section 1233(f), relating to arbitrage operations involving short sales of property, is effective only with respect to taxable years ending after August 12, 1955, and only with respect to short sales made after such date.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved September 26, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 26, 1960, 8:49 a.m., and published in the issue of the Federal Register for September 30, 1960, 25 F.R. 9372)

SECTION 1239.—GAIN FROM SALE OF CERTAIN PROPERTY BETWEEN SPOUSES OR BETWEEN AN INDIVIDUAL AND A CONTROLLED CORPORATION

26 CFR 1.1239–1: Gain from sale or exchange of certain property between spouses or between an individual and a controlled corporation.
(Also Sections 351, 357, 1231; 1.351–2, 1.357–2, 1.1231–1.)

Rev. Rul. 60–302

Where an individual transfers to a newly formed corporation a factory building which in the hands of the transferee is subject to depreciation and receives in exchange all the corporation's stock, plus a short-term note, the gain recognized on such transfer under the provisions of section 351(b) of the Internal Revenue Code of 1954 is treated as ordinary income since the exchange is within section 1239 of the Code.

If the depreciable property is encumbered by a liability which exceeds the total of the adjusted basis of the property transferred, the gain recognized to the transferor under the provisions of section 357(c) of the Code will also be treated as ordinary income under section 1239 of the Code.

Advice has been requested whether section 1239 of the Internal Revenue Code of 1954 applies to transactions where the recognition of gain is governed by the provisions of section 351(b) or 357(c) of the Code.

A, an individual, formed *Y* corporation, transferring a factory building with an adjusted basis of 200 *x* dollars to the corporation and receiving in exchange all the stock in the corporation plus a short-term note payable to himself. The property transferred was used in *A*'s trade or business and had been held by him for more than six months. The fair market value of the building was 500 *x* dollars at the time of the transfer. The fair market value of the stock was 420 *x* dollars and the market value of the note was the same as its face value of 80 *x* dollars. The transfer of this asset in return for stock and a note constituted the only sale or exchange entered into by *A* during the taxable year.

Section 351(a) of the Code provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in con-

trol (as defined in section 368(c) of the Code) of the corporation. Section 351(b) of the Code provides that if section 351(a) of the Code would apply to the exchange, except that, in addition to stock or securities permitted to be received under section 351(a) of the Code, other property or money is received, then gain, if any, to the transferor will be recognized to the extent of the money or other property received.

Section 1239 of the Code provides, in part, that in the case of a sale or exchange, directly or indirectly, of property which in the hands of the transferee is subject to the allowance for depreciation, between an individual and his controlled corporation, any gain recognized to the transferor from the sale or exchange shall be considered as a gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 of the Code.

Section 1231 of the Code provides, in part, that if the recognized gains on sales or exchanges of property used in trade or business exceed the recognized losses from such sales and exchanges, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than six months.

As a result of the transfer described above, *A* had a recognized gain of 80 *x* dollars: (The adjusted basis of the building to *A* was 200 *x* dollars and it was exchanged for property worth 500 *x* dollars on the date it was transferred to the corporation. Under section 351 of the Code the gain of 300 *x* dollars is recognized only to the extent of the 80 *x* dollars (other property) received on the transfer.) Since the building was a section 1231 asset in *A*'s hands, the gain recognized is treated under section 1231, unless section 1239 of the Code applies.

In *W. H. Weaver* v. *Commissioner*, 32 T.C. 411, the Tax Court of the United States held that gain recognized, when other property was received in an otherwise tax-free transaction, would be taxed as ordinary income to the extent that section 117(o) of the 1939 Code, the predecessor of section 1239 of the 1954 Code, applied. The gain in question was recognized under section 112(c) of the 1939 Code, a section which was similar in all respects material here to section 351(b) of the 1954 Code. Since the controlling statutory provisions in the *Weaver* case were similar in all material respects to sections 1239 and 351(b) of the 1954 Code, the *Weaver* decision supports the view that gain recognized under section 351(b) of the Code is subject to the provisions of section 1239 of the Code.

In this connection, the application of section 1239 of the Code to gain recognized under section 351(b) of the Code is necessary if the purpose for which section 1239 of the Code was enacted is to be uniformly applied. Section 1239 of the Code is intended to prevent the transfer of depreciable assets to a controlled corporation under circumstances which permit the corporation to get a "stepped-up" basis for depreciation at the cost of a capital-gains tax to the transferor. See H.R. Report No. 586, 82d Cong., 1st Session, C.B. 1951–2, 357, 376. If property is transferred to a corporation in a transaction in which gain is recognized under section 351(b) of the Code, then the basis of the property to the corporation is the transferor's basis, increased in the amount of the gain recognized on the transfer. See section 362 of the 1954 Code. Thus, unless section 1239 of the Code is applied to transactions like the instant one, the basis of depreciable assets may be

increased at the cost of a capital-gains tax, the result which section 1239 of the Code was intended to prevent.

Accordingly, since the exchange between *A* and *Y* meets the conditions of section 1239 of the Code, the gain of 80 *x* dollars recognized to *A* on the exchange is to be treated as ordinary income.

A further question arises as to the treatment of gain when property encumbered by a liability is transferred to a controlled corporation in an exchange which meets the conditions of section 1239 of the Code. For an illustration, assume the same facts as above, except that the property transferred by *A* is encumbered by a liability of 210 *x* dollars, which is assumed by the corporation.

Section 357(c) of the Code, which is a new provision in the 1954 Code, provides, in part, that if the liabilities assumed in an exchange to which section 351 of the Code applies exceed the adjusted basis of the property transferred, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

Thus, gain of 90 *x* dollars is recognized to *A* on this transfer. Of the gain, 80 *x* dollars represents the fair market value of the note and 10 *x* dollars represents the excess of the liability assumed over the basis of the property transferred. For the reasons given above, the 80 *x* dollars attributable to receipt of the note will be taxed as ordinary income. The status of the remaining 10 *x* dollars, as capital gain or ordinary income depends on whether section 1239 of the Code applies to gain recognized under section 357(c) of the Code.

By its terms, section 1239 of the Code is applicable to "any gain recognized to the transferor from the sale or exchange" of depreciable property. Thus, on its face it applies to gain recognized under section 357(c) of the Code. Moreover, section 357(c) of the Code is like section 351(b) of the Code in that it provides for the limited recognition of gain in otherwise tax-free transactions. Consequently, the reasons given above for applying section 1239 to gain recognized under section 351(b) of the Code apply equally where the gain is recognized under section 357(c) of the Code. The *Weaver* decision, cited above as supporting the view that section 1239 of the Code applied to section 351(b) gains, by analogy also supports the view that section 1239 of the Code applies to gains recognized under section 357(c) of the Code. See also *Jack L. Easson, et al.* v. *Commissioner*, 33 T.C. No. 109. Similarly, unless section 1239 of the Code is applied to gains recognized under section 357(c) of the Code, as well as to gains recognized under 351(b) of the Code, the purpose for which section 1239 of the Code was enacted will not be carried out.

Accordingly, it is held that the 10 *x* dollars gain recognized under section 357(c) of the Code, as well as the 80 *x* dollars gain recognized under section 351(b) of the Code, is taxable as ordinary income.

If the property transferred were a capital asset rather than an asset described in section 1231 of the Code, the conclusions reached here would remain the same. As long as all of the conditions set forth in section 1239 of the Code are present, the gain recognized on the transaction must be treated as ordinary income.

SECTION 1244.—LOSSES ON SMALL BUSINESS STOCK

26 CFR 1.1244(a): Statutory provisions; losses on small business stock; general rule. T. D. 6495[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under section 1244 of the Internal Revenue Code of 1954.

DEPARTMENT OF THE TREASURY,
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, 1959, notice of proposed rulemaking regarding the regulations under section 1244 of the Internal Revenue Code of 1954 was published in the Federal Register (24 F.R. 8231). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

Paragraph (g)(2) of § 1.1244(c)-1 will remain outstanding as a notice of proposed rulemaking and will be given further consideration before final action is taken thereon.

The regulations hereby prescribed are applicable for taxable years beginning after December 31, 1953.

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1.1244(e)-1	Records to be kept and information to be filed with the return.

AUTHORITY: §§ 1.1244(a) to 1.1244(e)-1, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 805.

§ 1.1244(a) STATUTORY PROVISIONS; LOSSES ON SMALL BUSINESS STOCK; GENERAL RULE.

SEC. 1244. LOSSES ON SMALL BUSINESS STOCK.

(a) GENERAL RULE.—In the case of an individual, a loss on section 1244 stock issued to such individual or to a partnership which would (but for this section) be treated as a loss from the sale or exchange of a

[1] The publication of this Treasury Decision in 25 F.R. 9675, dated October 8, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 24 F.R. 8231, dated October 9, 1959, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

capital asset shall, to the extent provided in this section, be treated as a loss from the sale or exchange of an asset which is not a capital asset.

[Sec. 1244(a) as added by sec. 202(b), Small Business Tax Revision Act 1958 (72 Stat. 1676) [P.L. 85-866, C.B. 1958-3, 254, at 324]]

§ 1.1244(a)-1 Loss on Small Business Stock Treated as Ordinary Loss.—(a) *In general.*—Subject to certain conditions and limitations, section 1244 provides that a loss on the sale or exchange (including a transaction treated as a sale or exchange, such as worthlessness) of "section 1244 stock" which would otherwise be treated as a loss from the sale or exchange of a capital asset shall be treated as a loss from the sale or exchange of an asset which is not a capital asset (referred to in this section and §§ 1.1244(b)-1 to 1.1244(e)-1, inclusive, as an "ordinary loss"). Such a loss shall be allowed as a deduction from gross income in arriving at adjusted gross income. The requirements that must be satisfied in order that stock may be considered section 1244 stock are described in §§ 1.1244(c)-1 and 1.1244(c)-2. These requirements relate to the stock itself and the corporation issuing such stock. In addition, the taxpayer who claims an ordinary loss deduction pursuant to section 1244 must satisfy the requirements of paragraph (b) of this section.

(b) *Taxpayers entitled to ordinary loss.*—The allowance of an ordinary loss deduction for a loss on section 1244 stock is permitted only to the following two classes of taxpayers:

(1) An individual sustaining the loss to whom such stock was issued by a small business corporation, or

(2) An individual who is a partner in a partnership at the time the partnership acquired such stock in an issuance from a small business corporation and whose distributive share of partnership items reflects the loss sustained by the partnership.

In order to claim a deduction under section 1244 the individual, or the partnership, sustaining the loss, must have continuously held the stock from the date of issuance. A corporation, trust, or estate is not entitled to ordinary loss treatment under section 1244 regardless of how the stock was acquired. An individual who acquires stock from a shareholder by purchase, gift, devise, or in any other manner is not entitled to an ordinary loss under section 1244 with respect to such stock. Thus, ordinary loss treatment is not available to a partner to whom the stock is distributed by the partnership. Stock acquired through an investment banking firm, or other person, participating in the sale of an issue may qualify for ordinary loss treatment only if the stock is not first issued to such firm or person. Thus, for example, if the firm acts as a selling agent for the issuing corporation the stock may qualify. On the other hand, stock purchased by an investment firm and subsequently resold does not qualify as section 1244 stock in the hands of the person acquiring the stock from the firm.

(c) *Examples.*—The provisions of paragraph (b) of this section may be illustrated by the following examples:

Example (1). A and B, both individuals, and C, a trust, are equal partners in a partnership to which a small business corporation issues section 1244 stock. The partnership sells the stock at a loss. A's and B's distributive share of the loss may be treated as an ordinary loss pursuant to section 1244, but C's distributive share of the loss may not be so treated.

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Example (2). The facts are the same as in example (1) except that the section 1244 stock is distributed by the partnership to partner A and he subsequently sells the stock at a loss. Section 1244 is not applicable to the loss since A did not acquire the stock by issuance from the small business corporation.

§ 1.1244(b) STATUTORY PROVISIONS; LOSSES ON SMALL BUSINESS STOCK; MAXIMUM AMOUNT FOR ANY TAXABLE YEAR.

SEC. 1244. LOSSES ON SMALL BUSINESS STOCK. * * *

(b) MAXIMUM AMOUNT FOR ANY TAXABLE YEAR.—For any taxable year the aggregate amount treated by the taxpayer by reason of this section as a loss from the sale or exchange of an asset which is not a capital asset shall not exceed—

(1) $25,000, or

(2) $50,000, in the case of a husband and wife filing a joint return for such year under section 6013.

[Sec. 1244(b) as added by sec. 202(b), Small Business Tax Revision Act 1958 (72 Stat. 1676)]

§ 1.1244(b)-1 ANNUAL LIMITATION.—Subsection (b) of section 1244 imposes a limitation on the aggregate amount of loss which for any taxable year may be treated as an ordinary loss by a taxpayer by reason of that section. The aggregate amount which may be so treated shall not exceed $25,000, except that in the case of a husband and wife who file a joint return under section 6013 for the taxable year during which the loss is sustained, the limitation on the aggregate amount of loss for such taxable year is $50,000, even though the loss may have been sustained by only one of the spouses. Thus, if a married taxpayer sustains, in the same taxable year, a $50,000 loss on section 1244 stock in corporation X and an equal amount of loss on such stock in corporation Y, he is limited to $50,000 of ordinary loss. In the case of a partnership, the limitation shall be determined separately as to each partner. Any amount of loss in excess of the applicable limitation is to be treated as loss from the sale or exchange of a capital asset.

§ 1.1244(c) STATUTORY PROVISIONS; LOSSES ON SMALL BUSINESS STOCK; SECTION 1244 STOCK DEFINED.

SEC. 1244. LOSSES ON SMALL BUSINESS STOCK. * * *

(c) SECTION 1244 STOCK DEFINED.—

(1) IN GENERAL.—For purposes of this section, the term "section 1244 stock" means common stock in a domestic corporation if—

(A) Such corporation adopted a plan after June 30, 1958, to offer such stock for a period (ending not later than two years after the date such plan was adopted) specified in the plan,

(B) At the time such plan was adopted, such corporation was a small business corporation.

(C) At the time such plan was adopted, no portion of a prior offering was outstanding,

(D) Such stock was issued by such corporation, pursuant to such plan, for money or other property (other than stock and securities), and

(E) Such corporation, during the period of its 5 most recent taxable years ending before the date the loss on such stock is sustained (or if such corporation has not been in existence for 5 taxable years ending before such date, during the period of its taxable years ending before such date, or if such corporation has not been in existence for one taxable year ending before such date, during the period such corporation has been in existence before such date), derived more than 50 percent of its ag-

gregate gross receipts from sources other than royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this subparagraph only to the extent of gains therefrom); except that this subparagraph shall not apply with respect to any corporation if, for the period referred to, the amount of the deductions allowed by this chapter (other than by sections 172, 242, 243, 244, and 245) exceed the amount of gross income.

Such term does not include stock if issued (pursuant to the plan referred to in subparagraph (A)) after a subsequent offering of stock has been made by the corporation.

(2) SMALL BUSINESS CORPORATION DEFINED.—For purposes of this section, a corporation shall be treated as a small business corporation if at the time of the adoption of the plan—

(A) The sum of—

(i) The aggregate amount which may be offered under the plan, plus

(ii) The aggregate amount of money and other property (taken into account in an amount, as of the time received by the corporation, equal to the adjusted basis to the corporation of such property for determining gain, reduced by any liabilities to which the property was subject or which were assumed by the corporation at such time) received by the corporation after June 30, 1958, for stock, as a contribution to capital, and as paid-in surplus,

does not exceed $500,000; and

(B) The sum of—

(i) The aggregate amount which may be offered under the plan, plus

(ii) The equity capital of the corporation (determined on the date of the adoption of the plan),

does not exceed $1,000,000.

For purposes of subparagraph (B), the equity capital of a corporation is the sum of its money and other property (in an amount equal to the adjusted basis of such property for determining gain), less the amount of its indebtedness (other than indebtedness to shareholders).

[Sec. 1244(c) as added by sec. 202(b), Small Business Tax Revision Act 1958 (72 Stat. 1676)]

§ 1.1244(c)-1 SECTION 1244 STOCK DEFINED.—(a) *In general.*—In order that stock may qualify as section 1244 stock the requirements described in paragraphs (b) through (h) of this section must be satisfied. Except for the requirement in paragraph (g) of this section, the determination as to whether such requirements are met may be made at or before the time the stock is issued. The determination as to whether the requirement set forth in paragraph (g), relating to gross receipts of the corporation, has been satisfied may be made only at the time a loss is sustained on the stock. Therefore, at the time of issuance it cannot be said with certainty that the stock would qualify for the benefits of section 1244.

(b) *Common stock.*—Only common stock, either voting or nonvoting, in a domestic corporation may qualify as section 1244 stock. For purposes of section 1244, neither securities of the corporation convertible into common stock nor common stock convertible into other securities of the corporation shall be treated as common stock. For definition of domestic corporation see section 7701(a)(4) and the regulations thereunder.

(c) *Written plan.*—(1) The common stock must be issued pursuant to a written plan adopted by the corporation after June 30, 1958, to

offer only such stock during a period specified in the plan ending not later than two years after the date the plan is adopted. The two-year requirement referred to in the preceding sentence will be met if the period specified in the plan is based upon the date when, under the rules or regulations of a Government agency relating to the issuance of the stock, the stock may lawfully be sold, and it is clear that such period will end, and in fact it does end, within two years after the plan is adopted. The plan must specifically state, in terms of dollars, the maximum amount to be received by the corporation in consideration for the stock to be issued pursuant thereto. See § 1.1244(c)-2 for the limitation of the amount that may be received by the corporation under the plan. For purposes of section 1244, an increase in the basis of outstanding stock as a result of a contribution to capital is not an issuance of stock.

(2) To qualify, the stock must be issued during the period of the offer, which period must end not later than two years after the date the plan is adopted. Stock which is subscribed for during the period of the plan but not issued during such period cannot qualify as section 1244 stock. Stock issued on the exercise of a stock right, stock warrant, or stock option (which right, warrant, or option was not outstanding at the time the plan was adopted) will be treated as issued pursuant to a plan only if the right, warrant, or option is applicable solely to unissued stock offered under the plan and is exercised during the period of the plan.

(3) Stock subscribed for prior to the adoption of the plan, including stock subscribed for prior to the date the corporation comes into existence, may be considered issued pursuant to a plan adopted by the corporation if the stock is not in fact issued prior to the adoption of such plan.

(4) Stock issued for a payment which, alone or together with prior payments, exceeds the maximum amount that may be received under the plan, is not considered issued pursuant to the plan, and none of such stock can qualify as section 1244 stock. See example (2) in § 1.1244(c)-2(d).

(d) *Small business corporation.*—At the time the plan is adopted the corporation must be a "small business corporation". See § 1.1244(c)-2 for the definition of a small business corporation.

(e) *Prior offering.*—Stock will not qualify as section 1244 stock if at the time of the adoption of the plan under which it is issued there remains unissued any portion of a prior offering of stock. Thus, if any portion of an outstanding offering of common or preferred stock is unissued at the time of the adoption of the plan, stock issued under the plan will not qualify as section 1244 stock. An offer is outstanding unless and until it is withdrawn by affirmative action prior to the date the plan is adopted. Stock rights, stock warrants, stock options, or securities convertible into stock, which are outstanding at the time the plan is adopted, are deemed to be prior offerings. The authorization in the corporate charter to issue stock different from stock offered under the plan or in excess of stock offered under the plan of itself is not a prior offering.

(f) *Issued for money or other property.*—(1) The stock must be issued to the taxpayer for money or other property transferred by the taxpayer to the corporation. However, stock issued in exchange

for stock or securities, including stock or securities of the issuing corporation, cannot qualify as section 1244 stock, except as provided in § 1.1244(d)-3, relating to certain cases where stock is issued in exchange for section 1244 stock. Stock issued for services rendered or to be rendered to, or for the benefit of, the issuing corporation does not qualify as section 1244 stock. Stock issued in consideration for cancellation of indebtedness of the corporation shall be considered issued in exchange for money or other property unless such indebtedness is evidenced by a security, or arises out of the performance of personal services.

(2) The following examples illustrate situations where stock fails to qualify as section 1244 stock as a result of the rules in subparagraph (1) of this paragraph:

Example (i). A taxpayer owns stock of Corporation X issued to him prior to July 1, 1958. Under a plan adopted after June 30, 1958, he exchanges his stock for a new issuance of stock of Corporation X. The stock received by the taxpayer in the exchange may not qualify as section 1244 stock even if the corporation has adopted a valid plan and is a small business corporation.

Example (ii). A taxpayer owns stock in Corporation X. Corporation X merges into Corporation Y. In exchange for his stock, Corporation Y issues shares of its stock to the taxpayer. The stock in Corporation Y does not qualify as section 1244 stock even if the stock exchanged by the taxpayer did qualify.

Example (iii). Corporation X transfers part of its business assets to Corporation Y, a new corporation, and all of the stock of Corporation Y is issued directly to the shareholders of Corporation X. Since the Corporation Y stock was not issued to the shareholders for a transfer by them of money or other property, none of the Corporation Y stock in the hands of the shareholders can qualify.

(g) *Gross receipts.*—(1) (i) (*a*) Except as provided in subparagraph (2) of this paragraph, stock will not qualify under section 1244 if 50 percent or more of the gross receipts of the corporation, for the period consisting of the five most recent taxable years of the corporation ending before the date the loss on such stock is sustained by the shareholders, is derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities. If the corporation has not been in existence for five taxable years ending before such date, the percentage test referred to in the preceding sentence applies to the period of the taxable years ending before such date during which the corporation has been in existence; and if the loss is sustained during the first taxable year of the corporation such test applies to the period beginning with the first day of such taxable year and ending on the day before the loss is sustained. The test under this paragraph shall be made on the basis of total gross receipts, except that gross receipts from the sales or exchanges of stock or securities shall be taken into account only to the extent of gains therefrom. The term "gross receipts" as used in section 1244(c)(1)(E) is not synonymous with "gross income." Gross receipts means the total amount received or accrued under the method of accounting used by the corporation in computing its taxable income. Thus, the total amount of receipts is not reduced by returns and allowances, cost, or deductions. For example, gross receipts will include the total amount received or

accrued during the corporation's taxable year from the sale or exchange (including a sale or exchange to which section 337 applies) of any kind of property, from investments, and for services rendered by the corporation. However, gross receipts does not include amounts received in nontaxable sales or exchanges (other than those to which section 337 applies), except to the extent that gain is recognized by the corporation, nor does that term include amounts received as a loan, as a repayment of a loan, as a contribution to capital, or on the issuance by the corporation of its own stock.

(*b*) The meaning of the term "gross receipts" as used in section 1244(c)(1)(E) may be further illustrated by the following examples:

Example (1). A corporation on the accrual method sells property (other than stock or securities) and receives payment partly in money and partly in the form of a note payable at a future time. The amount of the money and the face amount of the note would be considered gross receipts in the taxable year of the sale and would not be reduced by the adjusted basis of the property, the costs of sale, or any other amount.

Example (2). A corporation has a long-term contract as defined in paragraph (a) of § 1.451–3 with respect to which it reports income according to the percentage-of-completion method as described in paragraph (b)(1) of § 1.451–3. The portion of the gross contract price which corresponds to the percentage of the entire contract which has been completed during the taxable year shall be included in gross receipts for such year.

Example (3). A corporation which regularly sells personal property on the installment plan elects to report its taxable income from the sale of property (other than stock or securities) on the installment method in accordance with section 453. The installment payments actually received in a given taxable year of the corporation shall be included in gross receipts for such year.

(ii) The term "royalties" as used in subdivision (i) of this subparagraph means all royalties, including mineral, oil, and gas royalties (whether or not the aggregate amount of such royalties constitutes 50 percent or more of the gross income of the corporation for the taxable year), and amounts received for the privilege of using patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property. The term "royalties" does not include amounts received upon the disposal of timber or coal with a retained economic interest with respect to which the special rules of section 631 (b) and (c) apply or amounts received from the transfer of patent rights to which section 1235 applies. For the definition of "mineral, oil, or gas royalties", see paragraph (b)(11)(ii) and (iii) of § 1.543–1. For purposes of this subdivision, the gross amount of royalties shall not be reduced by any part of the cost of the rights under which they are received or by any amount allowable as a deduction in computing taxable income.

(iii) The term "rents" as used in subdivision (i) of this subparagraph means amounts received for the use of, or right to use, property (whether real or personal) of the corporation, whether or not such amounts constitute 50 percent or more of the gross income of the corporation for the taxable year. The term "rents" does not include payments for the use or occupancy of rooms or other space

where significant services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist homes, motor courts, or motels. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such services; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, the collection of trash, etc., are not considered as services rendered to the occupant. Payments for the use or occupancy of entire private residences or living quarters in duplex or multiple housing units, of offices in an office building, etc., are generally "rents" under section 1244(c)(1)(E). Payments for the parking of automobiles ordinarily do not constitute rents. Payments for the warehousing of goods or for the use of personal property do not constitute rents if significant services are rendered in connection with such payments.

(iv) The term "dividends" as used in subdivision (i) of this subparagraph includes dividends as defined in section 316, amounts required to be included in gross income under section 551 (relating to foreign personal holding company income taxed to United States shareholders), and consent dividends determined as provided in section 565.

(v) The term "interest" as used in subdivision (i) of this subparagraph means any amounts received for the use of money (including tax-exempt interest).

(vi) The term "annuities" as used in subdivision (i) of this subparagraph means the entire amount received as an annuity under an annuity, endowment, or life insurance contract, regardless of whether only part of such amount would be includible in gross income under section 72.

(vii) For purposes of subdivision (i) of this subparagraph, gross receipts from the sales or exchanges of stock or securities are taken into account only to the extent of gains therefrom. Thus, the gross receipts from the sale of a particular share of stock will be the excess of the amount realized over the adjusted basis of such share. If the adjusted basis should equal or exceed the amount realized on the sale or exchange of a cetain share of stock, bond, etc., there would be no gross receipts resulting from the sale of such security. Losses on sales or exchanges of stock or securities do not offset gains on the sales or exchanges of other stock or securities for purposes of computing gross receipts from such sales or exchanges. Gross receipts from the sale or exchange of stocks and securities include gains received from such sales or exchanges by a corporation even though such corporation is a regular dealer in stocks and securities. For the meaning of the term "stocks or securities", see paragraph (b)(5)(i) of § 1.543–1.

(2) [Reserved]

(3) In applying subparagraphs (1) and (2) of this paragraph to a successor corporation in a reorganization described in section 368(a)(1)(F), such corporation shall be treated as the same corporation as its predecessor. See paragraph (d)(2) of § 1.1244(d)–3.

(h) *Subsequent offering.*—(1) Even though the plan satisfies the requirements of paragraph (c) of this section, if another offering of stock is made by the corporation subsequent to, or simultaneous with, the adoption of the plan, stock issued pursuant to the plan after such other offering shall not qualify as section 1244 stock. The issuance of stock options, stock rights, or stock warrants, at any time during the period of the plan, which are exercisable with respect to stock other than stock offered under the plan, shall be considered a subsequent offering. Likewise, the issuance of stock other than that offered under the plan shall be considered a subsequent offering. Since stock issued upon exercise of a conversion privilege is stock issued for a security, and stock issued pursuant to a stock option granted in whole or in part for services is not issued for money or other property, the issuance of securities with a conversion privilege and the issuance of such a stock option are subsequent offerings, because the conversion privilege and the stock option are exercisable with respect to stock other than that which may properly be offered under the plan. Stock issued under the plan before a subsequent offering is not disqualified by reason of such subsequent offering. The rule of this paragraph, together with the rule of paragraph (e) of this section, relating to offers prior to the adoption of the plan, limits section 1244 stock to stock issued by the corporation during a period when any stock issued by it must have been issued pursuant to the plan.

(2) Any modification of a plan that changes the offering to include preferred stock, or that increases the amount of stock that may be issued thereunder to such an extent that the requirements of section 1244(c)(1)(B) would not have been satisfied if determined with reference to such amount as of the date such plan was initially adopted, or that extends the period of time during which stock may be issued thereunder to more than two years from the date such plan was initially adopted, shall be considered a subsequent offering, and no stock issued thereafter may qualify. However, a corporation may withdraw a plan and adopt a new plan to issue stock. To determine whether stock issued pursuant to such new plan may qualify, section 1244(c) must be applied with respect to the new plan as of the date of its adoption. For example, amounts received for stock under the prior plan must be taken into account in determining whether the requirements of section 1244(c)(2), relating to definition of small business corporation, are satisfied. In applying the requirements of section 1244(c)(2)(B), reference should be made to equity capital as of the date the new plan is adopted. The same principles apply if the period of the initial plan expires and the corporation adopts a new plan.

§ 1.1244(c)-2 Small Business Corporation Defined.—(a) *In general.*—To be treated as a small business corporation, the corporation which intends to issue the stock pursuant to a plan described in paragraph (c) of § 1.1244(c)-1 must be a domestic corporation and must, at the time the plan is adopted, meet certain requirements. These requirements are described in paragraphs (b) and (c) of this section. Since the requirements must be satisfied only at the time the plan to issue stock is adopted, it is possible that a loss on stock may be treated as an ordinary loss under section 1244 even though the corporation could not qualify as a small business corporation at the time such stock was issued or at the time the loss was sustained.

(b) *Amount received by corporation for stock.*—(1) At the time of the adoption of the plan the sum of the aggregate dollar amount to be paid for stock which may be offered under the plan plus the aggregate amount of money and other property which has been received by the corporation after June 30, 1958, for its stock, as a contribution to capital by its shareholders, and as paid-in surplus must not exceed $500,000. In making these determinations (i) property is taken into account at its adjusted basis to the corporation (for determining gain) as of the date received by the corporation, and (ii) such aggregate amount is reduced by the amount of any liability to which the property was subject and by the amount of any liabilities which were assumed by the corporation at such time.

(2) For purposes of the $500,000 test referred to in subparagraph (1) of this paragraph, the total amount of money and other property received for stock, as a contribution to capital, and as paid-in surplus shall not be reduced by distributions to shareholders, even though such distributions are capital distributions. Thus, once the total of such amount received after June 30, 1958, reaches $500,000, the corporation is precluded from subsequently adopting a plan under which section 1244 stock may be issued.

(c) *Equity capital.*—The sum of the aggregate dollar amount to be paid for stock which may be offered under the plan plus the equity capital of the corporation (determined on the date of the adoption of the plan) may not exceed $1,000,000. For this purpose, equity capital is the sum of its money and other property (in an amount equal to its adjusted basis for determining gain) less the amount of the corporation's indebtedness to persons other than its shareholders.

(d) *Examples.*—The provisions of this section may be illustrated by the following examples:

Example (1). Corporation W comes into existence on December 1, 1958. On that date the corporation may adopt a plan to issue common stock for an amount (determined under paragraph (b) of this section) not in excess of $500,000 during a period ending not later than November 30, 1960. Such corporation will qualify as a small business corporation as of the date that the plan is adopted. However, if the corporation adopts a plan to issue stock for an amount in excess of $500,000 it is not a small business corporation at the time the plan is adopted and no stock issued under the plan may qualify as section 1244 stock. If the cost of organizing Corporation W amounted to $1,000 and constituted paid-in surplus or a contribution to capital, such amount must be taken into account in determining the amount that may be received under the plan, with the result that only $499,000 may be so received.

Example (2). On December 1, 1958, Corporation X, a newly formed corporation, adopts a plan to issue common stock for an amount (determined under paragraph (b) of this section) not in excess of $500,000 during a period ending not later than November 30, 1960. By January 1, 1960, the corporation has, pursuant to the plan, issued at par, stock having an aggregate par value of $400,000, $200,000 of which was issued for $200,000 cash, and $200,000 of which was issued for property (other than stock or securities) having a basis to the corporation of $100,000 and a fair market value of $200,000. The corporation may, prior to November 30, 1960, issue stock for an amount

not in excess of $200,000 cash or property having a basis to it not in excess of $200,000. Stock issued for any payment which, alone or together with any payments received after January 1, 1960, exceeds such $200,000 amount would not qualify as section 1244 stock because it would not be issued pursuant to the plan.

Example (3). Assume that on December 1, 1958, Corporation Y, a newly formed corporation, adopts a plan to issue common stock for an amount (determined under paragraph (b) of this section) not in excess of $500,000 during a period ending not later than November 30, 1960. By January 1960 the corporation has received $400,000 cash for stock issued pursuant to the plan, but due to business successes the equity capital of the corporation exceeds $1,000,000. Since the equity capital test is made as of the date that the plan is adopted, the corporation may still, prior to November 30, 1960, issue section 1244 stock pursuant to the plan until the full amount specified in the plan has been received.

Example (4). Subsequent to June 30, 1958, Corporation Z receives a total of $600,000 cash on the issuance of its stock. In 1960 Corporation Z redeems shares of its stock for the total amount of $300,000 and the redemptions reduce Corporation Z's capital to substantially less than $500,000. Notwithstanding the redemptions, stock subsequently issued by Corporation Z will not qualify as section 1244 stock because the $500,000 limitation of section 1244(c)(2)(A) has been previously exceeded.

§ 1.1244(d) STATUTORY PROVISIONS; LOSSES ON SMALL BUSINESS STOCK; SPECIAL RULES.

SEC. 1244. LOSSES ON SMALL BUSINESS STOCK. * * *

(d) SPECIAL RULES.—

(1) LIMITATION ON AMOUNT OF ORDINARY LOSS.—

(A) CONTRIBUTIONS OF PROPERTY HAVING BASIS IN EXCESS OF VALUE.—If—

(i) Section 1244 stock was issued in exchange for property,

(ii) The basis of such stock in the hands of the taxpayer is determined by reference to the basis in his hands of such property, and

(iii) The adjusted basis (for determining loss) of such property immediately before the exchange exceeded its fair market value at such time,

then in computing the amount of the loss on such stock for purposes of this section the basis of such stock shall be reduced by an amount equal to the excess described in clause (iii).

(B) INCREASES IN BASIS.—In computing the amount of the loss on stock for purposes of this section, any increase in the basis of such stock (through contributions to the capital of the corporation, or otherwise) shall be treated as allocable to stock which is not section 1244 stock.

(2) RECAPITALIZATIONS, CHANGES IN NAME, ETC.—To the extent provided in regulations prescribed by the Secretary or his delegate, common stock in a corporation, as basis of which (in the hands of a taxpayer) is determined in whole or in part by reference to the basis in his hands of stock in such corporation which meets the requirements of subsection (c)(1) (other than subparagraph (E) thereof), or which is received in a reorganization described in section 368(a)(1)(F) in exchange for stock which meets such requirements, shall be treated as meeting such requirements. For purposes of paragraphs (1)(E) and (2)(A) of subsection (c), a successor corporation in a reorganization described in section 368(a)(1)(F) shall be treated as the same corporation as its predecessor.

(3) RELATIONSHIP TO NET OPERATING LOSS DEDUCTION.—For purposes of section 172 (relating to the net operating loss deduction), any amount of loss treated by reason of this section as a loss from the sale or exchange of an asset which is not a capital asset shall be treated as attributable to a trade or business of the taxpayer.

(4) INDIVIDUAL DEFINED.—For purposes of this section, the term "individual" does not include a trust or estate.

[Sec. 1244(d) as added by sec. 202(b), Small Business Tax Revision Act 1958 (72 Stat. 1676)]

§ 1.1244(d)-1 CONTRIBUTIONS OF PROPERTY HAVING BASIS IN EXCESS OF VALUE.—(a) *In general.*—(1) Section 1244(d)(1)(A) provides a special rule which limits the amount of loss on section 1244 stock that may be treated as an ordinary loss. This rule applies only when section 1244 stock is issued by a corporation in exchange for property that, immediately before the exchange, has an adjusted basis (for determining loss) in excess of its fair market value. If section 1244 stock is issued in exchange for such property and the basis of such stock in the hands of the taxpayer is determined by reference to the basis of such property, then for purposes of section 1244, the basis of such stock shall be reduced by an amount equal to the excess, at the time of the exchange, of the adjusted basis of the property over its fair market value.

(2) The provisions of section 1244(d)(1)(A) do not affect the basis of stock for purposes other than section 1244. Such provisions are to be used only in determining the portion of the total loss sustained that may be treated as an ordinary loss pursuant to section 1244.

(b) *Transfer of more than one item.*—If a taxpayer exchanges several items of property for stock in a single transaction so that the basis of the property transferred is allocated evenly among the shares of stock received, the computation under this section should be made by reference to the aggregate fair market value and the aggregate basis of the property transferred.

(c) *Examples.*—The provisions of this section may be illustrated by the following examples:

Example (1). B transfers property with an adjusted basis of $1,000 and a fair market value of $250 to a corporation for 10 shares of section 1244 stock in an exchange that qualifies under section 351. The basis of B's stock is $1,000 ($100 per share), but, solely for purposes of section 1244, the total basis of the stock must be reduced by $750, the excess of the adjusted basis of the property exchanged over its fair market value. Thus, the basis of such stock for purposes of section 1244 is $250 and the basis of each share for such purposes is $25. If B sells his 10 shares for $250, he will recognize a loss of $750, all of which must be treated as a capital loss. If he sells the 10 shares for $200, then $50 of his total loss of $800 will be treated as an ordinary loss under section 1244, assuming the various requirements of such section are satisfied, and the remaining $750 will be a capital loss.

Example (2). B owns property with a basis of $20,000. The fair market value of the property unencumbered is $15,000 but the property is subject to a $2,000 mortgage. B transfers the encumbered property to a corporation for 100 shares of section 1244 stock in an exchange that qualifies under section 351. The basis of the shares, determined in accordance with section 358, is $18,000 or $180 per share, but solely for purposes of section 1244 the basis is $13,000

($130 per share), which is its basis for purposes other than section 1244, reduced by $5,000, the excess of the adjusted basis, immediately before the exchange, of the property transferred over its fair market value.

Example (3). C transfers business assets to a corporation for 100 shares of section 1244 stock in an exchange that qualifies under section 351. The assets transferred are as follows:

	Basis	*Fair market value*
Cash	$10,000	$10,000
Inventory	15,000	30,000
Depreciable property	50,000	20,000
Land	25,000	10,000
	100,000	70,000

The basis for the shares received by C is $100,000, which is applied $1,000 to each share. However, the basis of the shares for purposes of section 1244 is $70,000 ($700 per share), the basis for general purposes reduced by $30,000, the excess of the aggregate adjusted basis of the property transferred over the aggregate fair market value of such property.

§ 1.1244(d)-2 INCREASES IN BASIS OF SECTION 1244 STOCK.—(a) *In general.*—If subsequent to the time of its issuance there is for any reason, including the operation of section 1376(a), an increase in the basis of section 1244 stock, such increase shall be treated as allocable to stock which is not section 1244 stock. Therefore, a loss on stock, the basis of which has been increased subsequent to its issuance, must be apportioned between the part that qualifies as section 1244 stock and the part that does not so qualify. Only the loss apportioned to the part that so qualifies may be treated as an ordinary loss pursuant to section 1244. The amount of loss apportioned to the part that qualifies is the amount which bears the same ratio to the total loss as the basis of the stock which is treated as allocated to section 1244 stock bears to the total basis of the stock.

(b) *Example.*—The provisions of paragraph (a) of this section may be illustrated by the following example:

Example. For $10,000 a corporation issues 100 shares of section 1244 stock to X. X later contributes $2,000 to the capital of the corporation and this increases the total basis of his 100 shares to $12,000. Subsequently, he sells the 100 shares for $9,000. Of the $3,000 loss, $2,500 is allocated to the portion of the stock that qualifies as section 1244 stock $\left(\frac{\$10,000}{\$12,000} \text{ of } \$3,000\right)$, and the remaining $500 is allocated to the portion of the stock that does not so qualify. Therefore, to the extent of $2,500, the loss may be treated as an ordinary loss assuming the various requirements of section 1244 stock are satisfied. However, the remaining $500 loss must be treated as a capital loss.

§ 1.1244(d)-3 STOCK DIVIDENDS, RECAPITALIZATION, CHANGES IN NAME, ETC.—(a) *In general.*—Section 1244(c)(1) provides that stock may not qualify for the benefits of section 1244 unless it is issued to the taxpayer for money or other property not including stock or

securities. However, section 1244(d)(2) authorizes exceptions to this rule. The exceptions may apply in three situations: (1) The receipt of a stock dividend; (2) the exchange of stock for stock pursuant to a reorganization described in section 368(a)(1)(E); and (3) the exchange of stock for stock pursuant to a reorganization described in section 368(a)(1)(F).

(b) *Stock dividends.*—(1) If common stock is received by an individual or partnership in a nontaxable distribution under section 305(a) made solely with respect to stock owned by such individual or partnership which meets the requirements of section 1244 stock determinable at the time of the distribution, then the common stock so received will also be treated as meeting such requirements. For purposes of this paragraph and paragraphs (c) and (d) of this section, the requirements of section 1244 stock determinable at the time of the distribution or exchange are all of the requirements of section 1244(c)(1) other than the one described in subparagraph (E) thereof, relating to the gross receipts test.

(2) If, however, such stock dividend is received by such individual or partnership partly with respect to stock meeting the requirements of section 1244 stock determinable at the time of the distribution, and partly with respect to stock not meeting such requirements, then only part of the stock received as a stock dividend will be treated as meeting such requirements. Assuming all the shares with respect to which the dividend is received have equal rights to dividends, such part is the number of shares which bears the same ratio to the total number of shares received as the number of shares owned immediately before the stock dividend which meets such qualifications bears to the total number of shares with respect to which the stock dividend is received. In determining the basis of shares received in the stock dividend and of the shares held before the stock dividend, section 307 shall apply as if two separate nontaxable stock dividends were made, one with respect to the shares that meet the requirements and the other with respect to shares that do not meet the requirements.

(3) The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example (i). Corporation X issues 100 shares of its common stock to B for $1,000. Subsequently, in a nontaxable stock dividend B receives 5 more shares of common stock of Corporation X. If the 100 shares meet all the requirements of section 1244 stock determinable at the time of the distribution of the stock dividend, the 5 additional shares shall also be treated as meeting such requirements.

Example (ii). In 1959, Corporation Y issues 100 shares of its common stock to C for $1,000 and these shares meet the requirements of section 1244 stock determinable at the time of the issuance. In 1960, C purchases an additional 200 shares of such stock from another shareholder for $3,000; however, these shares do not meet the requirements of section 1244 stock because they were not originally issued to C by the corporation. In 1961, C receives 15 shares of Corporation Y common stock as a stock dividend. Of the shares received, 5 shares, the number received with respect to the 100 shares of stock which met the requirements of section 1244 at the time of the distribution, i.e., $\frac{100}{300} \times 15$, shall also be treated as meeting such requirements. The

remaining 10 shares do not meet such requirements as they are not received with respect to section 1244 stock. The basis of such 5 shares is determined by applying section 307 as if the 5 shares were received as a separate stock dividend made solely with respect to shares that meet the requirements of section 1244 stock at the time of the distribution. Thus, the basis of the 5 shares is $\$47.61 \left(\frac{5}{105} \text{ of } \$1,000 \right)$.

(c) *Recapitalizations.*—(1) If, pursuant to a recapitalization described in section 368(a)(1)(E), common stock of a corporation is received by an individual or partnership in exchange for stock of such corporation meeting the requirements of section 1244 stock determinable at the time of the exchange, such common stock shall be treated as meeting such requirements.

(2) If common stock is received pursuant to such a recapitalization partly in exchange for stock meeting the requirements of section 1244 stock determinable at the time of the exchange and partly in exchange for stock not meeting such requirements, then only part of such common stock will be treated as meeting such requirements. Such part is the number of shares which bears the same ratio to the total number of shares of common stock so received as the basis of the shares transferred which meet such requirements bears to the basis of all the shares transferred for such common stock. The basis allocable, pursuant to section 358, to the common stock which is treated as meeting such requirements is limited to the basis of stock that meets such requirements transferred in the exchange.

(3) The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example (i). A owns 500 shares of voting common stock of Corporation X. Corporation X revises its capital structure to provide for two classes of common stock: Class A voting and Class B nonvoting. In a recapitalization described in subparagraph (E) of section 368(a)(1), A exchanges his 500 shares for 750 shares of Class B nonvoting stock. If the 500 shares meet all the requirements of section 1244 stock determinable at the time of the exchange, the 750 shares received in the exchange are treated as meeting such requirements.

Example (ii). B owns 500 shares of common stock of Corporation X with a basis of $5,000, and 100 shares of preferred stock of that corporation with a basis of $2,500. Pursuant to a recapitalization described in section 368(a)(1)(E), B exchanges all of his shares for 900 shares of common stock of Corporation X. The 500 common shares meet the requirements of section 1244 stock determinable at the time of the exchange, but the 100 preferred shares do not meet such requirements since only common stock may qualify. Of the 900 common shares received, 600 shares $\left(\frac{\$5,000}{\$7,500} \times 900 \text{ shares} \right)$ are treated as meeting the requirements of section 1244 stock at the time of the exchange, because they are deemed to be received in exchange for the 500 common shares which met such requirements. The remaining 300 shares do not meet such requirements as they are not deemed to be received in exchange for section 1244 stock. The basis of the 600

shares is $5,000, the basis of the relinquished shares meeting the requirements of section 1244.

(d) *Change of name, etc.*—(1) If, pursuant to a reorganization described in section 368(a)(1)(F), common stock of a successor corporation is received by an individual or partnership in exchange for stock of the predecessor corporation meeting the requirements of section 1244 stock determinable at the time of the exchange, such common stock shall be treated as meeting such requirements. If common stock is received pursuant to such a reorganization partly in exchange for stock meeting the requirements of section 1244 stock determinable at the time of the exchange and partly in exchange for stock not meeting such requirements, the principles of paragraph (c)(2) of this section apply in determining the number of shares received which are treated as meeting the requirements of section 1244 stock and the basis of those shares.

(2) For purposes of paragraphs (1)(E) and (2)(A) of section 1244(c), a successor corporation in a reorganization described in section 368(a)(1)(F) shall be treated as the same corporation as its predecessor.

§ 1.1244(d)-4 NET OPERATING LOSS DEDUCTION.—For purposes of section 172, relating to the net operating loss deduction, any amount of loss which is treated as an ordinary loss under section 1244 (taking into account the annual dollar limitation of that section) shall be treated as attributable to the trade or business of the taxpayer. Therefore, such loss is allowable in determining the taxpayer's net operating loss for a taxable year and is not subject to the application of section 172(d)(4), relating to nonbusiness deductions.

§ 1.1244(e) STATUTORY PROVISIONS; LOSSES ON SMALL BUSINESS STOCK; REGULATIONS.

SEC. 1244. LOSSES ON SMALL BUSINESS STOCK. * * *

(e) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section.

[Sec. 1244(e) as added by sec. 202(b), Small Business Tax Revision Act 1958 (72 Stat. 1676)]

§ 1.1244(e)-1 RECORDS TO BE KEPT AND INFORMATION TO BE FILED WITH THE RETURN.—(a) *By the corporation.*—The plan to issue stock which qualifies under section 1244 must appear upon the records of the corporation. In addition, in order to substantiate an ordinary loss deduction claimed by its shareholders, the corporation should maintain records showing the following:

(1) The persons to whom stock was issued pursuant to the plan, the date of issuance to each, and a description of the amount and type of consideration received from each;

(2) If the consideration received is property, the basis in the hands of the shareholder and the fair market value of such property when received by the corporation;

(3) Which certificates represent stock issued pursuant to the plan;

(4) The amount of money and the basis in the hands of the corporation of other property received after June 30, 1958, and before the

adoption of the plan for its stock, as a contribution to capital, and as paid-in surplus;

(5) The equity capital of the corporation on the date of adoption of the plan; and

(6) Information relating to any tax-free stock dividend made with respect to stock issued pursuant to the plan and any reorganization in which stock is transferred by the corporation in exchange for stock issued pursuant to the plan.

(b) *By the taxpayer.*—Any person who claims a deduction for an ordinary loss on stock under section 1244 shall file with his income tax return for the year in which a deduction for the loss is claimed a statement setting forth:

(1) The address of the corporation that issued the stock;

(2) The manner in which the stock was acquired by such person and the nature and amount of the consideration paid; and

(3) If the stock was acquired in a nontaxable transaction in exchange for property other than money—the type of property, its fair market value on the date of transfer to the corporation, and its adjusted basis on such date.

In addition, a person who owns section 1244 stock in a corporation shall maintain records sufficient to distinguish such stock from any other stock he may own in the corporation.

DANA LATHAM,
Commissioner of Internal Revenue.

Approved October 4, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 7, 1960, 8:48 a.m., and published in the issue of the Federal Register for October 8, 1960, 25 F.R. 9675)

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26 CFR 1.1244(c)-1: Section 1244 stock defined. T.D. 6508 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Section 1.1244(c)-1(g)(2) of the regulations under the Internal Revenue Code of 1954.

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

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

On October 8, 1960, a notice of proposed rulemaking regarding regulations under section 1244 (relating to losses on small business stock) of the Internal Revenue Code of 1954, as added by section 202 (b) of the Small Business Tax Revision Act of 1958 (72 Stat. 1676), was published in the Federal Register (25 F.R. 9682). No objection to the rules proposed having been received during the 30-day period prescribed in the notice, the regulations as so published are hereby adopted.

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[1] 25 F.R. 12345.

§ 1.1244(c)-1 SECTION 1244 STOCK DEFINED.

* * * * * * *

(g) *Gross receipts.* * * *

(2) The requirement of subparagraph (1) of this paragraph need not be satisfied if for the applicable period the aggregate amount of deductions allowed to the corporation exceeds the aggregate amount of its gross income. But for this purpose the deductions allowed by section 172, relating to the net operating loss deduction, and by sections 242, 243, 244, and 245, relating to certain special deductions for corporations, shall not be taken into account. Notwithstanding the provisions of this subparagraph and of subparagraph (1) of this paragraph, pursuant to the specific delegation of authority granted in section 1244(e) to prescribe such regulations as may be necessary to carry out the purposes of section 1244, ordinary loss treatment will not be available with respect to stock of a corporation which is not largely an operating company within the five most recent taxable years (or such lesser period as the corporation is in existence) ending before the date of the loss. Thus, for example, assume that a person who is not a dealer in real estate forms a corporation which issues stock to him which meets all the formal requirements of section 1244 stock. The corporation then acquires a piece of unimproved real estate which it holds as an investment. The property declines in value and the stockholder sells his stock at a loss. The loss does not qualify for ordinary loss treatment under section 1244 but must be treated as a capital loss.

(This Treasury Decision is issued under the authority contained in sections 1244(e) and 7805 of the Internal Revenue Code of 1954 (72 Stat. 1678; 26 U.S.C. 1244(e); 68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 29, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 1, 1960, 8:49 a.m., and published in the issue of the Federal Register for December 2, 1960, 25 F.R. 12345)

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

PART II.—MITIGATION OF EFFECT OF LIMITATIONS AND OTHER PROVISIONS

SECTION 1313.—DEFINITIONS

26 CFR 1.1313(a)-3: Final disposition of a claim for refund.

Comparison of the use of the term "determination" with its use in section 547 of the Code. See Rev. Rul. 60-287, page 188.

SUBCHAPTER R.—ELECTION OF CERTAIN PARTNERSHIPS AND PROPRIETORSHIPS AS TO TAXABLE STATUS

SECTION 1361.—UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS

26 CFR 1.1361: Statutory provisions; unincorporated business enterprises electing to be taxed as domestic corporations.

T. D. 6496 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under section 1361 of the Internal Revenue Code of 1954 and under section 63 of the Technical Amendments Act of 1958.

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

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

On April 8, 1959, notice of proposed rulemaking regarding the regulations under section 1361 of the Internal Revenue Code of 1954 and section 63 of the Technical Amendments Act of 1958 [72 Stat. 1649] [P.L. 85–866, C.B. 1958–3, 254] was published in the Federal Register (24 F.R. 2681). After careful consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. Such regulations supersede paragraph 23 of Treasury Decision 6118 (19 F.R. 9896), approved December 30, 1954 [C.B. 1955–1, 698], as amended by Treasury Decision 6124 (20 F.R. 1204), approved February 24, 1955 [C.B. 1955–1, 719], and also supersede Treasury Decision 6332 (23 F.R. 8606), approved October 30, 1958 [C.B. 1958–2, 1108]. (In addition, paragraphs 20 and 21 of Treasury Decision 6118 were superseded, respectively, by Treasury Decision 6296 (23 F.R. 4529), approved June 16, 1958 [C.B. 1958–2, 432], and Treasury Decision 6364 (24 F.R. 1178), approved February 12, 1959 [C.B. 1959–1, 546].)

Except as specifically provided otherwise, the regulations hereby prescribed are applicable for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

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[1] The publication of this Treasury Decision in 25 F.R. 9723, dated October 11, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 24 F.R. 2681, dated April 8, 1959, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

Section
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1.1361–15 Revocation of election and tolling of statute of limitations.

AUTHORITY: §§ 1.1361 to 1.1361–15, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

§ 1.1361 STATUTORY PROVISIONS; UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS.

SEC. 1361. UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS.

(a) GENERAL RULE.—Subject to the qualifications in subsection (b), an election may be made, in accordance with regulations prescribed by the Secretary or his delegate, not later than 60 days after the close of any taxable year of a proprietorship or partnership owning an unincorporated business enterprise, by the proprietor or all the partners, owning an interest in such enterprise at any time on or after the first day of the first taxable year to which the election applies or of the year described in subsection (f), to be subject to the taxes described in subsection (h) as a domestic corporation for such year and subsequent years.

(b) QUALIFICATIONS.—The election described in subsection (a) may not be made with respect to an unincorporated business enterprise unless at all times during the period on or after the first day of the first taxable year to which the election applies or of the year described in subsection (f), as the case may be, and on or before the date of election—

(1) Such enterprise is owned by an individual, or by a partnership consisting of not more than 50 individual members;

(2) No proprietor or partner having more than a 10 percent interest in profits or capital of such enterprise is a proprietor or a partner having more than a 10 percent interest in profits or capital of any other unincorporated business enterprise taxable as a domestic corporation;

(3) No proprietor or partner of such enterprise is a nonresident alien or a foreign partnership; and

(4) Such enterprise is one in which capital is a material income producing factor, or 50 percent or more of the gross income of such enterprise consists of gains, profits, or income derived from trading as a principal or from buying and selling real property, stock, securities, or commodities for the account of others.

(c) CORPORATE PROVISIONS APPLICABLE.—Under regulations prescribed by the Secretary or his delegate, an unincorporated business enterprise as to which an election has been made under subsection (a), shall, except as provided in subsection (m), be considered a corporation for purposes of this subtitle, except chapter 2 thereof, with respect to operation, distributions, sale of an interest, and any other purpose; and each owner of an interest in such enterprise shall be considered a shareholder thereof in proportion to his interest.

(d) LIMITATION.—A partner or proprietor of an unincorporated business enterprise as to which an election has been made under subsection (a) shall not be considered an employee for purposes of section 401(a) (relating to employees' pension trusts, etc.).

(e) ELECTION IRREVOCABLE.—Except as provided in subsection (f), the election described in subsection (a) shall be irrevocable—

(1) With respect to an enterprise as to which such election has been made and the proprietor or partners of such enterprise; and

(2) Any unincorporated successor to the business of such enterprise and the proprietor or partners of such successor.

(f) CHANGE OF OWNERSHIP.—In any year in which the electing proprietor or partners have an interest of 80 percent or less in profits and capital of an enterprise described in subsection (e), such enterprise shall not be considered a domestic corporation for such year or for subsequent years unless the proprietor or partners of such enterprise make a new election in accordance with subsection (a).

(g) CONSTRUCTIVE OWNERSHIP.—For purposes of subsection (f), the ownership of an interest shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) thereof.

(h) IMPOSITION OF TAXES.—The unincorporated business enterprise as to which an election has been made under subsection (a) shall be subject to—

(1) The normal tax and surtax imposed by section 11,

(2) The accumulated earnings tax imposed by section 531, and

(3) The alternative tax for capital gains imposed by section 1201.

(i) PERSONAL HOLDING COMPANY INCOME.—

(1) EXCLUDED FROM INCOME OF ENTERPRISE.—There shall not be included in the gross income of the enterprise as to which an election has been made under subsection (a) any personal holding company income (as defined in section 543), except income earned by such enterprise from buying and selling real property, stock, securities, or commodities for the account of others.

(2) INCOME AND DEDUCTIONS OF OWNERS.—Any personal holding company income not included in the gross income of the enterprise under paragraph (1), and the expenses attributable thereto, shall be treated as the income and deductions of the proprietor or partners (in accordance with their distributive shares of partnership income) of such enterprise.

(3) DISTRIBUTIONS.—If the amount of personal holding company income includible under paragraph (2) in the income of the proprietor or partner is distributed to him during the year earned, such amount shall not be taxed as a corporate distribution. The amount of such income not distributed during such year shall be considered as paid-in surplus or as a contribution to capital as of the close of such year.

(4) RENTS AND ROYALTIES.—For the purpose of determining whether rents, and mineral, oil, or gas royalties constitute personal holding company income under paragraph (1), all income earned by the enterprise in any taxable year shall enter into the determination of its gross income for such year.

(j) COMPUTATION OF TAXABLE INCOME.—In computing the taxable income of an unincorporated business enterprise as to which an election has been made under subsection (a)—

(1) A reasonable deduction shall be allowed for salary or compensation to a proprietor or partner for services actually rendered; and

(2) There shall be allowed as deductions only such items properly allocable to the operation of the business of such enterprise, except deductions allocable to the proprietor or partners under subsection (i)(2).

(k) DISTRIBUTIONS OTHER THAN IN LIQUIDATION.—Except as provided in subsection (l), a distribution with respect to a proprietorship or partnership interest by an enterprise as to which an election has been made under subsection (a), other than a distribution of personal holding company income under subsection (i)(3), shall be treated as a corporate distribution in accordance with part I of subchapter C of this chapter.

(l) DISTRIBUTIONS IN LIQUIDATION.—A distribution in partial or complete liquidation with respect to a proprietorship or partnership interest by an enterprise as to which an election has been made under subsection (a), shall be treated as a corporate liquidation in accordance with part II of subchapter C of this chapter.

(m) ORGANIZATIONS AND REORGANIZATION.—An enterprise as to which an election has been made under subsection (a) shall not be considered

a corporation, nor shall the proprietor or partners of such enterprise be considered shareholders, for purposes of parts III and IV of subchapter C of this chapter (relating to corporate organizations, and reorganizations, and insolvency reorganizations) except in the case of—

(1) A contribution of property, constituting either paid-in surplus or a contribution to capital, on which gain or loss is recognized; and

(2) The organization of an enterprise as to which the election described in subsection (a) is made for its first taxable year.

§ 1.1361–1 UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS.—(a) *General rule.*—(1) Section 1361 provides that, if certain qualifications are met, the proprietor or the partners of an unincorporated enterprise engaged in the operation of a trade or business may elect to have the enterprise treated as a domestic corporation subject to (i) the normal tax and surtax imposed by section 11, (ii) the accumulated earnings tax imposed by section 531, and (iii) the alternative tax for capital gains imposed by section 1201(a). An election made under section 1361 shall apply to the taxable year for which made and to all subsequent taxable years. Such election shall be irrevocable except as provided in § 1.1361–15. See, however, paragraph (b) of § 1.1361–5 for effect of ceasing to conduct the business of the enterprise in an unincorporated form, and § 1.1361–6 for effect of a change of ownership. An election may be made only with respect to taxable years of a proprietor or partnership beginning after December 31, 1953, and ending after August 16, 1954.

(2) An enterprise with respect to which an election under section 1361 applies shall be referred to as a "section 1361 corporation".

(3) A section 1361 corporation shall be treated as a domestic corporation and the proprietor or partners thereof shall be treated as shareholders of such a corporation except to the extent otherwise provided in section 1361 and the regulations under such section.

(b) *Manner of making election.*—The election under section 1361 shall be made by filing a statement that the proprietor or partners, as the case may be, elect under section 1361 to have the enterprise treated as a domestic corporation. The statement shall be filed with the district director with whom the enterprise would be required to file its income tax return if it were an actual corporation. See section 6091(b)(2). The statement shall be filed during the first 60 days after the close of the first taxable year of the proprietor or partnership to which the election is applicable. The statement shall give sufficient information to establish that the enterprise meets the qualifications set forth in section 1361(b) and § 1.1361–2. It shall also contain an agreement by the proprietor or partners to notify the district director with whom the statement is filed in the event a change of ownership occurs (as described in paragraph (a)(2) of § 1.1361–6), or if the owners cease conducting the business of the enterprise in an unincorporated form. The statement shall be signed by the proprietor of, or all the partners owning a profits or capital interest in, the enterprise at any time during the period beginning on the first day of the first taxable year to which the election applies and ending on the day on which the election is filed. A proprietor or partner having an interest in the enterprise at any time during the first taxable year with respect to which the election applies is required to sign the statement even though he held no such interest at

the end of such year or at the time the election is filed. A proprietor or partner who acquired his interest after the end of the first taxable year to which the election applies but prior to the date the election is filed is also required to assent to the election by signing the statement even though he held no interest at any time during the first taxable year to which the election applies. If in a year subsequent to the first taxable year with respect to which the election applies a change of ownership occurs (as described in paragraph (a)(2) of § 1.1361–6) which under the provisions of section 1361(f) causes the enterprise no longer to be considered a section 1361 corporation unless a new election is made, such new election shall be made under the provisions of this paragraph in the same manner as an original election.

(c) *Accounting methods and accounting period.*—In determining the methods of accounting or taxable year that may be used by a section 1361 corporation as of the first day to which the election applies, such corporation shall be treated as the same person as the proprietor who makes the election or as the partnership that is subject to the election, except as provided in paragraph (a)(4) of § 1.361–9, relating to carryover items. For example, if prior to the first taxable year to which the election applies, a partnership uses the cash method of accounting, the section 1361 corporation must continue to use the cash method unless the Commissioner consents to a change. See section 446 and paragraph (e) of § 1.446–1. For definition of the term "method of accounting", see paragraph (a)(1) of § 1.446–1. For other rules applicable to accounting periods, see part I of subchapter E, and the regulations thereunder.

§ 1.1361–2 QUALIFICATIONS.—(a) *General rule.*—(1) Section 1361(b) prescribes qualifications all of which must be satisfied by the enterprise and its owners before an election may be made under section 1361(a). These qualifications are described in paragraphs (b) through (e) of this section. The qualifications must be met during the period beginning on the first day of the first taxable year of the enterprise to which the election applies and ending on the day the election is filed. The same qualifications must be met in the event of a new election after a change of ownership occurs (as described in paragraph (a)(2) of § 1.1361–6). In such an event, the period during which the qualifications must be met begins on the first day of the taxable year in which the change of ownership occurs and ends on the day the new election is filed.

(2) If a valid election has been made and if such election has not been terminated by reason of a change of ownership, the qualifications prescribed by section 1361(b) do not apply for subsequent taxable years of the section 1361 corporation.

(b) *Ownership of the enterprise.*—At all times during the period described in paragraph (a)(1) of this section, the enterprise must be an unincorporated business enterprise owned by an individual or a partnership consisting of not more than 50 members all of whom are individuals. In determining the number of members of a partnership, all partners with an interest in partnership profits or capital, or both, must be taken into account.

(c) *Same owner of two enterprises.*—(1) No election may be made with respect to an enterprise which is owned at any time during the period described in paragraph (a)(1) of this section by a proprietor

who at the same time is the proprietor of, or who has more than a 10-percent partnership interest in the profits or the capital of, any section 1361 corporation.

(2) No election may be made with respect to an enterprise owned by a partnership, any partner of which has at any time during the period described in paragraph (a)(1) of this section more than a 10-percent interest in the profits or the capital of such enterprise, if at the same time such partner is the proprietor of, or has more than a 10-percent partnership interest in the profits or capital of, any section 1361 corporation.

(d) *Nonresident aliens and foreign partnerships.*—No election may be made with respect to an enterprise which at any time during the period described in paragraph (a)(1) of this section is owned by a proprietor who is a nonresident alien, by a partnership any member of which is a nonresident alien, or by a foreign partnership.

(e) *Nature of income.*—(1) An election may not be made with respect to an enterprise unless, during the period described in paragraph (a)(1) of this section, (i) the enterprise is one in which capital is a material income-producing factor, or (ii) 50 percent or more of the gross income of the enterprise consists of gains, profits, or income derived from trading as a principal or from either buying or selling real property, stock, securities or commodities for the account of others. Income derived from trading as a principal (other than personal holding company income as defined in section 543) shall be combined with income derived from buying or selling for the account of others in determining whether the 50-percent requirement is satisfied.

(2) The determination of whether capital is a material income-producing factor must be made by reference to all the facts of each case. Capital is a material income-producing factor if a substantial portion of the gross income of the business (other than income excluded from gross income of the enterprise under section 1361(i)(1)) is attributable to the employment of capital in the business conducted by the enterprise. Capital is not a material income-producing factor where gross income of the enterprise consists principally of fees, commissions, or other compensation for personal services performed by the owners or employees of the enterprise. Thus, an enterprise engaged in rendering professional services such as law, accounting, medicine, or engineering, ordinarily is not an enterprise in which capital is a material income-producing factor. On the other hand, capital is ordinarily a material income-producing factor if the operation of the business requires substantial inventories or substantial investments in plant, machinery, or other equipment.

(3) The 50-percent determination described in subparagraph (1) of this paragraph is made by reference to gross income, other than personal holding company income excluded from gross income by section 1361(i)(1). The determination is made by reference to the gross income of the entire period described in paragraph (a)(1) of this section; it is not necessary that the 50-percent test be satisfied on each day during such period.

§ 1.1361-3 Code Provisions Applicable.—(a) *Subtitle A.*—(1) Except as otherwise provided in section 1361 and the regulations thereunder, the provisions of subtitle A of the Internal Revenue Code of

1954 shall apply as if the section 1361 corporation were a domestic corporation commencing on the first day of the first taxable year to which the election applies.

(2) For purposes of subtitle A the proprietor of a section 1361 corporation shall be considered a shareholder thereof owning 100 percent of the stock. Each partner in a partnership to which an election under section 1361 applies shall be considered a shareholder in the section 1361 corporation in proportion to his interest in the profits of the partnership or, where the applicable provisions of subtitle A depend on his capital interest, in proportion to his interest in the capital of the partnership. See paragraph (a) of § 1.1361–13 for rules relating to basis of stock in a section 1361 corporation.

(3) A section 1361 corporation is not entitled to make an election under subchapter S of chapter 1.

(4) A section 1361 corporation may not be a member of an affiliated group which files a consolidated return. See section 1504(b)(7).

(5) In determining self-employment income for purposes of chapter 2 of subtitle A, the income of a proprietor or a partner shall be determined in accordance with paragraph (b) (6) or (8) of § 1.1402 (a)–1, as the case may be, without regard to any election under section 1361.

(b) *Subtitle C.*—For purposes of subtitle C, relating to employment taxes, an enterprise to which section 1361 applies shall not be treated as a domestic corporation and each owner shall be treated as a proprietor or a partner, as the case may be. Accordingly, an owner is not treated as an employee for purposes of that subtitle even though he receives payments from the enterprise which are regarded as salary or compensation under section 1361(j).

(c) *Subtitle F.*—(1) Except as otherwise provided in section 1361 and the regulations thereunder, subtitle F and the regulations thereunder, relating to procedure and administration, shall apply to a section 1361 corporation in the same manner as they apply to a domestic corporation actually incorporated under local law. For rules applying certain of the pertinent provisions of subtitle F to a section 1361 corporation and for special rules applying only to a section 1361 corporation, see § 1.1361–14.

(2) The income tax return of a section 1361 corporation shall be filed on Form 1120 in accordance with the instructions applicable to such form and in accordance with the regulations under section 1361. If the section 1361 corporation is owned by a proprietor the return shall be filed in the name of the proprietor. If the section 1361 corporation is owned by partners, the return shall be filed in the name of all the parties thereof as well as in the trade name, if any, under which the partnership is operated. If because of the number of partners it is impracticable to list the name of each partner, there shall be listed only the names of the three partners owning the largest interest in the enterprise, followed by the words "and others," or if there are no such three partners, then there shall be listed the names of any three partners whose aggregate interest is at least as large as the aggregate interest of any other three partners. The return shall be clearly designated as an income tax return of a section 1361 corporation. Such return shall be signed by the proprietor or by any general partner of the enterprise. If the section 1361 corporation is

owned by a proprietor, there shall be attached to such return a schedule of the personal holding company income and the expenses attributable thereto. If the section 1361 corporation is owned by partners, there shall be attached to the return a statement setting forth the name and address of each partner, and each partner's distributive share of the personal holding company income and the expenses attributable thereto. See § 1.1361–8. The provisions of this subparagraph shall apply to returns filed after June 30, 1959. For rules applicable to returns filed before July 1, 1959, see Treasury Decision 6124, approved February 24, 1955 (20 F.R. 1204; 26 CFR (1954) Parts 1 to 19 (1958 Rev.) page 10).

(3) For the first taxable year to which the election applies a section 1361 corporation shall not be subject to those provisions of subtitle F which relate to declarations and payment of estimated income tax by corporations but it shall be subject to such provisions for all subsequent taxable years to which the election applies.

(4) The proprietor of a section 1361 corporation shall be liable for the taxes imposed on such corporation. The partners of a section 1361 corporation shall be jointly and severally liable for the taxes imposed on such corporation. The proprietor or partners shall also be liable for interest, additions to the tax, and penalties imposed by subtitle F.

§ 1.1361–4 Pension or Profit-Sharing Plan.—A proprietor or partner of a section 1361 corporation shall not be considered an employee for purposes of section 401(a) (relating to employees' pension trusts, etc.). Accordingly, such a proprietor or partner may not participate in any stock bonus, pension, profit-sharing, or annuity plan to which section 401 or 403 applies which the section 1361 corporation may have for its employees.

§ 1.1361–5 Election Irrevocable.—(a) *Conducting of business in unincorporated form.*—Except as provided in § 1.1361–6 (relating to effect of change of ownership) and § 1.1361–15 (relating to revocation of election within stated period of time), an election made under section 1361(a) is irrevocable so long as the business of the enterprise is conducted in an unincorporated form. A section 1361 corporation, and any unincorporated successor to the business thereof, shall be taxable as a domestic corporation for the taxable year with respect to which the election is made and for all subsequent taxable years, and the proprietor or partners of the enterprise shall be treated as corporate shareholders for the same period. The election applies not only to the original enterprise and its owner or owners but also to any unincorporated successor to the business of the original enterprise and to the owner or owners of such successor. For example, the termination of a partnership under applicable local law and the transfer of the business to a new partnership does not terminate the election unless a change of ownership occurs (as described in paragraph (a) (2) of § 1.1361–6) and no new election is made.

(b) *Effect of ceasing to conduct business in an unincorporated form.*—Except as provided in paragraph (a) of this section, an election made under section 1361 continues so long as the business of the enterprise is conducted in an unincorporated form. If the owners cease conducting the business of the enterprise in an unincorporated form the election terminates and the assets of the enterprise are

deemed to have been distributed to the owners in a complete liquidation of the section 1361 corporation. The effect of the liquidation on the owners shall be determined under the provisions of sections 331, 334(a) and, in appropriate cases, 341. Therefore, if a substantial part of the business is transferred to an actual corporation, the transaction shall be treated as if immediately before the transfer all of the assets of the enterprise had been distributed to the owners in a complete liquidation. Accordingly, the transfer of the assets to the actual corporation shall be treated as a transfer made by the owners in their individual capacities immediately after the liquidation.

§ 1.1361–6 CHANGE OF OWNERSHIP OF 20 PERCENT OR MORE.—(a) *In general.*—(1) If at any time during any taxable year of a section 1361 corporation a change of ownership occurs (as described in subparagraph (2) of this paragraph) then the enterprise shall not be considered a domestic corporation for such year or for subsequent years, unless a new election is made in accordance with section 1361(a) and § 1.1361–1. Such a change of ownership may be the result of one or more transactions occurring over the entire period beginning with the date of the most recent election. Thus, a change of ownership may result from a transfer or a series of transfers by one or more of the owners of any part of their interest in the enterprise. Transfers of interests between electing partners are not taken into account in determining whether a change of ownership has occurred. For example, if A and B are the electing partners, a sale by B of part or all of his interest to A is not taken into account in determining whether a change of ownership has occurred.

(2) For purposes of the regulations under section 1361 a change of ownership occurs when, for any reason, the proprietor or partners who made the most recent election have a combined interest of 80 percent or less in profits and capital of the section 1361 corporation. But see paragraph (d) of this section, relating to the application of constructive ownership rules to determine whether a change of ownership has occurred.

(b) *New election after change of ownership.*—A new election after a change of ownership may be made only in accordance with section 1361(a) and § 1.1361–1. Such election shall be made during the first 60 days after the close of the taxable year of the enterprise in which the change of ownership occurs. If such new election is made, then the enterprise shall continue to be treated as the section 1361 corporation. In such a case, the transfer of any interest during such taxable year shall be treated as the sale or other disposition of stock in a corporation.

(c) *Failure to make new election after change of ownership.*—If during the taxable year of a section 1361 corporation a change of ownership occurs and if no new election is made, then the section 1361 corporation and its owners shall be treated as if the corporation had distributed its assets in a complete liquidation on the first day of the corporation's taxable year in which the change of ownership occurs. The effect of the liquidation on the owners shall be determined under the provisions of section 331, 334(a) and, in appropriate cases, 341. If the enterprise is a proprietorship, then as of the first day of such taxable year, the owner shall be treated as if he had used the assets deemed received in liquidation, in the conduct of an unincorporated

business. Accordingly, any transfer by him during such taxable year shall be treated as a sale or other disposition of assets of the business. If the enterprise is a partnership, then the partners shall be treated as if they had contributed the assets deemed received in liquidation to a new partnership as of the moment such assets were deemed received. Accordingly, any transfer of an owner's interest during such taxable year shall be treated as a sale or other disposition of a partner's interest in a partnership, and any transfer of the enterprise's property during such taxable year shall be treated as a sale or other disposition of property by a partnership.

(d) *Constructive ownership.*—For the purpose of determining whether a change of ownership has occurred, the rules for constructive ownership of stock provided in section 267(c), other than paragraph (3) thereof, shall apply. For example, if the sole proprietor of an enterprise sells or gives a 30-percent interest to his brother, no change of ownership will be considered to have occurred.

(e) *Effect of death of proprietor or partner.*—The death of a proprietor or partner shall not be taken into account in determining whether a change of ownership has occurred if the person or persons who are beneficially entitled to the decedent's interest in the section 1361 corporation could have received such interest immediately prior to the decedent's death without causing a change of ownership. The provisions of this paragraph may be illustrated by the following example:

Example. Immediately prior to his death A owned a 50-percent interest in a section 1361 corporation. Under A's will his 50-percent interest is divided equally among his wife and children. Since the wife and children are persons to whom A could have transferred his interest immediately prior to his death without causing a change of ownership under section 1361(f), no change of ownership will be deemed to have occurred.

§ 1.1361–7 Imposition of Taxes on Section 1361 Corporation.—(a) *General.*—A section 1361 corporation is subject to (1) the normal tax and surtax imposed by section 11, (2) the accumulated earnings tax imposed by section 531, and (3) the alternative tax for capital gains imposed by section 1201(a).

(b) *Personal holding company tax.*—A section 1361 corporation is not subject to the personal holding company tax imposed by section 541.

§ 1.1361–8 Personal Holding Company Income.—(a) *General rule.*—Personal holding company income received or accrued by a section 1361 corporation shall not be included in its gross income. For this purpose, the term "personal holding company income" means personal holding company income as defined in section 543 and the regulations thereunder, other than income received or accrued from either buying or selling real property, stock, securities, or commodities for the account of others.

(b) *Income and deductions of owners.*—(1) Personal holding company income and the deductions attributable to such income shall be treated as the income and deductions of the owner or owners of the section 1361 corporation whether or not such income is distributed. Such income and deductions shall be taken into account by an owner for his taxable year ending with, or within which ends, the taxable

year of the corporation. Such income and deductions shall be allocated among partners in accordance with their distributive shares of partnership income and deductions. For rules applicable in determining such distributive shares, see § 1.704–1.

(2) In determining the deductions attributable to personal holding company income for any taxable year of a section 1361 corporation, the rules of this subparagraph shall apply. All deductible items properly chargeable to personal holding company income shall be allocated thereto. For example, repairs to, taxes and depreciation on, and other expenses properly chargeable to, rental property or the collection of rental income shall be allocated to rental income. All deductible items properly chargeable to income other than personal holding company income shall be allocated to such income. For example, cost of goods sold, sales taxes, wages of salesmen, and other expenses properly chargeable to a retail business shall be allocated to income from such business. All remaining deductible items may be allocated in the proportion which the amount of each such type of income bears to total income, or in any other reasonable manner.

(c) *Distributions.*—(1) The rules of this paragraph shall apply in determining whether a distribution is a distribution of net personal holding company income or a corporate distribution. For purposes of this paragraph, the term "net personal holding company income" means the amount of personal holding company income received or accrued during the taxable year by a section 1361 corporation less the deductions properly attributable to such income (determined in accordance with paragraph (b)(2) of this section) for the taxable year.

(2) If a section 1361 corporation and an owner of an interest in such corporation have the same taxable year, distributions of money during any taxable year of the corporation to an owner shall be considered distributions of net personal holding company income to the extent of the owner's share of such income for such taxable year. All distributions of property (other than money) and distributions of money which are not considered distributions of net personal holding company income under the preceding sentence shall be considered corporate distributions.

(3) If a section 1361 corporation and an owner of an interest in such corporation have different taxable years, then—

(i) Distributions of money to such owner during the period beginning on the first day of any taxable year of the corporation and ending on the last day of the owner's taxable year which ends within such taxable year of the corporation, shall be considered distributions of net personal holding company income to the extent of the owner's share of such income for such period, and

(ii) Distribution of money to such owner during the remaining period of such taxable year of the corporation shall be considered distributions of net personal holding company income to the extent of the sum of—

(*a*) Such owner's share of net personal holding company income for such remaining period, and

(*b*) His share of net personal holding company income for the prior portion of the corporation's taxable year to the extent that such

share was not distributed to him in money during such portion of such taxable year.

(iii) All distributions of property and distributions of money in excess of the amounts described in subdivisions (i) and (ii) of this subparagraph shall be treated as corporate distributions.

(4) The excess of the amount of personal holding company income (less the deductions attributable thereto) treated as the income of an owner for a taxable year of a section 1361 corporation over the amount of net personal holding company income distributed to such owner during such year shall be considered as paid-in surplus or as a contribution to capital as of the close of the year, and such excess shall be added to the owner's basis for his stock in the corporation.

(d) *Rents and royalties.*—For the purpose of determining whether rents and mineral, oil, or gas royalties are personal holding company income under section 543 for any taxable year, all gross income received or accrued during the taxable year shall be taken into account, notwithstanding section 1361(i)(1). Thus, if a section 1361 corporation receives or accrues for its taxable year $35,000 from a mercantile business, $25,000 from dividends, and $40,000 from rents, the amount of such rents is personal holding company income because it does not constitute 50 percent or more of the gross income received or accrued by the corporation for the taxable year.

§ 1.1361–9 Computation of Taxable Income.—(a) *In general.*—(1) Except as otherwise provided in section 1361 and the regulations thereunder, subtitle A shall apply in determining the taxable income of a section 1361 corporation in the same manner that it applies in determining the taxable income of a domestic corporation. Thus, in determining its taxable income, such a corporation is entitled to a deduction for reasonable salary or compensation paid to its owner or owners for services rendered to the corporation. The amount allowable as a deduction for such payments is determined under section 162 and § 1.162–7. In order to distinguish a payment of compensation from a distribution to an owner, the section 1361 corporation should indicate on its books and records the nature of any amount paid to an owner. See paragraph (b)(1) of § 1.1361–14.

(2) A section 1361 corporation shall be allowed a deduction only for those items of expense which are properly allocable to the operation of the business of the corporation and for which no deduction was allowable to the proprietor, partnership or partners for any taxable year. Any amount paid by the corporation in satisfaction of a liability of an owner which is unrelated to the conduct of the business shall not be deductible unless such payment is in fact compensation for personal services performed for the corporation by such owner.

(3) All amounts of income received or accrued by a section 1361 corporation which (i) are attributable to transactions occurring before the first day to which the election applies and (ii) are not properly includible in the gross income of the owners for a previous taxable year, must be included in the gross income of the corporation to the same extent that they would have been included in the gross income of the owners if no election had been made.

(4) Any carryover or carryback of an item of a section 1361 corporation (such as a carryover or carryback under section 170, 172, or

1212) attributable to a taxable year to which section 1361 applies may be carried over or carried back only to another taxable year of such corporation and then may be used solely in computing the taxable income of such corporation. Similarly, any carryover or carryback arising out of the conduct of the business enterprise in a year to which section 1361 is not applicable may not be carried over or carried back to the corporation for a year to which section 1361 applies, but should be carried over or carried back by the owners in computing their individual income tax liabilities.

(b) *Special rules.*—(1) Personal holding company income and the deductions attributable to such income shall not be included in computing the taxable income of a section 1361 corporation. See § 1.1361–8.

(2) A section 1361 corporation shall not be entitled to the deductions provided for in section 242, relating to partially tax-exempt interest, and sections 243 through 245, relating to deductions for dividends received.

(3) Amounts paid by a section 1361 corporation in satisfaction of an owner's tax liability under local law for a taxable year to which the election applies are deductible by the corporation (and not by the owner) to the extent such tax liability is attributable to property used by the corporation or to taxable income of the corporation. However, amounts paid in excess of the tax liability so attributable shall be treated as additional compensation or as a distribution to the owner whose liability is satisfied. The determination of the amount of tax liability attributable to property used by the corporation or to taxable income of the corporation shall be made in a manner that is reasonable in the light of all the facts in each case.

§ 1.1361–10 Distribution Other Than in Liquidation.—(a) *General rule.*—(1) Except as provided in paragraph (b) of this section, all distributions from a section 1361 corporation to an owner of such corporation, with respect to his interest in such corporation, occurring at any time on or after the first day of the first taxable year to which the election applies shall be treated as corporate distributions to a shareholder in accordance with part I of subchapter C. Thus, for example, if a calendar year partnership makes a distribution in March 1958, and subsequently the partners make an election under section 1361 for 1958, the distribution is treated as a corporate distribution unless otherwise provided in paragraph (b) of this section.

(2) A distribution to an owner by a section 1361 corporation shall not ordinarily be considered a distribution in redemption of stock unless such distribution is in complete termination of his interest in the corporation. See paragraph (b) of § 1.1361–11, relating to requirements of written plan.

(b) *Exception.*—The provisions of paragraph (a)(1) of this section shall not apply to—

(1) A distribution in partial or complete liquidation of a section 1361 corporation;

(2) A distribution of net personal holding company income; and

(3) A distribution which is used by an owner of a section 1361 corporation to pay an expense or obligation (including taxes under local or Federal law) properly attributable to the business enterprise, whether or not such expense or obligation

was incurred prior to the first taxable year to which the election under section 1361 applies. For example, if an owner of a section 1361 corporation withdraws money from the business to pay the previous year's local real property tax attributable to property used in the business enterprise or the portion of his last quarterly payment of estimated tax for the previous year attributable to the business enterprise, such withdrawals would not be subject to the provisions of paragraph (a)(1) of this section even if for the previous year the enterprise was not a section 1361 corporation.

(c) *Earnings and profits.*—A section 1361 corporation shall maintain an earnings and profits account which shall be computed in accordance with the rules applicable generally to domestic corporations, except that the receipt and distribution of personal holding company income (and expenses attributable thereto) shall not be taken into account in determining the amount of earnings and profits for the taxable year or accumulated earnings and profits.

§ 1.1361–11 Distributions in Liquidation.—(a) *General rule.*—A section 1361 corporation may make distributions to its owners in complete or partial liquidation of the corporation. In addition, the failure to continue conducting the business of the enterprise in an unincorporated form, or the failure to make a new election after a change of ownership, results in a liquidation of the section 1361 corporation. See paragraph (b) of § 1.1361–5, and paragraph (c) of § 1.1361–6. The effect of such distributions shall be determined in accordance with the appropriate provisions of part II of subchapter C and the regulations thereunder. See, however, paragraph (c) of this section.

(b) *Requirement of written plan.*—Except as provided in paragraph (b) of § 1.1361–5, and paragraph (c) of § 1.1361–6, a section 1361 corporation shall not be considered to have made a distribution in partial or complete liquidation, or a distribution in redemption of stock, unless prior to the date of the distribution the corporation adopts a written plan providing for such liquidation or redemption. Moreover, the requirements of section 6043 (relating to information returns) and paragraph (d) of § 1.331–1 (relating to returns of shareholders) must be complied with.

(c) *Distributions not treated as liquidating distributions.*—Distributions by a section 1361 corporation shall not be treated as distributions in liquidation under part II of subchapter C if the owner or owners use the assets received in the distribution to conduct substantially the same business in an unincorporated form as that conducted by the corporation. In such a case, the section 1361 corporation shall continue in existence and any withdrawal of assets from the business shall be treated as a distribution which is not in partial or complete liquidation of the corporation.

§ 1.1361–12 Organizations and Reorganizations.—(a) *General rule.*—Except as provided in paragraphs (b) and (c) of this section, a section 1361 corporation shall not be considered a corporation nor shall its owners be considered shareholders for purposes of parts III and IV of subchapter C, relating to corporate organizations and reorganizations, and to insolvency reorganizations.

(b) *Contributions to capital.*—In any case where gain or loss would be recognized upon the contribution of property constituting either paid-in surplus or a contribution to capital by a shareholder to a corporation, gain or loss shall be recognized upon a similar contribution to a section 1361 corporation. For example, in a case where a shareholder in an actual corporation would recognize gain under section 357 on a transfer of property, an owner of a section 1361 corporation shall also recognize gain in a similar transaction.

(c) *Elections made for first taxable year of an enterprise.*—In any case in which the election under section 1361(a) is made with respect to the first taxable year of an unincorporated enterprise, the appropriate provisions of part III of subchapter C shall be applicable with respect to its initial organization. For example, for the purpose of determining whether gain or loss is recognized upon the organization of the enterprise, the provisions of section 351 and section 357 shall be applicable as if the owners had contributed property or services in exchange for corporate stock.

§ 1.1361–13 Basis.—(a) *Basis of stock.*—(1) If a proprietor makes an election under section 1361(a), the basis of his stock in the section 1361 corporation as of the first day to which the election applies shall be determined as if he had exchanged all the assets and liabilities of the enterprise on such first day for the stock of the corporation. Therefore, the basis of such stock is equal to the basis of the property exchanged, decreased by the amount of liabilities of the enterprise and increased by the amount of gain recognized by the proprietor on the exchange. See § 1.1361–12.

(2) If partners make an election under section 1361(a) and the first taxable year to which the election applies is not the first taxable year of the partnership, each partner's basis for his stock in the section 1361 corporation as of the first day to which the election applies shall be equal to the basis of his partnership interest (determined under § 1.705–1) at the end of the prior taxable year of the patrnership decreased by his share of the partnership liabilities as of the end of such prior taxable year and increased by his share of any gain recognized by the partnership. See paragraph (b) of § 1.1361–12.

(3) If a partnership makes an election under section 1361(a) which applies to its first taxable year, each partner's basis for his stock in the section 1361 corporation as of the first day to which the election applies shall be determined under the appropriate provisions of part III of subchapter C as though the partner had contributed property in exchange for stock. Thus, a partner's basis for his stock in a section 1361 corporation will be determined under section 358. See paragraph (c) of § 1.1361–12.

(b) *Basis of property.*—As of the first day to which the election applies, the basis of property held by a section 1361 corporation shall be the same as its basis in the hands of the proprietor or partnership (or in the hands of the partners in a case where the election applies to the first taxable year of a partnership), increased by any gain recognized as a result of the election. See § 1.1361–12.

§ 1.1361–14 Records, Statements, and Returns.—(a) *In general.*—Except as otherwise provided in the regulations under section 1361, a section 1361 corporation is required to keep records, render

statements, and make returns in the same manner as a domestic corporation. For rules applicable to the filing of income tax returns on Form 1120 by such a corporation, see paragraph (c)(2) of § 1.1361–3. A section 1361 corporation is also required to file such other returns, forms, documents, or statements as are required of a domestic corporation under subtitle F. For example, a section 1361 corporation is required to file Forms 1099 and 1096 with respect to distributions of dividends of $10 or more to its owners during the calendar year in accordance with section 6042 and the regulations thereunder. Such other returns, forms, documents, or statements should indicate that the reporting enterprise is a section 1361 corporation.

(b) *Other records.*—The following other records shall be maintained by a section 1361 corporation:

(1) Separate records shall be maintained for payments to owners of a section 1361 corporation in order that a determination may be made as to whether such payments are compensation for personal services to which section 1361(j) applies, or are distributions which may be treated either as corporate distributions or as distributions of personal holding company income.

(2) In the case of a partnership, separate capital accounts shall be maintained for each partner. Such accounts shall set forth the original capital contribution, adjustments thereto (for example, because of an owner's share of undistributed personal holding company income), and any other information necessary to establish each partner's interest in the section 1361 corporation.

(3) A section 1361 corporation shall maintain records of all transfers of interests by its owners made at any time during the period the election under section 1361 applies, showing the names of the transferor and the transferee, the relationship between them, and the interest transferred.

(4) The records of a section 1361 corporation shall be maintained in such a manner that assets, liabilities, income, and expenses of the section 1361 corporation are shown separately and distinctly from assets, liabilities, income, and expenses of the owners which do not relate to the enterprise. Moreover, separate records shall be maintained for personal holding income and deductions attributable thereto.

(5) For rules applicable to the earnings and profits account to be maintained by a section 1361 corporation, see paragraph (c) of § 1.1361–10.

§ 1.1361–15 REVOCATION OF ELECTION AND TOLLING OF STATUTE OF LIMITATIONS.—(a) *Provisions of section 63 of the Technical Amendments Act of 1958.*—Section 63 of the Technical Amendments Act of 1958 (72 Stat. 1649), approved September 2, 1958, provides as follows:

> SEC. 63. REVOCATION OF ELECTION PERMITTING CERTAIN PROPRIETORSHIPS AND PARTNERSHIPS TO BE TAXED AS CORPORATIONS [TECHNICAL AMENDMENTS ACT OF 1958 (72 STAT. 1649)].
>
> (a) REVOCATION OF ELECTION.—If—
>
> (1) A statement of an election to be taxed as a domestic corporation is heretofore or hereafter filed with respect to any unincorporated business enterprise under section 1361 of the Internal Revenue Code of 1954, and
>
> (2) Such filing is in accordance with regulations prescribed by the Secretary of the Treasury or his delegate,

then such statement of election shall be treated as a valid election; but such election may be revoked (in accordance with regulations prescribed by the Secretary of the Treasury or his delegate) after the date of the enactment of this section and on or before the last day of the third month following the month in which regulations prescribed under such section 1361 are published in the Federal Register.

(b) TOLLING OF STATUTE OF LIMITATIONS.—In the case of any election referred to in subsection (a) with respect to any unincorporated business enterprise—

(1) The statutory period for the assessment of any deficiency against any taxpayer for any taxable year, to the extent such deficiency is attributable to such enterprise and to the period to which such election applies (or would apply but for a revocation under subsection (a)), shall not expire before the expiration date specified in subsection (c); and such deficiency may be assessed at any time on or before such expiration date, notwithstanding any law or rule of law which would otherwise prevent such assessment.

(2) If credit or refund of the amount of any overpayment is prevented, at any time on or before the expiration date specified in subsection (c), by the operation of any law or rule of law (other than chapter 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises), credit or refund of such overpayment may, nevertheless, be allowed or made, to the extent such overpayment is attributable to such enterprise and to the period referred to in paragraph (1), if claim therefor is filed on or before the expiration date specified in subsection (c).

(c) EXPIRATION DATE DEFINED.—For purposes of subsection (b), the term "expiration date" means that day which is one year after whichever of the following days is the earlier:

(1) The last day of the third month following the month in which regulations prescribed under section 1361 of the Internal Revenue Code of 1954 are published in the Federal Register; or

(2) If the election is revoked under subsection (a), the day on which such revocation is filed with the Secretary of the Treasury or his delegate.

(d) EXCEPTION.—This section shall not apply to any statement of election filed with respect to any unincorporated business enterprise under section 1361 of the Internal Revenue Code of 1954, if, before the date of the enactment of this Act, such statement of election has been withdrawn with the permission of the Secretary of the Treasury or his delegate.

(b) *In general.*—A statement of election to be taxed as a domestic corporation under section 1361 shall be treated as a valid election if filed in accordance with regulations prescribed by the Secretary or his delegate. Thus, if a statement of election to be taxed as a corporation has been filed in accordance with the provisions of Treasury Decision 6124, approved February 24, 1955 (20 F.R. 1204; 26 CFR (1954) Parts 1 to 19 (1958 Rev.) page 10) such statement of election shall be treated as a valid election, except as provided in paragraph (f) of this section, relating to statements of election withdrawn with the permission of the Internal Revenue Service. Any such election (or any election made in accordance with § 1.1361–1) may be revoked (notwithstanding any provision to the contrary in section 1361), on or before the last day of the third month following the month in which the final regulations under section 1361 are published in the Federal Register. If a new election has been made after a change of ownership described in section 1361(f), then such new election, or the original election, or both, may be revoked. Any revocation shall be effective only if made in accordance with the provisions of paragraph (c) of this section. A revocation under this section may be made

notwithstanding the fact that the section 1361 corporation has been actually incorporated or completely liquidated.

(c) *Manner of revoking election.*—(1) The election shall be revoked by filing within the time prescribed in subparagraph (2) of this paragraph both (i) a statement (meeting the requirements of subparagraph (2) of this paragraph) that the proprietor or the partners, as the case may be, revoke the election made under section 1361(a) to have the enterprise taxed as a corporation, and (ii) the amended returns required by subparagraph (3) of this paragraph.

(2) The statement of revocation and the amended returns may be filed at any time after September 2, 1958, but must be filed on or before the last day of the third month following the month in which the final regulations under section 1361 are published in the Federal Register. In the case of a new election made after a change of ownership described in section 1361(f), a separate statement of revocation and the amended returns required by subparagraph (3) of this paragraph must be filed with respect to each election which is being revoked. The statement of revocation must be signed by the proprietor or all of the partners owning an interest in the enterprise at any time during the period with respect to which the particular election under section 1361 would apply but for the revocation. If any individual who is required to sign the statement of revocation is deceased, the statement shall be signed either by his successor in interest or by the executor or administrator of such deceased individual's estate. The statement of revocation must be filed with the district director for the district in which the statement of election was filed. Such statement of revocation must state the name and address under which the income tax returns of the section 1361 corporation were filed for the prior taxable years during which the election would apply but for the revocation, and the internal revenue district in which such returns were filed. The statement shall also set forth the names and addresses of the individuals affected by the revocation, their taxable years involved, and the internal revenue districts in which the income tax returns of such individuals were filed.

(3) Revocation of the election to be taxed as a corporation shall be effective only if the statement of revocation referred to in subparagraph (2) of this paragraph is filed and only if amended income tax returns of the proprietor, or partnership returns on Form 1065 (accompanied by amended income tax returns of the partners), are filed. Such returns shall be filed for each taxable year affected by the revocation and should be filed with the statement of revocation. However, if an amended income tax return is required to be filed with a district director other than the district director with whom the statement of revocation is filed, a copy of the statement of revocation must be filed with each such amended return. The amended income tax and partnership returns shall be filed as if there had been no election made under section 1361. The amended income tax returns shall reflect any increase or decrease in tax over the tax previously determined (as defined in section 1314(a)) which results from treating the enterprise as a proprietorship or as a partnership, as the case may be. See paragraph (a)(5) of this section for rules applicable to items of income, deduction, or credit to be taken into account in determining such increase or decrease in tax.

(d) *Effect of revocation.*—(1) A revocation made in accordance with the provisions of this section shall apply to all taxable years to which the particular election would apply but for the revocation.

(2) The increase or decrease in tax shown on amended returns filed in accordance with this section over the tax previously determined (as defined in section 1314(a)) shall not be subject to the additions to tax imposed by sections 6651 and 6654, to the extent that such increase or decrease in tax is attributable to the revocation of the election under section 1361. The provisions of chapter 67, relating to interest, shall be applicable to such increase or decrease in tax. For rules applicable in determining the increase or decrease in tax, see paragraph (e)(5) of this section.

(3) If the election under section 1361 is revoked, any election or option made on the corporation return, Form 1120, filed for the enterprise shall be deemed to have been made by the proprietor, partners or partnership, and such election or option shall be given effect in the making of amended income tax and partnership returns required to be filed by paragraph (c)(3) of this section.

(e) *Tolling of statute of limitations.*—(1) Notwithstanding any law or rule of law which would otherwise prevent an assessment, the statutory period for the assessment and collection of any deficiency attributable to an enterprise which has made an election under section 1361 (whether or not revoked) shall not expire until after the expiration date specified in subparagraph (4) of this paragraph. For rules applicable in determining such deficiency, see subparagraph (5) of this paragraph.

(2) If credit or refund of any overpayment attributable to an enterprise which has made an election under section 1361 (whether or not revoked) is prevented at any time on or before the expiration date specified in subparagraph (4) of this paragraph by the operation of any law or rule of law (other than chapter 74 of the 1954 Code, relating to compromises and closing agreements), credit or refund of such overpayment may nevertheless be allowed or made if claim therefor is filed on or before such expiration date. For rules applicable in determining such overpayment, see subparagraph (5) of this paragraph.

(3) A deficiency or overpayment in tax described in subparagraph (1) or (2) of this paragraph may be determined with respect to (i) an enterprise for which an election under section 1361 was made, (ii) the electing proprietor or partners, and (iii) any other taxpayer affected by the election.

(4) The term "expiration date" means that date which is one year after whichever of the following days is the earlier:

(i) The last day of the third month following the month in which final regulations under section 1361 are published in the Federal Register; or

(ii) If the election is revoked, the day on which an effective revocation is made.

(5) For purposes of this section, the deficiency or overpayment in tax attributable to an enterprise for which an election under section 1361 was made, shall be that amount of the increase or decrease in tax over the tax previously determined (as defined in section 1314(a)) for any taxable year which results from the correct treatment of all

items which pertain to the enterprise. Items of income, deduction, or credit completely unrelated to the enterprise shall not be taken into account. For example, the failure to claim a deduction for a dependent or the improper taking of such a deduction are not adjustments which are attributable to the enterprise. However, due regard shall be given to the effect which an adjustment attributable to the enterprise may have on the computation of gross income, taxable income and other matters under subtitle A of the 1954 Code. Thus, for example, if such an adjustment results in an increase in an individual's adjusted gross income, it may be necessary to recompute the deduction for charitable contributions or medical expenses since the amount of those deductions is determined or limited by the amount of the taxpayer's adjusted gross income. An adjustment attributable to the enterprise may affect more than one taxpayer and more than one taxable year. For example, if an election by a partnership is revoked, it will be necessary to recompute the income tax liability of all members of the partnership for all taxable years to which the election applied. Similar computations will be necessary for any other taxable year affected, or treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryover (as defined in section 1212) determined with reference to any taxable year to which an election applied (or would have applied for a revocation of such election). Moreover, if an election is revoked the income tax paid by the enterprise shall be treated as an overpayment of tax and shall be refunded or credited. On the other hand, if the election is not revoked, it may be necessary to make adjustments to the taxable income of the section 1361 corporation. Such adjustments may be necessary, for example, because of the failure to report items of income or to claim deductions. In addition, adjustments in items of income or deduction allocable to a proprietor or partner may be necessary. Such adjustments may be required, for example, because of failure to include personal holding company income or dividend distributions. Moreover, items which have been taken into account in filing the corporation return, Form 1120, for the section 1361 corporation, which items should have been taken into account in the returns of the proprietor or partners, or vice versa, are to be given proper effect in determining the increase or decrease in tax.

(f) *Exception.*—The provisions of this section do not apply to—

(1) Any statement of election filed in accordance with Treasury Decision 6124 which statement was withdrawn before September 2, 1958, with the permission of the Internal Revenue Service, and

(2) Any deficiency or overpayment of any taxpayer for any taxable year during which a statement of election described in subparagraph (1) of this paragraph was applicable, attributable to the withdrawal described in such subparagraph (1).

DANA LATHAM,
Commissioner of Internal Revenue.

Approved October 6, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

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CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1402.—DEFINITIONS

26 CFR 1.1402(a)-1: Net earnings from self employment.

Payments received under a fellowship grant in excess of the limitations of section 117(b)(2)(B) of the Internal Revenue Code of 1954. See Rev. Rul. 60-378, page 38.

CHAPTER 3.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS AND TAX-FREE COVENANT BONDS

SUBCHAPTER A.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

SECTION 1441.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS

26 CFR 1.1441-1: Requirement for withholding of tax on nonresident aliens and foreign corporations. Rev. Rul. 60-249

(Also Part IV, United States-France Income Tax Convention.)

Where a nonresident alien individual enters a horse in a race in the United States, any winner's purse received is subject to the withholding of income tax under section 1441 of the Internal Revenue Code of 1954, in the absence of definite information that he does not intend to enter a horse in another race in this country during the taxable year, even though such winnings may be exempt from Federal income tax under the provisions of a tax convention.

Revenue Ruling 58-63, C.B. 1958-1, 624, amplified.

Advice has been requested whether a winner's purse received by a nonresident alien individual from the entry of a horse in a race in the United States is subject to the withholding of income tax even though the winnings may be exempt from Federal income tax under a tax convention.

Revenue Ruling 58-63, C.B. 1958-1, 624, holds that a nonresident alien individual does not acquire a permanent establishment in the United States by entering a horse in a single race in this country. Although a winner's purse received by the owner of a racing stable operated for profit is considered to be commercial profits, the winnings concerned in that Revenue Ruling were held exempt from Federal income tax under the United States-France Income Tax Convention, T.D. 5499, C.B. 1946-1, 134, because the nonresident alien, a citizen and resident of France, did not have a permanent establishment in the United States.

Section 1441 of the Internal Revenue Code of 1954, with certain exceptions not here pertinent, requires the withholding of tax at the source with respect to all items of fixed or determinable annual or periodical gains, profits, or income from sources within the United States paid to a nonresident alien individual. See also Revenue Ruling 58–479, C.B. 1958–2, 60.

Although, by the entry of a horse in only one race in this country, a nonresident alien does not acquire a "permanent establishment" in the United States and the winnings from the race therefore may be exempt from Federal income tax under the terms of a tax convention, a "permanent establishment" may be acquired by the nonresident alien's entering his horse, or other horses owned by him, in other races in the United States during the taxable year.

Accordingly, it is held that in the absence of definite information that a nonresident alien individual does not intend to enter a horse in another race in the United States during the taxable year, tax must be withheld from the winnings received by such nonresident alien from the entry of a horse in a race in this country, even though such winning may be exempt from Federal income tax under the provisions of a tax convention.

Revenue Ruling 58–63, C.B. 1958–1, 624, is hereby amplified to hold that, in the absence of definite information that a nonresident alien individual does not intend to enter a horse in more than one race in the United States during the taxable year, tax must be withheld from the winnings received by the taxpayer from the entry of a horse in a race in this country, even though such winnings may be exempt from Federal income tax under the provisions of a tax convention.

(Also Section 1442; 1.1442–1.) Rev. Rul. 60–288

Schedule of withholding tax rates under conventions, to which the United States is a party, to be applied by withholding agents within the United States with respect to payments of dividends, interest, royalties, and real estate rentals made to nonresident aliens and nonresident foreign corporations.

Revenue Ruling 57–391, C.B. 1957–2, 606, superseded.

There is set forth below a revised table for withholding of tax at the source, in the case of nonresident alien individuals and nonresident foreign corporations, incident to the administration of the several income tax conventions to which the United States is a party. This table supersedes the table which appears in Revenue Ruling 57–391, C.B. 1957–2, 606.

The exemptions from, or reduced rates of, United States tax, varying as between countries and as to specific items of income, require withholding agents to consult, before disbursement of such income, the provisions of the Treasury Decision applicable to the country of the taxpayer (nonresident of the United States) to whom the payment is being made. The table has been confined to dividends, interest, royalties, and real estate rentals, which, with few exceptions, include practically all income subject to withholding under sections 1441 and 1442 of the Internal Revenue Code of 1954.

Rates of United States tax to be withheld at the source in the case of nonresident aliens and nonresident foreign corporations pursuant to existing income tax conventions

Country	Dividends	Interest [1]	Royalties	Real estate rentals and natural resource royalties	Applicable Treasury Decisions
Australia	15% [4]	NE	E [2 3]	NE [5]	6108, C.B. 1954–2, 614.
Austria	15% [3 6]	E [3 17 24]	E [3 11 18 25]	NE [8]	6322, C.B. 1958–2, 1038.
Belgium [23]	15% [3]	15% [3]	E [3]	NE [8]	6056, C.B. 1954–1, 132.
Canada	15% [3 5]	15% [3]	15% [3 13]	15% [3 9]	6047, C.B. 1953–2, 59.
Denmark	15% [3 5]	E [3]	E [3]	NE [8]	5692, C.B. 1949–1, 104.
Finland	15% [3 5]	E [3]	E [3 11]	NE [8]	6030, C.B. 1953–2, 185.
France	15% [3]	15% [3]	E [3]	NE [8]	6273, C.B. 1957–2, 1020.
Germany	15% [3 15]	E [3 16]	E [3]	NE [8]	6122, C.B. 1955–1, 641.
Greece	NE	E [3 6]	E [3 11]	NE [8]	6109, C.B. 1954–2, 638.
Honduras	NE	E [3]	E [3]	NE [8]	6264, C.B. 1957–2, 1040.
Ireland	15% [4 5]	E [3 6]	E [4]	15% [4 9]	5897, C.B. 1952–1, 89.
Italy	15% [3 5]	NE	E [3]	NE [8]	6215, C.B. 1956–2, 1105.
Japan	NE	15% [3]	15% [3]	NE [8]	6130, C.B. 1955–1, 665.
Netherlands	15% [3 5]	E [3 7]	E [3]	NE [8]	5690, C.B. 1949–1, 92.
Netherlands Ant	15% [3 5]	E [3 7]	E [3]	NE [8]	6153, C.B. 1955–2, 777.
New Zealand	15% [3 5]	NE	NE [10]	NE [10]	5957, C.B. 1953–1, 238.
Norway	15% [3 5]	E [3]	E [3]	NE [8]	5956, C.B. 1953–1, 228.[22]
Pakistan	15% [3 19]	NE	E [3 11 25]	NE	6431, C.B. 1960–1, 755.
South Africa	NE	NE	NE	NE [8]	None issued.[12]
Sweden	10% [14]	NE	E [14]	NE	4975, C.B. 1940–2, 43.
Switzerland	15% [3 5]	5% [3]	E [3]	NE [8]	5867, C.B. 1951–2, 75.
United Kingdom	15% [4 5]	E [4 6]	E [26]	15% [4 8]	5532, C.B. 1946–2, 73.
United Kingdom Colonies [20]	15% [4 5]	E [4 6 21]	E [26]	15% [4 8]	6437, C.B. 1960–1, 767.

Definitions:
E—Exempt.
NE—Not exempt—Tax to be withheld at the statutory rate prescribed by sections 1441 and 1442 of the Internal Revenue Code of 1954.
References:
1. Except interest on tax-free covenant bonds issued before January 1, 1934, as to which the obligor has assumed liability for tax greater than 2 percent of such interest.
2. Copyright royalties only.
3. Applicable if no permanent establishment in United States.
4. Applicable if no permanent establishment in United States and subject to tax of the other contracting party.
5. The rate is five percent on dividends paid by domestic subsidiary corporation subject to prescribed conditions.
6. Does not apply to interest paid by controlled corporation.
7. Does not apply to interest paid by controlled corporation nor to interest on mortgages secured on real estate.
8. Recipient may elect to be subject to tax on a net basis by filing Form 1040B.
9. Recipient may elect to be subject to tax on a net basis but only on real property by filing Form 1040B.
10. No exemption except motion picture film rentals; net basis tax elective (on filing Form 1040B) on real property rentals, natural resource royalties, and industrial royalties (other than film rentals).
11. Does not apply to motion picture film rentals or royalties.
12. See the Income Tax Convention between the United States and the Union of South Africa effective July 1, 1946, appearing in Cumulative Bulletin 1954–2, 651, 655.
13. Copyright royalties are exempt from tax and withholding provided the taxpayer has no permanent establishment in the United States.
14. Applicable whether or not engaged in trade or business in United States.
15. Applies only if the German company deriving dividend owns at least 10 percent of voting stock of the domestic corporation paying dividend.
16. Not applicable to interest on debts secured by mortgages on farms, timberlands, or real property used wholly or partly for housing purposes.
17. Not applicable to interest on debts secured by mortgages.
18. Motion picture film rentals are taxed at a rate of 10 percent.
19. Applies only to a Pakistan company owning shares carrying more than 50 percent of the voting power in the United States corporation paying the dividend.
20. Applicable to the following Overseas Territories of the United Kingdom: Aden, Antigua, Barbados, British Honduras, Cyprus, Dominica, Falkland Islands, Gambia, Grenada, Jamaica, Montserrat, Nigeria, Federation of Rhodesia and Nyasaland, Federation of St. Christopher, Nevis, and Anguilla, St. Lucia, St. Vincent, Seychelles, Sierra Leone, Trinidad and Tobago, and the Virgin Islands.
21. Applies only to the Federation of Rhodesia and Nyasaland.
22. Revised withholding regulations in process.
23. Applicable to the Trust Territory of Ruanda-Urundi as per Treasury Decisions 6438, C.B. 1960–1, 739, and 6469, C.B. 1960–1, 752. The question as to whether the Convention now applies to the new state of Congo has not been resolved.
24. The interest exempted shall be an amount not exceeding fair and reasonable consideration on indebtedness.
25. The royalty exempted shall be an amount not exceeding fair and reasonable consideration.
26. Applicable if subject to tax of the other contracting party and if no permanent establishment in the United States or if the royalty is not directly associated with the business carried on through a permanent establishment in the United States.

The exemptions from, or reductions in rate of, United States tax set forth above with respect to interest, royalties, real property rentals and natural resource royalties are applied at the source upon filing, by the payee of the income, with the withholding agent in the United States, of the appropriate certificate (or letter, as the case may be) as prescribed by regulations (Treasury Decisions cited above).

The reduced rate in the case of dividends (other than those with respect to which the rate of five percent is claimed) is applicable at the source in every case in which the address of the stockholder on the records of the disbursing entity paying the dividend (or on those of the domestic agent receiving such dividend on behalf of the nonresident alien individual or nonresident foreign corporation) is in the foreign country concerned. The reduced rate of five percent is applicable only where the Commissioner of Internal Revenue determines, and so notifies the paying corporation, that such reduced rate applies.

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax at source in the case of residents of Norway and of Norwegian corporations or other entities, as affected by the income tax convention between the United States and Norway. See T.D. 6489, page 630.

SECTION 1442.—WITHHOLDING OF TAX ON FOREIGN CORPORATIONS

26 CFR 1.1442–1: Withholding of tax on foreign corporations.

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax at source in the case of residents of Norway and of Norwegian corporations or other entities, as affected by the income tax convention between the United States and Norway. See T.D. 6489, page 630.

Revised schedule of withholding tax rates under conventions. See Rev. Rul. 60–288, page 265.

CHAPTER 6.—CONSOLIDATED RETURNS

SUBCHAPTER A.—RETURNS AND PAYMENT OF TAX

SECTION 1502.—REGULATIONS

26 CFR 1.1502–31: Bases of tax computation. Rev. Rul. 60–245

M corporation which is engaged in the construction business, is the common parent of an affiliated group of corporations which has filed consolidated income tax returns since 1954. In 1955, *M* constructed

an apartment building for its wholly-owned subsidiary, *N*, a member of the affiliated group, at a profit of $10x$ dollars. The $10x$ dollar profit on this transaction was eliminated on the consolidated return of the group for 1955, in accordance with section 1.1502–31(b)(1)(i) of the Income Tax Regulations, as an unrealized profit from an intercompany transaction. In 1959, *M* sold all of the stock of *N* to a party outside the affiliated group. At the time of the sale of its stock, *N* was still in possession of the apartment building. *Held*, the previously eliminated intercompany profit of $10x$ dollars, less the excess of depreciation on the building based on the construction price before the intercompany elimination over the depreciation based on the construction price reduced by the intercompany elimination, became a realized profit of *M* and subject to tax as ordinary income in 1959, the year in which the stock of *N* was sold to a party outside the affiliated group. The basis of the property in the hands of *N*, as reduced by the intercompany profit, is increased at the time that the *N* stock was sold by the amount of intercompany profit includible in the income of *M*.

(Also Section 922; 1.922–1(a).) Rev. Rul. 60–289

An affiliated group of corporations filing a consolidated return may take into account, in the computation of consolidated taxable income, unrealized profits and losses from transactions between members of the group occurring in the regular course of trade or business, provided such treatment is adopted for bona fide business reasons and not for the purpose of tax avoidance. Such practice, if adopted, must be consistently followed in all subsequent years for which a consolidated return is filed, or is required to be filed, and requires the prior approval of the Commissioner of Internal Revenue.

Advice has been requested whether the taxpayer may adopt the practice of taking into account, in the computation of consolidated taxable income, the gains and losses of its wholly owned subsidiary derived from intercompany transactions, under the circumstances described below.

The taxpayer, a corporation organized under the laws of the United States, is the common parent of an affiliated group of corporations which files consolidated income tax returns. The parent corporation owns all of the capital stock of *N*, a Mexican corporation. Since 1954, the *N* corporation has been considered a domestic corporation for the purpose of filing consolidated returns under section 1504(d) of the Code and for the purpose of determining its qualifications as a Western Hemisphere trade corporation under section 921 of the Code, which qualifications it met during that period.

Prior to the current year, the *N* corporation had been selling its products to purchasers throughout the world. However, it sold none of its products to its parent corporation. Heretofore, the corporation had shipped its products f.o.b. Mexican ports. This manner of selling put *N* at a competitive disadvantage since it requires that certain shipping and other costs be borne by the purchaser, as, for example (1) chartering of a ship, (2) unloading the vessel, (3) transportation from boat to plant and (4) keeping substantial stock on hand. On the other hand, if the products were stored in the United

States, the purchasers could pick them up as needed and, in addition, the cost of freight, handling and other charges would be greatly reduced. Such an arrangement would permit a purchaser to buy from *N* on the same terms and conditions as he could buy from others.

In view of the above and in order to expand its sales to United States customers, a plan was adopted whereby *N* will sell its products to its parent at the same price and under substantially the same conditions as it sells to outsiders. The parent corporation will transport the products to the United States and stockpile them at strategic locations there. It then will sell and distribute the products on a basis competitive with other producers. In the instant case, certain profits on such intercompany transactions will not be realized prior to the end of the taxable year of the group through final transactions with persons other than members of the group.

Section 1502 of the Code provides, in part, as follows:

> The Secretary or his delegate shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return * * * may be returned, determined, computed, assessed, collected, and adjusted, in such a manner as clearly to reflect the income-tax liability * * *.

Section 1.1502–31(b)(1) of the Income Tax Regulations provides, insofar as is pertinent here, that, in computing consolidated taxable income, intercompany profits which have been realized by the group through final transactions with persons outside the group shall not be eliminated, but that unrealized profits and losses in transactions between members of the affiliated group shall be eliminated. That section of the regulations also provides, in part, as follows:

> For the purpose of the regulations under section 1502, a transaction not involving a sale or exchange of a capital asset or of property subject to the provisions of section 1231 shall not be considered an intercompany transaction if such transaction occurs in the regular course of the trade or business of the members of the group and if such members adopt, with the consent of the Commission and subject to such conditions as he deems proper, a consistent accounting practice of taking into account in the computation of consolidated taxable income the gains and losses reflected in such transactions.

Section 1.1502–31(a)(1) of the regulations defines consolidated taxable income as the combined taxable income of the several affiliated corporations, adjusted for certain additions and reductions. One of the reductions permitted is the consolidated section 922 deduction.

Section 1.1502–31(a)(15) of the regulations provides as follows:

> * * * The consolidated section 922 deduction, relating to Western Hemisphere trade corporations, shall be that portion of the consolidated taxable income attributable to those members of the affiliated group which are Western Hemisphere trade corporations (computed without regard to the consolidated section 922 deduction) multiplied by the fraction specified in section 922(2).

Since the profits on such intercompany transactions had not been realized prior to the end of the taxable year of the group, such profits are ordinarily eliminated in computing consolidated taxable income. See section 1.1502–31(b)(1)(i) of the regulations. If this is done, the subsidiary, a Western Hemisphere trade corporation, could not take into account the profits on such transactions for the purpose of determining its section 922 deduction, which is allowed as a reduction in computing consolidated taxable income under section 1.1502–31

(a) (1) of the regulations. The basis of the property transferred, in the hands of the parent corporation, would be the same as in the hands of the subsidiary. See section 1.1502–38 of the regulations. Upon sale of the property by the parent in a subsequent year to persons outside the group, the profit would no longer be available for the purpose of determining the section 922 deduction since the parent corporation is not a Western Hemisphere trade corporation. However, if permission is granted by the Commissioner of Internal Revenue to take such intercompany profits into account in computing consolidated taxable income for a taxable year, such profits are available to the subsidiary, a Western Hemisphere trade corporation, in computing its section 922 deduction which, in turn, is taken into account in computing the consolidated taxable income of the affiliated group. Under such circumstances, the subsidiary would be in the same position as before, that is, in a position to take such profit into account in determining its section 922 deduction.

The facts presented in the instant case show that the arrangement between *N* and the parent corporation was entered into for bona fide business reasons and not for the purpose of tax avoidance.

Accordingly, it is held that the taxpayer may adopt the practice of taking into account the gains and losses on such intercompany transactions in the computation of consolidated taxable income. Such practice, if adopted, must be consistently followed in all subsequent years for which a consolidated return is filed or required to be filed. However, such permission is not to be construed as a waiver of the remaining requirements of paragraphs (i) through (xiii) of section 1.1502–31(b) (1) of the regulations.

In the instant case, the Commissioner has granted the members of the affiliated group of corporations permission to adopt the practice of taking into account the gains and losses on such intercompany transactions in determining the group's consolidated taxable income, pursuant to the authority contained in section 1.1502–31(b) (1) of the regulations. In the event that any other affiliated group wants to adopt such a practice, the prior approval of the Commissioner must be obtained.

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATES OF CITIZENS OR RESIDENTS

PART II.—CREDITS AGAINST TAX

SECTION 2013.—CREDIT FOR TAX ON PRIOR TRANSFERS

26 CFR 20.2013–5: "Property" and "transfer" defined.

Property received as a legatee and not as a creditor of the transferor's estate. See Rev. Rul. 60–247, page 272.

PART III.—GROSS ESTATE

SECTION 2036.—TRANSFERS WITH RETAINED LIFE ESTATE

26 CFR 20.2036–1: Transfers with retained life estate. T. D. 6501 [1]

TITLE 26—INTERNAL REVENUE, 1954—CHAPTER I, SUBCHAPTER B, PART 20.—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Amendment of regulations under section 2036 of the Internal Revenue Code of 1954, relating to estate tax.

DEPARTMENT OF THE TREASURY,
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 the Estate Tax Regulations (26 CFR Part 20) to section 2036(b) of the Internal Revenue Code of 1954, paragraph (a) of § 20.2036–1 is amended to read as follows:

§ 20.2036–1 TRANSFERS WITH RETAINED LIFE ESTATE.—(a) *In general.*—A decedent's gross estate includes under section 2036 the value of any interest in property transferred by the decedent after March 3, 1931, whether in trust or otherwise, except to the extent that the transfer was for an adequate and full consideration in money or money's worth (see § 20.2043–1), if the decedent retained or reserved (1) for his life, or (2) for any period not ascertainable without reference to his death (if the transfer was made after June 6, 1932), or (3) for any period which does not in fact end before his death—

(i) The use, possession, right to the income, or other enjoyment of the transferred property, or

(ii) The right, either alone or in conjunction with any other person or persons to designate the person or persons who shall possess or enjoy the transferred property or its income (except that, if the transfer was made before June 7, 1932, the right to designate must be retained by or reserved to the decedent alone).

If the decedent retained or reserved an interest or right with respect to all of the property transferred by him, the amount to be included in his gross estate under section 2036 is the value of the entire property, less only the value of any outstanding income interest which is not subject to the decedent's interest or right and which is actually being enjoyed by another person at the time of the decedent's death. If the decedent retained or reserved an interest or right with respect to a part only of the property transferred by him, the amount to be included in his gross estate under section 2036 is only a corresponding proportion of the amount described in the preceding sentence. An interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred.

Because this Treasury Decision makes only a correcting and liberalizing change, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

[1] 25 F.R. 10869.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 10, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 15, 1960, 8:51 a.m., and published in the issue of the Federal Register for November 16, 1960, 25 F.R. 10869)

PART IV.—TAXABLE ESTATE

SECTION 2053.—EXPENSES, INDEBTEDNESS, AND TAXES

26 CFR 20.2053–4: Deduction for claims against the estate; in general. (Also Section 2013; 20.2013–5.) Rev. Rul. 60–247

> **A deduction, for Federal estate tax purposes, will not be allowed for claims against the estate which have not been paid or will not be paid because the creditor waives payment, fails to file his claim within the time limit and under the conditions prescribed by applicable local law, or otherwise fails to enforce payment. An exception is made in cases where the claim may be deemed to have been paid through the payment of a legacy in an amount at least equal to that of the claim.**

Advice has been requested concerning the deduction, for Federal estate tax purposes, of claims against the estate which have not been paid or which will not be paid because the creditor waives payment, fails to file his claim within the time limit and under the conditions prescribed by applicable local law, or otherwise fails to enforce payment.

The question here arises from a United States District Court decision in the case of *Bertha Jacobi Winer* v. *United States*, 153 Fed. Supp. 941, which involved a suit by the executrix to recover estate tax paid by the estate of her deceased mother on the grounds that the Commissioner of Internal Revenue erred in disallowing a deduction for a claim of the daughter-executrix against the estate. The claim had become void and uncollectible by virtue of noncompliance with the applicable state statute. The daughter had loaned money to her mother and had received notes in exchange. The court found that there was no question of the legitimacy of the debt. Under the applicable state statute, however, a claim not filed in the office of the proper authority within a stated period of time becomes void and can no longer be the basis of a cause of action. The court found further that noncompliance with the statute was inadvertent and that the daughter could not profit by the deduction as she was taking nothing under the mother's will.

The United States District Court for the Southern District of New York held for the plaintiff on the ground that the daughter had, on date of death, an "enforceable claim" and that no more is needed to warrant deduction. It attached no importance to the fact that the debt could not be collected.

Section 2053(a) of the Internal Revenue Code of 1954 provides, in part, that the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for claims against the estate as are allowable by the laws of the jurisdiction under which the estate is being administered.

Section 20.2053–4 of the Estate Tax Regulations states, in part, that only claims enforceable against the decedent's estate may be deducted.

In *Jacob A. Jacobs, et al., Executors of the Last Will of Morris Eisenstadt, Deceased*, v. *Commissioner*, 34 Fed. (2d) 233, Ct. D. 128, C.B. VIII–2, 403 (1929), certiorari denied, 280 U.S. 603, the opinion of the court was that Congress intended to provide a deduction for those claims which were presented and allowed or otherwise determined as valid against the estate and actually paid or were to be paid. In that case a widow elected to accept the provision of the will of her deceased husband in her favor in lieu of the amount provided by an antenuptial contract. The antenuptial contract provided for payment of an amount to her upon his death out of his estate in lieu of dower and other marital rights. Under the state law such contract was valid and enforceable against the estate of the deceased husband at the time of his death. The court held, however, that the amount stipulated in the antenuptial contract was not deductible from the gross estate of the decedent for the reasons stated above.

The principles stated in the *Jacobs* case were cited with approval in *John Jacobs, et al., Executors of the Will of Carrie Jacobs Brown* v. *Commissioner*, 34 B.T.A. 594. There, personal property taxes were assessed by a county auditor upon property owned by the decedent. Subsequently, the state taxing authorities issued a certificate of immunity which, by state statute, constituted a defense in any action for recovery of the assessment. The taxes assessed had not been paid and no demand had been made by the taxing authorities. The court held that the assessment was not a claim against the estate and, therefore, the amount was not deductible for Federal Estate tax purposes.

Both the *Jacobs* and the *John Jacobs* cases were cited with approval in *Estate of William P. Metcalf, et al.*, v. *Commissioner*, 7 T.C. 153. In that case, real estate taxes and penalties had accrued and constituted a lien on certain property of the decedent prior to his death. A suit to enforce the lien had been instituted, and the suit was compromised by the estate for a lesser amount than the amount of the taxes claimed. The court held that only the lesser amount was deductible from the gross estate of the decedent.

In *Estate of Ethel M. DuVal, et al.*, v. *Commissioner*, 4 T.C. 722, affirmed, 152 Fed. (2d) 103, certiorari denied 328 U.S. 838, a bank, owner of a claim against decedent as guarantor of notes, consented to distribution of the estate without payment of its claim. It reserved, however, a claim against a co-guarantor. The estate would never be required to pay the claim. The court held that such claim was not

deductible from the gross estate of the decedent. The opinion of the Tax Court of the United States stated, "A claim is an assertion of a right. If there be no assertion of a right or if the right to assert has been relinquished or abandoned, there is no claim."

Accordingly, it is the position of the Internal Revenue Service that no deduction will be allowed for claims against the estate which have not been paid or will not be paid because the creditor waives payment, fails to file his claim within the time limit and under the conditions prescribed by applicable local law, or otherwise fails to enforce payment.

As an exception to this rule, a deduction would be allowed for a claim in favor of the sole beneficiary of an estate, where the claim is not formally presented and not formally paid, but where it is clear, under the facts of the case, that the claim may be deemed to have been paid through the payment of the legacy in an amount at least equal to that of the claim. See *Estate of Annie Feder, et al.*, v. *Commissioner*, 22 T.C. 30, acquiescence, C.B. 1954–2, 4. It is felt that, in such a case, to compel the creditor and the representatives of the estate to make formal presentation and formal payment of the claim as a condition precedent to deduction would be to compel a series of futile acts.

It is to be noted, however, that in *Estate of George Rice, et al.*, v. *Commissioner*, 7 T.C. 223, acquiescence, C.B. 1946–2, 4, the court held the evidence indicated that the decedent, who had been executor, principal creditor and sole legatee of his wife's estate, had waived his claim against her estate. Thus, he had taken her property as legatee, or by inheritance rather than by purchase, and, therefore, that property qualified as property previously taxed in his estate. It is to be noted further that where evidence indicates that a beneficiary under a will did not in fact waive his claim as creditor, a deduction under the Internal Revenue Code of 1939 for property previously taxed will be denied. Also, if the estate of a prior decedent was allowed a deduction as claims against the estate for the same item as is now sought to be deducted as property previously taxed, such deduction will be denied. The same principles should be applied with regard to credit for tax on prior transfers under section 2013 of the Internal Revenue Code of 1954.

SECTION 2055.—TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES

26 CFR 20.2055–1: Deduction for transfers for public, charitable, and religious uses; in general.

Contributions to a college for the construction of fraternity houses. See Rev. Rul. 60–367, page 73.

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26 CFR 20.2055–2: Transfers not exclusively for charitable purposes.

Value of charity's interest in the remainder of a trust which distributes its capital gains. See Rev. Rul. 60–385, page 77.

CHAPTER 12.—GIFT TAX

SUBCHAPTER C.—DEDUCTIONS

SECTION 2522.—CHARITABLE AND SIMILAR GIFTS

26 CFR 25.2522(a)-1: Charitable and similar gifts; citizens or residents.

Contributions or gifts to a college for the construction of fraternity houses. See Rev. Rul. 60-367, page 73.

26 CFR 25.2522(a)-2: Transfers not exclusively for charitable, etc., purposes.

Value of a charity's interest in the remainder of a trust which distributes its capital gains. See Rev. Rul. 60-385, page 77.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

26 CFR 31.3121(a)-1: Wages.

Payments made by an employer under supplemental unemployment benefit plan not involving the use of a trust. See Rev. Rul. 60-330, page 46.

Payments received under a fellowship grant in excess of the limitations of section 117(b)(2)(B) of the Internal Revenue Code of 1954. See Rev. Rul. 60-378, page 38.

26 CFR 31.3121(g)-1: Agricultural labor. (Also Sections 3306, 3401; 31.3306(k)-1, 31.3401(a)(2)-1.) Rev. Rul. 60-277

Services performed by employees in excavating and processing peat for use as a soil conditioner do not constitute "agricultural labor" for Federal employment tax purposes.

Advice has been requested whether services performed by employees of a peat company in connection with obtaining and processing peat for use as a soil conditioner constitute "agricultural labor" for Federal employment tax purposes.

The services in question are performed on a plot of uncultivated land, owned by the company, on which a deposit of peat was discovered. Such services consist of clearing land and removing small trees, brush, and peat roots by use of a bulldozer; digging drainage ditches to remove most of the water present in the moss peat; cleaning and leveling of the peat land for future operations; and breaking the peat into small chips by use of machinery and allowing it to dry. Vacuum cleaner tanks on large rubber wheels are then used to remove the dry chips. The tanks are emptied at the ends of the fields and, after further drying, the peat chips are loaded on wagons and hauled to the company's plant where the chips are finely ground and pressure packed into bales and special moisture-proof paper bags. At this point the peat is ready for use as a soil conditioner.

In order for a service to constitute agricultural labor for purposes of either the Federal Insurance Contributions Act or the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954), it must fall within the definition of agricultural labor as contemplated by the Act under consideration in a particular case.

Section 3121(g) of the Federal Insurance Contributions Act provides, in part, that the term "agricultural labor" includes all service performed:

> (1) on a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife;
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> * * * * * * *
>
> (4) (A) in the employ of the operator of a farm in handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, in its unmanufactured state, any agricultural or horticultural commodity; but only if such operator produced more than one-half of the commodity with respect to which such service is performed; * * *.

Section 3306(k) of the Federal Unemployment Tax Act provides, in part, that the term "agricultural labor" includes all service performed:

> (1) on a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife;
>
> * * * * * * *
>
> (4) in handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, any agricultural or horticultural commodity; but only if such service is performed as an incident to ordinary farming operations or, in the case of fruits and vegetables, as an incident to the preparation of such fruits or vegetables for market. * * *

Peat, a natural deposit which is neither planted, sown, nor grown, is not an agricultural or horticultural commodity within the intendment of the term as used in the definition of "agricultural labor" for Federal employment tax purposes. Also, the land on which the services are performed does not constitute a "farm" within the meaning of that term in sections 3121(g)(1) and 3306(k)(1).

Accordingly, it is held that the services in question performed by employees of the company do not constitute "agricultural labor" for purposes of the Federal Insurance Contributions Act or the Federal Unemployment Tax Act.

The above conclusion also applies for purposes of the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, of the Code.)

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26 CFR 36.3121(l)(1)–1: Agreements entered into by domestic corporations with respect to foreign subsidiaries. Rev. Rul. 60–380

Domestic corporation *A* wholly owns domestic corporation *B;* domestic corporation *B* wholly owns foreign subsidiary corporation *C;* and *C* owns 55 percent of the voting stock of foreign subsidiary *D. Held,* domestic corporation *B,* rather than *A,* is eligible to enter into an agreement under section 3121(l) of the Federal Insurance Contributions Act for the purpose of extending social security coverage to United States citizens employed by foreign subsidiary *D.*

Certain questions have been raised as to the liability arising from an agreement entered into under the provisions of section 3121(l) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) involving two domestic corporations and two foreign subsidiary corporations under the circumstances set forth below.

Domestic corporation *A* wholly owns domestic corporation *B;* domestic corporation *B* wholly owns foreign subsidiary *C;* and *C* owns 55 percent of the voting stock of foreign subsidiary *D.* Employees *X* and *Y*, United States citizens who were formerly employed in the home office of corporation *A*, are presently employed outside of the United States by foreign subsidiary *D. D* pays *X* and *Y* each a $5,000 salary. In addition, *A* pays *X* $2,000 and *Y* $5,000 in order to help provide for *X* and *Y*'s dependents who reside in the United States.

A pays Federal Insurance Contributions Act taxes on the amounts it pays to *X* and *Y* and it wishes to extend full social security coverage to *X* inasmuch as the $2,000 which *A* pays to *X* is less than the statutory limitation on "wages" contained in section 3121(a)(1) of the Federal Insurance Contributions Act.

Corporation *A* inquires whether it may extend complete social security coverage to *X* inasmuch as *X* is a United States citizen employed outside of the United States by a foreign subsidiary indirectly controlled by it. *A* also inquires whether, if it enters into an agreement to extend social security coverage to *X*, it must pay employment taxes on the salary it pays to *X*, in addition to the amount it must pay (under the agreement) equivalent to the employment taxes on the salary which foreign subsidiary *D* pays to *X*.

Under the provisions of section 3121(l) of the Federal Insurance Contributions Act, a domestic corporation may enter into an agreement, with the District Director of Internal Revenue with whom it files its employment tax returns, to extend social security coverage "to service performed outside the United States in the employ of one or more of its foreign subsidiaries (as defined in paragraph (8)) by

all employees who are citizens of the United States, * * *." (Italics supplied.) Section 3121(l)(8) provides as follows:

> (8) DEFINITION OF FOREIGN SUBSIDIARY.—For purposes of this subsection and section 210(a) of the Social Security Act, a foreign subsidiary of a domestic corporation is—
>
> (A) a foreign corporation not less than 20 percent of the voting stock of which is owned by such domestic corporation; or
>
> (B) a foreign corporation more than 50 percent of the voting stock of which is owned by the foreign corporation described in subparagraph (A).

In answer to the question of whether *A* may extend social security coverage to *X*, it is held that under the definition quoted above, corporation *B*, and *not* corporation *A*, is the entity that is eligible to extend social security coverage to United States citizens employed outside the United States by foreign subsidiary *D*. Furthermore, if corporation *B* should enter into a section 3121(l) agreement with the district director, the agreement would apply to *all employees* of the foreign subsidiary *who are citizens of the United States* and not just to employee *X*. See section 36.3121(l)(1)-3(a) of the Employment Tax Regulations.

In answer to the question of whether *A*, under these facts, must pay Federal Insurance Contributions Act taxes on the amounts *it* pays to *X* and *Y*, it is held that such amounts are not subject to employment taxes unless they actually represent compensation for employment services rendered to *A*. See S.S.T. 154, C.B. 1937-1, 391. However, if *X* and *Y* are actually employees of both corporations *A* and *D* and render employment services to both corporations, corporation *A* is, of course, required to pay employment taxes on the wages it pays to *X* and *Y* for services rendered to it.

Assuming that corporation *B* enters into a section 3121(l) agreement with respect to the United States citizens employed by its foreign subsidiary, corporation *B* (subject to the applicable statutory limitations) will be liable for the amounts equivalent to the Federal Insurance Contributions Act employer and employee taxes on the salaries paid by corporation *D* to all United States citizens in its employ. See section 36.3121(l)(9)-1 of the regulations pertaining to the treatment of a domestic corporation which enters into a section 3121(l) agreement as an employer in its separate capacity as a party to the agreement.

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3302.—CREDITS AGAINST TAX

26 CFR 31.3302(b)-1: Additional credit against tax. Rev. Rul. 60-355

> Where an employer pays contributions into the New York State unemployment fund at a normal or reduced rate and, in addition, is required to pay a subsidiary tax under specified conditions, such subsidiary contributions should be taken into consideration in determining the amount of State contributions to be allowed as a credit against his tax under section 3301 of the Federal Unemployment Tax Act.

The "experience rate," as called for in the annual Federal tax return of employers, means the rate assigned to an employer under State law for computing contributions to be paid into the State unemployment fund which is either in excess of or less than 2.7 percent. Where a subsidiary rate is required by State law, the experience rate is the total of the two rates applicable to the employer.

Advice has been requested relative to the treatment, for purposes of the tax imposed under the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954), of amounts paid as subsidiary contributions by an employer to the State of New York pursuant to the New York Unemployment Insurance Law.

The New York Unemployment Insurance Law contains an experience-rating system providing for variations in the contributions rate of a "qualified employer" from the standard rate of 2.7 percent. Generally, a qualified employer's rate is based on his experience with respect to unemployment and the adequacy of the State fund as a whole. Depending on the "size of fund index" and the "employer's experience factor" (both terms being explained in the State law), a qualified employer's rate may vary from a low of zero percent to a high of 3.2 percent (for the calendar year 1960 and thereafter) if his account shows a negative balance for two or more successive years. Furthermore, after 1958, if the balance in the general account in the fund falls below $100,000,000 on July 1, of any year, all employers, whether or not qualified for experience rates, are required to pay additional or "subsidiary contributions" at rates varying from .2 percent to 1 percent, depending upon the extent to which the general account is less than the established minimum.

Section 3302 of the Act provides, in part, as follows:

(a) CONTRIBUTIONS TO STATE UNEMPLOYMENT FUNDS.—(1) The taxpayer may, to the extent provided in this subsection and subsection (c), credit against the tax imposed by section 3301 the amount of contributions paid by him into an unemployment fund maintained during the taxable year under the unemployment law of a State which is certified for the taxable year as provided in section 3304.

* * * * * * *

(b) ADDITIONAL CREDIT.—In addition to credit allowed under subsection (a), a taxpayer may credit against the tax imposed by section 3301 for any taxable year an amount, with respect to the unemployment compensation law of each State * * *, equal to the amount, if any, by which the contributions required to be paid by him * * * were less than the contributions such taxpayer would have been required to pay if throughout the taxable year he had been subject under such State law to the highest rate applied thereunder in the taxable year to any person having individuals in his employ, or to a rate of 2.7 percent, whichever rate is lower.

(c) LIMIT ON TOTAL CREDITS.—(1) The total credits allowed to a taxpayer under this section shall not exceed 90 percent of the tax against which such credits are allowable.

Section 3306(g) of the Act provides that the term "contributions" means payments required by a State law to be made into an unemployment fund by any person on account of having individuals in his employ, to the extent that such payments are made by him without being deducted or deductible from the remuneration of the individuals in his employ.

Specifically, the questions presented and the answers thereto are as follows:

Question 1. Are payments of subsidiary contributions, in addition to normal or reduced rate contributions, made by an employer under the State law, considered as required contributions paid into the State unemployment fund for purposes of credit against the Federal unemployment tax?

Answer. Since the subsidiary contribution is a contribution required to be paid by employers under specified conditions pursuant to the provisions of the unemployment insurance law of the State of New York, such subsidiary contribution should be taken into consideration in determining the amount of State contributions to be allowed as a credit against the Federal unemployment tax.

Question 2. If an employer is granted a reduced rate for paying contributions and also is required to pay a subsidiary contribution under the State law, what is the employer's "experience rate" called for in the annual Federal tax return of employers?

Answer. The phrase "experience rate" called for in the return means the rate assigned to an employer under the provisions of a State law for the purpose of paying contributions into a State fund which is either in excess of or less than 2.7 percent. Accordingly, if pursuant to the law of the State of New York an employer is granted a reduced rate and is also required to pay contributions at a subsidiary rate under the State law, the total of the two rates would be the "experience rate" for the purpose of the Federal return provided such total is either in excess of or less than 2.7 percent. For example, if an employer is granted a reduced rate of two percent and, in addition, is required to pay a subsidiary contribution of one-tenth of one percent, his experience rate for the purpose of the Federal return would be 2.1 percent. Similarly, if an employer is required to pay contributions at the rate of 2.7 percent and, in addition, is required to pay a subsidiary contribution of one-tenth of one percent, his "experience rate" for the purpose of that return would be 2.8 percent.

SECTION 3306.—DEFINITIONS

26 CFR 31.3306(b)-1: Wages.

Payments made by an employer under supplemental unemployment benefit plan not involving the use of a trust. See Rev. Rul. 60-330, page 46.

Payments received under a fellowship grant in excess of the limitations of section 117(b)(2)(B) of the Internal Revenue Code of 1954. See Rev. Rul. 60-378, page 38.

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26 CFR 31.3306(k)-1: Agricultural labor.

Services performed in excavating and processing peat. See Rev. Rul. 60-277, page 275.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

26 CFR 31.3401(a)–1: Wages.

Payments made by an employer under supplemental unemployment benefit plan not involving the use of a trust. See Rev. Rul. 60–330, page 46.

26 CFR 31.3401(a)(2)–1: Agricultural labor.

Services performed in excavating and processing peat. See Rev. Rul. 60–277, page 275.

26 CFR 33.3401(a)–1: Wages.

Payments received under a fellowship grant in excess of the limitations of section 117(b)(2)(B) of the Internal Revenue Code of 1954. See Rev. Rul. 60–378, page 38.

SECTION 3402.—INCOME TAX COLLECTED AT SOURCE

26 CFR 31.3402(a)–1: Requirement of withholding.

Payments received under a fellowship grant in excess of the limitations of section 117(b)(2)(B) of the Internal Revenue Code of 1954. See Rev. Rul. 60–378, page 38.

SUBTITLE D.—MISCELLANEOUS EXCISE TAXES

CHAPTER 31.—RETAILERS EXCISE TAXES

SUBCHAPTER A.—JEWELRY AND RELATED ITEMS

SECTION 4001.—IMPOSITION OF TAX

Rev. Rul. 60–272

The retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954 applies to the retail sale of *any article commonly or commercially known and sold in the trade* as "gold-plated flatware," "gold-plated hollow ware," or "silver-plated hollow ware."

Advice has been requested whether the provisions of S.T. 935, C.B. 1948–2, 192, may be used in determining the applicability of the retailers excise tax to sales of "flatware" and "hollow ware."

A company produces numerous articles which it sells at retail as

gold-plated and silver-plated flatware and hollow ware. It has been stated that on some of these articles the gold or silver plating is less than one one-hundred-thousandth of an inch in thickness, and the question has arisen whether this fact precludes the applicability of the retailers excise tax.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on the sale at retail of several categories of articles referred to generally as "jewelry and related items." Among the categories of articles subject to this tax, in addition to articles commonly or commercially known as jewelry, are the following:

(1) Articles made of, or ornamented, mounted or fitted with precious metals or imitations thereof;

(2) Gold, gold-plated, silver, or sterling flatware or hollow ware and silver-plated hollow ware.

With respect to category (1) above, section 320.33 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, provides that the tax is imposed on the sale at retail of any articles, as distinguished from those articles commonly or commercially known as jewelry as described in section 320.31, which are made of, or ornamented, mounted or fitted with precious metals or imitations thereof. The term "precious metals" includes platinum, gold, silver, and other metals of similar or greater value. The term "imitations thereof" includes platings and alloys of such metals. Photograph frames, book ends, ash trays, vanity cases, mesh bags, cigarette cases, etc., glassware, china, pottery, and like articles, are set forth in the regulations as examples of articles which are taxable if ornamented with gold, silver, or other precious metals or imitations thereof.

With respect to the articles to which section 320.33 of the regulations relates, the Internal Revenue Service adopted the position, based upon certain facts presented by the industry, that articles, other than articles commonly or commercially known as jewelry, merely coated with a deposit of precious metal or an alloy of such metal which is less than one one-hundred-thousandth of an inch in thickness, are not *ornamented with* a precious metal or imitation thereof within the meaning of the statute so as to be subject to the tax. This position has been published as S.T. 935, *supra.*

With respect to category (2) above, section 320.35 of the regulations provides, as follows:

(a) The tax is imposed on the sale at retail of any gold, gold-plated, silver, or sterling flatware or hollow ware, and any silver-plated hollow ware. The terms "flatware and hollow ware" include all articles commonly or commercially known and sold as such in the trade. Any gold, gold-plated, silver, silver-plated, or sterling articles which is not so known or sold in the trade as flatware or hollow ware, is subject to the tax as an article made of, ornamented, mounted or fitted with precious metals or imitations thereof.

(b) No tax attaches to the sale at retail of any article commonly or commercially known or sold in the trade as "silver-plated flatware."

In accordance with the provisions of section 320.35 of the regulations, it is held that the retailers excise tax imposed by section 4001 of the Code applies to the retail sale of *any article commonly or commercially known and sold in the trade* as "gold-plated flatware" "gold-plated hollow ware," or "silver-plated hollow ware."

SUBCHAPTER E.—SPECIAL FUELS

SECTION 4041.—IMPOSITION OF TAX

Whether a ready-mixed two-cycle engine fuel which is produced by blending 80-octane gasoline with outboard motor oil is taxable as a special motor fuel. See Rev. Rul. 60–316, page 310.

26 CFR 48.4041: Statutory provisions; imposition of tax. (Also Section 4201; 48.4201.) T.D. 6505 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER D, PART 48..—MANUFACTURERS AND RETAILERS EXCISE TAXES

Regulations under section 4041 of the Internal Revenue Code of 1954, as amended, relating to the retailers excise tax on the sale or use of diesel fuel, and amendment of regulations under section 4201 of such Code, relating to the manufacturers excise tax on the sale of mechanical lighters for cigarettes, cigars, and pipes.

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

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

On August 17, 1960, notice of proposed rulemaking with respect to regulations under section 4041 of the Internal Revenue Code of 1954, as amended, relating to the retailers excise tax on the sale or use of diesel fuel and special motor fuel was published in the Federal Register (25 F.R. 7883). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations as so published are hereby adopted.

In addition, paragraphs 2 and 3 of this Treasury Decision amend §§ 48.4201 and 48.4201–1(b) of the regulations in Part 48, relating to the manufacturers excise tax on the sale of mechanical lighters for cigarettes, cigars, and pipes, to reflect the amendment of section 4201 of the Code by section 9(a) of the Act of September 14, 1960 (Public Law 86–779, 74 Stat. 1003) [page 709, this Bulletin].

PARAGRAPH 1. The following regulations are prescribed under section 4041 of the Internal Revenue Code of 1954, as amended.

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48.4041	Statutory provisions; imposition of tax.
48.4041–1	Tax on diesel fuel and special motor fuel.
48.4041–2	Application of tax on sale of diesel fuel.
48.4041–3	Application of tax on sale of special motor fuel.
48.4041–4	Sales of diesel and special motor fuel; rules of general application.

[1] The publication of this Treasury Decision in 25 F.R. 11217, dated November 26, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 7883, dated August 17, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

Section
48.4041–5 Application of tax on use of taxable liquid.
48.4041–6 Dual use of taxable liquid.
48.4041–7 Definitions.
48.4041–8 Exemption for farm use.
48.4041–9 Exemption for use as supplies for vessels or aircraft.
48.4041–10 Other exemptions.
48.4041–11 Other credits or refunds.

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RETAILERS EXCISE TAX

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Subpart F.—Special Fuels

§ 48.4041 Statutory Provisions; Imposition of Tax.

SEC. 4041. IMPOSITION OF TAX

(a) Diesel Fuel.—There is hereby imposed a tax of 3 cents a gallon upon any liquid (other than any product taxable under section 4081)—

(1) Sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle, for use as a fuel in such vehicle; or

(2) Used by any person as a fuel in a diesel-powered highway vehicle unless there was a taxable sale of such liquid under paragraph (1).

In the case of a liquid taxable under this subsection sold for use or used as a fuel in a diesel-powered highway vehicle (A) which (at the time of such sale or use) is not registered, and is not required to be registered, for highway use under the laws of any State or foreign country, or (B) which, in the case of a diesel-powered highway vehicle owned by the United States, is not used on the highway, the tax imposed by paragraph (1) or by paragraph (2) shall be 2 cents a gallon. If a liquid on which tax was imposed by paragraph (1) at the rate of 2 cents a gallon by reason of the preceding sentence is used as a fuel in a diesel-powered highway vehicle (A) which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any State or foreign country, or (B) which, in the case of a diesel-powered highway vehicle owned by the United States, is used on the highway, a tax of 1 cent a gallon shall be imposed under paragraph (2).

(b) Special Motor Fuels.—There is hereby imposed a tax of 3 cents a gallon upon benzol, benzene, naphtha, liquefied petroleum gas, or any other liquid (other than kerosene, gas oil, or fuel oil, or any product taxable under section 4081 or subsection (a) of this section)—

(1) Sold by any person to an owner, lessee, or other operator of a motor vehicle, motorboat, or airplane for use as a fuel for the propulsion of such motor vehicle, motorboat, or airplane; or

(2) Used by any person as a fuel for the propulsion of a motor vehicle, motorboat, or airplane unless there was a taxable sale of such liquid under paragraph (1).

In the case of a liquid taxable under this subsection sold for use or used otherwise than as a fuel for the propulsion of a highway vehicle (A) which (at the time of such sale or use) is registered, or is required to be registered, for highway use under the laws of any State or foreign country, or (B) which, in the case of a highway vehicle owned by the United States, is used on the highway, the tax imposed by paragraph (1) or by paragraph (2) shall be 2 cents a gallon. If a liquid on which tax was imposed by paragraph (1) at the rate of 2 cents a gallon by reason of the preceding sentence is used as a fuel for the propulsion of a highway vehicle (A) which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any State or foreign country, or (B) which, in the case of a highway vehicle owned by the United States, is used on the highway, a tax of 1 cent a gallon shall be imposed under paragraph (2).

(c) RATE REDUCTION.—On and after July 1, 1972—

(1) The taxes imposed by this section shall be 1½ cents a gallon; and

(2) The second and third sentences of subsections (a) and (b) shall not apply.

(d) EXEMPTION FOR FARM USE.—

(1) EXEMPTION.—Under regulations prescribed by the Secretary or his delegate—

(A) No tax shall be imposed under subsection (a)(1) or (b)(1) on the sale of any liquid sold for use on a farm for farming purposes, and

(B) No tax shall be imposed under subsection (a)(2) or (b)(2) on the use of any liquid used on a farm for farming purposes.

(2) USE ON A FARM FOR FARMING PURPOSES.—For purposes of paragraph (1) of this subsection, use on a farm for farming purposes shall be determined in accordance with paragraphs (1), (2), and (3) of section 6420(c).

(e) EXEMPTION FOR USE AS SUPPLIES FOR VESSELS.—Under regulations prescribed by the Secretary or his delegate, no tax shall be imposed under subsection (b) in the case of any fuel sold for use or used in supplies for vessels or aircraft (within the meaning of section 4221(d)(3)).

(f) TEMPORARY INCREASES IN TAX.—On and after October 1, 1959, and before July 1, 1961.—

(1) If (without regard to this subsection) the tax imposed by subsection (a) or (b) is 3 cents a gallon, the tax imposed by such subsection shall be 4 cents a gallon, and

(2) If (without regard to this subsection) the tax imposed under paragraph (2) of subsection (a) or (b) is 1 cent a gallon, the tax imposed under such paragraph shall be 2 cents a gallon.

[Sec. 4041 as amended and in effect Jan. 1, 1959, and as amended by sec. 201(b), Federal-Aid Highway Act 1959 (73 Stat. 613) [P.L. 86-342, C.B. 1959-2, 697]]

§ 48.4041-1 TAX ON DIESEL FUEL AND SPECIAL MOTOR FUEL.—Section 4041, in general, imposes an excise tax at the retail level on the sale of diesel fuel for use as a fuel in a diesel-powered highway vehicle and on the sale of special motor fuel for use as a fuel for the propulsion of a motor vehicle, motorboat, or airplane. A tax is also imposed when such liquids are purchased tax free and subsequently used for one of the above-mentioned purposes, or when such liquids are purchased at one rate of tax and a higher rate of tax applies as a result of the type of use made of the liquids.

§ 48.4041-2 APPLICATION OF TAX ON SALE OF DIESEL FUEL.—(a) *In general.*—The tax imposed by paragraph (1) of section 4041(a) applies to the sale of diesel fuel by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle for use as a fuel in such vehicle. The tax applies on diesel fuel sold for use in a diesel-powered highway vehicle, whether the vehicle actually is employed in highway or off-highway use.

(b) *Liability for tax.*—The tax on the sale of diesel fuel is payable by the person who sells such fuel to the owner, lessee, or other operator of a diesel-powered highway vehicle.

(c) *Rate of tax.*—Tax is imposed on the sale of diesel fuel at the rate applicable on the date on which the diesel fuel is sold.

(1) *Registered highway vehicles.*—Following are the rates applicable to the sale on or after January 1, 1959, of diesel fuel for use as a fuel in a diesel-powered highway vehicle which at the time of the sale is registered or required to be registered for highway use or in a

diesel-powered highway vehicle owned by the United States which is used on the highway:

	Diesel fuel sold	*Per gallon*
(i)	January 1, 1959 to September 30, 1959, inclusive	3 cents
(ii)	October 1, 1959 to June 30, 1961, inclusive	4 cents
(iii)	July 1, 1961 to June 30, 1972, inclusive	3 cents
(iv)	On and after July 1, 1972	1½ cents

(2) *Nonregistered highway vehicles.*—Following are the rates applicable to the sale on and after January 1, 1959, of diesel fuel for use in a diesel-powered highway vehicle which at the time of the sale is not registered and is not required to be registered for highway use (including a diesel-powered highway vehicle owned by the United States which is not used on the highway):

	Diesel fuel sold	*Per gallon*
(i)	January 1, 1959 to June 30, 1972, inclusive	2 cents
(ii)	On and after July 1, 1972	1½ cents

(3) *Tax rate to be applied.*—The test of taxability at a rate specified in subparagraph (1) of this paragraph (other than in the case of United States-owned vehicles) is whether the vehicle in which the fuel is to be used is registered, or required to be registered, for highway use under the laws of any State or foreign country at the time of sale. Tax at a rate specified in subparagraph (1) of this paragraph applies to all fuel sold for use in a diesel-powered highway vehicle which is registered, or required to be registered, for highway use under the laws of any State or foreign country even though the vehicle is seldom or never used on the highway and regardless of the proportion of the fuel used off the highway as compared to total fuel consumption.

(d) *Example.*—Application of the tax to the sale of diesel fuel may be illustrated by the following example: The M Corporation is engaged in the construction of a power dam at a site removed from all public highways. Part of its construction equipment consists of diesel-powered shovels, bulldozers, and highway type dump trucks. Some of the trucks are registered for highway use and are used both on and off the public roads. Others are not registered and under the applicable State law are not required to be registered for highway use inasmuch as they are used entirely on the construction site. The diesel fuel sold for use in the registered dump trucks is all subject to tax at the rate specified in paragraph (c)(1) of this section, even though a portion of it is used off the public highway. The fuel sold for use in the nonregistered trucks, which are operated entirely off the highway, is taxable at the rate specified in paragraph (c)(2) of this section. No tax is payable with respect to the diesel fuel sold for use in the power shovels and bulldozers, since they are not vehicles which may be operated in general use over a public highway.

(e) *Cross references.*—(1) See § 48.4041–5 for the tax applicable in certain cases based on the use of diesel fuel as a fuel in a diesel-powered highway vehicle.

(2) See paragraphs (a), (b), (e), and (h) of § 48.4041–7 for definition of the terms "highway", "highway vehicle", "diesel fuel", and "registered".

(3) For exemption from tax with respect to diesel fuel sold for use on a farm for farming purposes, see § 48.4041–8.

§ 48.4041–3 APPLICATION OF TAX ON SALE OF SPECIAL MOTOR FUEL.—(a) *In general.*—The tax imposed by paragraph (1) of section 4041(b) applies to the sale of special motor fuel by any person to an owner, lessee, or other operator of a motor vehicle, motorboat, or airplane, for use as a fuel for the propulsion of such motor vehicle, motorboat, or airplane.

(b) *Liability for tax.*—The tax on the sale of special motor fuel is payable by the person who sells such fuel to the owner, lessee, or other operator of a motor vehicle, motorboat, or airplane.

(c) *Rate of tax.*—Tax is imposed on the sale of special motor fuel at the rate applicable on the date on which the special motor fuel is sold.

(1) *Registered highway vehicles.*—Following are the rates applicable to the sale on or after January 1, 1959, of special motor fuel for use as a fuel for the propulsion of a motor vehicle which at the time of the sale is registered or required to be registered for highway use or in a motor vehicle owned by the United States which is used on the highway:

	Special motor fuel sold	*Per gallon*
(i)	January 1, 1959 to September 30, 1959, inclusive	3 cents
(ii)	October 1, 1959 to June 30, 1961, inclusive	4 cents
(iii)	July 1, 1961 to June 30, 1972, inclusive	3 cents
(iv)	On and after July 1, 1972	1½ cents

(2) *Motorboats, airplanes, and nonregistered motor vehicles.*—Following are the rates applicable to the sale on and after January 1, 1959, of special motor fuel for use as a fuel for the propulsion of a motorboat or airplane, or of a motor vehicle which at the time of the sale is not registered and is not required to be registered for highway use (including a motor vehicle owned by the United States which is not used on the highway):

	Special motor fuel sold	*Per gallon*
(i)	January 1, 1959 to June 30, 1972, inclusive	2 cents
(ii)	On and after July 1, 1972	1½ cents

(3) *Tax rate to be applied.*—In the case of the sale of special motor fuel for use as a fuel for the propulsion of a motor vehicle the test of taxability at a rate specified in subparagraph (1) of this paragraph (other than in the case of United States-owned vehicles) is whether the vehicle in which the fuel is to be used is registered, or required to be registered, for highway use under the laws of any State or foreign country at the time of sale. Tax at a rate specified in subparagraph (1) of this paragraph applies to special motor fuel sold for use in a motor vehicle which is registered, or required to be registered, for highway use under the laws of any State or foreign country even though the vehicle is seldom or never used on the highway and regardless of the proportion of the fuel used off the highway as compared to total fuel consumption. Tax at a rate specified in subparagraph (2) of this paragraph applies in any case of the sale of special motor fuel for use in the propulsion of a motorboat or airplane or a motor vehicle which is not registered and is not required to be registered for highway use under the laws of any State or foreign country.

(d) *Example.*—Application of the tax to the sale of special motor fuels may be illustrated by the following example: The N Company is

engaged in the manufacture of ceramic products. It has a vehicle which is used to haul clay from the clay pit to its factory. This vehicle has not been registered for highway use and under the applicable State law is not required to be registered for highway use inasmuch as none of the hauling of clay is done on public highways. The N Company also uses a ditch digging machine in the vicinity of the clay pit for the construction of drains. A fork lift truck is used to move cartons of merchandise from place to place inside the company's warehouse and to assist in the loading of merchandise onto the company's highway trucks for delivery to purchasers. The highway trucks are registered by the State for use on highways. Special motor fuel is used for the operation of all of these items of equipment. The special motor fuel sold for use as a fuel for the propulsion of the registered highway trucks is subject to tax at the rate specified in paragraph (c) (1) of this section. The special motor fuel sold for use as a fuel for the propulsion of the truck used to haul clay from the pit to the factory and for the propulsion of the fork lift truck is subject to tax at the rate specified in paragraph (c) (2) of this section. No tax is payable with respect to the special motor fuel sold for use as a fuel in the ditch digging machine since that machine is not a motor vehicle.

(e) *Cross references.*—(1) See § 48.4041–5 for the tax applicable in certain cases based on the use of special motor fuel as a fuel for the propulsion of a motor vehicle.

(2) See paragraphs (a), (c), (f), and (h) of § 48.4041–7 for definition of the terms "highway", "motor vehicle", "special motor fuel", and "registered".

(3) For exemption from tax with respect to special motor fuel sold for use on a farm for farming purposes or as supplies for vessels or aircraft, see §§ 48.4041–8 and 48.4041–9, respectively.

§ 48.4041–4 Sales of Diesel and Special Motor Fuel; Rules of General Application.—(a) *Taxability of liquid delivered into purchasers' tanks.*—The sale of diesel fuel to an owner, lessee, or other operator of a diesel-powered highway vehicle, or of special motor fuel to an owner, lessee, or other operator of a motor vehicle, motorboat, or airplane shall be considered a taxable sale of such liquid (1) if the liquid is delivered by the seller into the fuel supply tank of the vehicle, motorboat, or airplane, or (2) where not so delivered, the purchaser indicates in writing to the seller prior to or at the time of the sale that the entire quantity of the liquid covered by the sale is for use by him for a taxable purpose as a fuel in such a vehicle, motorboat, or airplane. If such a written statement is not furnished by the purchaser, he shall be liable for the tax at the applicable rate on that quantity of the liquid which is used by him as fuel in such a vehicle, motorboat, or airplane (see § 48.4041–5), or which is sold by him in a taxable transaction.

(b) *Sales for resale and to consignees.*—(1) A sale to a dealer for resale is not subject to tax even though it is known at the time of the sale that the liquid will be resold by such dealer for use as a fuel in a diesel-powered highway vehicle, or in a motor vehicle, motorboat, or airplane.

(2) The tax is payable by the person who makes the taxable sale. Where a taxable liquid is consigned to a person for sale and the consignor retains ownership in such liquid until it is disposed of by

the consignee, the consignor is the person liable for the tax when a taxable sale of the liquid is made by the consignee. In the event the consignor does not retain ownership in the taxable liquid, the consignee is the person liable for the tax upon the taxable sale of such liquid. See paragraph (d) of § 48.4041–7 for definition of the term "taxable liquid".

§ 48.4041–5 Application of Tax on Use of Taxable Liquid.—(a) *In general.*—(1) *Diesel fuel.*—If a person acquires any diesel fuel by any means other than through a transaction subject to tax under section 4041(a)(1) and uses it for any of the uses described in paragraph (c) (1) or (2) of § 48.4041–2, he shall be liable for a tax under section 4041(a)(2) on the quantity of diesel fuel so used at the appropriate rate set forth in paragraph (b) of this section. If a person acquires any diesel fuel through a transaction which is subject to tax at the rate set forth in paragraph (c)(2) of § 48.4041–2 and uses it for a use described in paragraph (c)(1) of § 48.4041–2, he shall be liable for an additional tax under section 4041(a)(2) on the quantity of diesel fuel so used. See paragraph (b)(1) of this section for the applicable rate of tax.

(2) *Special motor fuel.*—If a person acquires any special motor fuel by any means other than through a transaction subject to tax under section 4041(b)(1) and uses it for any of the uses described in paragraph (c) (1) or (2) of § 48.4041–3, he shall be liable for a tax under section 4041(b)(2) on the quantity of special motor fuel so used at the appropriate rate set forth in paragraph (b) of this section. If a person acquires any special motor fuel through a transaction which is subject to a tax at the rate set forth in paragraph (c)(2) of § 48.4041–3 and uses it for a use described in paragraph (c)(1) of § 48.4041–3, he shall be liable for an additional tax under section 4041(b)(2) on the quantity of special motor fuel so used. See paragraph (b)(1) of this section for the applicable rate of tax.

(b) *Rate of tax.*—Tax is imposed on the use of taxable liquid at the rate applicable on the date on which the taxable liquid is used.

(1) *Registered highway vehicles.*—Following are the rates applicable to the use on and after January 1, 1959, of taxable liquid as a fuel in a diesel-powered highway vehicle, or for the propulsion of a motor vehicle (i) which at the time of such use is registered or required to be registered for highway use, or (ii) in the case of such a vehicle owned by the United States which is used on the highway:

	Taxable liquid used	*Per gallon*
(*a*)	January 1, 1959 to September 30, 1959, inclusive, and no tax was imposed with respect to the sale of such liquid	3 cents
(*b*)	January 1, 1959 to September 30, 1959, inclusive, and tax at the rate of 2 cents per gallon was imposed with respect to the sale of such liquid	1 cent
(*c*)	October 1, 1959 to June 30, 1961, inclusive, and no tax was imposed with respect to the sale of such liquid	4 cents
(*d*)	October 1, 1959 to June 30, 1961, inclusive, and tax at the rate of 2 cents per gallon was imposed with respect to the sale of such liquid	2 cents
(*e*)	July 1, 1961 to June 30, 1972, inclusive, and no tax was imposed with respect to the sale of such liquid	3 cents
(*f*)	July 1, 1961 to June 30, 1972, inclusive, and tax at the rate of 2 cents per gallon was imposed with respect to the sale of such liquid	1 cent
(*g*)	On and after July 1, 1972, and no tax was imposed with respect to the sale of such liquid	1½ cents

(2) *Motorboats, airplanes, and nonregistered vehicles.*—Following are the rates applicable to the use on or after January 1, 1959, of taxable liquid as a fuel—

(i) For the propulsion of a motorboat or airplane,

(ii) In a diesel-powered highway vehicle, or for the propulsion of a motor vehicle, which at the time of such use is not registered and is not required to be registered for highway use, or

(iii) In a diesel-powered highway vehicle, or for the propulsion of a motor vehicle, owned by the United States which is not used on the highway:

	Taxable liquid used	*Per gallon*
(*a*)	January 1, 1959 to June 30, 1972, inclusive, and no tax was imposed with respect to the sale of such liquid.	2 cents
(*b*)	On and after July 1, 1972, and no tax was imposed with respect to the sale of such liquid.	1½ cents

(c) *Bulk purchases by users.*—Taxpayers who purchase taxable liquid in bulk delivered into storage tanks or other containers and use it for various purposes, both taxable and nontaxable, or in both registered and nonregistered vehicles, must maintain adequate records of all fuel used for each purpose to permit verification of the tax paid and of any credits, refunds, or exemptions claimed.

§ 48.4041–6 Dual Use of Taxable Liquid.—Tax applies to all taxable liquid sold for use or used as a fuel in the motor which is used to propel a diesel-powered highway vehicle or in the motor used to propel a motor vehicle, motorboat, or airplane, even though the motor is also used for a purpose other than the propulsion of the vehicle. Thus, where the motor of a diesel-powered highway vehicle or of a motor vehicle, motorboat, or airplane operates special equipment by means of a power take-off, tax applies to all taxable liquid sold for such use or so used, whether or not the special equipment is mounted on the vehicle. For example, tax applies to diesel fuel sold to operate the mixing unit on a concrete mixer truck if the mixing unit is operated by means of a power take-off from the motor of the vehicle. Similarly, tax applies to all taxable liquid sold for use or used in a motor propelling a fuel oil truck even though the same motor is used to operate the pump (whether or not mounted on the truck) for discharging the fuel into customers' storage tanks. However, tax does not apply to liquid sold for use or used in a separate motor to operate special equipment (whether or not the equipment is mounted on the vehicle). If the taxable liquid used in a separate motor is drawn from the same tank as the one which supplies fuel for the propulsion of the vehicle, a reasonable determination of the quantity of taxable liquid used in such separate motor will be acceptable for purposes of application of the tax. Such determination must be based, however, on the operating experience of the person using the taxable liquid and the taxpayer must maintain records which will support the allocation used.

§ 48.4041–7 Definitions.—For purposes of the regulations in this subpart, unless otherwise expressly indicated:

(a) *Highway.*—The term "highway" includes any road (whether a Federal highway, State highway, city street, or otherwise) in the United States which is not a private roadway.

(b) *Highway vehicle.*—The term "highway vehicle" has reference to the type of vehicle and not to the use which is made of the vehicle. The term means any motor vehicle, whether powered by diesel fuel or special motor fuel which is of the type used for transportation on the highways. It includes automobile trucks, buses, highway tractors, trolley buses, and other similar type vehicles. The term "highway vehicle" does not include any vehicle, which, although propelled by means of its own motor, is of a type not used for highway transportation, that is, of a type designed and manufactured for a purpose other than highway transportation. For example, vehicles such as earth movers, power shovels, trench diggers, and bulldozers, which are designed and manufactured as self-propelled units for "off-the-road" operations, are not highway vehicles. Neither are such motorized vehicles as road graders or rollers, which are designed and manufactured for construction or maintenance of roads, considered to be highway vehicles. The same is true of farm tractors, cotton pickers, and other motorized agricultural implements of a similar nature. However, the fact that equipment or machinery having a specialized use (as for example, an air compressor, crane, or specialized oil-field machinery) is mounted on a vehicle which, apart from such equipment or machinery, is of a type used for highway transportation will not remove such vehicle from classification as a highway vehicle.

(c) *Motor vehicle.*—The term "motor vehicle" includes all types of vehicles propelled by motor which are designed for carrying loads from one place to another, regardless of the type of load or material carried and whether or not the vehicle is registered or required to be registered for highway use, such as fork lift trucks used to carry loads at railroad stations, industrial plants, warehouses, etc. The term does not include farm tractors, trench diggers, power shovels, bulldozers, road graders or rollers, and similar equipment which does not carry a load; nor does it include any vehicle which moves exclusively on rails.

(d) *Taxable liquid.*—The term "taxable liquid" means any liquid which is—

(1) Diesel fuel as defined in paragraph (e), or

(2) Special motor fuel as defined in paragraph (f).

(e) *Diesel fuel.*—The term "diesel fuel" means any liquid (other than a product taxable as gasoline under the provisions of section 4081) which is sold for use or used as a fuel in a diesel-powered highway vehicle.

(f) *Special motor fuel.*—(1) The term "special motor fuel" includes any of the following sold for use or used as a fuel for the propulsion of a motor vehicle, motorboat, or airplane:

(i) Liquefied petroleum gases (such as propane, butane, or pentane, or mixtures of the same), or

(ii) Benzol, benzene, naphtha, or any other liquid, whether a refined, partly refined, or unrefined product, 10 percent of which has been recovered when the thermometer reads 347° F. (175° C.) *or* 95 percent of which has been recovered when the thermometer reads 464° F. (240° C.) when subjected to distillation in accordance with the "Standard Method of Test for Distillation of Gasoline, Naphtha, Kerosene, and Similar Petroleum Products" (A.S.T.M. designation: D86) of the American Society for Testing Materials, regardless of the trade name under which sold.

(2) The term "special motor fuel" does not include diesel fuel or any product taxable under the provisions of section 4081 nor does it include "kerosene, gas oil, or fuel oil", as defined in paragraph (g) of this section.

(g) *Kerosene, gas oil, or fuel oil.*—(1) The term "kerosene, gas oil, or fuel oil" means any product (i) 10 percent of which has not been recovered when the thermometer reads 347° F. (175° C.), *and* (ii) 95 percent of which has not been recovered when the thermometer reads 464° F. (240° C.), when subjected to distillation in accordance with the "Standard Method of Test for Distillation of Gasoline, Naphtha, Kerosene, and Similar Petroleum Products" (A.S.T.M. designation: D86) of the American Society for Testing Materials.

(2) Products designated as Kerosene, gas oil, or fuel oil which do not fall within the specifications of both subdivisions (i) *and* (ii) of subparagraph (1) of this paragraph are taxable as special motor fuel if sold or used as a fuel for the propulsion of a motor vehicle, motorboat, or airplane.

(h) *Registered.*—The term "registered" when used with reference to a highway vehicle means—

(1) Registered for highway use under the laws of any State, District of Columbia, or foreign country, or

(2) Required to be registered for highway use under the law of the State, District of Columbia, or foreign country in which it is operated or situated.

Any highway vehicle which is operated under a dealer's tag, license, or permit is considered to be registered. A highway vehicle is not considered to be registered solely by reason of the fact that there has been issued a special permit for operation of the vehicle at particular times and under specified conditions.

§ 48.4041–8 Exemption for Farm Use.—(a) *In general.*—The tax imposed by section 4041 does not apply to diesel fuel or special motor fuel sold for use or used on a farm in the United States for farming purposes. The tax applies in the case of diesel fuel delivered into the fuel supply tank of a highway vehicle, or special motor fuel delivered into the fuel supply tank of a motor vehicle, motorboat, or airplane, even though it is known that the liquid is to be used on a farm for farming purposes. Credit or refund of the tax paid in such case may be claimed as provided by section 6416(b)(2)(G) and the regulations thereunder contained in Subpart O upon proof that the taxable liquid was used on a farm for farming purposes. The terms "used on a farm for farming purposes", "farm", and "farming purposes", and related terms, shall have the same meaning for purposes of the exemption in section 4041(d) and the regulations in this section as such terms are defined in paragraphs (1), (2), and (3) of section 6420(c) and the regulations contained in § 48.6420(c)–1.

(b) *Application of exemption.*—The exemption referred to in paragraph (a) of this section does not apply with respect to diesel fuel or special motor fuel sold for use or used for nonfarming purposes, or diesel fuel or special motor fuel sold for use or used off a farm regardless of the nature of such use. If a vehicle is used both on a farm and off the farm or if it is used on a farm both for farming and nonfarming purposes, the exemption applies only with respect to that portion of the diesel fuel or special motor fuel which is sold for use or used "on

a farm for farming purposes". For purposes of this exemption it is immaterial whether or not the vehicle is registered for highway use. However, the actual use of the vehicle and the place where it is used are material. For example, if a truck used on a farm for farming purposes is also used on the highways (even though in connection with operating the farm), tax applies to that portion of the diesel fuel or special motor fuel which is sold for use or used in operating the truck on the highways, since such fuel was used off the farm.

§ 48.4041–9 EXEMPTION FOR USE AS SUPPLIES FOR VESSELS OR AIRCRAFT.—(a) *Application of exemption.*—The tax imposed by section 4041(b) does not apply to special motor fuel which is sold for use or used as supplies for vessels or aircraft within the meaning of section 4221(a)(3) and section 4221(d)(3) and the regulations thereunder contained in Subpart N. See section 6416(b)(2)(B) and the regulations thereunder contained in Subpart O for credit or refund of tax paid on special motor fuel which has been sold or used as supplies for vessels or aircraft.

(b) *Evidence required to establish exemption.*—(1) In order to establish exemption from tax in the case of a sale of special motor fuel for use as supplies for vessels or aircraft, it is necessary that the seller obtain from the owner, charterer, or authorized agent of the vessel or aircraft and retain in his possession a properly executed exemption certificate in the form prescribed by paragraph (c) of this section. If special motor fuel is sold tax free for use as supplies for civil aircraft employed in foreign trade or in trade between the United States and any of its possessions, the exemption certificate must show the name of the country in which the aircraft is registered.

(2) Where only occasional sales of special motor fuel are made to a purchaser for a use which is exempt from tax as provided in this section, a separate exemption certificate shall be furnished for each order. However, where sales are regularly or frequently made to a purchaser for such exempt use, a certificate covering all orders for a specified period not to exceed 4 calendar quarters will be aceptable. Such certificates and proper records of invoices, orders, etc., relative to tax-free sales must be kept for inspection by the district director as provided in section 6001. If a seller's records with respect to any sale claimed to be tax free do not include a proper certificate, with supporting invoices and such other evidence as may be necessary to establish the exempt character of the sale, tax is payable by the seller on such sale.

(c) *Acceptable form of exemption certificate.*—The following form of exemption certificate will be acceptable for the purposes of this section and must be adhered to in substance:

EXEMPTION CERTIFICATE

(For use by purchasers of special motor fuel for use as supplies for certain vessels or aircraft (section 4041(e) of Internal Revenue Code of 1954).)

_____ 19____
(Date)

The undersigned purchaser hereby certifies that he is the

_____
(Owner, charterer, or authorized agent of owner or charterer)

of _____ and that the special motor fuel speci-
(name of company and vessel)

fied in the accompanying order, or as specified below or on the reverse side hereof, will be used only as fuel supplies for a vessel belonging to one of the following classes of vessels to which section 4041(e) of the Internal Revenue Code applies:

(Check class to which vessel belongs)

(1) Vessels engaged in foreign trade.
(2) Vessels engaged in trade between the Atlantic and Pacific ports of the United States.
(3) Vessels engaged in trade between the United States and any of its possessions.
(4) Vessels employed in the fisheries or whaling business.
(5) Vessels of war of the United States or a foreign nation.

If the special motor fuel is purchased for use as fuel for the propulsion of civil aircraft engaged in trade as specified in (1) or (3) above, state the name of the country in which the aircraft is registered _____.

The undersigned understands that if the special motor fuel is sold or used otherwise than as stated above and for a taxable purpose specified in section 4041(b) of the Internal Revenue Code, he will be liable for the tax upon such sale or use. It is understood that this certificate may not be used in purchasing special motor fuel for use as fuel for the propulsion of pleasure vessels, or of any type of aircraft except (i) civil aircraft employed in foreign trade or trade between the United States and any of its possessions, and otherwise entitled to exemption, and (ii) aircraft owned by the United States or any foreign country and constituting a part of the armed forces thereof.

The undersigned understands that the fraudulent use of this certificate to secure exemption will subject him and all guilty parties to a penalty equivalent to the amount of tax due on the sale of the special motor fuel and upon conviction to a fine of not more than $10,000, or to imprisonment for not more than five years, or both, together with the costs of prosecution. The purchaser also understands that he must be prepared to establish by satisfactory evidence the purpose for which the special motor fuel purchased under this certificate was used.

_____
(Signature)

_____
(Address)

(d) *Exemption certificate not obtained prior to filing of seller's excise tax return.*—If the exemption certificate is not obtained prior to the time the seller files a return covering taxes due for the period during which the sale was made, the seller must include the tax on such sale in his return for that period. However, if the certificate is later obtained, a claim for refund of the tax paid on such sale may be filed on Form 843, or a credit for such amount may be taken upon a subsequent return, as provided by section 6416(b)(2)(B) and the regulations thereunder contained in Subpart O.

(e) *Liability of purchaser.*—The person who purchases special motor fuel tax free as provided in this section shall be liable for the tax imposed by section 4041(b) if he sells or uses the special motor fuel as a fuel for the propulsion of a motor vehicle, motorboat, or airplane, and if such sale or use is not exempt under any provision of law.

§ 48.4041–10 Other Exemptions.—For other provisions relating to tax-free sales or use of diesel fuel and special motor fuel, see—

(a) Section 4055, relating to sales for the exclusive use of any State or any political subdivision of a State, or the District of Columbia, or relating to use by any of the foregoing;

(b) Section 4056, relating to sales for export or for shipment to a possession of the United States; and

(c) Section 4057, relating to sales for the exclusive use of a nonprofit educational organization, or relating to use by such organization;

and the regulations thereunder contained in Subpart G.

§ 48.4041–11 OTHER CREDITS OR REFUNDS.—(a) *In general.*—For provisions relating to credit or refund of tax paid on taxable liquid resold by the purchaser, or used otherwise than as a fuel for the propulsion of a diesel-powered highway vehicle, motor vehicle, motorboat, or airplane, see section 6416(b)(2)(G)(i) and the regulations thereunder contained in Subpart O.

(b) *Taxable liquid used by local transit systems.*—For provisions relating to credit or refund in the case of taxable liquid used in vehicles while engaged in furnishing scheduled common carrier public passenger land transportation service along regular routes, see section 6416(b)(2)(H) and the regulations thereunder contained in subpart O.

PAR. 2. Section 48.4201 is amended to read as follows:

§ 48.4201 STATUTORY PROVISIONS; IMPOSITION OF TAX.

SEC. 4201. IMPOSITION OF TAX.

(a) There is hereby imposed upon the sale by the manufacturer, producer, or importer of the following articles, a tax equal to 10 percent of the price for which so sold:

Mechanical pencils, fountain pens and ball point pens.

(b) There is hereby imposed upon the sale by the manufacturer, producer, or importer of mechanical lighters for cigarettes, cigars, and pipes a tax of 10 cents for each lighter but not more than 10 percent of the price for which so sold.

[Sec. 4201 as originally enacted and in effect Jan. 1, 1959, and as amended by sec. 9(a), Act of Sept. 14, 1960 (Pub. Law 86–779, 74 Stat. 1003) [page 709, this Bulletin]]

PAR. 3. Paragraph (b) of § 48.4201–1 is amended to read as follows:

§ 48.4201–1 IMPOSITION AND RATE OF TAX.

* * * * * * *

(b) *Rate of tax.*—Tax is imposed on the sale of the articles enumerated in section 4201 and paragraph (a) of this section at the following rates:

(1)	Mechanical pencils, fountain pens, and ball point pens.	10 percent of the price for which sold.
(2)	Mechanical lighters for cigarettes, cigars, and pipes:	
	(i) Sold prior to October 1, 1960	10 percent of the price for which sold.
	(ii) Sold on and after October 1, 1960	10 cents per lighter but not more than 10 percent of the price for which sold.

For definition of the term "price", see section 4216 and the regulations thereunder contained in Subpart M of this part.

Because those changes made by this Treasury Decision which are required by the amendment made by section 9 of the Act of September 14, 1960 (Public Law 86–779, 74 Stat. 1003), merely reflect a statutory change in section 4201 which provides a limitation on the amount of manufacturers excise tax in respect of sales of lighters for cigarettes, cigars, and pipes, it is hereby found that it is unnecessary, with respect to such changes, 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 section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 21, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 25, 1960, 8:49 a.m., and published in the issue of the Federal Register for November 26, 1960, 25 F.R. 11217)

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER A.—AUTOMOTIVE AND RELATED ITEMS

PART I.—MOTOR VEHICLES

SECTION 4061.—IMPOSITION OF TAX

26 CFR 40.4061(a)-1: Imposition of tax. Rev. Rul. 60-258
(Also 40.4061(b)-1.)

A manufacturer sells motor vehicle articles consisting of automobile truck bodies and automobile truck chassis without engines. The purchaser installs engines therein and sells the completed automobile trucks. *Held*, sales by the manufacturer of motor vehicle articles consisting of automobile truck bodies and automobile truck chassis without engines are considered to be sales of complete truck bodies and of assemblies of automobile truck chassis parts. Accordingly, the manufacturers excise tax on automobile truck bodies, imposed by section 4061(a)(1) of the Internal Revenue Code of 1954, applies to sales by the manufacturer of such automobile truck bodies. However, the manufacturers excise tax on automobile parts and accessories, imposed by section 4061(b) of the Code, applies to sales by the manufacturer of such assemblies of chassis parts. On the other hand, under the provisions of sections 4221(a)(1) and 4222 of the Code, the assemblies of chassis parts may be sold tax-exempt to the purchaser for the purpose of further manufacture, since the purchaser, by installing engines in the assemblies, becomes the manufacturer of complete automobile truck chassis and uses the chassis parts as material in the manufacture of the chassis.

(Also 40.4061(b)-2.) Rev. Rul. 60-269

A vehicle body which is specially designed and adapted for use in the rescue of persons from crashed or damaged aircraft, an activity which does not normally involve use of the public highways, is not a taxable body within the meaning of section 4061(a)(1) of the Internal Revenue Code of 1954. The cab, in-

cluding the seat, which is specially designed for the vehicle and is an integral part of and nonseparable from the nontaxable body, is not an automobile part or accessory within the meaning of section 4061(b) of the Code.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of specially designed bodies, cabs, seats, and equipment which are installed by the manufacturer on customers' automobile chassis to produce airfield "crash trucks."

A truck body manufacturer removes the original cabs and seats from automobile truck chassis belonging to his customers and then mounts and installs on the chassis specially designed bodies, cabs, seats, and equipment of his own manufacture. These completed vehicles are used in rescuing of persons from crashed or damaged aircraft and in extinguishing minor fires on airfields. Such activities do not require the use of public highways except in unusual circumstances. The bodies have special heating equipment and are insulated to operate under extremes of weather and climate. In addition, the bodies have tanks permanently mounted therein to hold a fire extinguishing agent and a number of compartments for storage of special tools and fire extinguishing and rescue equipment. The vehicle cabs, with their seats, are integral parts of and nonseparable from the bodies and have sirens and beacons mounted on their roofs. These vehicles are equipped with auxiliary electric generators to provide power for tool operation, floodlighting, and battery charging. Other equipment includes floodlights, goggles, and wire snippers.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of automobile truck chassis and automobile truck bodies (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof). Section 4061(b) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes and other than automobile radio and television receiving sets) for any of the articles enumerated in section 4061(a) of the Code.

Section 40.4061(a)–1(d) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, that a chassis or body which is not designed for highway use is not subject to the tax imposed by section 4061(a) of the Code.

Revenue Ruling 57–440, C.B. 1957–2, 721, holds, in part, that the manufacturers excise tax imposed by section 4061(a)(1) of the Code shall not apply to the sale of any article, regardless of width, which is designed or adapted by the manufacturer for purposes predominantly other than the transportation of persons or property on the highway even though incidental highway use may occur. Revenue Ruling 56–275, C.B. 1956–1, 505, holds, in part, that a fire-fighting apparatus cab, which is designed in conjunction with and is physically attached to the pump and fire-fighting apparatus body, is not a part of a taxable truck chassis and is, therefore, not subject to the tax.

Since the bodies in the instant case are not designed or adapted for the transportation of persons or property on the highway, it is held that they are not taxable bodies within the meaning of section 4061(a)(1) of the Code. Furthermore, since the cabs, including their seats, are specially designed for these vehicles and are integral parts

of and nonseparable from the bodies, they are not automobile parts or accessories within the meaning of section 4061(b) of the Code. Accordingly, the bodies, cabs, and seats are not subject to the manufacturers excise tax imposed by section 4061 of the Code.

It is further held that the wire snippers, goggles, and fire extinguishing equipment are not automotive parts or accessories and are, therefore, not subject to the manufacturers excise tax imposed by section 4061(b) of the Code. However, other articles, such as floodlights, if primarily designed and adapted for use on taxable vehicles, are considered to be automobile parts or accessories which are taxable under section 4061(b) of the Code when sold by the manufacturer thereof.

(Also 40.4061(b)-2.) Rev. Rul. 60-270

Where a manufacturer sells a certain airport service vehicle, the highway-type chassis of the vehicle is subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954. However, the off-highway-type body of the vehicle is not subject to the tax. The equipment mounted on the vehicle, which consists of special tanks, pumps, ladders, hose, etc., is not subject to the manufacturers excise tax imposed by section 4061(b) of the Code.

Advice has been requested whether the manufacturers excise tax on motor vehicles applies to sales by the manufacturer, producer, or importer of a certain airport service vehicle.

The vehicle in question is used to supply airliners with their requirements of water and methyl-alcohol. The vehicle is equipped with two tanks fitted to a superstructure erected upon the vehicle frame. One of the tanks is an "additive direct injection" tank which carries a solution for the airliner's supercharge system. The second tank carries fresh water for refilling the drinking water tanks of the airliner. Each tank has a useable capacity of 235 gallons. These tanks are constructed and located on the vehicle in such a way that the vehicle can conveniently be used for servicing airplanes. Their presence, however, prevents the vehicle from being used effectively for the transportation of persons or property over public highways.

The vehicle is fitted with pumps, hose, ladders, gauges, etc., peculiar to airliner servicing operations. The ordinary highway-type chassis used in the construction of this vehicle incorporates reinforced frames and heavy duty springs, wheels, axles, and tires, in order to carry the extra-heavy load. Because of its frequent use, the vehicle is equipped with a toggle switch instead of an ignition key switch.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer. Section 4061(b) of the Code imposes a tax on the sale by the manufacturer of parts or accessories (with certain exceptions not here applicable) for any of the articles enumerated in section 4061(a).

Section 40.4061(a)–1(d) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, that a chassis or body which is not designed for highway use is not subject to the tax imposed by section 4061(a) of the Code.

Revenue Ruling 57–440, C.B. 1957–2, 721, sets forth the position of the Service that the only vehicle chassis and bodies intended to be taxed by section 4061(a)(1) of the Code are those primarily designed for highway use.

Revenue Ruling 58–424, C.B. 1958–2, 762, states that in considering the applicability of the manufacturers excise tax to the sale of a truck chassis, the determining factor is whether such chassis is or is not primarily designed and adapted for highway use, and not the actual use to which the chassis is put.

Although the chassis described above is reinforced and certain heavy duty articles are used in the construction thereof, it is considered that the chassis remains primarily adapted for highway use. The fact that the chassis of this vehicle is not used on the highway does not affect its taxability. Accordingly, it is held that, upon the sale by the manufacturer, producer, or importer of the above-described vehicle, the chassis is subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Code. It is further held that the body of this vehicle is not subject to the tax imposed by that section, since it is not primarily designed or adapted for the transportation of property over the highway.

The equipment mounted on this vehicle, which consists of special tanks, pumps, ladders, hose, etc., is not primarily designed or adapted for use on articles taxable under section 4061(a) of the Code and is, therefore, not subject to the manufacturers excise tax imposed by section 4061(b) of the Code.

Rev. Rul. 60–391 [1]

Certain three-wheel commercial motor vehicles which are designed for light hauling are considered to be automobile trucks for purposes of section 4061(a)(1) of the Internal Revenue Code of 1954. Accordingly, sales of such vehicles by the manufacturer are subject to the manufacturers excise tax on automobile truck chassis and bodies imposed by that section.

Advice has been requested whether the manufacturers excise tax on motor vehicle articles applies to sales by the manufacturer of the motor vehicles described below.

A manufacturer produces and sells various models of three-wheel commercial motor vehicles which are designed for light hauling. These vehicles are produced in a variety of body styles; however, the chassis are substantially alike.

Typical of these vehicles is a so-called "pickup" model. The chassis of this model vehicle has a four-cycle, one-cylinder, air-cooled engine and a power train consisting of a disc clutch, a three-speed transmission, and a shaft drive connected to an automotive-type differential. The chassis has two rear wheels on an automotive-type axle. The steering apparatus consists of handlebars and a shaft which is attached directly to a fork in which a single front wheel is mounted.

[1] Also released in Technical Information Release 279, dated December 20, 1960.

Mounted on the chassis of this vehicle is an all-steel pickup type body which has a rated load capacity of 800 pounds. On the forward portion of the chassis is a fibre glass cab with open sides to permit easy entrance and exit by the driver. The vehicle is approximately eight feet long and four feet wide and is equipped with a single headlight and a single taillight. The maximum speed attainable is about 35 miles per hour.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated motor vehicle articles, including automobile truck chassis and bodies. This section further provides that the sale of an automobile truck shall be considered to be a sale of the chassis and of the body.

For purposes of the manufacturers excise tax, the fact that a vehicle has less than four wheels or that it has some of the other characteristics of a motorcycle does not of itself place the vehicle outside the scope of the articles taxable under section 4061(a) of the Code. See Rev. Rul. 58–284, C.B. 1958–1, 400, and Rev. Rul. 58–488, C.B. 1958–2, 764.

The predominant characteristics of the vehicles described above are those of an automobile truck, within the meaning of section 4061(a)(1) of the Code. Accordingly, the "pickup" model and other vehicles which are similar in design, construction, and purpose are considered to be automobile trucks for purposes of the manufacturers excise tax imposed by section 4061(a)(1) of the Code. It is therefore held that sales of such vehicles by the manufacturer are subject to the tax on automobile truck chassis and bodies imposed by that section.

Under the authority of section 7805(b) of the Code, this Revenue Ruling will not be applied to sales made prior to January 1, 1961. Moreover, no manufacturers excise tax liability will be incurred with respect to sales of these vehicles pursuant to firm contracts entered into as a result of bids made prior to that date even though the vehicles are delivered on or after January 1, 1961.

Rev. Rul. 60-392 [1]

Revenue Ruling 58–284, C.B. 1958–1, 400, which was published in the Internal Revenue Bulletin dated June 9, 1958, holds that the manufacturers excise tax imposed by section 4061(a) of the Internal Revenue Code of 1954 applies to sales by the manufacturer of a certain three-wheel vehicle which is designed for use in the delivery and collection of mail. Under the authority of section 7805(b) of the Code, that conclusion will not be applied to vehicles sold before June 9, 1958. With respect to the performance of firm contracts entered into as the result of bids made prior to that date, no tax will be imposed even though delivery of the vehicles was made on or after that date. Revenue Ruling 58–284 is hereby modified accordingly.

Determination of the fair market price, for the purpose of computing the manufacturers excise tax on motor vehicle articles, of, for

[1] Also released in Technical Information Release 279, dated December 20, 1960.

example, tank trailers and truck bodies manufactured and sold by corporations to their wholly-owned subsidiaries at cost. See Rev. Rul. 60–241, page 329.

Liability for the manufacturers excise tax on motor vehicle articles with respect to the sale by the manufacturer of a vehicle consisting of a semitrailer chassis and a semitrailer "body shell" to a semitrailer body manufacturer. See Rev. Rul. 60–271, page 332.

Application of the tax on motor vehicles to automobile trucks sold for export by the manufacturer to a company which further manufactures the chassis of such vehicles prior to exportation. See Rev. Rul. 60–310, page 334.

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26 CFR 40.4061(b)–1: Imposition of tax.

Sales by a manufacturer of automobile truck chassis without engines to a purchaser who installs engines. See Rev. Rul. 60–258, page 296.

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26 CFR 40.4061(b)–2: Definition of parts or accessories.

Applicability of the manufacturers excise tax on motor vehicles to sales of specially designed bodies, cabs, seats, and equipment which are installed by the manufacturer on customers' automobile chassis to produce airfield "crash trucks." See Rev. Rul. 60–269, page 296.

Whether the manufacturers excise tax on motor vehicles applies to sales by the manufacturer, producer, or importer of a certain airport service vehicle. See Rev. Rul. 60–270, page 298.

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26 CFR 40.4061(b)–3: Rebuilt, reconditioned or repaired parts or accessories. Rev. Rul. 60–294

A certain process used in restoring unserviceable automobile cylinder heads to useful condition is considered to be a rebuilding operation. Therefore, the restorer's sales of such rebuilt heads are subject to the manufacturers excise tax on automobile parts or accessories imposed by section 4061(b) of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on automobile parts or accessories applies to the sale of used automobile cylinder heads which have been restored to useful condition.

A company is engaged in the business of restoring unserviceable automobile cylinder heads to useful condition. The company sells its restored cylinder heads either outright or on an exchange basis. In the restoration process, the company welds all cracks in the cylinder head and grinds such welds to a smooth finish. The heads are then placed on a stationary circular electric grinder to allow the head

to come to tolerance when engaged with a cylinder block. The valve seats are ground out and refaced, and the valve guides are replaced as needed.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on sales by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes and other than automobile radio and television receiving sets) for any of the motor vehicle articles enumerated in section 4061(a) of the Code.

Section 40.4061(b)-3(a) of the Manufacturers and Retailers Excise Tax Regulations provides that rebuilding of automobile parts or accessories, as distinguished from reconditioning or repairing, constitutes manufacturing, and the rebuilder of such parts or accessories is liable for the tax imposed by section 4061(b) with respect to his sales of such rebuilt parts or accessories. Reboring or other machining, rewinding and comparable major operations constitute rebuilding. The person owning the part or accessory being rebuilt is the manufacturer of the article and is liable for the tax on his sale of the rebuilt part or accessory.

The process used in restoring unserviceable cylinder heads to useful condition for sale as described above is considered to be a rebuilding operation. Therefore, it is held that the restorer's sales of such rebuilt cylinder heads are subject to the manufacturers excise tax on automobile parts or accessories imposed by section 4061(b) of the Code. See Revenue Ruling 56-192, C.B. 1956-1, 506, for information as to the records to be maintained by the company in the case of exchange sales.

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26 CFR 48.4061(a): Statutory provisions; imposition of tax; automobiles. T. D. 6499 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Regulations requiring bond of importers of automobiles, trucks, buses, etc., taxable under section 4061(a) of the Internal Revenue Code of 1954, as amended.

DEPARTMENT OF THE TREASURY,
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, 1960, notice of proposed rulemaking with respect to regulations requiring bond of importers of automobiles, trucks, buses, etc., taxable under section 4061(a) of the Internal Revenue Code of 1954 was published in the Federal Register (25 F.R. 8782). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. The regulations are applicable with respect to such

[1] The publication of this Treasury Decision in 25 F.R. 10347, dated October 28, 1960, contains (1) an instruction for modifying the notice of proposed rulemaking in 25 F.R. 8782, dated September 13, 1960, and (2) the full context of the regulations with such modification. As here published, the Treasury Decision reflects the full context of such regulations, with modification. The individual instruction has been omitted.

articles imported into the United States on or after the first day of the first calendar quarter which begins more than 60 days after the date on which this Treasury decision is published in the Federal Register.

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Automotive and Related Items

MOTOR VEHICLES

§ 48.4061(a) STATUTORY PROVISIONS; IMPOSITION OF TAX; AUTOMOBILES.

SEC. 4061. IMPOSITION OF TAX.

(a) AUTOMOBILES.—There is hereby imposed upon the following articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer a tax equivalent to the specified percent of the price for which so sold:

(1) Articles taxable at 10 percent, except that on and after July 1, 1972, the rate shall be 5 percent—

Automobile truck chassis.
Automobile truck bodies.
Automobile bus chassis.
Automobile bus bodies.
Truck and bus trailer and semitrailer chassis.
Truck and bus and semitrailer bodies.
Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this paragraph, be considered to be a sale of the chassis and of the body.

(2) Articles taxable at 10 percent except that on and after July 1, 1961, the rate shall be 7 percent—

Automobile chassis and bodies other than those taxable under paragraph (1).
Chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles.

A sale of an automobile, trailer, or semitrailer shall, for the purposes of this paragraph, be considered to be a sale of the chassis and of the body.

[Sec. 4061(a) as amended and in effect Jan. 1, 1959, and as further amended by sec. 3(a)(1), Tax Rate Extension Act 1959 (73 Stat. 157) [P.L. 86-75, C.B. 1959-2, 679] and sec. 202(a)(1), Public Debt and Tax Rate Extension Act 1960 (74 Stat. 290) [P.L. 86-564, page 681, this Bulletin].

§ 48.4061(a)-1 [Reserved]

§ 48.4061(a)-2 BONDING OF IMPORTERS.—(a) *Authority for requiring bond.*—Section 623 of the Tariff Act of 1930, as amended (19 U.S.C. 1623), provides as follows:

SEC. 623. BONDS AND OTHER SECURITY.

(a) In any case in which bond or other security is not specifically required by law, the Secretary of the Treasury may by regulation or specific instruction require, or authorize collectors of customs to require, such bonds or other security as he, or they, may deem necessary for the

protection of the revenue or to assure compliance with any provision of law, regulation, or instruction which the Secretary of the Treasury or the Customs Service may be authorized to enforce.

(b) Whenever a bond is required or authorized by a law, regulation, or instruction which the Secretary of the Treasury or the Customs Service is authorized to enforce, the Secretary of the Treasury may—

(1) Except as otherwise specifically provided by law, prescribe the conditions and form of such bond, and fix the amount of penalty thereof, whether for the payment of liquidated damages or of a penal sum: *Provided*, That when a consolidated bond authorized by paragraph 4 of this subsection is taken, the Secretary of the Treasury may fix the penalty of such bond without regard to any other provision of law, regulation, or instruction.

(2) Provide for the approval of the sureties on such bond, without regard to any general provision of law.

(3) Authorize the execution of a term bond the conditions of which shall extend to and cover similar cases of importations over such period of time, not to exceed one year, or such longer period as he may fix when in his opinion special circumstances existing in a particular instance require such longer period.

(4) Authorize, to the extent that he may deem necessary, the taking of a consolidated bond (single entry or term), in lieu of separate bonds to assure compliance with two or more provisions of law, regulations, or instructions which the Secretary of the Treasury or the Customs Service is authorized to enforce. A consolidated bond taken pursuant to the authority contained in this subsection shall have the same force and effect in respect of every provision of law, regulation, or instruction for the purposes for which it is required as though separate bonds had been taken to assure compliance with each such provision.

(c) The Secretary of the Treasury may authorize the cancellation of any bond provided for in this section, or of any charge that may have been made against such bond, in the event of a breach of any condition of the bond, upon the payment of such lesser amount or penalty or upon such other terms and conditions as he may deem sufficient.

(d) No condition in any bond taken to assure compliance with any law, regulation, or instruction which the Secretary of the Treasury or the Customs Service is authorized to enforce shall be held invalid on the ground that such condition is not specified in the law, regulation, or instruction authorizing or requiring the taking of such bond.

(e) The Secretary of the Treasury is authorized to permit the deposit of money or obligations of the United States, in such amount and upon such conditions as he may by regulation prescribe, in lieu of sureties on any bond required or authorized by a law, regulation, or instruction which the Secretary of the Treasury or the Customs Service is authorized to enforce.

(b) *Application for determination whether bond required.*—(1) *Requirement of application.*—(i) *In general.*—Except as otherwise provided in subparagraph (2) of this paragraph, every importer of articles taxable under section 4061(a) shall make application for a determination whether the importer is required to give bond in accordance with the provisions of paragraph (c) of this section. Such application shall be submitted in writing to the district director for the district in which the importer will file returns of any tax under section 4061(a) for which he may incur liability.

(ii) *Form of application.*—No form is prescribed for making the application required under subdivision (i) of this subparagraph, but such application shall include the following information:

(*a*) The name of the person making the application and the address of his principal place of business, and, if the principal place of business of such person is outside the United States, the address of his principal place of business, office, or agency in the United States.

(*b*) Information establishing that the person making the application is an importer of articles taxable under section 4061(a).

(*c*) The kind and approximate number of automobiles, trucks, buses, etc., which the importer may be expected to import during an average calendar quarter and the approximate amount of tax under section 4061(a) for which the importer may be expected to incur liability in respect of such articles.

(*d*) Whether the importer has filed returns of tax under chapter 31 or chapter 32 within the 2-year period immediately preceding the date on which the application is filed, and, if so, the internal revenue district in which such returns were filed.

(*e*) Facts pertaining to the importer's assets and liabilities which will aid the district director in determining whether a bond shall be required.

(2) *Exceptions.*—The provisions of subparagraph (1) of this paragraph shall have no application in any case where an article taxable under section 4061(a) is—

(i) Incidentally imported by an individual for his personal use.

(ii) Brought into the United States for export to a foreign country or possession of the United States.

(iii) Admitted to the United States free of duty as an instrument of international traffic.

(iv) Admitted to the United States free of duty as a temporary importation under bond.

(v) Returned to the United States after having been sold in the United States and exported.

(c) *Requirement of bond.*—(1) *In general.*—If the district director determines that a bond is necessary in order to insure payment of the tax under section 4061(a), and to assure compliance with all provisions of the Code and regulations thereunder, with respect to articles imported by any importer required to make application for a determination under paragraph (b) of this section, such bond shall be given by such importer. Such bond shall be submitted, in duplicate, to the district director for the district in which the importer will file returns of any tax under section 4061(a) for which he may incur liability.

(2) *Form and execution of bond.*—(i) *In general.*—The bond required under this paragraph shall be executed in accordance with the form, instructions, and regulations applicable thereto, and with satisfactory surety. (For provisions as to what will be considered "satisfactory surety", see subparagraph (3) of this paragraph.) Such bond shall be conditioned that the principal shall not engage in any attempt, by himself or by collusion with others, to defraud the United States of any tax under section 4061(a); that he shall render truly and completely all returns, statements, and other documents required of him by law or regulations in respect of such tax; that he shall timely pay all such tax for which he is liable; and, in the case of any such tax in respect of an article released from customs custody by reason of such bond, that he shall pay such tax, whether the liability therefor is incurred by him or by some other person as the importer of the articles covered by the bond, unless such other person makes payment of such tax on or before the due date. The bond shall be in an amount which the district director believes to be

sufficient to protect the interests of the United States with respect to all articles taxable under section 4061(a) which are released from customs custody by reason of such bond, but in no event shall the bond be in an amount less than the approximate amount of tax under section 4061(a) for which the principal may be expected to incur liability during an average calendar quarter. Such bond shall be signed by the individual, if the principal is an individual; the president, vice president, or other principal officer, if the principal is a corporation; a responsible and duly authorized member or officer having knowledge of its affairs, if the principal is a partnership or other unincorporated organization; or the fiduciary, if the principal is a trust or estate. Form 2932 is the form prescribed for use in giving such bond. Copies of such form may be obtained from any district director.

(ii) *Cancellation clause.*—The bond required under this paragraph may be accepted with a cancellation clause incorporated therein. Such cancellation clause shall provide that:

(*a*) Any surety on the bond may at any time give notice to the principal and the district director that he desires to be relieved of liability under said bond after a date named, which shall be at least 60 days after the receipt of notice by the district director.

(*b*) If the notice is not withdrawn in writing prior to the date named in the notice, the rights of the principal as supported by said bond shall be terminated on such date (unless supported by another bond or bonds). The surety shall, however, remain liable with respect to any tax under section 4061(a) (plus penalties and interest) the liability for which is incurred in respect of articles released from customs custody by reason of the bond.

(*c*) Said notice may not be given by an agent of the surety, unless it is accompanied by power of attorney duly executed by the surety authorizing the agent to give such notice or by a verified statement that such power of attorney is on file with the Treasury Department.

(iii) *Changes in bond.*—After filing of the bond required under this paragraph, no change may be made in the terms thereof except with the consent of the surety or sureties and subject to the approval of the district director. Any such change and the consent thereto of the surety or sureties shall be shown on Form 2933, copies of which may be obtained from any district director. Such form shall be executed and filed, in any case where a change is proposed in the terms of the bond, in the same manner as that prescribed with respect to the bond itself.

(3) *Satisfactory surety.*—(i) *Approved surety company or bonds or notes of the United States.*—For purposes of subparagraph (2) of this paragraph, a bond shall be considered executed with satisfactory surety if:

(*a*) It is executed by a surety company holding a certificate of authority from the Secretary as an acceptable surety on Federal bonds; or

(*b*) It is secured by bonds or notes of the United States as provided in 6 U.S.C. 15 (see 31 CFR Part 225).

(ii) *Other surety acceptable in discretion of district director.*—For purposes of subparagraph (2) of this paragraph, a bond may, in the discretion of the district director, be considered executed with satis-

factory surety if, in lieu of being executed or secured as provided in subdivision (i) of this subparagraph, it is—

(*a*) Executed by a corporate surety (other than a surety company), provided such corporate surety establishes that it is within its corporate powers to act as surety for another corporation or an individual;

(*b*) Executed by two or more individual sureties, provided such individual sureties meet the conditions contained in subdivision (iii) of this subparagraph;

(*c*) Secured by a mortgage on real or personal property;

(*d*) Secured by a certified, cashier's, or treasurer's check drawn on any bank or trust company incorporated under the laws of the United States or any State, Territory, or possession of the United States, or by a United States postal, bank, express, or telegraph money order;

(*e*) Secured by corporate bonds or stocks, or by bonds issued by a State or political subdivision thereof, of recognized stability; or

(*f*) Secured by any other acceptable collateral. Collateral shall be deposited with the district director or, in his discretion, with a responsible financial institution acting as escrow agent.

(iii) *Conditions to be met by individual sureties.*—If a bond is executed by two or more individual sureties, the following conditions must be met by each such individual surety:

(*a*) He must reside within the State in which the principal place of business or legal residence of the primary obligor is located;

(*b*) He must have property subject to execution of a current market value, above all encumbrances, equal to at least the penalty of the bond;

(*c*) All real proeprty which he offers as security must be located in the State in which the principal place of business or legal residence of the primary obligor is located;

(*d*) He must agree not to mortgage, or otherwise encumber, any property offered as security while the bond continues in effect without first securing the permission of the district director; and

(*e*) He must file with the bond, and annually thereafter so long as the bond continues in effect, an affidavit as to the adequacy of his security, executed on the appropriate form furnished by the district director.

Partners may not act as sureties upon bonds of their partnership. Stockholders of a corporate principal may be accepted as sureties provided their qualifications as such are independent of their holdings of the stock of the corporation.

(iv) *Adequacy of surety.*—No surety or security shall be accepted if it does not adequately protect the interest of the United States.

(4) *New or additional bond.*—The district director may require a new or additional bond under this section in any case where he deems it necessary or desirable in order to protect the interests of the United States.

(d) *Termination of requirement.*—(1) *Application for relief from requirement.*—Any importer who has given bond as required under

paragraph (c) of this section may make application for relief from such requirement at any time after the last day of the first month following the close of the calendar quarter in which the bond was given. Any such application shall be submitted to the district director to whom the bond was furnished and shall set forth such facts as will be of assistance to the district director in determining whether the relief shall be granted.

(2) *Relief from requirement.*—In any case where the district director determines that the bond required under paragraph (c) of this section to be given by an importer is no longer necessary to insure payment of any tax under section 4061(a) for which liability may be incurred by such importer, such importer shall no longer be required to give such bond.

(e) *Evidence required for release of imported articles from customs custody.*—(1) *In general.*—Each article taxable under section 4061(a) which arrives in the United States from any foreign country or possession of the United States on or after the first day of the first calendar quarter beginning more than 60 days after the date of publication of this Treasury decision in the Federal Register, and which is imported by any person required under paragraph (b) of this section to make application for a determination whether bond shall be given, shall not, if subject to customs examination and release, be released from customs custody until the evidence prescribed in subparagraph (2)(i) or (2) (ii) of this paragraph has been furnished by such person to the collector of customs.

(2) *Form of evidence.*—The evidence rejuired under subparagraph (1) of this paragraph shall be in the form of a statement, executed, signed, and dated by the district director. Such statement shall show the following:

(i) *Bond required.*—If the importer is required to give bond under this section, the statement shall show—

(*a*) The total number of articles in respect of which the statement is given.

(*b*) The model number of each such article.

(*c*) The name and address of the importer of such articles.

(*d*) If the articles are to be released from customs custody to a person other than the importer, the name and address of such other person.

(*e*) That the importer has given a bond which the district director finds sufficient to protect the interests of the United States with respect to any tax under section 4061(a) for which liability may be incurred in respect of such articles.

A statement under this subdivision shall be furnished to the importer by the district director, upon request of the importer, in every case where such importer furnishes the district director with information which establishes to the satisfaction of the district director that the importer has given bond in an amount sufficient to protect the interests of the United States with respect to any tax under section 4061(a) which may become due in respect of the articles to which the request relates, and with such other information as is required under this subdivision to be shown in the statement. Such request, together

with such information, shall be submitted by the importer immediately upon receipt by him of notice that articles taxable under section 4061(a) have been exported to his order. A separate request shall be made in respect of each shipment. Each statement given under this subdivision shall be executed in duplicate. The original of such statement shall be furnished by the district director to the importer and the copy shall be retained by the district director.

(ii) *No bond required.*—If the importer is not required to give bond under this section, the statement shall show—

(*a*) The name and address of the importer.

(*b*) That bond under this section is not required of such importer.

A statement under this subdivision shall be furnished to the importer by the district director on the date on which the district director determines that the importer is not required to give a bond under this section. Such statement shall be executed in triplicate. The original of such statement and one signed copy shall be furnished by the district director to the importer, and one copy shall be retained by the district director. Additional signed copies of such statement will be furnished by the district director to the importer upon request of the importer. However, once such statement, or a signed copy thereof, has been furnished by the importer to a collector of customs, the requirements imposed by subparagraph (1) of this paragraph are deemed to be satisfied in respect of all articles taxable under section 4061(a) which thereafter arrive in the United States for release to or for the importer in a port under the jurisdiction of such collector of customs, until such time, if any, as such collector of customs receives written notification from the district director or the Commissioner of Customs that such statement has been withdrawn.

AUTHORITY: §§ 48.4061(a) and 48.4061(a)–2 issued under sec. 623, Tariff Act of 1930 (46 Stat. 759; 19 U.S.C. 1623), and sec. 7805, I.R.C. 1954 (68A Stat. 917; 26 U.S.C. 7805).

DANA LATHAM,
Commissioner of Internal Revenue.

Approved October 24, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 27, 1960, 8:47 a.m., and published in the issue of the Federal Register for October 28, 1960, 25 F.R. 10347)

SECTION 4063.—EXEMPTIONS

26 CFR 40.4063–1: Tax-free sales of bodies to manufacturers.

Whether a semitrailer chassis manufacturer may sell a vehicle consisting of a semitrailer chassis and a semitrailer "body shell" tax-exempt to a semitrailer body manufacturer. See Rev. Rul. 60–271, page 332.

PART III.—PETROLEUM PRODUCTS

Subpart A.—Gasoline

SECTION 4082.—DEFINITIONS

26 CFR 48.4082–1: Definitions. (Also Section 4041.) Rev. Rul. 60–316

For Federal excise tax purposes, a ready-mixed two-cycle engine fuel which is produced by blending 80-octane gasoline with outboard motor oil is considered to be gasoline rather than special motor fuel. Therefore, it is subject to the manufacturers excise tax imposed by section 4081 of the Internal Revenue Code of 1954. However, under the provisions of section 6421(a) of the Code, the ultimate purchaser may obtain a payment of (1) one cent for each gallon of such fuel used for nonhighway purposes on which the tax was paid at the rate of three cents a gallon or (2) two cents for each gallon of such fuel used for nonhighway purposes on which the tax was paid at the rate of four cents a gallon.

Advice has been requested whether sales of a ready-mixed two-cycle engine fuel are subject to the manufacturers excise tax on gasoline or to the retailers excise tax on special motor fuels. This fuel is produced by blending 80-octane gasoline with outboard motor oil at a ratio of one quart of outboard motor oil to five gallons of gasoline. The resulting product is commonly and commercially known and sold as gasoline for use in marine outboard motors, chain saws, posthole diggers, and similar types of equipment.

Section 4041(b) of the Internal Revenue Code of 1954 imposes a tax on any liquid (other than kerosene, gas oil, or fuel oil, or any product taxable as gasoline or as diesel fuel) which is either (1) sold by any person to the owner, lessee, or other operator of a motor vehicle, motorboat, or airplane, for use as a fuel for the propulsion of such motor vehicle, motorboat, or airplane, or (2) used by any person as a fuel for the propulsion of a motor vehicle, motorboat, or airplane, if there was no taxable sale of that fuel under (1).

Section 4081 of the Code imposes a tax on gasoline sold by the producer or importer thereof, or by any producer of gasoline. Section 4082(b) of the Code defines the term "gasoline" to mean all products commonly or commercially known or sold as gasoline (including casing head and natural gasoline).

Section 48.4082–1(b) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, that the term "gasoline" includes (1) all products commonly or commercially known or sold as gasoline (whether or not they meet the specifications in (2) below), including casinghead gasoline, natural gasoline, and aviation gasoline, and (2) all petroleum products meeting the volatility requirements (exclusive of vapor pressure) of United States motor gasoline (United States Government Specification No. VV–G–101a), except that the term "gasoline" does not include liquefied gases, such as propane, butane, or pentane, or mixtures of the same, or any product (i) more than 90 percent of which is evaporated at 310 degrees Fahrenheit and having an A.S.T.M. octane number of less than 70, or (ii) having a Reid vapor pressure at 100 degrees Fahrenheit of more than 30 pounds.

Since the gasoline used in blending the ready-mixed two-cycle engine fuel described above has an octane number of 80 and since the resulting product is commonly or commercially known and sold as gasoline, it is held that such product is gasoline within the meaning of section 4081 of the Code rather than special motor fuel under section 4041. Accordingly, the manufacturers excise tax imposed by section 4081 applies to the sale by the producer or importer, or by any producer, of such ready-mixed two-cycle engine fuel.

However, under the provisions of section 6421(a) of the Code, the ultimate purchaser may obtain a payment of (1) one cent for each gallon of such fuel used for nonhighway purposes on which the tax was paid at the rate of three cents a gallon or (2) two cents for each gallon of such fuel used for nonhighway purposes on which the tax was paid at the rate of four cents a gallon.

SUBCHAPTER B.—HOUSEHOLD TYPE EQUIPMENT, ETC.

PART II.—ELECTRIC, GAS, AND OIL APPLIANCES

SECTION 4121.—IMPOSITION OF TAX

26 CFR 48.4121–1: Imposition of tax. Rev. Rul. 60–308

Section 4121 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated electric, gas, and oil appliances of the household type (including in each case parts or accessories therefor sold on or in connection with the sale thereof). *Held*, since electric can openers for household use do not come within the scope of any of the articles enumerated in section 4121 of the Code, the manufacturers excise tax imposed by that section does not apply to the manufacturer's sales of electric can openers which are designed for independent operation. However, where a can opening apparatus, designed for use as an attachment for an electric mixer or other taxable article, is sold on or in connection with the taxable article, the tax applies to the total selling price of the article, including the can opening apparatus.

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26 CFR 48.4121–2: Definitions. Rev. Rul. 60–309

> Certain articles which are designed for outdoor cooking and which utilize liquefied petroleum gas as a fuel are considered to be gas cooking appliances of the household type within the meaning of section 4121 of the Internal Revenue Code of 1954. Accordingly, sales by the manufacturer of such articles are subject to the manufacturers excise tax imposed by that section on certain electric, gas, and oil appliances.

Advice has been requested whether the manufacturers excise tax on certain electric, gas, and oil appliances applies to the sale by the manufacturer of the so-called "rotisserie cart" described below.

The rotisserie cart is designed for family-type use for outdoor

cooking. It consists of a cooking unit of the type commonly referred to as a "rotisserie," a body on which the cooking unit is mounted, and a two-wheeled chassis which supports the body. The rotisserie cart may be wheeled about by use of a handle which is attached to the body.

The cooking unit utilizes liquefied petroleum gas as a fuel. A gas cylinder with pressure regulator is attached to the chassis and is connected to the cooking unit by a rubber hose through which the gas flows. By disconnecting this hose, the cooking unit may be removed for separate use after the hose is again connected.

Section 4121 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain "articles of the household type (including in each case parts or accessories therefor sold on or in connection with the sale thereof)." Included in the enumeration of articles subject to tax are "electric, gas, or oil appliances of the type used for cooking, warming, or keeping warm, food or beverages for consumption on the premises."

Section 48.4121–2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "articles of the household type" includes all articles enumerated in section 4121 of the Code which have an actual, practical, commercial fitness, or are specifically designed and constructed, for household use.

Section 48.4121–2(c) of the regulations provides that the term "electric, gas, or oil appliances of the type used for cooking, warming, or keeping warm, food or beverages for consumption on the premises" includes any type of appliance operated by, or for which the heat is generated by, electricity, gas, or oil, which is used to cook, warm, or keep warm, food or beverages for consumption on the premises.

The rotisserie cart described above is an appliance "of the type used for cooking, warming, or keeping warm, food or beverages for consumption on the premises" within the meaning of section 4121 of the Code. Furthermore, it is considered to be a "gas" appliance, since liquefied petroleum gases, such as butane and propane, are gaseous when in a natural state. Even though they are liquefied when under pressure for transportation and storage, they again become gaseous when released for use.

This rotisserie cart also is considered to be an article "of the household type" since it is designed for domestic or family-type use, rather than for commercial or industrial use. The fact that it is primarily designed for outdoor use is immaterial. Charcoal or wood-burning barbecue grills, braziers, etc., for outdoor cooking are not taxable because those articles are not "electric, oil, or gas" appliances rather than because they are designed for outdoor use.

Accordingly, it is held that this rotisserie cart is a gas cooking appliance of the household type which is subject to the tax imposed by section 4121 of the Code when sold by the manufacturer thereof. Likewise, the tax imposed by that section applies to the cooking unit if it is sold separately by the manufacturer. However, the tax does not apply to separate sales of parts or accessories, including a separate sale of the body or the chassis.

SUBCHAPTER C.—ENTERTAINMENT EQUIPMENT

PART I.—RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS, ETC.

SECTION 4141.—IMPOSITION OF TAX

26 CFR 48.4141: Statutory provisions; imposition of tax. T.D. 6504 [1]
(Also Section 4151; 48.4151.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Regulations under subchapter C of chapter 32 of the Internal Revenue Code of 1954, as amended, relating to the tax on sales of radio and television receiving sets, phonographs, combinations of any of the foregoing, phonograph records, radio and television components, and musical instruments.

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

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

On December 19, 1959, notice of proposed rulemaking with respect to the Manufacturers and Retailers Excise Tax Regulations (26 CFR Part 48) under subchapter C of chapter 32 of the Internal Revenue Code of 1954, as in effect January 1, 1959, relating to the manufacturers excise tax imposed on the sale of radio and television receiving sets, phonographs, combinations of any of the foregoing, phonograph records, radio and television components, and musical instruments by manufacturers, producers, or importers was published in the Federal Register (24 F.R. 10311). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

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[1] The publication of this Treasury Decision in 25 F.R. 11028, dated November 19, 1960, contains (1) an instruction for modifying the notice of proposed rulemaking in 24 F.R. 10311, dated December 19, 1950, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modification. The individual instruction has been omitted.

Subpart J.—Radio and Television Sets, Phonographs, Phonograph Records, and Musical Instruments

RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS, ETC.

§ 48.4141 STATUTORY PROVISIONS; IMPOSITION OF TAX.

SEC. 4141. IMPOSITION OF TAX.

There is hereby imposed upon the sale by the manufacturer, producer, or importer of the following articles (including in each case parts or accessories therefor sold on or in connection with the sale thereof), a tax equivalent to 10 percent of the price for which so sold:

Radio receiving sets.
Automobile radio receiving sets.
Television receiving sets.
Automobile television receiving sets.
Phonographs.
Combinations of any of the foregoing.
Radio and television components.
Phonograph records.

[Sec. 4141 as amended and in effect Jan. 1, 1959]

§ 48.4141–1 IMPOSITION AND RATE OF TAX.—(a) *Imposition of tax.*—Section 4141 imposes a tax upon the sale by the manufacturer, producer, or importer of the following articles (including in each case parts or accessories therefor sold on or in connection with the sale thereof):

(1) Radio receiving sets,
(2) Automobile radio receiving sets,
(3) Television receiving sets,
(4) Automobile television receiving sets,
(5) Phonographs,
(6) Combinations of any of the foregoing,
(7) Radio and television components, and
(8) Phonograph records.

See section 4143 and § 48.4143–1 for exemption from tax in respect of the sale of articles specified in subparagraphs (1) through (6) of this paragraph which are communication, detection, or navigation equipment of the type used in commercial, military, or marine installations, and for exemption from tax in respect of radio and television components suitable for use only on or in connection with, or as component parts of such equipment.

(b) *Rate of tax.*—The tax is imposed upon the sale of articles specified in section 4141 and in paragraph (a) of this section at the rate of 10 percent of the price for which sold. For definition of the term "price", see section 4216 and the regulations thereunder contained in Subpart M.

(c) *Liability for tax.*—The tax imposed by section 4141 is payable by the manufacturer, producer, or importer making the sale.

(d) *Phonograph records.*—The term "phonograph records" means all disks, cylinders, or other articles, regardless of the material from which they are made, upon which are recorded music, speech, or other sounds which are capable of reproduction by means of a phonograph. The term does not include tape or wire recordings.

§ 48.4141–2 PARTS OR ACCESSORIES.—(a) *In general.*—The tax attaches in respect of parts or accessories for articles specified in section 4141 and paragraph (a) of § 48.4141–1 sold on or in connection with

the sale thereof at the rate applicable to the sale of the basic articles. The tax attaches in such case whether or not the parts or accessories are billed separately. On the other hand, no tax attaches in respect of parts or accessories for articles specified in section 4141 and paragraph (a) of § 48.4141–1 which are sold otherwise than on or in connection with such articles or with the sale thereof.

(b) *Essential equipment.*—If taxable articles are sold by the manufacturer, producer, or importer thereof without parts or accessories which are considered equipment essential for the operation or appearance of such aticles, the sale of such parts or accessories will be considered, in the absence of evidence to the contrary, to have been made in connection with the sale of the basic article even though they are shipped separately at the same time or on a different date.

§ 48.4142 Statutory Provisions; Definition of Radio and Television Component.

SEC. 4142. DEFINITION OF RADIO AND TELEVISION COMPONENT.

As used in section 4141, the term "radio and television components" means chassis, cabinets, tubes, speakers, amplifiers, power supply units, antenna of the "built-in" type, phonograph mechanisms, and phonograph record-players, which are suitable for use on or in connection with, or as component parts of, any of the articles enumerated in section 4141, whether or not primarily adapted for such use.

[Sec. 4142 as amended and in effect Jan. 1, 1959]

§ 48.4142–1 Radio and Television Components.—(a) *In general.*—The term "radio and television components" means chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the "built-in" type, phonograph mechanisms, and phonograph record-players, which are suitable for use on or in connection with, or as a component part of, any radio or television receiving set, phonograph, or combination of any of the following.

(b) *Suitable for use defined.*—An item is suitable for use, within the meaning of section 4142 and paragraph (a) of this section, if it is commonly used with any of the articles enumerated in section 4141 and paragraph (a) (1) through (6) of § 48.4141–1 or if it possesses actual, practical commercial fitness for such use. It is immaterial whether the item is primarily adapted for such use.

(c) *Definitions.*—(1) *Chassis.*—The term "chassis" includes any assembly of parts into circuits for the reception and conversion of radio or television signals into impulses suitable for the reproduction of (i) sound by a radio receiving set, or (ii) a picture, either with or without its associated sound, by a television receiving set.

(2) *Cabinets.*—The term "cabinets" includes containers suitable for housing a chassis for any radio or television receiving set, phonograph, or combination of any of the foregoing.

(3) *Tubes.*—The term "tubes" includes tubes of all types suitable for use on or in connection with, or as component parts of, any radio or television receiving set, phonograph, or combination of any of the foregoing.

(4) *Speakers.*—The term "speakers" includes all devices for use in converting electrical impulses to sound whether or not equipped with coupling units (but not including earphones) which are suitable for use on or in connection with, or as component parts of, any radio or

television receiving set, phonograph, or combination of any of the foregoing.

(5) *Amplifiers.*—The term "amplifiers" includes all apparatus for the amplification of audio frequency or video frequency impulses which are suitable for use on or in connection with, or as component parts of, any radio or television receiving set, phonograph, or combination of any of the foregoing.

(6) *Power supply units.*—The term "power supply units" includes all devices which are suitable for use on or in connection with, or as component parts of, any radio or television receiving set, phonograph, or combination of any of the foregoing and which convert electric current of ordinary commercial and domestic voltages into electric current voltages suitable for operating any such articles.

(7) *Antennae of the "built-in" type.*—The term "antennae of the 'built-in' type" includes all types of aerials designed to be contained in any radio or television receiving set, or combination of any of the foregoing.

(8) *Phonograph mechanism.*—The term "phonograph mechanism" means any article consisting of at least a motor, pick-up arm, and turntable, even though the article may also have other parts, but which in its entirety does not constitute a phonograph record player or a phonograph.

(9) *Phonograph record player.*—The term "phonograph record player" means an article capable of playing phonograph records (as defined in paragraph (d) of § 48.4141–1) but lacking an amplifier or a speaker, or both.

§ 48.4143 Statutory Provisions; Exemption for Communication, etc., Equipment.

SEC. 4143. EXEMPTION FOR COMMUNICATION, ETC., EQUIPMENT.

(a) In General.—Except in the case of radio and television components and phonograph records, the tax imposed by section 4141 shall not apply to communication, detection, or navigation equipment of the type used in commercial, military, or marine installations.

(b) Components.—The tax imposed by section 4141 on radio and television components shall not apply to any article which is suitable for use only on or in connection with, or as a component of, articles exempt from tax under subsection (a).

[Sec. 4143 as amended and in effect Jan. 1, 1959]

§ 48.4143–1 Exemption of Communication, etc., Equipment.—(a) *Radio and television receiving sets, etc.*—The tax imposed by section 4141 shall not apply to radio or television receiving sets, phonographs, or combinations of any of the foregoing which are designed and manufactured for use primarily as communication, detection, or navigation equipment and are of the type used in commercial, military, or marine installations. The following articles are illustrative of the type of articles which are exempt under this section:

(1) radar equipment,

(2) sonar equipment,

(3) receivers for use in connection with ship-to-ship and ship-to-shore equipment, and

(4) radio direction finding equipment.

(b) *Radio and television components.*—The tax imposed by section 4141 shall not apply to a radio or television component suitable

for use *only* on or in connection with, or as a component of, a radio or television receiving set, phonograph, or combination of any of the foregoing which is exempt under section 4143(a) as an article designed and manufactured primarily as communication, detection, or navigation equipment of the type used in commercial, military, or marine installations. However, a radio or television component is not exempt from tax under section 4143(b) if it is suitable for use on or in connection with, or as a component of, both (1) a radio or television receiving set or phonograph, or any combination thereof, exempt under section 4143(a), and (2) any radio or television receiving set or phonograph, or any combination thereof, which is not exempt under section 4143(a), whether or not the use with the nontaxable article is its primary use.

§ 48.4143–2 OTHER TAX-FREE SALES.—For provisions relating to tax-free sales of articles referred to in section 4141, see—

(a) Section 4221, relating to certain tax-free sales;
(b) Section 4222, relating to registration; and
(c) Section 4223, relating to special rules with respect to further manufacture;

and the regulations thereunder contained in Subpart N.

MUSICAL INSTRUMENTS

§ 48.4151 STATUTORY PROVISIONS; IMPOSITION OF TAX.

SEC. 4151. IMPOSITION OF TAX.

There is hereby imposed upon the sale of musical instruments by the manufacturer, producer, or importer a tax equivalent to 10 percent of the price for which so sold.

[Sec. 4151 as originally enacted and in effect Jan. 1, 1959]

§ 48.4151–1 IMPOSITION AND RATE OF TAX.—(a) In general.—Section 4151 imposes a tax upon the sale of musical instruments by the manufacturer, producer, or importer thereof.

(b) *Rate of tax.*—The tax is imposed upon the sale of musical instruments at the rate of 10 percent of the price for which sold. For a definition of the term "price", see section 4216 and the regulations thereunder contained in Subpart M.

(c) *Liability for tax.*—The tax imposed by section 4151 is payable by the manufacturer, producer, or importer making the sale.

(d) *Definition of musical instruments.*—The term "musical instruments" includes all wind, reed, string, percussion or electronic instruments used to produce music, including but not limited to all types of pianos and organs, trombones, saxophones, violins, drums, xylophones, chimes, cymbals, bongos, castanets, maracas, claves, etc. The term does not include articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music.

§ 48.4151–2 TAX-FREE SALES.—For provisions relating to tax-free sales of musical instruments, see

(a) Section 4221(a) relating to tax-free sales in general, including tax-free sales to nonprofit educational organizations for their exclusive use;

(b) Section 4221(e)(3) relating to tax-free sales of musical instruments to religious institutions for exclusively religious purposes;

(c) Section 4222 relating to registration; and

(d) Section 4223 relating to special rules with respect to further manufacture;

and the regulations thereunder contained in Subpart N.

AUTHORITY: §§ 48.4141 to 48.4143–2, incl., and §§ 48.4151 to 48.4151–2, incl., are issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 15, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 18, 1960, 8:49 a.m., and published in the issue of the Federal Register for November 19, 1960, 25 F.R. 11028)

PART II.—MUSICAL INSTRUMENTS

SECTION 4151.—IMPOSITION OF TAX

26 CFR 48.4151: Statutory provisions; imposition of tax.

Regulations under the Internal Revenue Code of 1954 relating to the manufacturers tax on sales of musical instruments, effective January 1, 1959. See T.D. 6504, page 313.

SUBCHAPTER D.—RECREATIONAL EQUIPMENT

PART I.—SPORTING GOODS

SECTION 4161.—IMPOSITION OF TAX

26 CFR 48.4161–1: Imposition and rate of tax. Rev. Rul. 60–259

The manufacturers excise tax on certain articles of sporting goods, imposed by section 4161 of the Internal Revenue Code of 1954, applies to croquet balls and croquet mallets, as individual articles, but does not apply to croquet sets, as such. The sale of a croquet set by a manufacturer is considered to be a combination sale of the various articles making up the set, and he is liable for the tax only on his sale of the taxable articles of his own manufacture included in the set. If the set includes taxable articles which he has purchased on a tax-paid basis from another manufacturer, they are treated in the same manner as nontaxable articles in computing the tax liability incurred at the time of the sale of the set.

Advice has been requested concerning the applicability of the manufacturers excise tax on certain sporting goods where a manufacturer sells croquet sets under the circumstances described below.

M corporation sells croquet sets containing balls, mallets, arches, racks, and stakes. *M* manufactures the mallets and the stakes. The

balls, arches, and racks are purchased from *N* company, which manufactures those articles.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles of sporting goods, including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof. Included in the articles enumerated are "croquet balls" and "croquet mallets."

The statute does not impose the manufacturers excise tax on the sale of the croquet sets, as such. The tax is imposed upon sales of croquet balls and croquet mallets, as individual articles. Furthermore, the tax is imposed upon the sale of these articles by the manufacturer, producer, or importer thereof and not upon resales of the articles by someone else.

Accordingly, in the instant case, it is held that the manufacturers excise tax on sporting goods applies to the sale of the croquet balls at the time they are sold to *M* corporation by *N* company. Therefore, *N* company is liable for the tax on its sale of the croquet balls.

The sale of the croquet set by *M* corporation is considered to be a combination sale of the various articles making up the set. *M* is liable for tax on the sale of the taxable articles of its manufacture included in the set, *i.e.*, the croquet mallets. *M* incurs no liability on its resale of the taxpaid articles purchased from *N* (croquet balls) when such articles are resold as part of the croquet set. The stakes, arches, and racks do not fall within the scope of section 4161 of the Code and, therefore, are not subject to the manufacturers excise tax on sporting goods.

M corporation's tax liability on the sale of the croquet set should be computed in accordance with the method described in Revenue Ruling 59–16, C.B. 1959–1, 340. For the purpose of this computation, the croquet balls purchased tax-paid from *N* company are to be treated as nontaxable articles. Therefore, if *M*'s cost of the taxable mallets is one-third of its total cost of the complete combination (excluding any shipping carton), the tax applies to one-third of the price charged by *M* for the entire set (including the shipping carton). This method indirectly allocates in the same ratio a part of any shipping carton to the taxable mallets.

Rev. Rul. 60–347

Sales of bowls or balls used in the game of lawn bowling and sales of other lawn bowling equipment, such as books on lawn bowling, bowl measures, lawn bowl polish, and porcelain jacks, are not subject to the manufacturers excise tax on certain sporting goods, imposed by section 4161 of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on certain sporting goods applies to the sale by an importer of bowls or balls used in different versions of the game of lawn bowling, an outdoor game which does not involve the use of pins.

The importer sells numerous items of lawn bowling equipment, including lawn bowls or balls, books on lawn bowling, bowl measures, lawn bowl polish, and porcelain jacks. The bowls are constructed in various sizes. They are not entirely round but are flattened somewhat on each side so that they roll on a curve and are thus not suitable for

use in the game of bowling which is usually played indoors on an "alley" and which utilizes pins.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles of sporting goods, including "bowling balls and pins."

It is held that since the bowls or balls described above are not designed or constructed for use in the conventional game of bowling which utilizes pins, they are not considered to be bowling balls within the meaning of section 4161 of the Code. Furthermore, none of the items of lawn bowling equipment listed above falls within the classification of "bowling balls and pins" or any of the other articles of sporting goods enumerated in section 4161 of the Code. Accordingly, sales of bowls or balls used in the game of lawn bowling and sales of other lawn bowling equipment such as books on lawn bowling, bowl measures, lawn bowl polish, and porcelain jacks, are not subject to the manufacturers excise tax on sporting goods.

PART II.—PHOTOGRAPHIC EQUIPMENT

SECTION 4171.—IMPOSITION OF TAX

26 CFR 48.4171-3: Parts or accessories. Rev. Rul. 60-263

A certain light seal set, consisting of a bridge hinge seal, a shutter bonnet, and a bulb knob cover, is not subject to the manufacturers excise tax on cameras, imposed by section 4171 of the Internal Revenue Code of 1954, when sold separately by the manufacturer, producer, or importer thereof. However, the tax applies to the light seal set when sold on or in connection with the sale of a taxable camera by the camera manufacturer.

Advice has been requested whether the manufacturers excise tax on cameras applies to separate sales by a manufacturer of the light seal set described below.

The light seal set is designed to eliminate minute light leaks in a certain camera which weighs less than four pounds. It consists of a bridge hinge seal, a shutter bonnet, and bulb knob cover. The bridge hinge seal is a straight length of black wire chenille similar to pipe cleaner material. When inserted between the negative spool drag spring and the bridge hinge, it prevents light from entering through the bridge hinge and striking the negative.

The shutter bonnet is a plastic cap which fits over the top of the shutter housing covering the exposure value window and the exposure value selector wheel. It is designed to prevent light from entering the camera through the exposure value selector wheel clearance slot and the exposure value window. The bulb knob cover consists of a small neoprene washer cemented to a metal cover. The unit fits over the bulb knob and an extension on the metal cover is fitted under the trip lever. The unit is then snapped in place at the back of the shutter housing. It is designed to prevent light from entering the camera through the bulb knob clearance hole, the trip lever clearance slot, and the bottom rear of the shutter housing.

The light seal set is sold either as a separate accessory or in a package with other accessories, such as a filter. It is not sold on or in connection with the sale of a camera.

Section 4171 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles of photographic equipment, including cameras. In each case, the tax applies to parts or accessories of such articles sold on or in connection therewith, or with the sale thereof. Section 4173(1) of the Code provides that the manufacturers excise tax on photographic equipment shall not apply to X-ray cameras or cameras weighing more than four pounds exclusive of lens and accessories.

Section 48.4171–3(b) of the Manufacturers and Retailers Excise Tax Regulations provides that if taxable articles are sold by the manufacturer thereof without parts or accessories which are considered equipment essential for the operation or appearance of such articles, the sale of such parts or accessories will be considered, in the absence of evidence to the contrary, to have been made in connection with the sale of the basic article even though they are shipped separately at the same time or on different date.

Section 48.4171–3(c) of the regulations provides that in the case of cameras and lenses the term "parts or accessories" only includes articles that are incorporated in, or are intended for incorporation in, a taxable camera or a taxable lens so as to become an integral part thereof, and range finders which, although detachable from a taxable camera, cannot operate independently thereof.

The light seal set described above is not essential for the operation or appearance of the taxable camera within the meaning of section 48.4171–3(b) of the regulations. In the instant case, it is not sold on or in connection with the taxable sale of a camera but is sold by the manufacturer thereof as a separate accessory or in a package with other accessories. Accordingly, it is held that such sales of the light seal set are not subject to the manufacturers excise tax on photographic equipment, imposed by section 4171 of the Code. However, since the light seal set is intended for incorporation in a taxable camera, it is considered a part or accessory within the meaning of section 48.4171–3(c) of the regulations and, therefore, the tax applies to such article if sold on or in connection with the sale of a taxable camera by the camera manufacturer.

PART III.—FIREARMS

SECTION 4181.—IMPOSITION OF TAX

26 CFR 48.4181–2: Meaning of terms. Rev. Rul. 60–233

A starter pistol which uses blank ammunition and which cannot discharge by an explosive a shot, bullet, or projectile is not a pistol, revolver, or firearm (other than a pistol and revolver) within the meaning of section 4181 of the Internal Revenue Code of 1954. Accordingly, sales of such starter pistols are not subject to the manufacturers excise tax on firearms imposed by that section of the Code. However, where a person removes the original barrels from such starter pistols and inserts prefitted, bored, and rifled barrels in the pistols so that a shot, bullet, or projectile can be discharged by an explosive, such person is a "manufacturer" of

taxable firearms within the meaning of section 4181 of the Code. Therefore, his sales of the converted starter pistols described above are subject to the manufacturers excise tax on firearms.

Advice has been requested whether the manufacturers excise tax on firearms, imposed by section 4181 of the Internal Revenue Code of 1954, applies to sales of starter pistols of the type used for signaling at athletic events or to sales of converted starter pistols which are fitted with bored and rifled barrels.

A manufacturer produces and sells starter pistols of the type used for signaling purposes at track meets, football games, and other athletic events. The pistols are constructed so that they use blank ammunition to produce an explosive sound. The starter pistols cannot discharge a shot, bullet, or projectile.

Another manufacturer imports similar starter pistols and changes the barrels on such pistols before he sells them to his customers. He removes the original barrels from the imported starter pistols and inserts prefitted, bored, and rifled barrels. The converted pistols can discharge a shot, bullet, or projectile by an explosive.

Section 4181 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of pistols, revolvers, firearms (other than pistols and revolvers), shells, and cartridges.

Section 48.4181–2(c) of the Manufacturers and Retailers Excise Tax Regulations, provides that the term "firearms" means any portable weapons, such as rifles, carbines, machine guns, shotguns, or fowling pieces, from which a shot, bullet, or other projectile may be discharged by an explosive.

Capability of discharging a projectile by means of an explosive is one of the factors which are to be considered in determining whether a device is a "pistol" or "revolver."

It is held that a starter pistol which uses blank ammunition and which cannot discharge by an explosive a shot, bullet, or projectile is not a pistol, revolver, or firearm (other than a pistol and revolver) within the meaning of section 4181 of the Code. Accordingly, sales of such starter pistols are not subject to the manufacturers excise tax on firearms imposed by that section of the Code.

However, where a person removes the original barrels from such starter pistols and inserts prefitted, bored, and rifled barrels in the pistols so that a shot, bullet, or projectile can be discharged therefrom by an explosive, it is held that such person is a "manufacturer" of taxable firearms for the purpose of section 4181 of the Code. Therefore, his sales of the converted starter pistols are subject to the manufacturers excise tax on firearms at the rate of eleven percent.

SUBCHAPTER E.—OTHER ITEMS

PART I.—BUSINESS MACHINES

SECTION 4191.—IMPOSITION OF TAX

26 CFR 48.4191–1: Imposition and rate of tax. Rev. Rul. 60–251

Fastening machines which are primarily designed to fasten materials other than paper do not come within the scope of the term "portable paper fastening machines" used in section 4191 of the In-

ternal Revenue Code of 1954, which imposes a manufacturers excise tax upon certain business machines. Furthermore, paper fastening machines which are not suitable for performing their function in an efficient and satisfactory manner without being attached to a desk, bench, or table are not considered to be "portable paper fastening machines." Based upon various facts presented by the industry, it will be presumed that the term "portable paper fastening machines" does not include a fastening machine which has a throat depth greater than 12 inches and which has design characteristics, such as holes in the base, for attaching it to a desk, bench, or table, even though it can be operated without being so attached.

Revenue Ruling 57–238, C.B. 1957–1, 380, amplified.

Advice has been requested whether, for purposes of the manufacturers excise tax on certain business machines, the devices described below are "portable paper fastening machines" within the purview of section 4191 of the Internal Revenue Code of 1954.

Item (1): *A "long reach" stapler with a throat depth of eight inches.*—This machine measures one and five-eights inches wide by nine and five-sixteenths inches long. It is equipped with an adjustable depth gauge, and its base is designed with holes so that it may be attached to a desk, bench, or table. However, the machine will operate efficiently without being attached in any manner. It uses standard preformed staples. It is used for fastening ordinary paper, such as letters, invoices, etc., as well as for general carding work, such as stapling cellophane bags containing potato chips, peanuts, small hardware, etc., to display cards.

Item (2): *A "long reach" stapler with a throat depth of 12 inches.*—This machine measures one and five-eighths inches wide by thirteen and five-sixteenths inches long. It is manufactured in two models, both of which are equipped with adjustable depth gauges. The bases of both models are designed with holes so that the machines may be attached to a desk, bench, or table. However, they will operate efficiently without being attached in any manner. Both models can be used to fasten ordinary paper, such as letters, invoices, etc. One model uses standard staples and is advertised for use in general carding work of the type referred to in *item* (1) above. The other model uses staples with a leg length of from one-fourth inch to one-half inch; therefore, it is capable of stapling material up to one-half inch in thickness.

Item (3): *A "long reach" stapler with a throat depth of 16 inches.*—This machine measures one and five-eighths inches wide by seventeen and five-sixteenths inches long. It is equipped with an adjustable depth gauge, which permits the placing of staples in material at a predetermined depth up to sixteen inches. It is advertised for use in stitching pamphlets or other light periodicals. The base of the machine is designed with holes, and it normally is attached to a work bench. However, the machine can be operated without being attached.

Item (4): *A "deep throat" stapler with a throat depth of 15 inches.*—This machine is essentially the same size and shape as the stapler identified as *item* (3) above. However, it has a raised handle which projects forward for ease of operation, and it is specifically designed for stapling bags on cards for display purposes.

Item (5): *A pedestal stand stapler.*—This device consists of a base, a foot lever, a vertical shaft and arm, a platform, and one, two, or three stapler heads. The base rests on the floor and supports the

foot lever and the vertical shaft. Resting upon the top of the vertical shaft, which is approximately three feet tall, is a horizontal platform on which the stapler heads are mounted. When the foot lever is depressed, the arm which extends from the vertical shaft activates the stapler head or heads. The machine is designed for stapling bags.

Item (6) : *A multiple head, foot-power device.*—This device is similar in general construction to *item* (5) above. It can be equipped with two, three, or four stapling heads with throat depths up to 12 inches. It is designed for use by mail letter service firms, mail order firms, printing shops, duplicating firms, food packers, etc.

Item (7) : *A foot-power saddle stitcher.*—This device also is similar in general construction to *item* (5) above. However, instead of a continuous horizontal platform, it has a combination saddle and flat back, adjustable, steel plate mounted on a second vertical shaft extending from the floor base. A stapling head and arm mounted on the first vertical shaft extends forward and above the combination saddle and flat back, adjustable, steel plate. This machine is designed for use in printing shops, letter service firms, and similar businesses.

Item (8) : *An electric stapler.*—This machine consists of a box-type housing containing a stapler head and an alternating current electric motor. When paper is fed into the "mouth" of the machine, an electric switch is triggered, causing the stapler head to operate. It will staple up to 20 sheets of medium weight paper and is designed for speed and quantity stapling. Another model of this machine is equipped with two stapler heads.

Item (9) : *A tacker.*—This device consists of a stapler head, a horizontal track for housing preformed staples, and a handle. It does not have a base or anvil. It is designed for use by garment makers for tacking patterns to cloth, by builders for attaching roofing paper to roofs, by corrugated box manufacturers for attaching rubber printing dies, and for similar uses.

Item (10) : *A bag fastener.*—This machine has a base approximately eight inches long. A raised arm extends forward for ease of operation. It is designed for use in closing bags with bulky contents. A "step" about midway in the base provides room for the contents of the bags to be stapled. This "step" also permits the fold of the bag to be brought readily to the anvil, which is located on the upper level of the base, where the staples are pressed into the material being fastened.

Section 4191 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain business machines, including "portable paper fastening machines." The statute does not define the term "portable paper fastening machines."

The development of criteria for determining which fastening machines are taxable is made difficult by the fact that some machines which are designed for use in fastening paper may also be used under certain circumstances for fastening other materials, while, on the other hand, certain machines which are said to be designed to fasten materials other than paper may be used quite satisfactorily for fastening paper. Furthermore, aside from the type of material with which they are to be used, some machines are designed for use either as portable or nonportable machines.

A fastening machine, regardless of its dimensions, which is primarily designed to fasten materials other than paper is not considered to come within the scope of section 4191 of the Code, even though it may have some incidental use to fasten paper. Therefore, the tax imposed by that section does not apply to machines which are designed for use in fastening leather, aluminum, etc.

Furthermore, the tax imposed by section 4191 of the Code does not apply to those paper fastening machines which are not considered portable. Revenue Ruling 57–238, C.B. 1957–1, 380, relating to the taxability of an "automatic eyeleter," states that the fact that a paper fastening machine has holes drilled in the base does not necessarily remove it from the category of "portable paper fastening machines." The determining factor is whether it is suitable for performing its function in an efficient manner without being fastened to a desk, bench, or table.

Accordingly, a paper fastening machine which is not suitable for performing its function in an efficient and satisfactory manner without being attached to a desk, bench, or table is not considered to come within the scope of the term "portable paper fastening machines."

Based upon various facts presented by the industry, and with due consideration of the combination of pertinent factors, that is, portability and the type of material for which designed, it will be presumed that the term "portable paper fastening machines" does not apply to a fastening machine which has a throat depth greater than 12 inches and which has design characteristics, such as holes in the base, for attaching it to a desk, bench, or table, even though it can be operated without being so attached.

The staplers identified above as *items* (1) and (2) will operate efficiently without being fastened to a desk, bench, or table. The throat depth of each is not greater than 12 inches. Accordingly, it is held that each of those staplers is subject to the manufacturers excise tax imposed by section 4191 of the Code.

Since the staplers identified above as *items* (3) and (4) have throat depths greater than 12 inches and are designed for attachment to a desk, bench, or table, they are presumed not to be "portable paper fastening machines" within the meaning of section 4191 of the Code. The devices identified above as *items* (5), (6), and (7) are designed with floor bases and, therefore, are self-supporting while in operation. This factor and other design characteristics lead to the conclusion that these articles are not "portable paper fastening machines." Furthermore, the articles identified above as *items* (8), (9), and (10) are not considered to be "portable paper fastening machines." Accordingly, it is further held that *items* (3), (4), (5), (6), (7), (8), (9), and (10) are not subject to the manufacturers excise tax imposed by section 4191 of the Code.

Revenue Ruling 57–238 is hereby amplified.

Rev. Rul. 60–252

Certain portable so-called "power-arm" *attachments* for use with taxable "portable paper fastening machines" are not themselves business machines which are subject to the manufacturers excise tax imposed by section 4191 of the Internal Revenue Code of 1954 when sold separately. However, they are considered to be acces-

sories for the taxable machines with which they are designed to be used. Therefore, the tax applies to these "power-arm" attachments when they are sold in connection with the taxable machines by the manufacturer, producer, or importer. On the other hand, the tax does not apply to certain floor-mounted, foot-power devices irrespective of whether they are sold separately or in combination with the taxable staplers with which they are designed to be used.

Advice has been requested concerning the applicability of the manufacturers excise tax on certain business machines to the articles described below.

Item (1): *A "power-arm" attachment.*—This device is designed for use with a heavy duty, desk-type stapler which comes within the scope of the term "portable paper fastening machines" as used in section 4191 of the Internal Revenue Code of 1954. See Rev. Rul. 60–251, page 322, of this Bulletin. The "power-arm" attachment consists of a narrow base constructed with an indentation into which the stapler may be placed, a fixed arm extending upward and forward from the rear of the base, and a lever which extends forward from the upper end of the fixed arm. This lever rests upon the head of the stapler, which may be operated by a downward pressure on the free end of the lever. This is said to enable the operator to staple together up to 100 sheets of paper with the application of slight pressure. The stapler with the "power-arm" attachment will operate efficiently without being fastened to a desk, table, or bench. The attachment may be sold separately or in connection with the stapler.

Item (2): *A foot-power apparatus.*—This pedestal-type apparatus consists of a base, a vertical shaft, a horizontal platform, and a lever mechanism which includes a foot pedal attached to the lower part of the shaft, a vertical rod, and an arm which is mounted above the platform. The vertical shaft extends about three feet from the floor base and supports the platform. The platform is constructed with an indentation into which there may be placed a stapler similar to that described above. The arm which is mounted above the platform rests upon the head of the stapler, which may be operated by pressure on the foot pedal. This foot-power device is designed for use in mass production packaging as well as in assembling operations by printers, publishers, mail order houses, etc.

Section 4191 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain business machines, including parts or accessories of such articles sold on or in connection therewith, or with the sale thereof. The enumeration of taxable business machines include "portable paper fastening machines."

Both of the articles described above are designed for use with desk-type staplers which also may be used independently.. Neither the "power-arm" attachment nor the foot-power apparatus, when considered alone, is a taxable business machine. Accordingly, no tax applies to the separate sale of such articles by the manufacturer, producer, or importer.

However, a different issue is presented when the described articles are sold by the manufacturer, producer, or importer in connection with the sale of staplers which come within the scope of the term "portable paper fastening machines." The question then is whether these articles should be considered as accessories for the taxable articles with which they are sold. The article described as *item* (1) merely en-

hances the use of the stapler as a portable paper fastening machine. Therefore, it is considered to be an accessory for the stapler. Accordingly, it is held that, when a taxable stapler and a "power-arm" attachment are sold together by the manufacturer, producer, or importer thereof, the manufacturers excise tax imposed by section 4191 of the Code applies to the price for which the stapler and its accessory are sold.

On the other hand, the article described as *item* (2) is designed for nonportable use. While this essential feature of the design of this item does not change the basic character of the stapler with which it may be sold, it is considered to be an adequate basis for concluding that the foot-power apparatus is not an accessory of the type referred to in section 4191 of the Code. Accordingly, it is further held that, when a taxable stapler and foot-power apparatus are sold together by the manufacturer, producer, or importer thereof, the manufacturers excise tax applies to the portion of the price attributable to the stapler but does not apply to the portion attributable to the foot-power apparatus, provided the articles are billed separately or the vendor's records are sufficient to establish a proper allocation of the price.

Rev. Rul. 60–253

A so-called "shade marker" designed for use by garment manufacturers to number various shades of cloth is considered to be a numbering machine within the meaning of section 4191 of the Internal Revenue Code of 1954 and, accordingly, is subject to the manufacturers excise tax on certain business machines imposed by that section. The separate sale of a "ribbon attachment" or a "numbering machine platform" which are designed to be used in connection with a numbering machine is not subject to the tax. However, where these articles are sold by the manufacturer on or in connection with the sale of a taxable numbering machine with which they may be used, the manufacturers excise tax applies to the price for which the numbering machine and its accessories are sold.

Advice has been requested concerning the applicability of the manufacturers excise tax on certain business machines to the articles described below.

Item (1): *A so-called "shade marker."*—The device consists of an inverted "U" shaped frame, a plunger, and a figure-wheel mechanism. The figure-wheel mechanism in the various models includes three or more wheels and may be set for consecutive, duplicate, or repeat numbering operation. The plunger extends through the top of the frame and is connected to the wheel mechanism. When the plunger is depressed, the wheel mechanism moves downward and prints a number on the material on which the machine is resting. It is designed for use by garment manufacturers for numbering various shades of cloth.

Item (2): *A "ribbon attachment."*—This article consists of two spools containing a hectograph ribbon. The spools are designed for attachment on either side of a numbering machine in such a way that the ribbon is drawn across the bottom of the frame of the machine. The attachment eliminates the need for fluid ink in a numbering machine, and its use makes impressions on material in the same manner as a typewriter makes impressions through a hectograph ribbon.

Item (3): *A "numbering machine platform."*—This article is made of metal and is equipped with an arm for the attachment of a num-

bering machine. The platform is designed to serve as a base for a numbering machine so that the stroke of the machine will be uniform.

Section 4191 of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of various enumerated business machines, including numbering machines. The tax imposed by that section also applies in each case to parts and accessories of such articles sold on or in connection therewith, or with the sale thereof.

It is held that the shade marker, described as *item* (1) above, is a numbering machine within the meaning of section 4191 of the Code. Accordingly, the manufacturers excise tax on business machines imposed by that section applies to the sale of such article by the manufacturer, producer, or importer thereof.

The ribbon attachment and the platform, described as *items* (2) and (3) above, do not come within the scope of any of the business machines enumerated in section 4191 of the Code. Therefore, the separate sales of such articles by the manufacturer, producer, or importer thereof are not subject to the tax imposed by that section. However, they are considered to be accessories for the numbering machines with which they are designed to be used. Accordingly, it is further held that, where such a ribbon attachment or platform is sold by the manufacturer thereof on or in connection with, or with the sale of, a taxable numbering machine of his manufacture with which the attachment or platform may be used, the tax applies to the price for which he sells the numbering machine and its accessory.

Applicability of the manufacturers excise tax on business machines where a manufacturer uses a typewriter for sales demonstration purposes. See Rev. Rul. 60–290, page 331.

PART II.—PENS AND MECHANICAL PENCILS AND LIGHTERS

SECTION 4201.—IMPOSITION OF TAX

26 CFR 48.4201: Statutory provisions; imposition of tax.

Limitation on amount of manufacturers tax in respect of sales, on and after October 1, 1960, of lighters for cigarettes, cigars, and pipes. See T.D. 6505, page 283.

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26 CFR 48.4201–1: Imposition and rate of tax. Rev. Rul. 60–356

> Where a manufacturer of mechanical pencils produces magnetic pencils at the request of certain customers by inserting magnetic rods into the barrel of mechanical pencils already completed by the manufacturer, the manufacturers excise tax on mechanical pencils, fountain pens, and ball point pens, imposed by section 4201 of the Internal Revenue Code of 1954, applies to the total price for which the magnetic mechanical pencils are sold by the manufacturer thereof, including the amount attributable to the magnetic rods.

Advice has been requested concerning the application of the manufacturers excise tax on mechanical pencils, fountain pens, and ball

point pens to sales of magnetic mechanical pencils under the circumstances described below.

A company is engaged in manufacturing and selling mechanical pencils. Under special arrangements, the company produces magnetized mechanical pencils for certain customers. This is done by inserting magnetic rods into the barrel of mechanical pencils already completed by the company. The conversion of the pencils to magnetic pencils is accomplished by removing the plug from the top of the pencils, inserting the magnetic rods, and replacing the plug. As a result, the pencils are magnetized and will adhere to metal surfaces. These mechanical pencils are not made of, or ornamented, mounted, or fitted with precious metals or imitations thereof.

Section 4201 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of mechanical pencils, fountain pens, and ball point pens.

The manufacturers excise tax on mechanical pencils applies to the total price for which the mechanical pencils are sold by the manufacturer thereof. This is so, even though the manufacturer may have produced complete pencils and subsequently may have performed additional operations on such pencils prior to selling them.

Accordingly, it is held that the addition of a magnet to a mechanical pencil merely constitutes another step in the manufacture of the article which the manufacturer sells, that is, a magnetic mechanical pencil. Therefore, the manufacturers excise tax on mechanical pencils, fountain pens, and ball point pens, imposed by section 4201 of the Code, applies to the total price for which the magnetic mechanical pencils are sold by the manufacturer thereof, including the amount attributable to the magnetic rods. Since the pencils are not made of, or ornamented, mounted, or fitted with precious metals or imitations thereof, they are not subject to the retailers excise tax imposed by section 4001 of the Code.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4216.—DEFINITION OF PRICE

(Also Section 4061; 26 CFR 40.4061(a)-1.) Rev. Rul. 60-241

The fair market price of motor vehicle articles, for the purpose of computing the manufacturers excise tax on motor vehicles imposed by section 4061(a)(1) of the Internal Revenue Code of 1954, which are manufactured by a corporation and sold, at cost, to its wholly owned subsidiary, in transactions at less than arm's length, is the total manufacturing cost plus 10 percent of the total cost if such corporation does not have an established practice of selling such articles at wholesale.

Advice has been requested concerning the proper basis for computing the manufacturers excise tax on motor vehicle articles, imposed by

section 4061(a)(1) of the Internal Revenue Code of 1954, when such articles are sold under the circumstances described below.

A corporation manufactures and sells certain motor vehicle articles, such as tank trailers and automobile truck bodies. These articles are of a different type of motor vehicle article than those generally sold on the open market by other manufacturers. The corporation sells, at cost, all such articles to its wholly-owned subsidiary. The subsidiary uses the motor vehicle articles in the operation of its business.

Section 4061(a)(1) of the Code imposes a tax on the price for which certain enumerated motor vehicle articles are sold by the manufacturer, producer, or importer thereof. Automobile truck bodies and truck and bus trailer and semitrailer chassis and bodies are included in that enumeration of motor vehicle articles.

Section 4216(b)(1)(C) of the Code provides, in part, that if an article is sold, otherwise than through an arm's length transaction, at less than the fair market price, the manufacturers excise taxes shall (if based on the price for which the articles are sold) be computed on the price for which such articles are sold in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary of the Treasury or his delegate.

Section 316.15 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, provides, in part, that a sale is not at arm's length when made pursuant to special arrangements between a manufacturer and a purchaser (as in the case of intercompany transactions). When a sale is not at arm's length and the price is less than the fair market price, as in the case of intercompany transactions at cost or at a fictitious price, the tax is to be computed upon a fair market price to be computed by the Commissioner of Internal Revenue.

Revenue Ruling 54–490, C.B. 1954–2, 416, relating to a manufacturer who manufactures automobile truck bodies for use in the operation of his dairy business and not for sale, states that where the articles are custom made and the manufacturer does not make sales at wholesale, the fair market price of automobile truck bodies has been found to represent the manufacturer's actual cost of producing the bodies plus 10 percent of such cost.

Under the circumstances described above, the corporation is liable for the manufacturers excise tax on motor vehicle articles on sales to its subsidiary. Since such sales are not arm's length transactions and the intercompany prices are at less than a fair market price, it is necessary to determine a fair market price in accordance with section 4216(b)(1)(C) of the Code.

Accordingly, it is held that where the manufacturer makes no sales at wholesale, the fair market price for the purposes of computing the manufacturers excise tax on intercompany sales is the total cost of the tank trailers, automobile truck bodies, or other articles taxable under section 4061(a)(1), when in condition ready for delivery by the manufacturer, plus 10 percent of such total cost. The cost of these articles is to be determined in accordance with standard accepted accounting methods. The cost includes labor, material, and overhead expenses attributable to the manufacture of such tank trailers, automobile truck bodies, etc.

SECTION 4218.—USE BY MANUFACTURER OR IMPORTER CONSIDERED SALE

(Also Section 4191; 26 CFR 48.4191–1.) Rev. Rul. 60–290

In accordance with the provisions of section 4218(a) of the Internal Revenue Code of 1954, the use of a business machine as a demonstrator by the manufacturer, producer, or importer thereof, in the operation of a business in which he is engaged, makes such person liable for the manufacturers excise tax on business machines, imposed by section 4191 of the Code, in the same manner as if the business machine were sold by him. The tax liability arises at the time the manufacturer first places the business machine into such use and is computed on the price for which such or similar business machines are sold by manufacturers in the ordinary course of trade, as determined by the Secretary of the Treasury or his delegate.

The Internal Revenue Service has been asked whether a manufacturer of business machines is liable for the manufacturers excise tax on business machines, imposed by section 4191 of the Internal Revenue Code of 1954, when the manufacturer uses taxable business machines as demonstrators in his sales showrooms.

A manufacturer produces and sells various business machines, including typewriters. Some of the typewriters are used by the manufacturer as demonstrators in the manufacturer's sales showrooms. After a certain period of time, or when newer models are introduced, the demonstrators are removed and sold at reduced prices as used typewriters.

Section 4191 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated business machines, including typewriters. Under the provisions of section 4218 (a) of the Code, as amended by the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92, if any person manufactures, produces, or imports an article (other than specified articles not involved here) and uses it (otherwise than as material in the manufacture or production of, or as a component part of, another article taxable under Chapter 32 of the Code to be manufactured or produced by him), then he is liable for tax under Chapter 32 of the Code in the same manner as if such article were sold by him. In accordance with section 4218(e) of the Code, if the manufacturer of an article is made liable for the tax by the provisions of section 4218(a) of the Code and if the tax is based on the price for which such articles are sold, the tax shall be computed on the price at which such or similar articles are sold in the ordinary course of trade, by manufacturers, producers, or importers thereof, as determined by the Secretary of the Treasury or his delegate.

It is held, therefore, that the use of a taxable business machine as a demonstrator by the manufacturer, producer, or importer thereof, in the operation of a business in which he is engaged, makes such person liable, under the provisions of section 4218(a) of the Code, for the manufacturers excise tax imposed by section 4191 of the Code in the same manner as if the business machine were sold by him. It is further held that the liability for such tax is incurred at the time the demonstrator is placed in use and is computed on the price for which such or similar business machines are sold by manufacturers in the ordinary

course of trade as determined by the Secretary of the Treasury or his delegate.

Accordingly, in the instant case, the manufacturer of typewriters is liable for the manufacturers excise tax when he first uses them as demonstrators in his showrooms. No manufacturers excise tax is incurred on a later sale of the used typewriters.

SUBCHAPTER G.—EXEMPTIONS, REGISTRATION, ETC.

SECTION 4221.—CERTAIN TAX-FREE SALES

(Also Sections 4061, 4063; 26 CFR 40.4061(a)–1, 40.4063–1.) Rev. Rul. 60–271

> Where a manufacturer sells a vehicle consisting of a semitrailer chassis and a semitrailer "body shell" to a semitrailer body manufacturer who completes the vehicle by further manufacturing the body shell, only the body shell may be sold tax free under section 4221(a)(1) of the Internal Revenue Code of 1954. Neither the chassis nor the body shell may be sold tax free under the provisions of section 4063(b) of the Code.

Advice has been requested whether, under the circumstances described below, a vehicle consisting of a semitrailer chassis and a semitrailer "body shell" may be sold by the manufacturer thereof to a semitrailer body manufacturer on a tax free basis.

X company is engaged in the business of manufacturing semitrailer bodies. *Y* corporation manufactures semitrailer chassis and bodies. Under special arrangements, *Y* corporation manufactures and sells to *X* company a vehicle consisting of a chassis and body shell. The body shell has outer walls, a roof, and door openings. *X* company completes the body by installing floors, doors, ceiling, wall linings, insulation, and refrigeration equipment. The completed semitrailer is then sold by *X* company.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of certain enumerated motor vehicle articles, including truck and bus trailer and semitrailer chassis and truck and bus trailer and semitrailer bodies. This section further provides that the sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this paragraph, be considered to be a sale of the chassis and of the body.

In accordance with section 4221(a)(1) of the Code, no manufacturers excise tax shall be imposed on the sale by the manufacturer of an article for use by the purchaser for further manufacture, or for resale by the purchaser to a second purchaser for use by such second purchaser in further manufacture, but only if such use is to occur before any other use. Section 4221(d)(6)(A) of the Code provides that an article shall be treated as sold for use in further manufacture if such article (with certain exceptions not here material) is sold for use by the purchaser as material in the manufacture or production of, or as a component part of, another article to be manufactured or produced by him which will be subject to the manufacturers excise tax. Section 4222(a) of the Code provides, in part, that section 4221

shall not apply with respect to the sale of any article unless the manufacturer, the first purchaser, and the second purchaser (if any) are all registered under this section.

Section 4063(b) of the Code provides that under regulations prescribed by the Secretary of the Treasury or his delegate, the tax under section 4061 shall not apply in the case of sales of bodies by the manufacturer, producer, or importer to a manufacturer or producer of automobile trucks or other automobiles to be sold by such vendee. For the purposes of section 4061, such vendee shall be considered the manufacturer or producer of such bodies.

Section 40.4063–1 of the Manufacturers and Retailers Excise Tax Regulations provides that a manufacturer of automobile truck bodies or other automobile bodies is permitted to sell such bodies tax free to manufacturers (but not an importer) of automobile truck chassis or other automobile chassis. However, there is no similar provision with respect to the sale of automobile truck chassis or other automobile chassis to manufacturers of automobile truck bodies or other automobile bodies.

In the instant case, the body shell has reached such a stage of manufacture at the time it is sold to *X* company that it is considered to be a semitrailer body. Therefore, when the vehicle consisting of a chassis and body shell is sold by *Y* corporation, it is considered to be the sale of a semitrailer chassis and a semitrailer body. See Revenue Ruling 58–582, C.B. 1958–2, 768, which holds that a "truck body kit" constitutes an automobile truck body such as contemplated by section 4061(a)(1) of the Code. The "truck body kit" therein described has reached a stage of manufacture comparable to that of the "body shell" described above. The subsequent installation of floors, doors, ceiling, wall linings, insulation, and refrigeration equipment by *X* company constitutes further manufacture of a new and different semitrailer body.

Accordingly, it is held that, pursuant to the provisions of section 4221(a)(1) of the Code, the body shell may be sold tax free by *Y* corporation to *X* company, provided the requirements of section 4222 of the Code and the applicable regulations with respect to tax free sales and registration are met. However, since *X* company is not a manufacturer of "automobile truck chassis or other automobile chassis," section 4063(b) of the Code does not apply. The semitrailer chassis, on which *X* company performs no act of further manufacture, may not be sold tax free by *Y* corporation to *X* company under either 4221(a)(1) or 4063(b) of the Code. Consequently, *Y* corporation is liable for the manufacturers excise tax imposed by section 4061(a)(1) of the Code on its sale of such chassis.

Upon the sale of the completed semitrailer, *X* company is liable for the manufacturers excise tax imposed by section 4061(a)(1) of the Code on that portion of the wholesale price of the completed semitrailer which is attributable to the semitrailer body, subject to the adjustments provided by section 4216(a) of the Code. Credit may be claimed by *X* company for the tax paid on the body shell by *Y* corporation provided such credit is properly supported by the required evidence. *X* company is considered to be merely a dealer with respect to the chassis when it sells the completed semitrailer and, thus, incurs no manufacturers excise tax liability thereon.

(Also Section 4061; 26 CFR 40.4061(a)–1.) Rev. Rul. 60–310

Where a manufacturer sells automobile trucks complete with gasoline engines to a company for the purpose of export and prior to exportation the company substitutes diesel engines, different clutches, and different transmissions in such vehicles, the company is considered to have further manufactured the automobile truck chassis. Accordingly, the exemption for export, provided by section 4221(a)(2) of the Internal Revenue Code of 1954, does not apply to the sale by the manufacturer of such automobile truck chassis. However, the exemption for export applies to the sale of the truck bodies, since they are not further manufactured prior to exportation.

Advice has been requested concerning the applicability of the exemption from manufacturers excise tax, with respect to sales for export, in situations where automobile trucks are sold under the circumstances described below.

Manufacturer *X* sells automobile trucks complete with gasoline engines to *Y* company for the purpose of export. However, prior to exportation, *Y* company substitutes diesel engines for the gasoline engines and also substitutes different clutches and transmissions.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of automobile truck chassis, automobile truck bodies, and other enumerated motor vehicles articles. A sale of an automobile truck shall, for the purposes of this paragraph, be considered to be a sale of the chassis and of the body.

Section 4221(a)(2) of the Code provides, in part, that under regulations prescribed by the Secretary of the Treasury or his delegate no manufacturers excise tax shall be imposed on the sale by the manufacturer of an article for export. Section 4221(b)(2) of the Code provides, in part, that where an article has been sold free of tax under subsection (a) for export, subsection (a) shall cease to apply in respect of such sale of such article unless, within the six-month period which begins on the date of the sale by the manufacturer (or, if earlier, on the date of shipment by the manufacturer), the manufacturer receives proof that the article has been exported.

Section 316.25(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, provides that to exempt from tax a sale for export it is necessary that two conditions be met; namely, (1) that the article be identified as having been sold by the manufacturer for export and (2) that it be exported in due course. Section 316.25(b) of the regulations provides, in part, that where delivery by the manufacturer of an article is to be made within the United States, such article will be regarded as having been sold by the manufacturer for export if the manufacturer has in his possession at the time title passes or at the time of shipment a statement from the purchaser showing (a) that the article is purchased to fill existing or future orders for delivery to a foreign destination, and (b) that such article will be transported to its foreign destination in due course prior to use or further manufacture and prior to any resale except for export.

In the instant case, when *Y* company substitutes diesel engines, different clutches, and different transmissions in such vehicles, it is considered to have further manufactured the automobile truck chassis

prior to their exportation. Accordingly, it is held that the exemption for export, provided by section 4221(a)(2) of the Code, is not applicable to sales of such automobile truck chassis by manufacturer *X* to *Y* company. Moreover, *Y* company becomes the manufacturer of automobile truck chassis and is liable for the manufacturers excise tax on his sales of such chassis unless they are sold for one of the tax-free purposes enumerated in section 4221 of the Code. However, under the provisions of section 4221(a)(1) and 4222 of the Code, manufacturer *X* could sell the chassis with gasoline engines to *Y* company tax-free for the purpose of further manufacture, without regard to their ultimate disposition by *Y* company. Then *Y* company, as the manufacturer of chassis, could in turn sell them tax-free for export.

With respect to the automobile truck bodies, the exemption for export is applicable to sales of such bodies by manufacturer *X* to *Y* company, since they were not further manufactured prior to exportation.

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26 CFR 148.1–4: Tax-free sales or services to certain nonprofit educational organizations. Rev. Rul. 60–303

> The principles stated in Revenue Ruling 59–319, C.B. 1959–2, 311, with respect to tax-free sales of gasoline for the exclusive use of school districts of a state or local government, are equally applicable to gasoline sold under similar circumstances for the exclusive use of parochial or other privately operated schools which qualify as nonprofit educational organizations for purposes of section 4221(a)(5) of the Internal Revenue Code of 1954. Therefore, sales by producers of gasoline to such schools for use by contract carriers in fulfillment of contracts to transport students to and from such schools are exempt from the manufacturers excise tax on gasoline, imposed by section 4081(a) of the Code.

Advice has been requested whether the principles set forth in Revenue Ruling 59–319, C.B. 1959–2, 311, with respect to tax-free sales of gasoline for the exclusive use of school districts of a state or local government, are also applicable under similar circumstances to sales of gasoline to certain parochial or other privately operated schools.

Certain parochial and other privately operated schools, which qualify as nonprofit educational organizations for purposes of section 4221(a)(5) of the Internal Revenue Code of 1954, purchase gasoline to be furnished without charge to contract carriers who transport school children to and from such schools. The carriers own and operate the buses and perform the transportation services under the terms of contracts with the schools. Sometimes the carrier transports on the same bus both students who attend parochial schools and students who attend other privately operated schools. In some situations, instead of purchasing gasoline directly from producers, the schools purchase tax-paid gasoline from intermediate dealers.

Section 4081(a) of the Code imposes a tax on gasoline sold by the producer or importer thereof, or by any producer of gasoline.

Section 4221(a)(5) of the Code provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, no manufacturers excise tax shall be imposed on the sale by the manufacturer

of an article to a nonprofit educational organization for its exclusive use, but only if such use is to occur before any other use. Section 4221(d)(1) of the Code provides that for purposes of this section of the Code the term "manufacturer" includes a producer or importer of an article.

Under the provisions of section 6416(b)(2)(D) of the Code, if an article is sold by any person to a nonprofit educational organization for its exclusive use, the manufacturers excise tax paid in respect of such article shall be deemed to be an overpayment, and a credit or refund (without interest) shall be allowed or made in respect of such overpayment under regulations prescribed by the Secretary or his delegate.

Revenue Ruling 59–319, *supra*, holds that the sale of gasoline by a producer or importer to a school district to be furnished without charge to a contract carrier for use in the performance of a contract with the school district for transportation of school children to and from school is regarded as a sale to a state or local government for its exclusive use within the meaning of section 4221(a)(4) of the Code, irrespective of whether or not the gasoline pumps are installed on the premises of the contract carrier. That ruling further states that such sales are exempt from manufacturers excise tax on gasoline provided they are supported by properly executed exemption certificates.

Inasmuch as section 4221(a)(5) of the Code provides for tax-free sales of articles sold to a nonprofit educational organization for its exclusive use, it is held that the principles stated in Revenue Ruling 59–319, *supra*, are equally applicable to gasoline sold to parochial or other privately operated schools for their exclusive use in the same manner as gasoline sold for use by schools operated by a state or local government. Therefore, where parochial or other privately operated schools qualify as nonprofit educational organizations within the meaning of section 148.1–4(b) of Treasury Decision 6344, C.B. 1959–1, 776, sales by producers of gasoline to such schools for use by contract carriers in fulfillment of contracts to transport students to and from such schools are exempt from manufacturers excise tax provided that the requirements of registration are fulfilled. Furthermore, it is immaterial whether the contract carriers transport on the same vehicle both students who attend parochial schools and students who attend other privately operated schools, so long as each school qualifies as a nonprofit educational organization.

Articles subject to manufacturers excise tax may not be sold tax-free under section 4221(a)(5) of the Code to dealers, distributors, or other persons for resale to nonprofit educational organizations. However, a credit or refund of manufacturers excise tax is allowable to the manufacturer under the provisions of section 6416(b)(2)(D) of the Code in the amount of excise tax paid by the manufacturer on the sale of such articles. The manufacturer's claim for credit or refund must be supported by evidence showing that the manufacturer has complied with the provisions of section 6416(a) of the Code, and by evidence, on Form 2670, Credit or Refund Exemption Certificate for use by a Nonprofit Educational Organization, establishing that the articles were actually sold or resold to a nonprofit educational organization for its exclusive use.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART II.—CLUB DUES

SECTION 4243.—EXEMPTIONS

Rev. Rul. 60-315

The exemption from the club dues tax, provided by section 4243(b) of the Internal Revenue Code of 1954, applies to amounts paid by members of a country club on and after November 1, 1959, for the repayment of a bank loan (or the restoration of the club's reserve fund) which was used to pay for certain capital improvements begun on or after January 1, 1959.

Advice has been requested concerning the applicability of the exemption from the club dues tax, provided by section 4243(b) of the Internal Revenue Code of 1954, to amounts paid by members of a country club under the circumstances described below.

In January 1960, the members of a country club authorized the club's board of directors to contract for the construction of certain additions to the club buildings and to purchase the furniture and equipment necessary for the new building additions. To raise the funds necessary to pay for these capital improvements, the club has provided that, beginning in January 1960, (1) each new member will be required to pay, in addition to the usual initiation fee, a specified amount to be used only for these improvements and (2) there will be made against each club member a monthly assessment in a specified amount, in addition to the regular membership dues, to be used only for these improvements.

A period of several years will be required for the funds obtained in this manner to equal the total amount necessary to cover the cost of the capital improvements. However, in order to proceed expeditiously with the planned improvements, arrangements have been made to pay the costs of the building construction and furnishings acquisition, as they arise, from funds obtained from two sources, as follows: (1) a reserve fund accumulated by the club in prior years and (2) a loan obtained from a bank. The members' payments described above will then be used to repay the bank loan and to restore the reserve fund to its former amount.

The specific question is whether the exemption provided by section 4243(b) of the Code applies to the amounts which are paid by the club members for this repayment and restoration.

Section 4241(a)(1) of the Code imposes a tax upon any amount paid as dues or membership fees to any social, athletic, or sporting club or organization, if the dues or fees of an active resident annual member are in excess of ten dollars per year. Section 4241(a)(2) of the Code imposes a tax upon any amount paid as initiation fees to such a club or organization, if such fees amount to more than ten dollars, or if the dues or membership fees, not including initiation fees,

of an active resident annual member are in excess of ten dollars per year.

Section 4243(b) of the Code, added by the Excise Tax Technical Changes Act of 1958, Public Law 85-859, C.B. 1958-3, 92, effective January 1, 1959, as amended by Public Law 86-344, C.B. 1959-2, 700, effective November 1, 1959, provides as follows:

> PAYMENTS FOR CAPITAL IMPROVEMENTS.—Notwithstanding any other provision of this part, there shall be exempted from the provisions of section 4241 any amount paid as dues or membership fees or as initiation fees—
> (1) for the construction or reconstruction of any social, athletic, or sporting facility, or
> (2) For the construction or reconstruction of any capital addition to, or capital improvement of, any such facility, or
> (3) for furnishings or fixtures (including installation charges) for any such facility, to the extent that such furnishings or fixtures are required, by reason of the construction or reconstruction described in paragraph (1) or (2), for the use of such facility upon completion of such construction or reconstruction;
> except that, in the case of any such amount which is not expended for such construction, reconstruction, furnishings or fixtures (including installation charges) within three years after the date of payment of such amount, the exemption provided by this subsection shall cease to apply upon the expiration of such three-year period, and the club or organization, rather than the person who made such payment, shall be liable for any tax imposed by section 4241 in respect of such payment, as if such payment had been made on the first day following the expiration of such three-year period.

In general, this exemption applies to all amounts paid by club members on and after November 1, 1959, for the construction or reconstruction of any social, athletic, or sporting facility (or any capital addition to, or capital improvement of, any such facility) begun on or after January 1, 1959, or for furnishings and fixtures required for the use of such facility upon the completion of such construction or reconstruction begun on or after that date, provided those amounts are expended for such purposes within three years after the date of payment by the members of the club.

Since in the instant case the construction was not begun and the amounts involved in this ruling were not paid by members until 1960, the controlling factor is the purpose for which the original funds were expended. Where funds obtained by means of the bank loan or from the club's reserve fund have been expended, as in this case, for capital improvements of the type covered by section 4243(b) of the Code, the amounts paid by the club members for the repayment of the bank loan or for the restoration of the reserve fund are considered as being paid for those capital improvements.

Accordingly, it is held that under the circumstances described the exemption provided by section 4243(b) of the Code applies to the amounts paid by club members for the repayment of the bank loan, including the interest thereon, or for the restoration of the club's reserve fund. This conclusion applies to the specified amounts required to be paid by new members as well as the special monthly assessments against all members. However, the exemption would not apply to any portion of such payments used for the repayment or restoration of funds used for the payment of current operating expenses or for the purchase of land rather than for the financing of the capital improvements. Therefore, to assure the proper application of the exemption, the club must maintain adequate records to show the actual disposition of the funds being repaid or restored.

SUBCHAPTER B.—COMMUNICATIONS

SECTION 4251.—IMPOSITION OF TAX

26 CFR 42.4251–1: Imposition and rates of tax. Rev. Rul. 60–318

Amounts paid to a company for background music furnished by that company to subscribers by means of wires leased from a telegraph company are subject to the tax on "wire and equipment service" imposed by section 4251 of the Internal Revenue Code of 1954. However, amounts paid to the company by manufacturers for spot announcements to be made by means of the "wire and equipment service" are not subject to the tax. Moreover, amounts paid to the company for background music furnished to other subscribers by means of tape players which are installed on the subscriber's premises are not subject to the tax, since such service is not a "wire and equipment service" as that term is defined by section 4252(f) of the Code and does not come within the scope of any other communication service enumerated in section 4251 of the Code.

Advice has been requested whether the excise tax on communication services applies to amounts paid for background music and spot advertisements under the circumstances described below.

A music company is engaged in the business of furnishing background music to supermarkets. The music is transmitted to some supermarkets from a central studio by means of wires leased from a telegraph company and is furnished to other supermarkets by means of tape players and remote speakers which are installed on the premises of the supermarkets. The tape players, tapes, and all equipment installed in the supermarkets are furnished, owned, and serviced by the music company. Spot advertising announcements to be transmitted over the wires, or placed on tapes to be replayed in the supermarkets, are sold by the music company to manufacturers whose products are displayed and sold in the supermarkets subscribing to the music service. The supermarkets pay the music company a standard fee for the service, and the manufacturers pay the music company a charge proportionate to the amount of advertising to which they subscribe.

Section 4251 of the Internal Revenue Code of 1954, as amended by the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92, imposes a tax on amounts paid for certain enumerated communication services, including "wire mileage service" and "wire and equipment service."

Section 4252(e) of the Code, as amended by the Excise Tax Technical Changes Act of 1958, defines the term "wire mileage service" as any telephone or radio telephone service, and any other wire or radio circuit service, not included in any other subsection of this section; except that such term does not include service used exclusively in furnishing wire and equipment service. Section 4252(f) of the Code (section 4252(e) prior to its redesignation and amendment by the Excise Tax Technical Changes Act of 1958) provides that the term "wire and equipment service" includes stock quotations and informa-

tion services, burglar alarm or fire alarm service, and all other similar services (whether or not oral transmission is involved).

Section 42.4252–6(a) of the Facilities and Services Excise Tax Regulations, Treasury Decision 6356, C.B. 1959–1, 368, provides that, in general, the term "wire and equipment service" relates to lines or channels and equipment by means of which information or services are furnished to the subscriber. Tax is imposed on the amounts paid for such lines or channels, equipment, and information or services. Section 42.4252–6(b)(3) of the regulations provides that wire and equipment services include 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.

Revenue Ruling 55–710, C.B. 1955–2, 658, holds that amounts paid to a company for a music program service transmitted over leased telephone wires running from the company's central studio to the places of business of its subscribers are subject to the tax on wire and equipment service.

Accordingly, in the instant case, it is held that amounts paid to the company by its subscribers for background music furnished by means of wires leased from a telegraph company are subject to the tax on "wire and equipment service" imposed by section 4251 of the Code. However, under the facts presented, the manufacturers who purchase spot announcements are not subscribers to the "wire and equipment service." Therefore, the amounts paid to the company by such manufacturers are not subject to the communications tax.

It is significant that section 42.4252–6(b)(3) of the regulations uses the phrase "channels furnished between a point of origin and the subscriber's premises over which are given" musical programs, etc. Accordingly, in the instant case, since there are no channels furnished between a point of origin and the subscriber's premises with respect to the background music furnished to some subscribers by means of tape players which are installed on the subscriber's premises, that service does not constitute a "wire and equipment service" within the meaning of section 4252(f) of the Code and does not come within the scope of any other communication service enumerated in section 4251 of the Code. Therefore, amounts paid to the music company for background music furnished to subscribers by means of tape players which are installed on the subscriber's premises are not subject to the excise tax on communication services.

SUBCHAPTER C.—TRANSPORTATION OF PERSONS

SECTION 4261.—IMPOSITION OF TAX

26 CFR 49.4261–1: Imposition of tax; in general.

Whether the exemption from the tax on the transportation of persons applies where a state-operated school reimburses a person who

is not an officer or employee of the school for actual traveling expenses incurred for its benefit. See Rev. Rul. 60–304, page 343.

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26 CFR 42.4261–7: Examples of payments subject to tax. Rev. Rul. 60–311

Certain helicopter rental companies are considered to be furnishing a transportation service which is subject to the excise tax on the transportation of persons, imposed by section 4261 of the Internal Revenue Code of 1954, where they enter into contracts, designated as leases, whereby they (1) lease helicopters with pilots to an oil company for use in transporting personnel engaged in geophysical prospecting for petroleum, along with necessary equipment, (2) retain possession, command, and control of the helicopters, and (3) perform all services in connection with the operation of the helicopters. Accordingly, the tax on the transportation of persons applies to the portion of the total payment which is allocable to the transportation of persons, provided such allocation is made on a fair and reasonable basis and can be supported by proper records. If no allocation is made, the tax applies to the total payment for the lease of the helicopters. The total amount paid by the oil company for the lease of the helicopters includes, in addition to the cash payments, the cost of any gas, oil, or lubricants supplied to the rental companies by the oil company for the operation of the helicopters.

Advice has been requested concerning the applicability of the excise tax on the transportation of persons to payments made under the circumstances described below.

An oil company entered into contracts, designated as leases, under the terms of which it leases helicopters from various companies for use in geophysical prospecting for petroleum in certain rugged and remote areas. Geophysical prospecting involves the analysis of the sub-surface of the earth by the study of various physical data obtained through the use of complex and delicate instruments. In these areas where geophysical prospecting is being conducted, the oil company establishes a base camp near the sites where ground surveys are to be made. The leased helicopters are stationed at the base camp and are used for transporting personnel and equipment between the camp and the sites where the surveys are being made. The helicopters are also used to transport supplies and are available for aerial surveys and aerial navigation necessary for the conduct of the company's explorations and activities. The personnel and equipment are flown into the base camps by fixed wing aircraft, and operations with the helicopters begin after the arrival of the personnel and equipment.

Under the terms of the contracts between the oil company and the various helicopter rental companies, the rental companies agree to make available a helicopter and pilot for the exclusive use of the oil company. The pilot and the helicopter must meet the qualifications set by the lessee. The rental companies also agree to furnish an experienced mechanic, the mechanical parts, and the services and facilities necessary to keep the helicopters in good operating condition. Decisions as to the time and place for operations are made by the lessee, while decisions regarding load limits, weather conditions, etc., are the responsibility of the pilots of the helicopters.

Various methods are used in determining the consideration to be paid to the rental companies by the lessee. The methods of payment include (1) a guaranteed minimum monthly fee for a scheduled number of hours of flying service per month, plus an additional amount for each hour flown in excess of the scheduled hours, (2) a guaranteed monthly fee plus an additional amount for each flying hour, and (3) a certain sum for each flying hour. In addition, the lessee agrees to supply and deliver, at its own expense, all gas, oil, and lubricants used in the helicopters. The rental companies agree to accept responsibility for all losses, damages, expenses, liability, and claims resulting from their performance of the contracts.

Section 4261(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within the United States for taxable transportation of persons by rail, motor vehicle, water, or air.

Where the owner of a vehicle (such as a helicopter) leases it to others for the transportation of persons but retains possession, command, and control of the vehicle, he is furnishing a taxable transportation service within the meaning of section 4261 of the Code. However, where the owner of the vehicle transfers the complete possession, command, and control of his vehicle to a lessee, either by a charter-party or by actual practice, the owner is not engaging in a taxable transportation service but is merely leasing his vehicle. See Rev. Rul. 56–45, C.B. 1956–1, 521; Rev. Rul. 56–608, C.B. 1956–2, 878; Rev. Rul. 57–545, C. B. 1957–2, 749; and Rev. Rul. 58–215, C. B. 1958–1, 439.

Accordingly, in the instant case, it is held that, since the helicopter rental companies retain the elements of possession, command, and control of the helicopters and perform all services in connection with the operation of the helicopters, they are, in fact, furnishing taxable transportation to the lessee. Therefore, the tax on the transportation of persons applies to the portion of the total payment which is allocable to the transportation of persons, provided such allocation is made on a fair and reasonable basis and can be supported by proper records. If no allocation is made, the tax applies to the total payment for the lease of the helicopters. See Rev. Rul. 60–63, C.B. 1960–1, 548.

It is further held that the total payment for transportation service includes not only cash payments but also payments in kind. Therefore, where a company receiving transportation service supplies the carrier with items which represent necessary elements of transportation (such as gas, oil, lubricants, equipment, or insurance), such items are considered to be payments for transportation. Accordingly, in the instant case, the total payment for the lease of the helicopters includes the cost of the gas, oil, and lubricants supplied by the lessee to the rental companies, as well as the cash amount paid to the rental companies by the lessee.

It should be noted, however, that section 4263(f) of the Code, as added by the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92, effective January 1, 1959, provides an exemption from the tax on the transportation of persons for certain small aircraft when operated on nonestablished lines. This exemption applies to helicopters qualifying under the statutory rules as well as to other types of aircraft.

SUBCHAPTER E.—SPECIAL PROVISIONS APPLICABLE TO SERVICES AND FACILITIES TAXES

SECTION 4292.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

26 CFR 42.4292–1: State and local government exemptions.
(Also Section 4261; 49.4261–1.)

Rev. Rul. 60–304

The exemption from the tax on the transportation of persons with respect to transportation furnished to a state or local government, provided by section 4292 of the Internal Revenue Code of 1954, applies to transportation furnished to an individual who receives reimbursement from a state-operated school for the actual travel expense incurred by him for the benefit of the school, even though such individual is not an officer or employee of the school and even though the school does not make the original payment to the carrier for the transportation.

Advice has been requested whether the exemption from the tax on the transportation of persons with respect to transportation furnished to a state or local government, provided by section 4292 of the Internal Revenue Code of 1954, applies to payments made for transportation in the situations described below.

Situation (1). A school, operated by a state, invites a prospective employee to visit the school for an employment interview. The school will subsequently reimburse the prospective employee for the actual travel expense incurred by him.

Situation (2). A school, also operated by a state, invites a member of the faculty of another institution to the school for the purpose of attending a technical conference which is of benefit to the school. The school will subsequently reimburse the visitor for the actual travel expense incurred by him.

Situation (3). A private employer "lends" some of his employees to a state-operated school for the purpose of conducting technical research which is of direct benefit to the school. The employees are required to travel during the course of conducting this technical research and the school will subsequently reimburse such employees for the actual travel expense incurred by them. However, the employees will not be paid by the school but will continue to receive their regular salaries from their private employer.

Section 4261 of the Code imposes a tax upon amounts paid within the United States for taxable transportation (as defined in section 4262) of any person by rail, motor vehicle, water, or air.

Section 4292 of the Code provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, no tax shall apply to payments received for transportation services or facilities furnished to the Government of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. Section 42.4292–1 of the Facilities and Services Excise Tax Regulations provides, in part, that amounts paid for transportation or facilities by an officer or employee of a State, Territory, etc., who is traveling on a mileage or other allowance basis are exempt from tax where reimbursement is made to such officer or employee.

Revenue Ruling 56–482, C.B. 1956–2, 885, holds that where a state-

operated school pays to a person engaged to speak before the student body a specified sum for his services and, in addition, reimburses him for the actual travel expense incurred by him, the payment made by the speaker for such transportation constitutes payment for transportation furnished to a state within the meaning of section 4292 of the Code and, accordingly, is exempt from tax on the transportation of persons.

Similarly, where an individual has been authorized by an agency or instrumentality of a state to travel on its behalf or for its benefit and will subsequently receive specific reimbursement from such agency or instrumentality for his travel expenses, the payment made by such individual for his transportation may properly be regarded as a payment for transportation furnished to a state within the meaning of section 4292 of the Code, even though the individual is not an officer or employee of the agency or instrumentality and even though the agency or instrumentality does not make the original payment to the carrier for the transportation.

Accordingly, it is held that the payments for transportation made by the individuals in *situations* (1), (2), and (3), described above, constitute payments for transportation furnished to a state within the meaning of section 4292 of the Code and, therefore, are exempt from the tax on the transportation of persons imposed by section 4261. The right to exemption in such cases must be established by Form 731, Exemption Certificate, executed by an officer of the school. The certificate should designate the limits of the travel and should be forwarded to the traveler for presentation to the agent of the carrier at the time he makes payment for the transportation. The school should also furnish the traveler a letter or other written evidence which will disclose that he is the person on whose behalf the certificate is issued.

CHAPTER 34.—DOCUMENTARY STAMP TAXES

SUBCHAPTER A.—ISSUANCE OF CAPITAL STOCK AND CERTIFICATES OF INDEBTEDNESS BY A CORPORATION

PART I.—ISSUANCE OF CAPITAL STOCK AND SIMILAR INTERESTS

SECTION 4301.—IMPOSITION OF TAX

26 CFR 43.4301-2: Illustrations. Rev. Rul. 60-273

The payment date, rather than the declaration date or the record date, is considered to be the date of issuance of stock pursuant to a declaration of stock dividend. The actual value of such dividend stock on the payment date is the proper basis for computing the original issuance tax imposed by section 4301 of the Internal Revenue Code of 1954.

Advice has been requested whether, for purposes of computing the documentary stamp tax imposed on the original issue of shares or certificates of stock, the date of issuance of shares or certificates issued as a stock dividend is (1) the date the dividend is declared, (2) the record date, or (3) the date of payment of the dividend.

On November 1, 1958, the board of directors of a domestic corporation voted a stock dividend on its par value common stock. The dividend was payable on January 30, 1959, to holders of record on January 15, 1959.

Section 4301 of the Internal Revenue Code of 1954, as amended by the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92, effective January 1, 1959, imposes a tax on each original issue of shares or certificates of stock issued by a corporation at the rate of ten cents on each $100 (or major fraction thereof) of the *actual* value of the certificates (or of the shares where no certificates are issued). The tax imposed by this section is computed on the basis of all certificates (or shares) so issued by a corporation on each day. Prior to January 1, 1959, the tax on the original issue of par value shares or certificates was 11 cents on each $100.00 or fraction thereof of the *par* or *face* value of each certificate or share.

Section 43.4301–2(a)(4) of the Documentary Stamp Tax Regulations provides that stock issued as a dividend is subject to the tax.

The question of when a stock dividend is issued has been considered in a number of court actions. These decisions hold that the record date of a stock dividend does not serve to fix the date of the issuance of the stock. Rather, the record date is significant only to the extent that it determines those stockholders who will be entitled to the stock upon its issuance. The stock involved in a stock dividend is not issued until the designated shareholders have a vested right with respect thereto and are in a position to demand the execution and delivery of certificates regarding such stock. Where a board of directors declares a stock dividend, the right of the board subsequently to rescind its action at any time prior to the actual issuance of the stock is recognized. See *Staats* v. *Biograph Co.*, 236 Fed. 454, and the decisions and authorities mentioned therein.

In view of the foregoing, it is held that the payment date of the stock dividend, that is, the date the dividend becomes payable, is the date the shares are created and the time at which a vested right in the stock is received by the shareholders. In other words, the payment date, rather than the declaration date or the record date, is considered to be the date of issuance of the stock. Therefore, the actual value of such dividend stock on January 30, 1959, is the proper basis, in the instant case, for computing the original issuance tax imposed by section 4301 of the Code.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES

SUBCHAPTER A.—PLAYING CARDS

SECTION 4451.—IMPOSITION OF TAX

Rev. Rul. 60–234

The excise tax on playing cards, imposed by section 4451 of the Internal Revenue Code of 1954, does not apply to the sale of a single playing card. However, the assembly and sale of two or more playing cards is subject to the tax.

Advice has been requested whether the excise tax on playing cards applies to cards acquired by persons engaged in the hobby of collecting playing card designs.

Certain individuals and groups of individuals have taken up the collecting of playing cards as a hobby. The object of the hobby is to acquire a collection of cards with different backs and there is no intent to use these cards in playing card games. Cards are obtained by purchasing them at second-hand stores and rummage sales or from antique dealers and other collectors of playing cards.

Section 4451 of the Internal Revenue Code of 1954 imposes a tax of 13 cents per pack upon every pack of playing cards containing not more than 54 cards, manufactured or imported, and sold, or removed for consumption or sale, by a manufacturer.

Section 4452 of the Code states that every person who offers or exposes for sale playing cards, whether the articles so offered or exposed are of foreign manufacture and imported or are of domestic manufacture, shall be deemed the manufacturer thereof, and subject to all the duties, liabilities, and penalties imposed by law in regard to the sale of domestic articles without the use of the proper stamps denoting the tax paid thereon.

Section 4454 of the Code states that the tax imposed upon playing cards shall be paid by any person who makes, sells, removes, consigns, or ships any playing cards, or for whose use or benefit the same are made, removed, consigned, or shipped.

Article 8 of Regulations 66, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, states, in part, that each additional 54 cards or fraction thereof in a pack constitutes a new pack on which tax must be paid. That article further provides that where packages of playing cards are sent out from the factory duly stamped and are thereafter opened and stamp broken, the cards can not be returned to the packages and sold under a broken stamp; a new stamp must be affixed to each package and duly canceled.

The Internal Revenue Service has consistently held that not fewer than two nor more than 54 cards constitute a pack of playing cards.

Accordingly, it is held that any person may sell a single card without incurring liability for the tax under section 4451 of the Code. However, any person, even though he may be an antique dealer, a collector of playing cards, or a dealer in second-hand goods, who assembles and sells a set of two or more playing cards, but not more than 54, is deemed to be the manufacturer of a pack of playing cards. Therefore, he is subject to the tax imposed by section 4451 of the Code, regardless of the fact that the tax may have been paid on previous sales of such cards.

Rev. Rul. 60–339

The excise tax on playing cards, imposed by section 4451 of the Internal Revenue Code of 1954, applies to cards which are suitable for use as "playing cards," even though they may be "miniature." The size of the cards is only one of the factors which determine the suitability of the cards for such use.

Revenue Ruling 54–461, C.B. 1954–2, 394, amplified.

Advice has been requested concerning the criteria which determine whether the excise tax on playing cards applies to cards of small size.

Section 4451 of the Internal Revenue Code of 1954 impose a tax on every pack of playing cards containing not more than 54 cards, manufactured or imported, and sold, or removed for consumtion or sale, by a manufacturer.

Article 8 of the Regulations 66, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, provides that the tax applies to ordinary playing cards such as are used in playing games of skill or chance such as "poker," "euchre," "pinochle," and the like and to cards that may be used in lieu of ordinary playing cards. The regulations further state that miniature playing cards, playing cards with advertising matter printed thereon, and so-called "fortune-telling," "magic," or "trick" decks composed wholly or in part of playing cards or cards that may be used in lieu of playing cards are all subject to the tax.

Revenue Ruling 54–461, C.B. 1954–2, 394, holds that, in view of the extremely small size of the cards involved in that Revenue Ruling (5/8 inch by 7/8 inch), they are not considered adaptable for use in playing games of cards and, accordingly, are not subject to the tax.

Although no minimum-size standard has been established for determining whether cards are "playing cards," the cards are not considered to be taxable if of such a small size that they may not be shuffled and dealt. Taxability is determined not only on the basis of size but on various other factors as well, such as whether the cards are made of material of a weight and thickness that will withstand handling and whether imprinted with the conventional playing card markings.

Accordingly, it is held that the tax imposed by section 4451 of the Code applies to cards which, in view of all the pertinent factors, are suitable for use as "playing cards," even though they may be characterized as "miniature."

In any case where the taxability of particular cards cannot be determined on the basis of the foregoing factors, sample cards should be submitted to the Internal Revenue Service together with any information which is considered pertinent to the determination of taxability.

Revenue Ruling 54–461 is hereby amplified.

SUBCHAPTER D.—TAX ON USE OF CERTAIN VEHICLES

SECTION 4482.—DEFINITIONS

26 CFR 41.4482(b)–1: Definition of taxable gross weight. Rev. Rul. 60–260

> Dump trucks are classed as "single unit" vehicles for purposes of determining their taxable gross weight under the Highway Motor Vehicle Use Tax Regulations, even though they may be equipped with coupling devices for occasional use with lightweight trailers or semitrailers.

Advice has been requested whether dump trucks equipped with pintle hooks or similar coupling devices should be classed as "single units" or as "combinations" for purposes of determining the taxable

gross weight under the Highway Motor Vehicle Use Tax Regulations.

In the instant case, single-unit dump trucks, each having an empty weight of less than 13,000 pounds, are equipped with pintle hooks or similar coupling devices for the purpose of occasionally pulling construction equipment, lightweight trailers for tar, tools, or the like, etc., from job-site to job-site.

Section 4481(a) of the Internal Revenue Code of 1954 imposes a tax upon the use of any highway motor vehicle which (together with the semitrailers and trailers customarily used in connection with highway motor vehicles of the same type as such highway motor vehicle) has a taxable gross weight of over 26,000 pounds.

Section 4482(b) of the Code provides as follows:

> TAXABLE GROSS WEIGHT.—For purposes of this subchapter, the term "taxable gross weight," when used with respect to any highway motor vehicle, means the sum of—
>
> (1) the actual unloaded weight of—
>
> (A) such highway motor vehicle fully equipped for service, and
>
> (B) the semitrailers and trailers (fully equipped for service) customarily used in connection with highway motor vehicles of the same type as such highway motor vehicle, and
>
> (2) the weight of the maximum load customarily carried on highway motor vehicles of the same type as such highway motor vehicles and on the semitrailers and trailers referred to in paragraph (1)(B).
>
> Taxable gross weight shall be determined under regulations prescribed by the Secretary or his delegate (which regulations may include formulas or other methods for determining the taxable gross weight of vehicles by classes, specifications, or otherwise).

A schedule of taxable gross weights for determining the amount of the tax imposed under section 4481 is prescribed in section 41.4482(b)–1(c) of the regulations. For purposes of determining the taxable gross weight of a highway motor vehicle, this schedule sets forth various categories of "single units" and various categories of "combinations." The term "combinations," as used in such schedule, is not specifically defined in the regulations and should, therefore, be given its ordinary and usual meaning in the trucking industry.

It is held that a dump truck should be considered as a "single unit" vehicle for purposes of determining its taxable gross weight under the use tax schedule set forth in section 41.4882(b)–1(c) of the regulations, even though it may be equipped with a pintle hook or similar coupling device, since the trailers and semitrailers customarily used with such trucks are not of a type contemplated as being within the ordinary and usual meaning of the term "combinations," as such term appears in the use tax schedule. Therefore, where the actual unloaded weight fully equipped for service is less than 13,000 pounds, a dump truck is not subject to the tax.

See Revenue Ruling 57–547, C.B. 1957–2, 789, for a similar conclusion with respect to a certain type of utility truck which may be equipped with a pintle hook or similar coupling device for pulling a pipe or pole dolly, tool or equipment trailer, or other similar lightweight trailer.

SUBTITLE E.—ALCOHOL, TOBACCO, AND CERTAIN OTHER EXCISE TAXES

CHAPTER 52.—TOBACCO, CIGARS, CIGARETTES, AND CIGARETTE PAPERS AND TUBES

SUBCHAPTER A.—DEFINITIONS: RATE AND PAYMENT OF TAX; EXEMPTION FROM TAX; AND REFUND AND DRAWBACK OF TAX

SECTION 5701.—RATE OF TAX

26 CFR 270.61: Classification of large cigars. T.D. 6502

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 270.—CIGARS AND CIGARETTES—MANUFACTURERS, IMPORTERS, AND DEALERS

Determination of the retail price of large cigars, for Federal tax purposes.

DEPARTMENT OF THE TREASURY,
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 to the provisions of section 5701(b) of the Internal Revenue Code of 1954, as amended by Public Law 86-779, [page 709, this Bulletin] the regulations in 26 CFR Part 270 are amended as follows:

§ 270.61 [Amendment]

1. Section 270.61 is amended by striking in the third sentence the words "exclusive of any State or local taxes imposed on the retail sale of cigars" and inserting in lieu thereof "exclusive of any State or local taxes imposed on cigars as a commodity"; and

2. By changing the citation to read "(72 Stat. 1414, 74 Stat. 998; 26 U.S.C. 5701)".

Because the amendment made by this Treasury Decision is liberalizing and conforming in nature it is found that it is impracticable and unnecessary to issue this Treasury Decision with notice and public procedure under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

This Treasury Decision shall be effective October 9, 1960.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 14, 1960.

FRED C. SCRIBNER, Jr.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 16, 1960, 8:52 a.m., and published in the issue of the Federal Register for November 17, 1960, 25 F.R. 10928)

SECTION 5704.—EXEMPTION FROM TAX

26 CFR 290.205: To contiguous foreign countries.

Exportation of tobacco products by truck to the United States Armed Forces in a contiguous foreign country. See Rev. Proc. 60–32, page 1011.

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26 CFR 290.261: To contiguous foreign countries.

Exportation of tobacco products by truck to the United States Armed Forces in a contiguous foreign country. See Rev. Proc. 60–32, page 1011.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART I.—RECORDS, STATEMENTS, AND SPECIAL RETURNS

SECTION 6001.—NOTICE OF REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS

26 CFR 1.6001–1: Records.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 60–27, page 1003.

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26 CFR 31.6001–6: Notice by district director requiring returns, statements, or the keeping of records.

Regulations under the Internal Revenue Code of 1954 relating to notice by District Directors requiring returns, statements, or the keeping of records with respect to employment taxes. See T.D. 6472, page 351.

PART II.—TAX RETURNS OR STATEMENTS

Subpart A.—General Requirement

SECTION 6011.—GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST

26 CFR 1.6011–1: General requirement of return, statement, or list.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 60–27, page 1003.

26 CFR 31.6011(b): Statutory provisions; identification of taxpayer.
(Also Sections 6001, 6101, 6161, 6205, 6402, 6674; 31.6001-6, 31.6101, 31.6161(a)(1), 31.6205, 31.6402(a), 31.6674.)

T. D. 6472 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955

Regulations of special application to the employment taxes imposed by subtitle C (chapters 21 to 25, inclusive) of the Internal Revenue Code of 1954, as amended, prescribed under sections 6011(b), 6051, 6061, 6065(a), 6091, 6101, 6161(a)(1), 6205, 6302(b), 6402(a), 6404(a), 6413, 6414, 6674, and 7805 of subtitle F (Procedure and Administration) of such Code; and existing employment tax regulations under sections 6001, 6011(a), and 6051 of such subtitle amended.

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

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

On March 23, 1960, notice of proposed rulemaking with respect to certain administrative regulations of special application to the employment taxes imposed by subtitle C of the Internal Revenue Code of 1954, and with respect to amendments of existing employment tax regulations under sections 6001, 6011(a), and 6051 of such Code, was published in the Federal Register (25 F.R. 57). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following administrative regulations and amendments are hereby adopted.

PARAGRAPH 1. The following regulations are prescribed under selected provisions of subtitle F of the Internal Revenue Code of 1954:

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[1] 25 F.R. 5723.

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§ 31.6011(b) STATUTORY PROVISIONS; IDENTIFICATION OF TAXPAYER.

SEC. 6011. GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST. * * *

(b) IDENTIFICATION OF TAXPAYER.—The Secretary or his delegate is authorized to require such information with respect to persons subject to the taxes imposed by chapter 21 or chapter 24 as is necessary or helpful in securing proper identification of such persons.

§ 31.6011(b)-1 EMPLOYERS' IDENTIFICATION NUMBERS.—(a) *Requirement of application.*—(1) *In general.*—Except as provided in subparagraph (2) of this paragraph, every employer who on or after January 1, 1955, has in his employ one or more individuals in employment for wages subject to the taxes imposed by the Federal Insurance Contributions Act, but who prior to such date has neither secured an identification number nor made application therefor, shall make an application on Form SS–4 for an identification number. Each application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Copies of Form SS–4 may be obtained from any district director, or any district office of the Social Security Administration. The application shall be filed with the district director with whom the employer will file returns of the taxes imposed by the Federal Insurance Contributions Act, or with the nearest district office of the Social Security Administration. Each application shall be signed by (i) the individual, if the employer is an individual; (ii) the president, vice president, or other principal officer, if the employer is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the employer is a partner-

ship or other unincorporated organization; or (iv) the fiduciary, if the employer is a trust or estate. An identification number will be assigned to the employer in due course upon the basis of information reported on the application required under this section.

(2) *Exception.*—An employer, other than an employer who is required to file returns of the taxes imposed by the Federal Insurance Contributions Act with the office of the United States Internal Revenue Service in Puerto Rico, who has in his employ only employees who are engaged exclusively in the performance of domestic service in his private home not on a farm operated for profit (see § 31.3121 (a) (7)–1) is not required to apply for an identification number.

(3) *Time for filing Form SS–4.*—The application for an identification number shall be filed on or before the seventh day after the date on which the first payment of wages, as defined in the Federal Insurance Contributions Act, is made by the employer. For provisions relating to the time when wages are paid, see § 31.3121(a)–2 of Subpart B of the regulations in this part.

(b) *Employers who are assigned identification numbers without application.*—An identification number will be assigned by a district director in the case of (1) an employer who is required to make returns of the taxes imposed by the Federal Insurance Contributions Act but who by reason of the provisions of paragraph (a) (2) of this section is not required to apply for an identification number, and (2) an employer who is required to make returns of income tax withheld from wages pursuant to section 3402 but who is not required to make returns of the taxes imposed by the Federal Insurance Contributions Act.

(c) *Crew leaders.*—Any person who, as a crew leader within the meaning of section 3121(o), furnishes individuals to perform agricultural labor for another person shall, on or before the first date on which he furnishes such individuals to perform such labor for such other person, advise such other person of his name; permanent mailing address, or if none, present address; and identification number, if any.

(d) *Use of identification number.*—The identification number assigned to an employe (other than a household employer referred to in paragraph (a) (2) of the section) shall be shown in the employer's records, returns, statements for employees, depositary receipts, and claims to the extent required by the applicable forms, regulations, and instructions.

§ 31.6011(b)–2 Employee's Account Numbers.—(a) *Requirement of application.*—(1) *In general.*—Every employee who on or after January 1, 1955, is in employment for wages subject to the taxes imposed by the Federal Insurance Contributions Act, but who prior to such date has neither secured an account number nor made application therefor, shall make an application on Form SS–5 for an account number. Each application shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Such employee shall file the application with any district office of the Social Security Administration or, if the employee is not working within the United States, with the district office of the Social Security Administration at Baltimore, Maryland. Copies of Form SS–5 may be obtained from

any district office of the Social Security Administration or from any district director. An account number will be assigned to the employee by the Social Security Administration in due course upon the basis of information reported on the application required under this section. A card showing the name and account number of an employee to whom an account number has been assigned will be furnished to the employee by the Social Security Administration.

(2) *Time for filing Form SS–5.*—The application shall be filed on or before the seventh day after the date on which the employee first performs employment for wages, unless the employee leaves the employ of his employer before such seventh day, in which case the application shall be filed on or before the date on which the employee leaves the employ of his employer.

(3) *Changes and corrections.*—Any employee may have his account number changed at any time by applying to a district office of the Social Security Administration and showing good reasons for a change. With that exception, only one account number will be assigned to an employee. Any employee whose name is changed by marriage or otherwise, or who has stated incorrect information on Form SS–5, should report such change or correction to a district office of the Social Security Administration. Copies of the form for making such reports may be obtained from any district office of the Administration.

(b) *Duties of employee with respect to his account number.*—(1) *Information to be furnished to employer.*—An employee shall, on the day on which he enters the employ of any employer for wages, comply with the provisions of subdivision (i), (ii), (iii), or (iv) of this subparagraph, except that, if the employee's services for the employer consist solely of agricultural labor, domestic service in a private home of the employer not on a farm operated by profit, or service not in the course of the employer's trade or business, the employee shall comply with such provisions on the first day on which wages are paid to him by such employer, within the meaning of § 31.3121(a)–2 of Subpart B of the regulations in this part.

(i) *Employee who has account number card.*—If the employee has been issued an account number card by the Social Security Administration and has the card available, the employee shall show it to the employer.

(ii) *Employee who has number but card not available.*—If the employee does not have available the account number card issued to him by the Social Security Administration but knows what his account number is, and what his name is, exactly as shown on such card, the employee shall advise the employer of such number and name. Care must be exercised that the employer is correctly advised of such number and name.

(iii) *Employee who has receipt acknowledging application.*—If the employee does not have an account number card but has available a receipt issued to him by an office of the Social Security Administration acknowledging that an application for an account number has been received, the employee shall show such receipt to the employer.

(iv) *Employee who is unable to furnish number or receipt.*—If an employee is unable to comply with the requirement of sub-

division (i), (ii), or (iii) of this subparagraph, the employee shall furnish to the employer a statement in writing, signed by the employee, setting forth the date of the statement, the employee's full name, present address, date and place of birth, father's full name, mother's full name before marriage, and the employee's sex, including a statement as to whether the employee has previously filed an application on Form SS–5 and, if so, the date and place of such filing. The information required by this subdivision shall be furnished on Form SS–5, if a copy of Form SS–5 is available. The furnishing of such a Form SS–5 or other statement by the employee to the employer does not relieve the employee of his obligation to make an application on Form SS–5 and file it with a district office of the Social Security Administration as required by paragraph (a) of this section. The foregoing provisions of this subdivision are not applicable to an employee engaged exclusively in the performance of domestic service in a private home of his employer not on a farm operated for profit, or in the performance of agricultural labor, if the services are performed for an employer other than an employer required to file returns of the taxes imposed by the Federal Insurance Contributions Act with the office of the United States Internal Revenue Service in Puerto Rico. However, such employee shall advise the employer of his full name and present address.

For provisions relating to the duties of an employer when furnished the information required by subdivision (i), (ii), (iii), or (iv) of this subparagraph, see paragraph (c) of this section.

(2) *Additional information to be furnished by employee to employer.*—Every employee who, on the day on which he is required to comply with subdivision (i), (ii), (iii), or (iv) of subparagraph (1) of this paragraph, has an account number card but for any reason does not show such card to the employer on such day shall promptly thereafter show the card to the employer. An employee who does not have an account number card on such day shall, upon receipt of an account number card from the Social Security Administration, promptly show such card to the employer, if he is still in the employ of that employer. If the employee has left the employ of the employer when the employee receives an account number card from the Social Security Administration, he shall promptly advise the employer of his account number and name exactly as shown on such card. The account number originally assigned to an employee (or the number as changed in accordance with paragraph (a) (3) of this section) shall be used by the employee as required by this paragraph even though he enters the employ of other employers.

(c) *Duties of employer with respect to employees' account numbers.*—(1) *Employee who shows account number.*—Upon being shown the account number card issued to an employee by the Social Security Administration, the employer shall enter the account number and name, exactly as shown on the card, in the employer's records, returns, statements for employees, and claims to the extent required by the applicable forms, regulations, and instructions.

(2) *Employee who does not show account number card.*—With respect to an employee who, on the day on which he is required to com-

ply with subdivision (i), (ii), (iii), or (iv) of paragraph (b)(1) of this section, does not show the employer an account number card issued to the employee by the Social Security Administration, the employer shall request such employee to show him such card. If the card is not shown, the employer shall comply with the applicable provisions of subdivision (i), (ii), (iii), (iv), or (v) of this subparagraph:

(i) *Employee who has not applied for account number.*—If the employee has not been assigned an account number and has not made application therefor with a district office of the Social Security Administration, the employer shall inform the employee of his duties under this section.

(ii) *Employee who has account number.*—If the employee advises the employer of his number and name as shown on his account number card, as provided in paragraph (b)(1)(ii) of this section, the employer shall enter such number and name in his records.

(iii) *Employee who has receipt for application.*—If the employee shows the employer, as provided in paragraph (b)(1)(iii) of this section, a receipt issued to him by an office of the Social Security Administration acknowledging that an application for an account number has been received from the employee, the employer shall enter in his records with respect to such employee the name and address of the employee exactly as shown on the receipt, the expiration date of the receipt, and the address of the issuing office. The receipt shall be retained by the employee.

(iv) *Employee who furnishes Form SS–5 or statement.*—If the employee furnishes information to the employer as provided in paragraph (b)(1)(iv) of this section, the employer shall retain such information for use as provided in subparagraph (3)(ii) of this paragraph.

(v) *Household or agricultural employees.*—If the employee advises the employer of his full name and present address in accordance with those provisions of paragraph (b)(1)(iv) of this section which are applicable in the case of employees engaged exclusively in the performance of domestic service in a private home of the employer not on a farm operated for profit, or agricultural labor, the employer shall enter such name and address in his records.

(3) *Account number unknown when return is filed.*—In any case in which the employee's account number is for any reason unknown to the employer at the time the employer's return is filed for any return period with respect to which the employer is required to report the wages paid to such employee—

(i) *If employee has shown receipt for application.*—If the employee has shown to the employer, as provided in paragraph (b)(1)(iii) of this section, a receipt issued to him by an office of the Social Security Administration acknowledging that an application for an account number has been received from the employee, the employer shall enter on the return, with the entry with respect to the employee, the name and address of the employee exactly as shown on the receipt, the expiration date of the receipt, and the address of the issuing office.

(ii) *If employee furnished Form SS–5 or statement.*—If the employee has furnished information to the employer as provided in

paragraph (b)(1)(iv) of this section, the employer shall prepare a copy of the Form SS–5 or statement furnished by the employee and attach the copy to the return.

(iii) *If employee did not furnish receipt, Form SS–5, or statement.*—If neither subdivision (i) nor (ii) of this subparagraph is applicable, the employer shall, except as provided in subparagraph (4) of this paragraph, attach to the return a Form SS–5 or statement, signed by the employer, setting forth as fully and clearly as practicable the employee's full name, his present or last known address, date and place of birth, father's full name, mother's full name before marriage, the employee's sex, and a statement as to whether an application for an account number has previously been filed by the employee and, if so, the date and place of such filing. The employer shall also insert in such Form SS–5 or statement an explanation of why he has not secured from the employee the information referred to in paragraph (b)(1)(iv) of this section, and shall insert the word "Employer" as part of his signature.

(4) *Household or agricultural employees.*—The provisions of subparagraph (3)(iii) of this paragraph are not applicable with respect to an employee engaged exclusively in the performance of domestic service in a private home of his employer not on a farm operated for profit, or in the performance of agricultural labor, if the services are performed for an employer other than an employer required to file returns of the taxes imposed by the Federal Insurance Contributions Act with the office of the United States Internal Revenue Service in Puerto Rico. If any such employee has not furnished to the employer the information required by paragraph (b)(1)(i), (ii), or (iii) of this section prior to the time the employer's return is filed for any return period with respect to which the employer is required to report wages paid to such employee, the employer shall enter the word "Unknown" in the account number column of the return and (i) file with the return a statement showing the employee's full name and present or last known address, or (ii) enter such address on the return form immediately below the name of the employee.

(5) *Where to obtain Form SS–5.*—Employers may obtain copies of Form SS–5 from any district office of the Social Security Administration or from any district director.

(6) *Prospective employees.*—While not mandatory, it is suggested that the employer advise any prospective employee who does not have an account number of the requirements of paragraphs (a) and (b) of this section.

§ 31.6051–1 Statements for Employees.—(a) *Requirement if wages are subject to withholding of income tax.*—(1) *General rule.*—(i) Every employer, as defined in section 3401(d), required to deduct and withhold from an employee a tax under section 3402, or who would have been required to deduct and withhold a tax under section 3402 if the employee had claimed no more than one withholding exemption, shall furnish to each such employee, in respect of the remuneration paid by such employer to such employee during the calendar year, the tax return copy and the employee's copy of a statement on Form W–2. For example, if the wage bracket method of withholding provided in section 3402(c)(1) is used, a statement on Form W–2

must be furnished to each employee whose wages during any payroll period are equal to or in excess of the smallest wage from which tax must be withheld in the case of an employee claiming one exemption. If the percentage method is used, a statement on Form W–2 must be furnished to each employee whose wages during any payroll period are in excess of one withholding exemption for such payroll period as shown in the percentage method withholding table contained in section 3402(b)(1). Each statement on Form W–2 shall show the following:

(*a*) The name, address, and identification number of the employer,

(*b*) The name and address of the employee, and, if wages as defined in section 3121(a) have been paid, his social security account number,

(c) The total amount of wages as defined in section 3401(a),

(*d*) The total amount deducted and withheld as tax under section 3402,

(*e*) The total amount of wages as defined in section 3121(a), and

(*f*) The total amount of employee tax under section 3101 deducted and withheld (increased by any adjustment in the calendar year for overcollection, or decreased by any adjustment in such year for undercollection, of such tax during any prior year).

See paragraph (d) of this section for provisions relating to the time for furnishing the statement required by this subparagraph.

(ii) Payments made in 1955 under a wage continuation plan shall be reported on Form W–2 to the extent, and in the manner, provided in paragraph (b)(8)(i) of § 31.3401(a)–1 of Subpart E of the regulations in this part.

(iii)

NOTE: For regulations under this subdivision (iii) (26 CFR 31.6051–1(a)(1)(iii)), see Treasury Decision 6155 [C.B. 1956–1, 493], approved December 27, 1955 (20 F.R. 10097).

(iv) Form W–2 is not required in respect of any wage continuation payment made to an employee by or on behalf of a person who is not the employer for whom the employee performs services but who is regarded as an employer under section 3401(d)(1). See paragraph (b)(8) of § 31.3401(a)–1 of Subpart E of the regulations in this part.

(v) In the case of remuneration paid for service described in section 3121(m), relating to service in the uniformed services, performed after 1956, "wages as defined in section 3121(a)", as used in section 6051(a)(2) and (5), shall be determined in accordance with section 3121(i)(2) and section 3122.

(2) *Statements for members of the Armed Forces of the United States.*—Section 6051(b) contains certain special provisions which are applicable in the case of members of the Armed Forces of the United States in active service. In such case, Form W–2 shall be furnished to each such member of the Armed Forces if any tax has been withheld under section 3402 during the calendar year from the remuneration of such member or if any of the remuneration paid during the calendar year for such active service is includible under chapter 1 in the gross income of such member. Form W–2, in the case of such member, shall show, as "the total amount of wages as defined in sec-

tion 3401(a)", as used in section 6051(a)(3), the amount of the remuneration paid during the calendar year which is not excluded under chapter 1 of the Internal Revenue Code of 1954 from the gross income of such member, whether or not such remuneration constitutes wages as defined in section 3401(a) and whether or not paid for such active service.

(3) *Undelivered Forms W–2.*—The tax return copy and the employee's copy of each withholding statement on Form W–2 for the calendar year which the employer is required to furnish to the employee and which after reasonable effort he is unable to deliver to the employee shall be transmitted to the district director with the return on Form 941 filed by the employer for the return period ending June 30 in the next succeeding calendar year or with the employer's final return if filed for a period ending on an earlier date. Thus, the undelivered copies of Forms W–2 ordinarily will be transmitted to the district director on or before July 31 or August 10 of the year following that for which they were issued, depending upon when the return for such return period is required to be filed. In the case of an employer having branch offices, the undelivered copies of Forms W–2 held in such branch offices may be transmitted by the employer with such return or, at the option of the employer, may be transmitted by the branch office directly to the district director for the internal revenue district in which the branch office is located. Such direct transmittal by branch offices shall be made at the time prescribed for the filing of the employer's return for the return period ending June 30 in the calendar year following that for which the Forms W–2 were issued or at the time of the filing of the employer's final return if filed for a period ending on an earlier date. The provisions of this subparagraph are also applicable with respect to any undelivered corrected statements issued for a prior calendar year.

(b) *Requirement if wages are not subject to withholding of income tax.*—(1) *General rule.*—If during the calendar year an employer pays to an employee wages subject to the employee tax imposed by section 3101, and the employer is not required by paragraph (a) of this section to furnish to such employee a statement on Form W–2 for such calendar year, the employer shall, in accordance with the provisions of this paragraph, furnish a written statement to the employee with respect to such wages. Such statement shall be in a form suitable for retention by the employee and shall show, with respect to the wages paid by the employer to the employee during the calendar year for employment after 1936, the following:

(i) The name and address of the employer,

(ii) The name, address, and social security account number of the employee,

(iii) The total amount of wages as defined in section 3121(a), and

(iv) The total amount of employee tax deducted and withheld from such wages (increased by any adjustment in such year for overcollection, or decreased by any adjustment in such year for undercollection, of employee tax during any prior year).

See paragraph (d) of this section for provisions relating to the time for furnishing the statement required by this paragraph.

(2) *Uniformed services.*—In the case of remuneration paid for service described in section 3121(m), relating to service in the uniformed services, performed after 1956, "wages as defined in section 3121(a)", as used in section 6051(a)(5), shall be determined in accordance with section 3121(i)(2) and section 3122.

(3) *Form of statement.*—No particular form is prescribed for the statement required by this paragraph. For the convenience of employers in complying with the requirements of this paragraph, copies of a form of statement, Form SS–14, will be furnished by district directors upon request.

(c) *Correction of statements.*—(1) *Federal Insurance Contributions Act.*—If (i) the amount of employee tax under section 3101 deducted and withheld in the calendar year from the wages, as defined in section 3121(a), paid during such year was less or greater than the tax imposed by section 3101 on such wages by reason of the adjustment in such year of an overcollection or undercollection of the tax in any prior year, or (ii) regardless of the reason for the error or the method of its correction, the amount of wages as defined in section 3121(a), or tax under section 3101, entered on a statement furnished pursuant to this section to an employee for a prior year was incorrect, a corrected statement for such prior year reflecting the adjustment or the correct data shall be furnished to the employee. Such statement shall be marked "Corrected by Employer".

(2) *Income tax withholding.*—A corrected statement on Form W–2 shall be furnished to the employee with respect to a prior calendar year (i) to show the correct amount of wages, as defined in section 3401(a), paid during the prior calendar year if the amount of such wages entered on a statement furnished to the employee for such prior year is incorrect, or (ii) to show the amount actually deducted and withheld as tax under section 3402 if such amount is less or greater than the amount entered as tax withheld on the statement furnished the employee for such prior year. Such statement shall be marked "Corrected by Employer".

(3) *Cross reference.*—For provisions relating to the disposition of the district director's copy of a corrected Form W–2, see paragraph (b)(4) of § 31.6011(a)–4.

(d) *Time for furnishing statements.*—(1) *In general.*—Each statement required by this section for a calendar year and each corrected statement required for any prior year shall be furnished to the employee on or before January 31 of the year succeeding such calendar year, or, if his employment is terminated before the close of such calendar year, on the day on which the last payment of wages is made. For provisions relating to the filing of the district director's copies of Form W–2, see paragraph (b) of § 31.6011(a)–4.

(2) *Extensions of time.*—(i) For good cause shown upon written application by an employer, the district director may grant an extension of time not exceeding 30 days in which to furnish to employees the statements required by this section. Each application for an extension of time under this subdivision shall be made in writing, properly signed by the employer or his duly authorized agent; shall be addressed to the district director with whom the employer files his returns; and shall contain a full recital of the reasons for requesting the extension, to aid the district director in determining the period

of the extension, if any, which will be granted. Such a request in the form of a letter to the district director will suffice as an application. The application shall be filed on or before the date prescribed in subparagraph (1) of this paragraph for furnishing the statements required by this section. In any case in which an employer is unable, by reason of illness, absence, or other good cause, to sign a request for an extension, any person standing in close personal or business relationship to the employer may sign the request on his behalf, and shall be considered as a duly authorized agent for this purpose, provided the request sets forth a reason for a signature other than the employer's and the relationship existing between the employer and the signer. For provisions relating to extensions of time for filing the district director's copies of Form W–2, see paragraph (a)(3) of § 31.6081(a)–1.

(ii) An extension of time, not exceeding 30 days, within which to furnish any statement required by this section upon termination of employment is hereby granted to any employer with respect to any employee whose employment is terminated during the calendar year. In the case of intermittent or interrupted employment where there is reasonable expectation on the part of both employer and employee of further employment, there is no requirement that a written statement be immediately furnished the employee; but when such expectation ceases to exist, the statement must be furnished within 30 days from that time.

(3) *Cross references.*—For provisions relating to the penalties provided for the willful furnishing of a false or fraudulent statement, or for the willful failure to furnish a statement, see § 31.6674–1 and section 7204.

§ 31.6061 Statutory Provisions; Signing of Returns and Other Documents.

SEC. 6061. SIGNING OF RETURNS AND OTHER DOCUMENTS.

* * * any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be signed in accordance with forms or regulations prescribed by the Secretary or his delegate.

§ 31.6061–1 Signing of Returns.—Each return required under the regulations in this subpart shall, if signature is called for by the form or instructions relating to the return, be signed by (1) the individual, if the person required to make the return is an individual; (2) the president, vice president, or other principal officer, if the person required to make the return is a corporation; (3) a responsible and duly authorized member or officer having knowledge of its affairs, if the person required to make the return is a partnership or other unincorporated organization; or (4) the fiduciary, if the person required to make the return is a trust or estate. The return may be signed for the taxpayer by an agent who is duly authorized in accordance with § 31.6011(a)–7 to make such return.

§ 31.6065(a) Statutory Provisions; Verification of Returns.

SEC. 6065. VERIFICATION OF RETURNS.

(a) Penalties of Perjury.—Except as otherwise provided by the Secretary or his delegate, any return, declaration, statement, or other document required to be made under any provision of the internal rev-

enue laws or regulations shall contain or be verified by a written declaration that it is made under the penalties of perjury.

§ 31.6065(a)-1 VERIFICATION OF RETURNS OR OTHER DOCUMENTS.—If a return, statement, or other document made under the regulations in this part is required by the regulations contained in this part, or the form and instructions issued with respect to such return, statement, or other document, to contain or be verified by a written declaration that it is made under the penalties of perjury, such return, statement, or other document shall be so verified by the person signing it.

§ 31.6091 STATUTORY PROVISIONS; PLACE FOR FILING RETURNS.

SEC. 6091. PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

(a) GENERAL RULE.—When not otherwise provided for by this title, the Secretary or his delegate shall by regulations prescribe the place for the filing of any return, declaration, statement, or other document, or copies thereof, required by this title or by regulations.

(b) TAX RETURNS.—In the case of returns of tax required under authority of part II of this subchapter—

(1) INDIVIDUALS.—Returns (other than corporation returns) shall be made to the Secretary or his delegate in the internal revenue district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in any internal revenue district, then at such place as the Secretary or his delegate may by regulations prescribe.

(2) CORPORATIONS.—Returns of corporations shall be made to the Secretary or his delegate in the internal revenue district in which is located the principal place of business or principal office or agency of the corporation, or, if it has not principal place of business or principal office or agency in any internal revenue district, then at such place as the Secretary or his delegate may by regulations prescribe.

* * * * * * *

(4) EXCEPTIONAL CASES.—Notwithstanding paragraph (1), (2) * * * of this subsection, the Secretary or his delegate may permit a return to be filed in any internal revenue district, and may require the return of any officer or employee of the Treasury Department to be filed in any internal revenue district selected by the Secretary or his delegate.

§ 31.6091-1 PLACE FOR FILING RETURNS.—(a) *Persons other than corporations.*—The return of a person other than a corporation shall be filed with the district director for the internal revenue district in which is located the principal place of business or legal residence of such person. If such person has no principal place of business or legal residence in any internal revenue district, the return shall be filed with the District Director at Baltimore, Maryland, except as provided in paragraph (c) of this section.

(b) *Corporations.*—The return of a corporation shall be filed with the district director for the district in which is located the principal place of business or principal office or agency of the corporation, except as provided in paragraph (c) of this section.

(c) *Return of taxpayers outside the United States.*—The return of a person (other than a corporation) outside the United States having no legal residence or principal place of business in any internal revenue district, or the return of a corporation having no principal place of business or principal office or agency in any internal revenue district, shall be filed with the Director, International Operations

Division, Internal Revenue Service, Washington 25, D.C., unless the principal place of business or legal residence of such person, or the principal place of business or principal office or agency of such corporation, is located in the Virgin Islands or Puerto Rico, in which case the return shall be filed with the Office of the Director, International Operations Division, United States Internal Revenue Service, Santurce, Puerto Rico.

(d) *Exceptional cases.*—(1) *Permission to file in district other than required district.*—The Commissioner may permit the filing of any return required to be made under the regulations in this subpart in any internal revenue district, notwithstanding the provisions of paragraphs (1) and (2) of section 6091(b) and paragraphs (a), (b), and (c) of this section.

(2) *Returns of officers and employees of the Internal Revenue Service.*—The Commissioner may require any officer or employee of the Internal Revenue Service to file any return required of him under the regulations in this subpart in any internal revenue district selected by the Commissioner, notwithstanding the provisions of paragraphs (1) and (2) of section 6091(b) and paragraphs (a), (b), and (c) of this section.

§ 31.6101 STATUTORY PROVISIONS; PERIOD COVERED BY RETURNS OR OTHER DOCUMENTS.

SEC. 6101. PERIOD COVERED BY RETURNS OR OTHER DOCUMENTS.

When not otherwise provided for by this title, the Secretary or his delegate may by regulations prescribe the period for which, or the date as of which, any return, statement, or other document required by this title or by regulations, shall be made.

§ 31.6101–1 PERIOD COVERED BY RETURNS.—The period covered by any return required under the regulations in this subpart shall be as provided in those provisions of the regulations under which the return is required to be made. See § 31.6011(a)–1, relating to returns of taxes under the Federal Insurance Contributions Act; § 31.6011(a)–2, relating to returns of taxes under the Railroad Retirement Tax Act; § 31.6011(a)–3, relating to returns of tax under the Federal Unemployment Tax Act; § 31.6011(a)–4, relating to returns of income tax withheld under section 3402; and § 31.6011(a)–5, relating to monthly returns of taxes under the Federal Insurance Contributions Act and of income tax withheld under section 3402.

§ 31.6161(a)(1) STATUTORY PROVISIONS; EXTENSION OF TIME FOR PAYING TAX.

SEC. 6161. EXTENSION OF TIME FOR PAYING TAX.

(a) AMOUNT DETERMINED BY TAXPAYER ON RETURN.—

(1) GENERAL RULE.—The Secretary or his delegate, except as otherwise provided in this title, may extend the time for payment of the amount of the tax shown, or required to be shown, on any return or declaration required under authority of this title (or any installment thereof), for a reasonable period not to exceed 6 months from the date fixed for payment thereof. Such extension may exceed 6 months in the case of a taxpayer who is abroad.

§ 31.6161(a)(1)–1 EXTENSIONS OF TIME FOR PAYING TAX.—No extension of time will be granted for payment of any of the taxes to which the regulations in this part have application.

§ 31.6205 Statutory Provisions; Special Rules Applicable to Certain Employment Taxes.

SEC. 6205. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

(a) Adjustment of Tax.—

(1) General rule.—If less than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid with respect to any payment of wages or compensation, proper adjustments, with respect to both the tax and the amount to be deducted, shall be made, without interest, in such manner and at such times as the Secretary or his delegate may by regulations prescribe.

(2) United States as employer.—For purposes of this subsection, in the case of remuneration received from the United States or a wholly-owned instrumentality thereof during any calendar year, each head of a Federal agency or instrumentality who makes a return pursuant to section 3122 and each agent, designated by the head of a Federal agency or instrumentality, who makes a return pursuant to such section shall be deemed a separate employer.

(b) Underpayments.—If less than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid or deducted with respect to any payment of wages or compensation and the underpayment cannot be adjusted under subsection (a) of this section, the amount of the underpayment shall be assessed and collected in such manner and at such times (subject to the statute of limitations properly applicable thereto) as the Secretary or his delegate may by regulations prescribe.

§ 31.6205–1 Adjustments of Underpayments.—(a) *In general.*—(1) An employer who makes, or has made, an undercollection or underpayment of—

(i) Employee tax under section 3101, employer tax under section 3111, or the employee or employer tax under corresponding provisions of prior law,

(ii) Employee tax under section 3201, employer tax under section 3221, or the employee or employer tax under corresponding provisions of prior law, or

(iii) Income tax required under section 3402 to be withheld, with respect to any payment of wages of compensation, shall correct such error as provided in this section. Such correction shall constitute an adjustment without interest to the extent provided in paragraph (b) or (c) of this section.

(2) Every correction under this section of an underpayment of tax with respect to a payment of wages or compensation shall be made on the return form which is prescribed for use, at the time the correction is made, in reporting tax which corresponds to the tax underpaid.

(3) Every return or supplemental return on which an underpayment is corrected pursuant to this section must have securely attached as a part thereof a statement explaining the correction, designating the return period in which the error was ascertained and the return period to which the error relates, and setting forth such other information as may be required by the regulations in this subpart and by the instructions relating to the return.

(4) For purposes of this section, an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

(5) If a correction is made under this section with respect to the erroneous reporting on a return, or omission from a return, under the Federal Insurance Contributions Act, as in effect prior to or on and after January 1, 1955, of an amount of wages required to be shown on the return as a separate item in respect of a particular employee,

the statement referred to in subparagraph (3) of this paragraph shall include the following information:

(i) The name and account number of each employee whose wages were erroneously reported or omitted from such return,

(ii) The period for which such wages were required to be reported on such return,

(iii) The amount, if any, of wages actually reported on such return for each such employee, and

(iv) The amount of wages which should have been reported on such return for each such employee.

No particular form is prescribed for furnishing the information required by this subparagraph, but if printed forms are desired, the district director will supply Form 941c or Form 941c PR, whichever is appropriate, upon request.

(6) No underpayment shall be reported pursuant to this section after receipt from the district director of notice and demand for payment thereof based upon an assessment, but the amount shall be paid in accordance with such notice and demand.

(7) For provisions relating to correction of erroneous statements furnished to employees in respect of wages subject to withholding of income tax under section 3402, and of wages under the Federal Insurance Contributions Act, see paragraph (c) of § 31.6051–1.

(b) *Federal Insurance Contributions Act and Railroad Retirement Tax Act.*—(1) *Undercollection ascertained before return is filed.*—If no employee tax or less than the correct amount of employee tax is deducted from any payment to an employee of wages, as defined in the Federal Insurance Contributions Act, or compensation as defined in the Railroad Retirement Tax Act, and the error is ascertained before the filing of the return on which the employee tax with respect to such wages or compensation is required to be reported, the employer shall nevertheless report on such return and pay to the district director the correct amount of such employee tax. However, the reporting and payment by the employer of the correct amount of such tax in accordance with this subparagraph do not constitute an adjustment.

(2) *Underpayment ascertained after return is filed.*—(i) If a return is filed, and if no employee tax, no employer tax, or less than the correct amount of either such tax with respect to any payment to an employee of wages as defined in the Federal Insurance Contributions Act or corresponding provisions of prior law, or compensation as defined in the Railroad Retirement Tax Act or corresponding provisions of prior law, is reported on such return and paid to the district director, the employer shall adjust the underpayment (*a*) by reporting the additional amount due by reason of the underpayment as an adjustment on a return filed on or before the last day on which the return is required to be filed for the return period in which the error is ascertained, or (*b*) by reporting such additional amount on a supplemental return for the return period in which such payment of wages or compensation is made. The reporting of such underpayment on a supplemental return constitutes an adjustment within the meaning of this section only when the supplemental return is filed on or before the last day on which the return is required to be filed for the return period in which the error is ascertained. The amount of each underpayment adjusted in accordance with this

subdivision shall be paid to the district director, without interest, at the time fixed for reporting the adjustment. If an adjustment is reported pursuant to this subdivision, but the amount thereof is not paid when due, interest thereafter accrues (see section 6601).

(ii) If a return is filed, and if no employee tax, no employer tax, or less than the correct amount of either such tax with respect to a payment to an employee of wages or compensation is reported on such return and paid to the district director, and such underpayment is not reported as an adjustment within the time prescribed by subdivision (i) of this subparagraph, the amount of such underpayment shall be (*a*) reported on the employer's next return, or (*b*) reported immediately on a supplemental return. For interest accruing on amounts so reported, see section 6601 and corresponding provisions of prior law.

(3) *Deductions from employees.*—If an employer collects no employee tax or less than the correct amount of employee tax from an employee with respect to a payment of wages as defined in the Federal Insurance Contributions Act or corresponding provisions of prior law, or compensation as defined in the Railroad Retirement Tax Act or corresponding provisions of prior law, the employer shall collect the amount of the undercollection by deducting such amount from remuneration of the employee, if any, under his control after he ascertains the error. Such deductions may be made even though the remuneration for any reason, does not constitute wages or compensation. The amount of an undercollection of employee tax from an employee shall be reported and paid, as provided in subparagraph (1) or (2) of this section, whether or not the undercollection is corrected by a deduction made as prescribed in the foregoing provisions of this subparagraph. If such a deduction is not made, the obligation of the employee to the employer with respect to the undercollection is a matter for settlement between the employee and the employer. If any employer makes an erroneous collection of employee tax from two or more of his employees, a separate settlement must be made with respect to each employee. Thus, an overcollection of employee tax from from one employee may not be used to offset an undercollection of such tax from another employee.

(c) *Income tax required to be withheld from wages.*—(1) *Undercollection ascertained before return is filed.*—If no income tax, or less than the correct amount of income tax, required under section 3402 to be withheld from wages is deducted from wages paid to an employee in any return period, and if the error is ascertained before the return is filed for the period in which such wages are paid, the employer shall nevertheless report on such return the correct amount of the tax required to be withheld. However, the reporting and payment by an employer of tax in accordance with this subparagraph do not constitute an adjustment.

(2) *Underpayment ascertained after return is filed.*—(i) If a return is filed for a return period, and if no income tax, or less than the correct amount of income tax, required under section 3402 to be withheld from wages paid to an employee in such period, is reported on a return and paid to the district director, the employer shall (*a*) report the additional amount due by reason of the underpayment on a re-

turn for any return period in the calendar year in which the wages were paid, or (*b*) report such additional amount on a supplemental return for the return period in which such wages were paid. Such reporting constitutes an adjustment within the meaning of this section only if the return or supplemental return on which the underpayment is reported is filed on or before the last day on which the return is required to be filed for the return period in which the error was ascertained.

(ii) If a return is filed for a return period, and if no income tax, or less than the correct amount of income tax, required under section 3402 to be withheld from wages paid to an employee in such period is reported on such return and paid to the district director, and such underpayment is not reported as an adjustment within the time prescribed by subdivision (i) of this subparagraph, the amount of such underpayment shall be (*a*) reported on the employer's next return, if such next return is for any return period in the calendar year in which the wages were paid, or (*b*) reported immediately on a supplemental return.

(3) *Payment of amounts reported as undercollections or underpayments.*—(i) For provisions relating to the employer's liability for an underpayment of tax unless he can show that the income tax against which the tax under section 3402 may be credited has been paid, see § 31.3402(d)–1 of Subpart E of the regulations in this part.

(ii) Except as provided in § 31.3402(d)–1 of Subpart E of the regulations in this part, any amount reported as an adjustment within the meaning of this paragraph shall be paid to the district director, without interest, at the time fixed for reporting the adjustment.

(iii) For interest accruing on amounts which are not paid when due, see section 6601.

(4) *Deductions from employee.*—If no income tax, or less than the correct amount of income tax, required under section 3402 to be withheld from wages is deducted from wages paid to an employee in a calendar year, the employer shall collect the amount of the undercollection on or before the last day of such year by deducting such amount from remuneration of the employee, if any, under his control. Such deductions may be made even though the remuneration, for any reason, does not constitute wages. Any undercollection in a calendar year not corrected by a deduction made pursuant to the foregoing provisions of this subparagraph is a matter for settlement between the employee and the employer within such calendar year. For provisions relating to the employer's liability for the tax, whether or not he collects it from the employee, see § 31.3403–1 of Subpart E of the regulations in this part.

§ 31.6302(b) Statutory Provisions; Mode or Time of Collection; Discretionary Method.

SEC. 6302. MODE OR TIME OF COLLECTION. * * *

(b) Discretionary Method.—Whether or not the method of collecting any tax imposed by chapters 21, 31, 32, 33, section 4481 of chapter 36, sections 4501(a) or 4511 of chapter 37, or sections 4701, or 4721 of chapter 39 is specifically provided for by this title, any such tax may, under regulations prescribed by the Secretary or his delegate, be collected by means of returns, stamps, coupons, tickets, books, or such

other reasonable devices or methods as may be necessary or helpful in securing a complete and proper collection of the tax.

[Sec. 6302(b) as amended by sec. 206(b), Highway Revenue Act 1956 (70 Stat. 391) [P.L. 627, C.B. 1956–2, 1150]]

§ 31.6302(b)–1 METHOD OF COLLECTION.—For provisions relating to collection by means of returns of the taxes imposed by chapter 21 (Federal Insurance Contributions Act), see §§ 31.6011(a)–1 and 31.6011(a)–5.

§ 31.6402(a) STATUTORY PROVISIONS; AUTHORITY TO MAKE CREDITS OR REFUNDS.

SEC. 6402. AUTHORITY TO MAKE CREDITS OR REFUNDS.

(a) GENERAL RULE.—In the case of any overpayment, the Secretary or his delegate, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall refund any balance to such person.

§ 31.6402(a)–1 CREDITS OR REFUNDS.—(a) *In general.*—For regulations under section 6402 of special application to credits or refunds of employment taxes, see §§ 31.6402(a)–2, 31.6402(a)–3, and 31.6414–1. For regulations under section 6402 of general application to credits or refunds, see §§ 301.6402–1 and 301.6402–2 of this chapter (Regulations on Procedure and Administration). For provisions relating to credits of employment taxes which constitute adjustments without interest, see §§ 31.6413(a)–1 and 31.6413(a)–2.

(b) *Period of limitation.*—For the period of limitation upon credit or refund of taxes imposed by the Internal Revenue Code of 1954, see § 301.6511(a)–1 of this chapter (Regulations on Procedure and Administration). For the period of limitation upon credit or refund of any tax imposed by the Internal Revenue Code of 1939, see the regulations applicable with respect to such tax.

§ 31.6402(a)–2 CREDIT OR REFUND OF TAX UNDER FEDERAL INSURANCE CONTRIBUTIONS ACT OR RAILROAD RETIREMENT TAX ACT.—(a) *Claim by person who paid tax to district director.*—(1) *In general.*—Any person who pays to the district director more than the correct amount of—

(i) Employee tax under section 3101, or employer tax under section 3111, of the Federal Insurance Contributions Act,

(ii) Employee tax under section 3201, employee representative tax under section 3211, or employer tax under section 3221, of the Railroad Retirement Tax Act,

(iii) Any such tax under a corresponding provision of prior law, or

(iv) Interest, addition to the tax, additional amount, or penalty with respect to any such tax,

may file a claim for refund of the overpayment (except to the extent that the overpayment must be credited pursuant to § 31.3503–1 of Subpart F of the regulations in this part), or may claim credit for such overpayment, in the manner and subject to the conditions stated in this section and § 301.6402–2 of this chapter (Regulations on Procedure and Administration). If credit is claimed pursuant to this section, the amount thereof shall be claimed by entering such amount

as a deduction on a return filed by the person making the claim. The return on which the credit is claimed must be on a form which is prescribed for use, at the time of the claim, in reporting tax which corresponds to the tax overpaid. If credit is taken pursuant to this section, a claim on Form 843 is not required, but the return on which the credit is claimed shall have attached as a part thereof a statement which shall constitute the claim for credit, setting forth in detail the grounds and facts relied upon in support of the credit, designating the return period in which the error was ascertained, and setting forth such other information as may be required by the regulations in this subpart and by the instructions relating to the return. No refund or credit of employee tax under the Federal Insurance Contributions Act shall be allowed if for any reason (for example, an overcollection of employee tax having been inadvertently included by the employee in computing a special refund—see § 31.6413(c)–1) the employee has taken the amount of such tax into account in claiming a credit against, or refund of, his income tax, or if so, such claim has been rejected.

(2) *Statements supporting employers' claims for employee tax.*—(i) Every claim filed by an employer for refund or credit of employee tax under section 3101 or section 3201, or a corresponding provision of prior law, collected from an employee shall include a statement that the employer has repaid the tax to such employee or has secured the written consent of such employee to allowance of the refund or credit. The employer shall retain as part of his records the written receipt of the employee showing the date and amount of the repayment, or the written consent of the employee, whichever is used in support of the claim.

(ii) Every claim filed by an employer for refund or credit of employee tax under section 3101, or a corresponding provision of prior law, collected from an employee in a calendar year prior to the year in which the credit or refund is claimed, also shall include a statement that the employer has obtained from the employee a written statement (*a*) that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and (*b*) that the employee will not claim refund or credit of such amount. The employer shall retain the employee's written statement as part of the employer's records.

(b) *Claim by employee.*—(1) *In general.*—If more than the correct amount of employee tax under section 3101 or section 3201, or a corresponding provision of prior law, is collected by an employer from an employee and paid to the district director, the employee may file a claim for refund of the overpayment if (i) the employee does not receive reimbursement in any manner from the employer and does not authorize the employer to file a claim and receive refund or credit, (ii) the overcollection cannot be corrected under § 31.3503–1 of Subpart F of the regulations in this part, and (iii) in the case of employee tax under section 3101 or a corresponding provision of prior law, the employee has not taken the overcollection into account in claiming a credit against, or refund of, his income tax, or if so, such claim has been rejected. See § 31.6413(c)–1.

(2) *Statements supporting employee's claim.*—(i) Each employee who makes a claim under subparagraph (1) of this paragraph shall

submit with such claim a statement setting forth (*a*) the extent, if any, to which the employer has reimbursed the employee in any manner for the overcollection, and (*b*) the amount, if any, of credit or refund of such overpayment claimed by the employer or authorized by the employee to be claimed by the employer. The employee shall obtain such statement, if possible, from the employer, who should include in such statement the fact that it is made in support of a claim against the United States to be filed by the employee for refund of employee tax paid by such employer to the district director. If the employer's statement is not submitted with the claim, the employee shall make the statement to the best of his knowledge and belief, and shall include therein an explanation of his inability to obtain the statement from the employer.

(ii) Each individual who makes a claim under subparagraph (1) of this paragraph for refund of employee tax under section 3101, or a corresponding provision of prior law, also shall submit with such claim a statement setting forth whether the individual has taken the amount of the overcollection into account in claiming a credit against, or refund of, his income tax, and the amount, if any, so claimed (see § 31.6413(c)-1).

(c) *Statements to accompany employers' and employees' claims under the Federal Insurance Contributions Act.*—Whenever a claim for credit or refund of employee tax under section 3101, employer tax under section 3111, or either such tax under a corresponding provision of prior law, is made with respect to remuneration which was erroneously reported on a return or schedule as wages paid to an employee, such claim shall include a statement showing (1) the identification number of the employer, if he was required to make application therefor, (2) the name and account number of such employee, (3) the period covered by such return or schedule, (4) the amount of remuneration actually reported as wages for such employee, and (5) the amount of wages which should have been reported for such employee. No particular form is prescribed for making such statement, but if printed forms are desired, the district director will supply copies of Form 941c or Form 941c PR, whichever is appropriate, upon request.

§ 31.6402(a)-3 Refund of Federal Unemployment Tax.—Any person who pays to the district director more than the correct amount of—

(a) Tax under section 3301 of the Federal Unemployment Tax Act or a corresponding provision or prior law, or

(b) Interest, addition to the tax, additional amount, or penalty with respect to such tax,

may file a claim for refund of the overpayment, in the manner and subject to the conditions stated in § 301.6402-2 of this chapter (Regulations on Procedure and Administration). See § 31.6413(d) and the corresponding section of prior law for provisions which bar the allowance or payment of interest on the amount of any refund based on credit allowable for contributions paid under the unemployment compensation law of a State.

§ 31.6404(a) STATUTORY PROVISIONS; ABATEMENTS.

SEC. 6404. ABATEMENTS.

(a) GENERAL RULE.—The Secretary or his delegate is authorized to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which—

(1) Is excessive in amount, or

(2) Is assessed after the expiration of the period of limitation properly applicable thereto, or

(3) Is erroneously or illegally assessed.

§ 31.6404(a)–1 ABATEMENTS.—For regulations under section 6404 of general application to the abatement of taxes, see § 301.6404–1 of this chapter (Regulations on Procedure and Administration). Every claim filed by an employer for abatement of employee tax under section 3101 or section 3201, or a corresponding provision of prior law, shall be made in the manner and subject to the conditions stated in paragraphs (a)(2) and (c) of § 31.6402(a)–2, as if the claim for abatement were a claim for refund.

§ 31.6413(a) STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES; ADJUSTMENT OF TAX.

SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

(a) ADJUSTMENT OF TAX.—

(1) GENERAL RULE.—If more than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid with respect to any payment of remuneration, proper adjustments, with respect to both the tax and the amount to be deducted, shall be made, without interest, in such manner and at such times as the Secretary or his delegate may by regulations prescribe.

(2) UNITED STATES AS EMPLOYER.—For purposes of this subsection, in the case of remuneration received from the United States or a wholly-owned instrumentality thereof during any calendar year, each head of a Federal agency or instrumentality who makes a return pursuant to section 3122 and each agent, designated by the head of a Federal agency or instrumentality, who makes a return pursuant to such section shall be deemed a separate employer.

§ 31.6413(a)–1 REPAYMENT BY EMPLOYER OF TAX ERRONEOUSLY COLLECTED FROM EMPLOYEE.—(a) *Before employer files return.*—(1) *Employee tax under the Federal Insurance Contributions Act or the Railroad Retirement Tax Act.*—(i) If an employer—

(*a*) During any return period collects from an employee more than the correct amount of tax under section 3101 or section 3201, or a corresponding provision of prior law,

(*b*) Repays the amount of the overcollection to the employee before the return for such period is filed with the district director, and

(*c*) Obtains and keeps as part of his records the written receipt of the employee showing the date and amount of the repayment,

the employer shall not report on any return or pay to the district director the amount of the overcollection.

(ii) Any overcollection not repaid to and receipted for by the employee as provided in subdivision (i) of this subparagraph shall be reported and paid to the district director with the return for the return period in which the overcollection was made. Such return shall be accompanied by a statement explaining the overcollection,

setting forth the account number (if known) and name of the individual from whom the overcollection was made, and showing the total amount overcollected from and not repaid to the individual. If the employer is not required to make a return for such period, the employer nevertheless shall furnish to the district director a statement as described in the preceding sentence, on or before the date fixed for filing a return for such period, and shall pay the amount of the overcollection with such statement.

(2) *Income tax withheld from wages.*—(i) If an employer—

(*a*) During any return period collects from an employee more than the correct amount of tax under section 3402,

(*b*) Repays the amount of the overcollection to the employee before the return for such period is filed with the district director and before the end of the calendar year in which the overcollection was made, and

(*c*) Obtains and keeps as part of his records the written receipt of the employee showing the date and amount of the repayment,

the employer shall not report on any return or pay to the district director the amount of the overcollection.

(ii) Any overcollection not repaid to and receipted for by the employee as provided in subdivision (i) of this subparagraph shall be reported and paid to the district director with the return for the return period in which the overcollection was made.

(b) *After employer files return.*—(1) *Employee tax under the Federal Insurance Contributions Act or the Railroad Retirement Tax Act.*—(i) If an employer collects from any employee and pays to the district director more than the correct amount of employee tax under section 3101 or section 3201, or a corresponding provision of prior law, and if the error is ascertained within the applicable period of limitation on credit or refund, the employer shall repay or reimburse the employee in the amount thereof prior to the expiration of the return period following the return period in which the error is ascertained and prior to the expiration of such limitation period. This subparagraph has no application in any case in which an overcollection is made the subject of a claim by the employer for refund or credit, and the employer elects to secure the written consent of the employee to the allowance of the refund or credit under the procedure provided in paragraph (a) (2) (i) of § 31.6402(a)-2.

(ii) If the amount of an overcollection is repaid to an employee, the employer shall obtain and keep as part of his records the written receipt of the employee, showing the date and amount of the repayment. If, in any calendar year, an employer repays or reimburses an employee in the amount of an overcollection of employee tax under section 3101, or a corresponding provision of prior law, which was collected from the employee in a prior calendar year, the employer shall obtain from the employee and keep as part of his records a written statement (*a*) that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and (*b*) that the employee will not claim refund or credit of such amount. See § 31.6413(c)-1.

(iii) If the employer does not repay the employee the amount overcollected, the employer shall reimburse the employee by applying the

amount of the overcollection against the employee tax which attaches to wages or compensation paid to the employee prior to the expiration of the return period following the return period in which the error is ascertained and prior to the expiration of the applicable period of limitation on credit or refund. If the amount of the overcollection exceeds the amount so applied against such employee tax, the excess amount shall be repaid to the employee as required by this subparagraph.

(iv) For purposes of this subparagraph, an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

(v) For the period of limitation upon credit or refund of taxes imposed by the Internal Revenue Code of 1954, see § 301.6511(a)–1 of this chapter (Regulations on Procedure and Administration). For the period of limitation upon credit or refund of any tax imposed by the Internal Revenue Code of 1939, see the regulations applicable with respect to such tax.

(2) *Income tax withheld from wages.*—(i) If, in any return period in a calendar year, an employer collects from any employee more than the correct amount of tax under section 3402, and the employer pays the amount of such overcollection to the district director, the employer may repay or reimburse the employee in the amount thereof in any subsequent return period in such calendar year.

(ii) If the amount of the overcollection is repaid to the employee, the employer shall obtain and keep as part of his records the written receipt of the employee, showing the date and amount of the repayment. If the employer does not repay the amount of the overcollection, the employer may reimburse the employee by applying the amount of the overcollection against the tax under section 3402 which otherwise would be required to be withheld from wages paid by the employer to the employee in the calendar year in which the overcollection is made.

§ 31.6413(a)–2 ADJUSTMENT OF OVERPAYMENTS.—(a) *Taxes under the Federal Insurance Contributions Act or the Railroad Retirement Tax Act.*—(1) *Employee tax.*—After an employer repays or reimburses an employee in the amount of an overcollection, as provided in paragraph (b)(1) of § 31.6413(a)–1, the employer may claim credit for such amount in the manner, and subject to the conditions, stated in § 31.6402(a)–2. Such credit shall constitute an adjustment, without interest, if the amount thereof is entered on a return for a period ending on or before the last day of the return period following the return period in which the error was ascertained. No credit or adjustment in respect of an overpayment shall be entered on a return after the filing of a claim for refund of such overpayment.

(2) *Employer tax.*—If an employer pays more than the correct amount of employer tax under section 3111 or section 3221, or a corresponding provision of prior law, the employer may claim credit for the amount of the overpayment in the manner, and subject to the conditions, stated in § 31.6402(a)–2. Such credit shall constitute an adjustment, without interest, if the amount thereof is entered on the same return on which the employer adjusts, pursuant to subpara-

graph (1) of this paragraph, a corresponding overpayment of employee tax.

(b) *Income tax withheld from wages.*—If, pursuant to paragraph (b) (2) of § 31.6413(a)–1, an employer repays or reimburses an employee in the amount of an overcollection of tax under section 3402, the employer may adjust the overcollection, without interest, by entering the amount thereof as a deduction on a return of tax under section 3402, filed by the employer for any return period in the calendar year in which the employer repays or reimburses the employee. The return on which the adjustment is entered as a deduction shall have attached thereto a statement explaining the adjustment, designating the return period in which the error occurred, and setting forth such other information as is required by the regulations in this subpart and by the instructions relating to the return.

§ 31.6413(b) STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES; OVERPAYMENTS OF CERTAIN EMPLOYMENT TAXES.

SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES. * * *

(b) OVERPAYMENTS OF CERTAIN EMPLOYMENT TAXES.—If more than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid or deducted with respect to any payment of remuneration and the overpayment cannot be adjusted under subsection (a) of this section, the amount of the overpayment shall be refunded in such manner and at such times (subject to the statute of limitations properly applicable thereto) as the Secretary or his delegate may by regulations prescribe.

§ 31.6413(b)–1 OVERPAYMENTS OF CERTAIN EMPLOYMENT TAXES.—For provisions relating to the adjustment of overpayments of tax imposed by section 3101, 3111, 3201, 3221, or 3402, see § 31.6413(a)–2. For provisions relating to refunds of tax imposed by section 3101, 3111, 3201, or 3221, see §§ 31.6402(a)–1 and 31.6402(a)–2. For provisions relating to refunds of tax imposed by section 3402, see §§ 31.6402(a)–1 and 31.6414–1.

§ 31.6413(c) STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES; SPECIAL REFUNDS.

SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES. * * *

(c) SPECIAL REFUNDS.—

(1) IN GENERAL.—If by reason of an employee receiving wages from more than one employer during a calendar year after the calendar year 1950 and prior to the calendar year 1955, the wages received by him during such year exceed $3,600, the employee shall be entitled (subject to the provisions of section 31(b)) to a credit or refund of any amount of tax, with respect to such wages, imposed by section 1400 of the Internal Revenue Code of 1939 and deducted from the employee's wages (whether or not paid to the Secretary or his delegate), which exceeds the tax with respect to the first $3,600 of such wages received; or if by reason of an employee receiving wages from more than one employer (A) during any calendar year after the calendar year 1954 and prior to the calendar year 1959, the wages received by him during such year exceed $4,200, or (B) during any calendar year after the calendar year 1958, the wages received by him during such year exceed $4,800, the employee shall be entitled (subject to the provisions of section 31(b)) to a credit or refund of any amount of tax, with respect to such wages, imposed by section 3101 and deducted from

the employee's wages (whether or not paid to the Secretary or his delegate), which exceeds the tax with respect to the first $4,200 of such wages received in such calendar year after 1954 and before 1959, or which exceeds the tax with respect to the first $4,800 of such wages received in such calendar year after 1958.

(2) APPLICABILITY IN CASE OF FEDERAL AND STATE EMPLOYEES AND EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS.—

(A) FEDERAL EMPLOYEES.—In the case of remuneration received from the United States or a wholly-owned instrumentality thereof during any calendar year, each head of a Federal agency or instrumentality who makes a return pursuant to section 3122 and each agent, designated by the head of a Federal agency or instrumentality, who makes a return pursuant to such section shall, for purposes of this subsection, be deemed a separate employer, and the term "wages" includes for purposes of this subsection the amount, not to exceed $3,600 for the calendar year 1951, 1952, 1953, or 1954, $4,200 for the calendar year 1955, 1956, 1957, or 1958, or $4,800 for any calendar year after 1958, determined by each such head or agent as constituting wages paid to an employee.

(B) STATE EMPLOYEES.—For purposes of this subsection, in the case of remuneration received during any calendar year, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 218 of the Social Security Act as would be wages if such services constituted employment; the term "employer" includes a State or any political subdivision thereof, or any instrumentality of any one or more of the foregoing; the term "tax" or "tax imposed by section 3101" includes, in the case of services covered by an agreement made pursuant to section 218 of the Social Security Act, an amount equivalent to the tax which would be imposed by section 3101, if such services constituted employment as defined in section 3121; and the provisions of this subsection shall apply whether or not any amount deducted from the employee's remuneration as a result of an agreement made pursuant to section 218 of the Social Security Act has been paid to the Secretary.

(C) EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS.—For purposes of paragraph (1) of this subsection, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 3121(l) as would be wages if such services constituted employment; the term "employer" includes any domestic corporation which has entered into an agreement pursuant to section 3121(l); the term "tax" or "tax imposed by section 3101", includes, in the case of services covered by an agreement entered into pursuant to section 3121(l), an amount equivalent to the tax which would be imposed by section 3101, if such services constituted employment as defined in section 3121; and the provisions of paragraph (1) of this subsection shall apply whether or not any amount deducted from the employee's remuneration as a result of the agreement entered into pursuant to section 3121(l) has been paid to the Secretary or his delegate.

[Sec. 6413(c) as amended by sec. 202 (a) (1), Social Security Amendments 1954 (68 Stat. 1089) [P.L. 761, C.B. 1954–2, 603]; sec. 402 (d), Social Security Amendments 1958 (72 Stat. 1043) [P.L. 85–840, C.B. 1958–3, 85]]

§ 31.6413(c)–1 SPECIAL REFUNDS.—(a) *Who may make claims.*—(1) *In general.*—(i) If, during any calendar year after 1954 and before 1959, an employee receives wages, as defined in section 3121(a), in excess of $4,200 from two or more employers, or if during any calendar year after 1958, an employee receives wages, as defined in section 3121(a), in excess of $4,800 from two or more employers, the employee shall be entitled to a special refund of the amount, if any,

by which the employee tax imposed by section 3101 with respect to such wages and deducted therefrom (whether or not paid to the district director) exceeds the employee tax with respect to the first $4,200 or $4,800, whichever is appropriate, of such wages. If the employee is required to file an income tax return for such calendar year (or for his last taxable year beginning in such calendar year) he may obtain the benefit of the special refund only by claiming credit as provided in § 1.31–2 of this chapter (Income Tax Regulations).

(ii) The application of this subparagraph may be illustrated by the following examples:

Example (1). Employee A in the calendar year 1959 receives taxable wages in the amount of $3,000 from each of his employers, B, C, and D, for services performed during such year (or at any time after 1936), or a total of $9,000. Employee tax (computed at 2½ percent, the employee tax rate in effect in 1959) is deducted from A's wages in the amount of $75 by B and $75 by C, or a total of $150. Employer D pays employee tax in the amount of $75 to the district director *without deducting such tax from A's wages.* The employee tax with respect to the first $4,800 of such wages is $120. A is entitled to a special refund of $30 ($150 minus $120). The $3,000 of wages received from employer D and the $75 of employee tax paid with respect thereto have no bearing in computing A's special refund since such tax was not deducted from his wages.

Example (2). Employee E in the calendar year 1959 performs services for employers F and G, for which E is entitled to wages of $4,800 from each employer, or a total of $9,600. On account of such services, E in 1958 received an advance payment of $600 of wages from F; and in 1959, receives wages in the amount of $4,200 from F and $4,800 from G. Employee tax was deducted as follows: In 1958, $13.50 ($600 x 2¼%, the employee tax rate in effect in 1958) by employer F; and in 1959, $105 ($4,200 x 2½%, the employee tax rate in effect in 1959) by employer F, and $120 ($4,800 x 2½%) by employer G. Thus, E in the calendar year 1959 received $9,000 in wages, from which $225 of employee tax was deducted. The amount of employee tax with respect to the first $4,800 of such wages received in 1959 is $120. E is entitled to a special refund of $105 ($225 minus $120). The $600 advance of wages received in 1958 from F, and the $13.50 of employee tax with respect thereto, have no bearing in computing E's special refund for 1959, because the wages were not received in 1959. Such amounts could not form the basis for a special refund unless E during 1958 received from F and at least one more employer wages totaling more than $4,200.

(2) *Federal employees.*—For purposes of special refunds of employee tax, each head of a Federal agency or of a wholly-owned instrumentality of the United States who makes a return pursuant to section 3122 (and each agent designated by a head of a Federal agency or instrumentality who makes a return pursuant to such section) is considered a separate employer. For such purposes, the term "wages" includes the amount which each such head (or agent) determines to constitute wages paid an employee, but not in excess of $4,200 paid in any calendar year after 1954 and before 1959, or $4,800 paid in any

calendar year after 1958. For example, if wages received by an employee during any calendar year after 1958 are reportable by two or more agents of one or more Federal agencies and the amount of such wages is in excess of $4,800, the employee shall be entitled to a special refund of the amount, if any, by which the employee tax imposed with respect to such wages and deducted therefrom exceeds the employee tax with respect to the first $4,800 of such wages. Moreover, if an employee receives wages during any calendar year from an agency or wholly-owned instrumentality of the United States and from one or more other employers, either private or governmental, the total amount of such wages shall be taken into account for purposes of the special refund provisions.

(3) *State employees.*—For purposes of special refunds of employee tax, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 218 of the Social Security Act, relating to voluntary agreements for coverage of employees of State and local governments, as would be wages if such services constituted employment (see § 31.3121(a)–1 of Subpart B of the regulations in this part, relating to wages); the term "employer" includes a State or any political subdivision thereof, or any instrumentality of any one or more of the foregoing; and the term "tax" or "tax imposed by section 3101" includes an amount equivalent to the employee tax which would be imposed by section 3101 if such services constituted employment. The provisions of subparagraph (1) of this paragraph are applicable whether or not any amount deducted from an employee's remuneration as a result of an agreement made pursuant to section 218 of the Social Security Act has been paid pursuant to such agreement. Thus, the special refund provisions are applicable to amounts equivalent to employee tax deducted from employees' remuneration by States, political subdivisions, or instrumentalities by reason of agreements made under section 218 of the Social Security Act. Moreover, if during any calendar year an employee receives remuneration for services covered by such an agreement and during the same calendar year receives wages from one or more other employers, either private or governmental, the total amount of such remuneration and wages shall be taken into account for purposes of the special refund provisions.

(4) *Employees of certain foreign corporations.*—For purposes of special refunds of employee tax, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 3121(l), relating to agreements for coverage of employees of certain foreign corporations, as would be wages if such services constituted employment (see § 31.3121(a)–1 of Subpart B of the regulations in this part, relating to wages); the term "employer" includes any domestic corporation which has entered into an agreement pursuant to section 3121(l); and the term "tax" or "tax imposed by section 3101" includes, in the case of services covered by an agreement entered into pursuant to section 3121(l), an amount equivalent to the employee tax which would be imposed by section 3101 if such services constituted employment. The provisions of subparagraph (1) of this paragraph are applicable whether or not any amount deducted from the employee's remuneration by reason of such agreement has been

paid to the district director. Thus, the special refund provisions are applicable to amounts equivalent to employee tax deducted from employees' remuneration by reason of agreements made under section 3121(l). A domestic corporation which enters into an agreement pursuant to section 3121(l) shall, for purposes of this paragraph, be considered an employer in its capacity as a party to such agreement separate and distinct from its identity as an employer employing individuals on its own account (see section 3121(l)(9)). If during any calendar year an employee receives remuneration for services covered by such an agreement and during the same calendar year receives wages for services in employment, the total amount of such remuneration and wages shall be taken into account for purposes of the special refund provisions. For provisions relating to agreements entered into under section 3121(l), see the regulations in Part 36 of this chapter (Regulations on Contract Coverage of Employees of Foreign Subsidiaries).

(b) *Claims for special refund.*—(1) *In general.*—An employee who is entitled to a special refund under section 6413(c) may claim such refund under the provisions of this section only if the employee is not entitled to claim the amount thereof as a credit against income tax as provided in § 1.31–2 of this chapter (Income Tax Regulations). Each claim under this section shall be made with respect to wages received within one calendar year (regardless of the year or years after 1936 during which the services were performed for which such wages are received), and shall be filed after the close of such year.

(2) *Form of claim.*—Each claim for special refund under this section shall be made on Form 843, in accordance with the regulations in this subpart and the instructions relating to such form. The claim shall be filed with the district director for the internal revenue district in which the employee resides or, if the employee does not reside in any internal revenue district, with the District Director at Baltimore, Maryland. However, in the case of an employee who does not reside in any internal revenue district and who is outside the United States, the claim shall be filed with the Director, International Operations Division, United States Internal Revenue Service, Washington 25, D.C., unless the employee resides in Puerto Rico or the Virgin Islands, in which case the claim shall be filed with the office of the Director, International Operations Division, United States Internal Revenue Service, Santurce, Puerto Rico. The claim shall include the employee's account number and the following information with respect to each employer from whom he received wages during the calendar year: (i) The name and address of such employer, (ii) the amount of wages received during the calendar year to which the claim relates, and (iii) the amount of employee tax collected by the employer from the employee with respect to such wages. Other information may be required but should be submitted only upon request.

(3) *Period of limitation.*—For the period of limitation upon special refund of employee tax imposed by section 3101, see § 301.6511(a)–1 of this chapter (Regulations on Procedure and Administration).

§ 31.6413(d) STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES; REFUND OR CREDIT OF FEDERAL UNEMPLOYMENT TAX.

SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES. * * *

(d) REFUND OR CREDIT OF FEDERAL UNEMPLOYMENT TAX.—Any credit allowable under section 3302, to the extent not previously allowed, shall be considered an overpayment, but no interest shall be allowed or paid with respect to such overpayment.

§ 31.6414 STATUTORY PROVISIONS; INCOME TAX WITHHELD.

SEC. 6414. INCOME TAX WITHHELD. In the case of an overpayment of tax imposed by chapter 24, * * * refund or credit shall be made to the employer * * * only to the extent that the amount of such overpayment was not deducted and withheld by the employer * * *.

§ 31.6414–1 CREDIT OR REFUND OF INCOME TAX WITHHELD FROM WAGES.—(a) *In general.*—Any employer who pays to the district director more than the correct amount of—

(1) Tax under section 3402 or a corresponding provision of prior law, or

(2) Interest, addition to the tax, additional amount, or penalty with respect to such tax,

may file a claim for refund of the overpayment or may claim credit for such overpayment, in the manner and subject to the conditions stated in this section and § 301.6402–2 of this chapter (Regulations on Procedure and Administration). If credit is claimed pursuant to this section, the amount thereof shall be claimed by entering such amount as a deduction on a return of tax under section 3402 filed by the employer. If credit is taken pursuant to this section, a claim on Form 843 is not required, but the return on which the credit is claimed shall have attached as a part thereof a statement, which shall constitute the claim for credit, setting forth in detail the grounds and facts relied upon in support of the credit, and showing such other information as is required by the regulations in this subpart and by the instructions relating to the return. No refund or credit to the employer shall be allowed under this section for the amount of any overpayment of tax which the employer deducted or withheld from an employee.

(b) *Period of limitation.*—For the period of limitation upon credit or refund of taxes imposed by the Internal Revenue Code of 1954, see § 301.6511(a)–1 of this chapter (Regulations on Procedure and Administration). For the period of limitation upon credit or refund of any tax imposed by the Internal Revenue Code of 1939, see the regulations applicable with respect to such tax.

§ 31.6674 STATUTORY PROVISIONS; FRAUDULENT STATEMENT OR FAILURE TO FURNISH STATEMENT TO EMPLOYEE.

SEC. 6674. FRAUDULENT STATEMENT OR FAILURE TO FURNISH STATEMENT TO EMPLOYEE.

In addition to the criminal penalty provided by section 7204, any person required under the provisions of section 6051 to furnish a statement to an employee who willfully furnishes a false or fraudulent statement, or who willfully fails to furnish a statement in the manner, at the time, and showing the information required under section 6051, or regulations prescribed thereunder, shall for each such failure be subject to a penalty under this subchapter of $50, which shall be

assessed and collected in the same manner as the tax on employers imposed by section 3111.

§ 31.6674–1 PENALTIES FOR FRAUDULENT RECEIPT OR FAILURE TO FURNISH RECEIPT.—Any person required to furnish a statement to an employee under the provisions of section 6051 is subject to a civil penalty for willful failure to furnish such statement in the manner, at the time, and showing the information required under such section or § 31.6051–1, or for willfully furnishing a false or fraudulent statement to an employee. The penalty for each such violation is $50, which shall be assessed and collected in the same manner as the tax imposed on employers under the Federal Insurance Contributions Act. See section 7204 for criminal penalty.

§ 31.7805. STATUTORY PROVISIONS; RULES AND REGULATIONS.

SEC. 7805. RULES AND REGULATIONS.

(a) AUTHORIZATION.—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) RETROACTIVITY OF REGULATIONS OR RULINGS.—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

(c) PREPARATION AND DISTRIBUTION OF REGULATIONS, FORMS, STAMPS, AND OTHER MATTERS.—The Secretary or his delegate shall prepare and distribute all the instructions, regulations, directions, forms, blanks, stamps, and other matters pertaining to the assessment and collection of internal revenue.

§ 31.7805–1 PROMULGATION OF REGULATIONS.—In pursuance of section 7805 of the Internal Revenue Code of 1954, the foregoing regulations are hereby prescribed. (See § 31.0–3 of Subpart A of the regulations in this part relating to the scope of the regulations.)

PAR. 2. The Employment Tax Regulations (26 CFR Part 31) are amended by inserting the following immediately after § 31.6001–5:

§ 31.6001–6 NOTICE BY DISTRICT DIRECTOR REQUIRING RETURNS, STATEMENTS, OR THE KEEPING OF RECORDS.—The district director may require any person, by notice served upon him, to make such returns, render such statements, or keep such specific records as will enable the district director to determine whether or not such person is liable for any of the taxes to which the regulations in this part have application.

PAR. 3. Paragraph (c) of § 31.6011(a)–7 of the Employment Tax Regulations (26 CFR Part 31) is amended to read as follows:

§ 31.6011(a)–7 EXECUTION OF RETURNS.

* * * * * * *

(c) *Signing and verification.*—For provisions relating to the signing of returns, see § 31.6061–1. For provisions relating to the verifying of returns, see § 31.6065(a)–1.

PAR. 4. Section 31.6051 of the Employment Tax Regulations (26 CFR Part 31) is amended to read as follows:

§ 31.6051 STATUTORY PROVISIONS; RECEIPTS FOR EMPLOYEES.

SEC. 6051. RECEIPTS FOR EMPLOYEES.

(a) REQUIREMENT.—Every person required to deduct and withhold from an employee a tax under section 3101 or 3402, or who would have

been required to deduct and withhold a tax under section 3402 if the employee had claimed no more than one withholding exemption, shall furnish to each such employee in respect of the remuneration paid by such person to such employee during the calendar year, on or before January 31 of the succeeding year, or, if his employment is terminated before the close of such calendar year, on the day on which the last payment of remuneration is made, a written statement showing the following:

(1) The name of such person,

(2) The name of the employee (and his social security account number if wages as defined in section 3121(a) have been paid),

(3) The total amount of wages as defined in section 3401(a),

(4) The total amount deducted and withheld as tax under section 3402,

(5) The total amount of wages as defined in section 3121(a), and

(6) The total amount deducted and withheld as tax under section 3101.

In the case of compensation paid for service as a member of a uniformed service, the statement shall show, in lieu of the amount required to be shown by paragraph (5), the total amount of wages as defined in section 3121(a), computed in accordance with such section and section 3121(i)(2).

(b) SPECIAL RULE AS TO COMPENSATION OF MEMBERS OF ARMED FORCES.—In the case of compensation paid for service as a member of the Armed Forces, the statement required by subsection (a) shall be furnished if any tax was withheld during the calendar year under section 3402, or if any of the compensation paid during such year is includible in gross income under chapter 1, or if during the calendar year any amount was required to be withheld as tax under section 3101. In lieu of the amount required to be shown by paragraph (3) of subsection (a), such statement shall show as wages paid during the calendar year the amount of such compensation paid during the calendar year which is not excluded from gross income under chapter 1 (whether or not such compensation constituted wages as defined in section 3401(a)).

(c) ADDITIONAL REQUIREMENTS.—The statements required to be furnished pursuant to this section in respect of any remuneration shall be furnished at such other times, shall contain such other information, and shall be in such form as the Secretary or his delegate may by regulations prescribe.

(d) STATEMENTS TO CONSTITUTE INFORMATION RETURNS.—A duplicate of any statement made pursuant to this section and in accordance with regulations prescribed by the Secretary or his delegate shall, when required by such regulations, be filed with the Secretary or his delegate.

[Sec. 6051 as amended by sec. 412, Servicemen's and Veterans' Survivor Benefits Act (70 Stat. 879) [P.L. 881, C.B. 1956–2, 1196]]

AUTHORITY: §§ 31.6011(b) to 31.7805–1, incl., and amendments of the regulations under secs. 6001, 6011(a), and 6051 issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved June 17, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 22, 1960, 8:51 a.m., and published in the issue of the Federal Register for June 23, 1960, 25 F.R. 5723)

Subpart C—Estate and Gift Tax Returns

SECTION 6018.—ESTATE TAX RETURNS

26 CFR 20.6018–1: Returns.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 60–27, page 1003.

SECTION 6019.—GIFT TAX RETURNS

26 CFR 25.6019–1: Persons required to file returns.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 60–27, page 1003.

PART III.—INFORMATION RETURNS

Subpart A.—Information Concerning Persons Subject to Special Provisions

SECTION 6033.—RETURNS BY EXEMPT ORGANIZATIONS

26 CFR 1.6033–1: Returns by exempt organizations. Rev. Rul. 60–364[1]

A State agency may file a group information return, Form 990, Return of Organization Exempt from Income Tax, covering all of the exempt State-chartered credit unions under its control and supervision, which will be in lieu of each individual credit union filing a separate information return.

Advice has been requested whether the principle of Revenue Ruling 60–169, C.B. 1960–1, 62, may be extended to permit a State instrumentality to file an annual group information return, Form 990, Return of Organization Exempt from Income Tax, covering all of the exempt, State-chartered credit unions which are under its control and supervision.

Revenue Ruling 60–169, holds that the Bureau of Federal Credit Unions, an agency of the Federal government under the Department of Health, Education and Welfare, may file, annually, a group information return, Form 990, covering all of the exempt Federal Credit Unions under its supervision, which will be in lieu of a separate annual return by each of the individual Federal Credit Unions, although the Bureau is not itself subject to Federal income tax and is not required to file an information return covering its own activities.

Section 6033(a) of the Internal Revenue Code of 1954 provides, in part, that every organization, with certain exceptions, exempt from taxation under section 501(a) shall file an annual return stating specifically the items of gross income, receipts, and disbursements, and such other information as the Secretary of the Treasury or his delegate may by forms or regulations prescribe.

[1] Also released as Technical Information Release 268, dated November 18, 1960.

Section 1.6033–1 of the Income Tax Regulations provides that a central, parent, or like organization exempt under section 501(a) of the Code and described in section 501(c), although required to file a separate annual return for itself under section 6033, may file annually, in addition to such separate annual return, a group return on Form 990. Such group return may be filed for two or more of the local organizations which are (1) chartered by, or affiliated or associated with, such central organization at the close of its annual accounting period, (2) subject to the general supervision of, and examination by, the central organization, and (3) exempt from taxation under section 501(a) and described by the same provision of section 501(c) as the central organization.

The regulations also provide that the filing of such a group return shall be in lieu of the filing of separate returns by each of the local organizations included in the group return. The group return shall include only those local organizations which in writing have authorized the central organization to include them in the group return and which have filed statements with the central organization specifically stating their items of gross income, receipts, and disbursements, and such other information relating to them as is required to be stated in the group return.

The regulations provide further that there shall be attached to the group return and made a part thereof a schedule showing the name and address of each of the local organizations and the total number thereof included in such return, as well as a schedule showing the name and address of each of the local organizations and the total number thereof not included in the group return. Prior to or simultaneously with the filing of a group return, the central organization shall notify each District Director of Internal Revenue for the internal revenue district in which is located the principal place of business or principal office of each local organization included in or excluded from such group return that the local organization has or has not been, or will or will not be, included in such group return. The filing with each District Director concerned of a copy of the above mentioned schedule shall constitute the required notice.

Neither section 6033 of the Code nor section 1.6033–1 of the regulations provides specifically for the filing of group information returns by State agencies. However, the situation in State-chartered credit union cases is closely analogous to that in the Federal Credit Union cases since the controlling State agency is not subject to Federal income tax and is not required to file Form 990, in its own behalf.

Accordingly, it is held that a State agency may file with the District Director in whose district the principal office of the State agency is located, a group information return, Form 990, Return of Organization Exempt from Income Tax, covering all of the exempt State-chartered credit unions under its control and supervision, which will be in lieu of each individual credit union filing a separate information return.

However, only those State credit unions, under the supervision of the State agency, whose exempt status has been established under section 501(a) of the Code, may be included in such a group information return. In addition, there must be attached to the Form 990 a combined financial report of all of the credit unions included in the

group return. A copy of a published combined report, if any, may be furnished for this purpose.

SECTION 6038.—INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS

26 CFR 1.6038: Statutory provisions; information with respect to certain foreign corporations. T.D. 6506 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Income tax regulations under section 6038 of the Internal Revenue Code of 1954 requiring information returns of domestic corporations with respect to certain foreign corporations.

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

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

On October 28, 1960, notice of proposed rulemaking regarding the regulations under section 6038, as added to the Internal Revenue Code of 1954 by section 6 of the Act of September 14, 1960 (Public Law 86-780, 74 Stat. 1014 [page 720, this Bulletin], relating to the filing of information returns by a domestic corporation with respect to each foreign corporation which it controls and each foreign subsidiary of such foreign corporation, was published in the Federal Register (25 F.R. 10355). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

§ 1.6038 STATUTORY PROVISIONS; INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

(a) REQUIREMENT.—

(1) IN GENERAL.—A domestic corporation shall furnish, with respect to any foreign corporation which it controls (within the meaning of subsection (c)(1)) and with respect to any foreign subsidiary of any such foreign corporation (within the meaning of subsection (c)(2)), such information as the Secretary or his delegate may prescribe by regulations relating to—

(A) The name, the principal place of business, and the nature of business of such foreign corporation or foreign subsidiary, and the country under whose laws incorporated;

(B) The accumulated profits (as defined in section 902(c)) of such foreign corporation or foreign subsidiary, including the items of income (whether or not included in gross income under chapter 1), deductions (whether or not allowed in computing taxable income under chapter 1), and any other items taken into account in computing such accumulated profits;

(C) A balance sheet for such foreign corporation or foreign subsidiary, listing assets, liabilities, and capital;

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[1] 25 F.R. 12240.

(D) Transactions between such foreign corporation or foreign subsidiary and—

(i) Any foreign corporation controlled by the domestic corporation,

(ii) Any foreign subsidiary of a foreign corporation controlled by the domestic corporation, and

(iii) The domestic corporation or any shareholder of the domestic corporation owning at the time the transaction takes place 10 percent or more of the value of any class of stock outstanding of the domestic corporation; and

(E) A description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each citizen or resident of the United States and each domestic corporation who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation or foreign subsidiary.

(2) PERIOD FOR WHICH INFORMATION IS TO BE FURNISHED, ETC.—The information required under paragraph (1) shall be furnished—

(A) In the case of a foreign corporation, for its annual accounting period ending with or within the domestic corporation's taxable year, and

(B) In the case of any foreign subsidiary of such foreign corporation, for such subsidiary's annual accounting period ending with or within such foreign corporation's annual accounting period described in subparagraph (A).

The information required under this subsection shall be furnished at such time and in such manner as the Secretary or his delegate shall by regulations prescribe.

(3) LIMITATION.—No information shall be required to be furnished under this subsection with respect to any foreign corporation or foreign subsidiary for any annual accounting period unless such information was required to be furnished under regulations in effect on the first day of such annual accounting period.

(b) EFFECT OF FAILURE TO FURNISH INFORMATION.—If a domestic corporation fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any foreign corporation or foreign subsidiary required under paragraph (1) of subsection (a), then, in applying section 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) to such domestic corporation (or to any person who acquires from any person any portion of the interest of such domestic corporation in any such foreign corporation or foreign subsidiary, but only to the extent of such portion) for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation and foreign subsidiary with respect to which the domestic corporation is required to furnish information during the annual accounting period or periods with respect to which such information is required under such paragraph (2) of subsection (a) shall be reduced by 10 percent. If such failure continues 90 days or more after notice by the Secretary or his delegate to the domestic corporation, then the amount of the reduction under this subsection shall be 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure to furnish information continues after the expiration of such 90-day period. No taxes shall be reduced under this subsection more than once for the same failure. For purposes of this subsection, the time prescribed under paragraph (2) of subsection (a) to furnish information (and the beginning of the 90-day period after notice by the Secretary) shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary or his delegate) reasonable cause existed for failure to furnish such information.

(c) CONTROL ETC.—For purposes of this section—

(1) If at any time during its taxable year a domestic corporation owns more than 50 percent of the voting stock of a foreign corporation, it shall be deemed to be in control of such foreign corporation.

(2) If at any time during its annual accounting period a foreign

corporation owns more than 50 percent of the voting stock of another foreign corporation, such other corporation shall be considered a foreign subsidiary of the corporation owning such stock.

(d) ANNUAL ACCOUNTING PERIOD.—For purposes of this section, the annual accounting period of a foreign corporation or of a foreign subsidiary is the annual period on the basis of which such foreign corporation or such foreign subsidiary regularly computes its income in keeping its books.

(e) CROSS REFERENCE.—For provisions relating to penalties for violations of this section, see section 7203.

[Sec. 603 as added by sec. 6, Act of September 14, 1960 (Pub. Law 86-780, 74 Stat. 1014)]

§ 1.6038-1 INFORMATION RETURNS REQUIRED OF DOMESTIC CORPORATIONS WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.—(a) *Requirement of return.*—For taxable years beginning after December 31, 1960, every domestic corporation shall make a separate annual information return on Form 2952, in duplicate, with respect to each foreign corporation which it controls, as defined in paragraph (b) of this section, and with respect to each foreign subsidiary, as defined in paragraph (c) of this section, for the annual accounting period (described in paragraph (d) of this section and beginning after December 31, 1960) of each such controlled foreign corporation or foreign subsidiary. Such information shall not be required to be furnished, however, with respect to a corporation defined in section 1504 (d) of the Code which makes a consolidated return for the taxable year.

(b) *Control.*—A domestic corporation shall be deemed to be in control of a foreign corporation if at any time during its taxable year it owns more than 50 percent of the voting stock of such foreign corporation.

(c) *Foreign subsidary.*—A foreign corporation more than 50 percent of the voting stock of which is owned by a controlled foreign corporation at any time during the annual accounting period of such controlled foreign corporation shall be considered a foreign subsidiary.

(d) *Period covered by return.*—(1) *Controlled foreign corporation.*—The information with respect to a controlled foreign corporation shall be furnished for its anual accounting period ending with or within the domestic corporation's taxable year.

(2) *Foreign subsidary.*—The information with respect to a foreign subsidary shall be furnished for such subsidary's annual accounting period ending with or within the controlled foreign corporation's annual accounting period.

(3) *Annual accounting period defined.*—For purposes of this section, the annual accounting period of a controlled foreign corporation or of a foreign subsidary is the annual period on the basis of which the controlled foreign corporation or foreign subsidiary regularly computes its income in keeping its books. The term "annual accounting period" may refer to a period of less than 1 year, where for example the foreign income, war profits, and excess profits taxes are determined on the basis of an accounting period of less than 1 year as described in section 902(c)(2).

(e) *Contents of return.*—The return on Form 2952 shall contain the following information with respect to each controlled foreign corporation and each foreign subsidiary:

(1) The name and address of the corporation;
(2) The principal place of business of the corporation;
(3) The date of incorporation and the country under whose laws incorporated;
(4) The nature of the corporation's business;
(5) As regards the outstanding stock of the corporation—
(i) A description of each class of the corporation's stock, and
(ii) The number of shares of each class outstanding at the beginning and the end of the annual accounting period;
(6) A list showing the name and address of, and the number of shares of each class of the corporation's stock held by, each citizen or resident of the United States, and each domestic corporation, who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of the corporation's outstanding stock;
(7) The amount of the corporation's gross receipts, net profits before taxes and provision for foreign income taxes, for the annual accounting period, as reflected on the financial statements required under paragraph (f) of this section to be filed with the return; and
(8) A summary showing the total amount of each of the following types of transactions of the corporation, which took place during the annual accounting period, with the domestic corporation or any shareholder of the domestic corporation owning at the time of the transaction 10 percent or more of the value of any class of stock outstanding of the domestic corporation:
(i) Sales and purchases of stock in trade;
(ii) Purchases of property of a character which is subject to the allowance for depreciation;
(iii) Compensation paid and compensation received for the rendition of technical, managerial, engineering, construction, scientific, or like services;
(iv) Commissions paid and commissions received:
(v) Rents and royalties paid and rents and royalties received;
(vi) Amounts loaned and amounts borrowed (other than open accounts which arise and are collected in the ordinary course of business);
(vii) Dividends paid and dividends received;
(viii) Interest paid and interest received; and
(ix) Premiums received for insurance or reinsurance.

If the domestic corporation is a bank, as defined in section 581, or is controlled within the meaning of section 368(c) by a bank, the term "transactions" shall not, as to a corporation with respect to which a return is filed, include banking transactions entered into on behalf of customers; in any event, however, deposits in accounts between a controlled foreign corporation or a foreign subsidiary and the domestic corporation or a 10-percent shareholder described in this subparagraph and withdrawals from such accounts shall be summarized by reporting end-of-month balances.

(f) *Financial statements.*—The following information with respect to each controlled foreign corporation and each foreign subsidiary shall be attached to and filed as part of the return required by this section:

(1) A statement of the corporation's profit and loss for the annual accounting period;

(2) A balance sheet as of the end of the annual accounting period of the corporation showing—

(i) The corporation's assets,

(ii) The corporation's liabilities, and

(iii) The corporation's net worth; and

(3) An analysis of changes in the corporation's surplus accounts during the annual accounting period including both opening and closing balances.

The statements listed in subparagraphs (1), (2), and (3) of this paragraph shall be prepared in conformity with generally accepted accounting principles, and in such form and detail as is customary for the corporation's accounting records.

(g) *Method of reporting.*—All amounts furnished under paragraphs (e) and (f) of this section shall be expressed in United States currency with a statement of the exchange rates used.

(h) *Time and place for filing return.*—Returns on Form 2952 required under paragraph (a) of this section shall be filed with the domestic corporation's income tax return on or before the fifteenth day of the third month following the close of such corporation's taxable year.

(i) *Extensions of time for filing.*—District directors are authorized to grant reasonable extensions of time for filing returns on Form 2952 in accordance with the applicable provisions of § 1.6081–1 of this chapter. An application by a domestic corporation for an extension of time for filing a return of income shall also be considered as an application for an extension of time for filing returns on Form 2952.

(j) *Failure to furnish information.*—(1) *Effect on foreign tax credit.*—(i) Failure by a domestic corporation to furnish, in accordance with the provisions of this section, any return or any information in any return, required to be filed for a taxable year under authority of section 6038 on or before the date prescribed in paragraph (h) of this section (determined with regard to any extension of time for such filing) shall affect the application of section 902 as provided in subparagraph (2) of this paragraph. Such failure shall affect the application of section 902 to such domestic corporation or to any person who acquires from any person any portion (but only to the extent of such portion) of the interest of such domestic corporation in any controlled foreign corporation or foreign subsidiary.

(ii) Where the domestic corporation, having filed the return required by this section except for an omission of, or error with respect to, some of the information referred to in paragraphs (e) and (f) of this section, establishes to the satisfaction of the Commissioner that such omission or error was inadvertant or for reasonable cause and that such domestic corporation has substantially complied with this section, such omission or error shall not constitute a failure under this section.

(2) *Reduction of foreign taxes.*—In the application of section 902 to the domestic corporation or person referred to in subdivision (i) of subparagraph (1) of this paragraph for any taxable year, the amount of taxes paid or deemed paid by each controlled foreign corporation and each foreign subsidiary for the accounting period or periods for which the domestic corporation was required for the taxable

year of the failure to furnish information under this section shall be reduced by 10 percent. The 10-percent reduction is not limited to the taxes paid or deemed paid by the controlled foreign corporation or foreign subsidiary with respect to which there is a failure to file information but shall apply to the taxes paid or deemed paid by all controlled foreign corporations and foreign subsidiaries.

(3) *Reduction for continued failure.*—(i) If the failure, referred to in subdivision (i) of subparagraph (1) of this paragraph, continues for 90 days or more after date of written notice by the district director to the domestic corporation, then the amount of the reduction referred to in subparagraph (2) of this paragraph shall be 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure continues after the expiration of such 90-day period.

(ii) Taxes paid by a foreign subsidiary when once reduced for a failure shall not be reduced again for the same failure in their status as taxes deemed paid by a controlled foreign corporation. Where a failure continues, each additional periodic 5 percent reduction, referred to in subdivision (i) of this subparagraph, shall be considered as part of the one reduction.

(4) *Reasonable cause.*—(i) For purposes of subsection (b) of section 6038 and this section the time prescribed for furnishing information under this paragraph, and the beginning of the 90-day period after notice by the district director, shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the district director) reasonable cause existed for failure to furnish such information.

(ii) A domestic corporation, which wishes to avoid a reduction in foreign tax credit as provided in subparagraphs (2) and (3) of this paragraph for failure to furnish information in accordance with this section, must make an affirmative showing of all facts alleged as a reasonable cause for such failure in the form of a written statement containing a declaration that it is made under the penalties of perjury.

(5) *Penalties.*—The information required by section 6038 of the Code must be furnished even though there are no foreign taxes which would be reduced under the provisions of subparagraph (2) of this paragraph. For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207 of the Code.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 28, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 29, 1960, 8:53 a.m., and published in the issue of the Federal Register for November 30, 1960, 25 F.R. 12240)

Subpart B.—Information Concerning Transactions With Other Persons

SECTION 6041.—INFORMATION AT SOURCE

26 CFR 1.6041–3: Payments for which no return of information on Forms 1099 and 1096 is required.

Mileage and per diem allowances regarded as the equivalent to an accounting by an employee to his employer. See Rev. Rul. 60–282, page 56.

Subpart C.—Information Regarding Wages Paid Employees

SECTION 6051.—RECEIPTS FOR EMPLOYEES

26 CFR 31.6051–1: Statement for employees.

Printing of substitutes for Form W–2, Withholding Tax Statement—1961. See Rev. Proc. 60–28, page 1006.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6101.—PERIOD COVERED BY RETURNS OR OTHER DOCUMENTS

26 CFR 31.6101: Statutory provisions; period covered by returns or other documents.

Regulations under the Internal Revenue Code of 1954 relating to the period covered by any returns required with respect to employment taxes. See T.D. 6472, page 351.

CHAPTER 62.—TIME AND PLACE FOR PAYING TAX

SUBCHAPTER B.—EXTENSIONS OF TIME FOR PAYMENT

SECTION 6161.—EXTENSION OF TIME FOR PAYING TAX

26 CFR 31.6161(a)(1): Statutory provisions; extension of time for paying tax.

Regulations under the Internal Revenue Code of 1954 relating to the granting of extensions of time for paying employment taxes. See T.D. 6472, page 351.

SECTION 6166.—EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS

26 CFR 24.1–1: Extension of time for payment of estate tax where estate consists largely of interest in closely held business.

Processing by Audit Divisions of the District Directors' offices of elections by executors to pay estate taxes in installments. See Rev. Proc. 60–33, page 1012.

CHAPTER 63.—ASSESSMENT

SUBCHAPTER A.—IN GENERAL

SECTION 6205.—SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES

26 CFR 31.6205: Statutory provisions; special rules applicable to certain employment taxes.

Regulations under the Internal Revenue Code of 1954 relating to proper adjustments of undercollections or underpayments of certain employment taxes. See T.D. 6472, page 351.

CHAPTER 64.—COLLECTION

SUBCHAPTER C.—LIEN FOR TAXES

SECTION 6321.—LIEN FOR TAXES

26 CFR 301.6321: Lien for taxes. Ct. D. 1855

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF COURT

1. COLLECTION OF TAXES—LIENS—BANKRUPTCY AND RECEIVERSHIP—DETERMINATION OF TAXPAYERS' PROPERTY RIGHTS—CONSTRUCTION OF STATE LAW—NORTH CAROLINA.

State law governs in determining a taxpayer's interest in property to which a tax lien can attach. Here, the Supreme Court of the United States holds that the Court of Appeals' construction of North Carolina law as giving a general contractor a property right in amounts owed by the owner of real estate for whom construction work has been performed only to the extent that the amounts exceed sums owed to subcontractors was not clearly erroneous or unreasonable. Accordingly, under North Carolina law it was held that the Federal tax lien did not attach to that part of the fund sufficient to pay the subcontractors.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Fourth Circuit, 257 Fed. (2d) 570, affirmed.

SUPREME COURT OF THE UNITED STATES

United States of America, petitioner v. *Durham Lumber Company, and George H. Carter, Jr.*

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

[June 20, 1960]

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

This case involves the competing claims of the Federal Government and certain subcontractors to a sum of money owed to the taxpayers under a general construction contract.

The taxpayers, Michael & Embree, were general contractors doing business at Durham, North Carolina. Early in 1954, they agreed to construct certain buildings for persons herein referred to as the "owners." This work was completed on July 15, 1954, but because the owners disputed the amount due under the contract, payment to the taxpayers was delayed.

In completing the construction work, the taxpayers had utilized the services and materials of numerous subcontractors, most of whom had not been compensated. The respondents are two such subcontractors, who in January and February 1955, gave the owners notice of their respective claims against the taxpayers.

On January 18, 1955, the taxpayers were adjudicated bankrupts. At that time, there was an unpaid balance of $5,250 due from the owners under the construction contract. After extensive negotiations between the owners, the trustee in bankruptcy, and the subcontractors, it was agreed that the owners would absolve themselves from further liability by paying the $5,250 to the trustee, and that the subcontractors could thereafter assert the same rights against the trustee as they could have asserted against the owner. This arrangement was approved by both the Superior Court for Durham County, North Carolina, and the federal bankruptcy court.

Another claimant of the money deposited with the trustee was the Federal Government, which on August 13, 1954, and November 22, 1954, had assessed the taxpayers for uncollected withholding and unemployment insurance taxes. By virtue of Sections 6321 [1] and 6322 [2] of the Internal Revenue Code of 1954, a federal tax lien attached to all "the property and rights to property" belonging to the taxpayers at the time the assessments were made. The Government contended that the money owing under the construction contract was property of the taxpayers to which the tax lien attached.

The Referee in bankruptcy, attempting to resolve the competing claims against the fund as if the parties were before a state court, decided that the rights of the Federal Government under its tax lien were superior to those of the respondents. The District Court for the Middle District of North Carolina disagreed, and held that the respondents were entitled to payment of their claims before the Government could satisfy its tax lien. On appeal, the Court of Appeals for the Fourth Circuit affirmed, 257 F. 2d 570. We granted certiorari. 359 U.S. 905.

In affirming the judgment of the District Court, the Court of Appeals stated that the nature and extent of the general contractors' property rights, to which the tax lien attached must be ascertained under state law. The court then undertook an extensive analysis of the relevant North Carolina statutes [3] and cases. It found that the North Carolina law provides as follows: Subcontractors who have not been paid by the general contractor have a direct, independent cause of action against the owner to the extent of any amount due under the general construction contract, and any money owed by the owner under the

[1] Section 6321. Lien for taxes:
"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, 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."

[2] Section 6322. Period of lien:
"Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time."

[3] N.C. Gen. Stat., 1950, secs 44-6 to 44-12.

construction contract must first be used to satisfy subcontractors' claims of which the owner has notice. Moreover, to insure that the owner will receive notice of outstanding subcontractors' claims, the North Carolina statute, N.C. Gen. Stat., 1950, section 44–8, requires the general contractor, before receiving any payment, to furnish the owner with a statement of all sums due subcontractors, and if the general contractor fails to supply the required statement, he is guilty of a misdemeanor. N.C. Gen. Stat. 1950, section 44–12. Finally, the court found further evidence of the direct and independent nature of the subcontractors' claims against the owner in N.C. Gen. Stat., 1950, section 44–9, which provides that should the owner pay the general contractor after receiving notice of a subcontractor's claim, he will nevertheless be liable to the subcontractor to the extent of the amount which was due under the construction contract at the time notice was received.

Based upon these considerations, the Court of Appeals held that, under North Carolina law, the general contractor did not have a property interest in the face amount, as such, of the general construction contract. Specifically, the court said that "except to the extent the claim of the general contractor exceeds the aggregate of the claims of the subcontractors, the general contractor has no right which is subject to seizure under the tax lien." *Id.*, at 574. Therefore, concluded the court, since under North Carolina law the taxpayers possessed merely a right to the residue of the funds, and since the Government's tax lien attached to the property interests of the taxpayers as defined by state law, the Government can recover only "so much of the construction price as will remain unpaid after the owners have deducted a sum sufficient to pay the subcontractors." *Id.*, at 575.

The Court of Appeals was correct in asserting that the Government's tax lien attached to the taxpayers' property interests in the fund as defined by North Carolina law. *Aquilino* v. *United States*, pp. 509, 513[4] [Ct. D. 1856, page 477, this Bulletin]; [4] *Bess* v. *United States*, 357 U.S. 51, 55 [Ct. D. 1829, C.B. 1958–2, 934]; cf. *Morgan* v. *Commissioner*, 309 U.S. 78, 82 [Ct. D. 1441, C.B. 1940–1, 229]. It is suggested that the courts of North Carolina have never specifically described the nature of the property rights created by the North Carolina statutes involved in this case, and that the Court of Appeals interpretation of those statutes is probably incorrect. However, where "the precise issue of state law involved * * * is one which has not been decided by the * * * [state] courts," this Court has said that, "in dealing with issues of state law that enter into judgments of federal courts, we are hesitant to overrule decisions by federal courts skilled in the law of particular states unless their conclusions are shown to be unreasonable." *Propper* v. *Clark*, 337 U.S. 472, 486–487. Since the Court of Appeals is much closer to North Carolina law than we are, and since we cannot say that the court's characterization of the taxpayers' property interests under that law is clearly erroneous or unreasonable,[5] the judgment is

Affirmed.

MR. JUSTICE HARLAN, whom MR. JUSTICE BLACK joins, dissenting, in a separate opinion.

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[4] This case points up the distinction we drew in *Aquilino*. The facts here show how it simply begs the question to suggest that the principle of the lien-priority cases is somehow subverted or evaded by recognizing that what constitutes the taxpayer's property in the first place is a question of state law. The facts show, too, that it does not promote clarity to substitute, for the property interests created by state law, a rule of federal property law, the main feature of which seems to be an inquiry into what the consequences would be if state law were different from what it in fact is. It is said that we should regard the subcontractor's interest as equivalent to a lien on the general contractor's claim against the owner, overlooking the fact that the law of North Carolina, as interpreted by the Court of Appeals, indicates that there is no such claim. If we are to equate the subcontractor's interest with something it is not, it would be much more appropriate, in terms of similarity, to equate it with the usual mechanic's lien of a subcontractor on the owner's property being improved—which of course is not the general contractor's property, and which could not be taken by the United States under a lien against the general contractor. This only points up the lack of precision and content in the proposed federal definition of property. See also *Fidelity & Deposit Co. of Md.* v. *New York City Housing Auth.*, 241 F. 2d 142 (C.A. 2d Cir.), cited with approval in *Bess* v. *United States*, 357 U.S. 51, 55 [Ct. D. 1829, C.B. 1958–2, 934].

[5] See *Sims* v. *United States*, 359 U.S. 108, 114 [Ct. D. 1837, C.B. 1959–1, 636]; *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U.S. 530, 534; *Estate of Speigel* v. *Commissioner*, 335 U.S. 701, 707–708.

SECTION 6323.—VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

26 CFR 301.6323–1: Validity of lien against mortgagees, pledgees, purchasers, and judgment creditors — Rev. Rul. 60–350[1]

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Fifth Circuit in *Campbell* v. *Lema P. Bagley*, 276 Fed. (2d) 28.

The taxpayer in this case owned a drilling rig which was located in Winn Parish, Louisiana. Taxpayer lived in Harrison County, Texas, and a notice of Federal tax lien was filed in that county. The Government contended that since the rig was personalty, it had its situs at the owner's domicile in Texas.

The court held, among other things, that the filing of the notice of Federal tax lien at the domicile of the taxpayer was not effective as to tangible personal property physically located in another state.

In so doing, the Court of Appeals distinguished its holding in *Grand Prairie State Bank* v. *United States*, 206 Fed. (2d) 217, where it held that a notice of Federal tax lien filed at the domicile of the taxpayer was effective with respect to two diamond rings owned by the taxpayer, but which were physically located at a place other than his domicile. The court in *Bagley* stated that the *Grand Prairie State Bank* rationale applied only to personalty which was readily movable or capable of being secreted.

Accordingly, in appropriate cases, the Service will continue to regard the filing of a notice of Federal tax lien at the taxpayer's domicile as effective with respect to all of his personal property, wherever located.

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER A.—PROCEDURE IN GENERAL

SECTION 6402.—AUTHORITY TO MAKE CREDITS OR REFUNDS

26 CFR 31.6402(a): Statutory provisions; authority to make credits or refunds.

Regulations under the Internal Revenue Code of 1954 relating to credits or refunds with respect to overpayments of certain employment taxes. See T.D. 6472, page 351.

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[1] Based on Technical Information Release 260, dated October 17, 1960.

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6416.—CERTAIN TAXES ON SALES AND SERVICES

Rev. Rul. 60–360

If the manufacturers excise tax has been paid on tires which were sold by the tire manufacturer directly to a motor vehicle manufacturer and if the motor vehicle manufacturer sold these tires on or in connection with motor vehicles sold for export, any claim for credit or refund of the tax paid on the tires must be filed by the motor vehicle manuafcturer rather than by the tire manufacturer. The claim must contain a statement that documentary proof of exportation has been obtained. either by the claimant or by the ultimate vendor in the United States (if other than the claimant), and the claim must indicate where this proof of exportation is readily available for inspection by Government officers.

Advice has been requested concerning the filing of claims for credit or refund of the manufacturers excise tax on tires under the circumstances decribed below, particularly with respect to any requirements for documentary proof of exportation.

A tire manufacturer sells tires directly to various manufacturers of motor vehicles. The tire manufacturer pays the manufacturers excise tax imposed upon these sales by section 4071 of the Internal Revenue Code of 1954. The tires are installed on and sold with motor vehicles by the vehicle manufacturers. Some of these vehicles are sold for export by the vehicle manufacturers. Questions have arisen concerning claims for credit or refund of the tax paid with respect to the tires which are sold on or in connection with the exported motor vehicles, as follows:

Question (1): Should the claims for credit or refund be filed by the tire manufacturer or by the motor vehicle manufacturers?

Question (2): Is it necessary that documentary proof of actual exportation be submitted with the return on which the credit is claimed or with Form 843, Claim, on which the refund is claimed, or is it sufficient to submit a statement that the articles have been exported?

In accordance with section 6416(b)(3)(C) of the Code, insofar as material here, if the manufacturers excise tax imposed by section 4071 of the Code has been paid with respect to the sale of a tire by the manufacturer, producer, or importer thereof to a second manufacturer or producer, such tax shall be deemed to be an overpayment by such second manufacturer or producer if the tire is sold by the second manufacturer or producer on or in connection with, or with the sale of, any other article manufactured or produced by him and such other article is by any person exported.

In the case of a tire *resold* for use in the manner described in the paragraph above, if the other article is by any person exported in the manner described, the tax paid by the tire manufacturer is deemed to be an overpayment under the provisions of section 6416(b)(2)(F) of the Code.

Under the provisions of section 316.26 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2,

47, exportation may be evidenced by (1) a copy of the export bill of lading issued by the delivering carrier, or (2) a certificate by the agent or representative of the export carrier showing actual exportation of the article, or (3) a certificate of lading signed by a customs officer of the foreign country to which the article is exported, or (4) where such foreign country has no customs administration, a statement of the foreign consignee showing receipt of the article.

The answer to question (1), that is, whether the claims should be filed by the tire manufacturer or by the motor vehicle manufacturer, depends upon whether the tires were sold by the tire manufacturer directly to the motor vehicle manufacturers without intervening dealers. If the tires were sold directly to the motor vehicle manufacturers, the motor vehicle manufacturers are entitled to file the claims for credit or refund under the provisions of section 6416(b)(3)(C) of the Code. On the other hand, if there was an intervening dealer between the tire manufacturer and a motor vehicle manufacturer, the tire manufacturer is entitled to file the claim under the provisions of section 6416(b)(2)(F) of the Code. In either case, prior notice of intent to export the tires is no longer required as a condition precedent to the allowance of a credit or refund of the tax paid with respect to the tires, since the provisions of section 6416(g) of the Code do not apply to tires. Moreover, the amount of the tax may be refunded to the exporter or shipper provided a waiver is obtained under the provisions of section 6416(e) of the Code.

Accordingly, under the circumstances in this case in which the tires were sold directly without intervening dealers, it is held that the motor vehicle manufacturers, rather than the tire manufacturer, are entitled to file the claims for credit or refund.

In filing a claim for credit or refund on the grounds of exportation, the claimant must be able to support his claim with proof of exportation. Therefore, it is further held, with respect to question (2) in the instant case, that proof of exportation of the tires is required. This proof of exportation must be in the form described in the regulations or in comparable documentary form. Although it is not required that the proof of exportation be submitted with the return on which the credit is claimed or with the Form 843 on which the refund is claimed, the claim must contain a statement that such proof of exportation has in fact been obtained, and the claim must also indicate where this proof is readily available for inspection by Government officers.

If the claimant is the exporter of the articles, he must have the proof of exportation in his possession. Or, if the claimant is not the exporter of the articles, he must have in his possession either the proof of exportation or a statement from the ultimate vendor in the United States (if other than the claimant) showing that such ultimate vendor has the proof of exportation in his possession. The statement also must specify the nature of the proof of exportation and the location at which it is available for examination.

SECTION 6421.—GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS

26 CFR 48.6421(a)–1: Payments to ultimate purchasers of gasoline used for certain nonhighway purposes. Rev. Rul. 60–357

Newly produced highway vehicles on which the manufacturer displays "manufacturer's plates" for the purpose of operating the vehicles over the highways are considered to be registered for highway use within the meaning of section 6421(a) of the Internal Revenue Code of 1954. Therefore, the gasoline used in operating these vehicles over the highways does not qualify for the payment authorized by that section of the Code with respect to certain nonhighway uses of gasoline. However, where the vehicle code of a State does not require the manufacturer to comply with any form of registration, such as obtaining and displaying "manufacturer's plates," for the purpose of testing the vehicles on private test sites, the vehicles are not considered to be registered, or required to be registered, for highway use while operated on the test sites. Therefore, gasoline used in testing the vehicles at the test sites, under such circumstances, qualifies for the payment authorized by section 6421(a) of the Code.

Advice has been requested whether the payment authorized by section 6421(a) of the Internal Revenue Code of 1954 with respect to certain nonhighway uses of gasoline may be made under the circumstances described below.

Various automobile manufacturers operate private vehicle test sites at some distance from the factories where the vehicles are produced. For the purpose of operating these vehicles over the highways, the manufacturers generally obtain and display "manufacturer's plates" on the vehicles. Generally, these "manufacturer's plates" are not required to be displayed on the vehicles when they are operated on the private test sites.

The vehicle codes of the several states in which these vehicles are operated provide (1) that such motor vehicles may be operated by the manufacturer without registration, if manufacturer's plates are displayed on them; (2) that the manufacturer or the manufacturer's place of business is required to be registered, although the individual vehicles are not required to be registered; or (3) that such motor vehicles are regarded as registered under the general number or mark assigned to the manufacturer.

Section 6421(a) of the Code provides, in part, that if gasoline is used otherwise than as a fuel in a highway vehicle which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any State or foreign country, the Secretary of the Treasury or his delegate shall pay (without interest) to the ultimate purchaser of such gasoline an amount equal to one cent for each gallon of gasoline so used on which tax was paid at the rate of three cents a gallon and two cents for each gallon of gasoline so used on which tax was paid at the rate of four cents a gallon.

With respect to registration for highway use, section 48.6421(a)–1(b) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, that any highway vehicle which is operated under a dealer's tag, license, or permit is considered to be registered.

The above provision of the regulations furnishes an example, which is not intended to be all-inclusive, of a situation wherein a highway vehicle is considered to be registered, irrespective of variations in the provisions of State laws. Furthermore, in view of the number of vehicles operated on the highways by automobile manufacturers, the various State laws relating to the registration of motor vehicles provide for what may be regarded as a general registration of such vehicles.

Accordingly, newly produced highway vehicles which are operated over highways by the manufacturer in the manner described above are considered to be registered for highway use within the meaning of section 6421(a) of the Code. Therefore, it is held that the gasoline used in operating these vehicles over the highways does not qualify for the payment authorized by that section of the Code with respect to certain nonhighway uses of gasoline. However, where the vehicle code of a state does not require the manufacturer to comply with any form of registration, such as obtaining and displaying "manufacturer's plates," for the purpose of testing the vehicles on the private test sites, the vehicles are not considered to be registered, or required to be registered for highway use while operated on the test sites. Therefore, gasoline used in testing the vehicles at the test sites, under such circumstances, is used otherwise than as a fuel in a highway vehicle which is registered or required to be registered for highway use; accordingly, such gasoline qualifies for the payment authorized by section 6421(a) of the Code.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER A.—LIMITATIONS ON ASSESSMENT AND COLLECTION

SECTION 6501.—LIMITATIONS ON ASSESSMENT AND COLLECTION

26 CFR 301.6501(c)–1: Exceptions to general period of limitations on assessment and collection. Rev. Rul. 60–312

> Where a person who files Form 720, Quarterly Federal Excise Tax Return, writes the word "none" across the length of the form or in the upper summary portion of the form in such a manner that it clearly indicates a positive denial of liability for all categories of the excise taxes listed on the form, a return is considered to have been filed, for purposes of the period of limitations prescribed by section 6501 of the Internal Revenue Code of 1954, for all the categories of excise taxes listed on the form.
>
> Revenue Ruling 59–366, C.B. 1959–2, 418, amplified.

The Internal Revenue Service has been asked whether, for purposes of the period of limitations prescribed by section 6501 of the Internal Revenue Code of 1954, a return is considered to have been filed, under the circumstances described below, for all of the categories of excise taxes listed on Form 720, Quarterly Federal Excise Tax Return.

A person filed a Form 720 on which the word "none" had been written across the length of the form, thereby indicating no liability

for the return period but not stating for which category of tax the return was intended. Another person filed a Form 720 on which the word "none" was written in the upper summary portion of the form (Items 1 through 5) in such a way as to indicate no liability, but no entry was made in the portion of the form which lists various categories of excise taxes.

Section 6501(a) of the Code provides the general rule that the amount of any tax imposed by the Code shall be assessed within three years after the return was filed (whether or not such return was filed on or after the date prescribed), and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period. However, section 6501(c) of the Code provides that the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time, (1) in the case of a false or fraudulent return with intent to evade tax, (2) in the case of a willful attempt in any manner to defeat or evade certain taxes, or (3) in the case of failure to file a return.

As an amplification of Revenue Ruling 58–274, C.B. 1958–1, 495, it has been held in Revenue Ruling 59–366, C.B. 1959–2, 418, that where a person files a Form 720 on which he reports one or more categories of tax, but makes no entry on the return concerning any other category, he has filed no return for the category of tax for which no entry was made. In effect, a blank space opposite a category of excise tax on Form 720, even though due to oversight or to incompletion of the form, will not be considered as a return for that category.

However, Revenue Ruling 59–366 further holds that where a person enters on any line of Form 720 the word "none," a "zero," or some other comparable entry clearly indicating a denial of liability for a category of tax, such entry constitutes the filing of a return for the category of excise tax to which that line relates. Therefore, with respect to that category of tax, the period of limitations prescribed by section 6501 of the Code starts to run from the date the return is filed.

Where, as in the instant case, a person who files Form 720 writes the word "none" across the length of the form or in the upper summary portion of the form in such a manner that it clearly indicates a positive denial of liability for all categories of the excise taxes listed on the form, that action is considered to be tantamount to writing the word "none" on each line. Accordingly, for purposes of the exception provided by section 6501(c)(3) of the Code to the period of limitations prescribed by section 6501(a) of the Code, a return is considered to have been filed by that person for all of the categories of excise taxes listed on the form.

Therefore, with respect to the person submitting the Form 720 under those circumstances, the amount of any tax which should have been reported on the return for that reporting period must be assessed within three years after the return was filed, unless one of the exceptions provided by section 6501(c) (1) and (2) of the Code is applicable in a particular situation. However, compare Revenue Ruling 59–127, C.B. 1959–1, 656, which relates to the applicability of the period of limitations to persons upon whom the so-called "collected" excise taxes are imposed.

Revenue Ruling 59–366 is hereby amplified.

SUBCHAPTER B.—LIMITATIONS ON CREDIT OR REFUND

SECTION 6511.—LIMITATIONS ON CREDIT OR REFUND

26 CFR 301.6511(d): Statutory provisions; limitations on credit or refund; special rules applicable to income taxes. T. D. 6488[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Extension of period for filing claims for credit or refund of overpayments of income taxes arising as a result of renegotiation of Government contracts.

DEPARTMENT OF THE TREASURY,
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 the Regulations on Procedure and Administration (26 CFR Part 301) to section 1(a) of the Act of September 16, 1959 (Public Law 86-280, 73 Stat. 563) [C.B. 1959-2, 689], the regulations are amended as follows:

PARAGRAPH 1. Section 301.6511(d), as amended by Treasury Decision 6425, approved November 5, 1959 [C.B. 1959-2, 384], is further amended to read as follows:

§ 301.6511(d) STATUTORY PROVISIONS; LIMITATIONS ON CREDIT OR REFUND; SPECIAL RULES APPLICABLE TO INCOME TAXES.

SEC. 6511. LIMITATIONS ON CREDIT OR REFUND. * * *

(d) SPECIAL RULES APPLICABLE TO INCOME TAXES. * * *

(2) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO NET OPERATING LOSS CARRYBACKS.—

(A) PERIOD OF LIMITATION.—If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month (or 39th month, in the case of a corporation) following the end of the taxable year of the net operating loss which results in such carryback, or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later; except that, with respect to an overpayment attributable to the creation of or an increase in a net operating loss carryback as a result of the elimination of excessive profits by a renegotiation (as defined in section 1481(a)(1)(A)), the period shall not expire before September 1, 1959, or the expiration of the twelfth month following the month in which the agreement or order for the elimination of such excessive profits becomes final, whichever is the later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to such carryback.

* * * * * * *

[Sec. 6511(d) as amended by sec. 82(d), Technical Amendments Act 1958 (72 Stat. 1663) [P.L. 85-866, C.B. 1958-3, 254]; sec. 1(a), Act of Sept. 16, 1959 (Pub. Law 86-280, 73 Stat. 563) [C.B. 1959-2, 689]]

[1] 25 F.R. 7738.

PAR. 2. Section 301.6511(d)-2, as amended by Treasury Decision 6425, approved November 5, 1959, is further amended to read as follows:

§ 301.6511(d)-2 OVERPAYMENT OF INCOME TAX ON ACCOUNT OF NET OPERATING LOSS CARRYBACKS.—(a) *Special period of limitation.*—(1) If the claim for credit or refund relates to an overpayment of income tax attributable to a net operating loss carryback, provided in section 172(b), then in lieu of the 3-year period from the time the return was filed in which the claim may be filed or credit or refund allowed, as prescribed in section 6511 (a) or (b), the period shall be whichever of the following 2 periods expires later:

(i) The period which ends with the expiration of the fifteenth day of the fortieth month (or thirty-ninth month, in the case of a corporation) following the end of the taxable year of the net operating loss which resulted in the carryback; or

(ii) The period which ends with the expiration of the period prescribed in section 6511(c) within which a claim for credit or refund may be filed with respect to the taxable year of the net operating loss which resulted in the carryback;

except that, with respect to an overpayment attributable to the creation of or an increase in a net operating loss carryback as a result of the elimination of excessive profits by a renegotiation (as defined in section 1481(a)(1)(A)), the period shall not expire before September 1, 1959, or the expiration of the twelfth month following the month in which the agreement or order for the elimination of such excessive profits becomes final, whichever is the later.

* * * * * * *

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

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved August 9, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 12, 1960, 8:51 a.m., and published in the issue of the Federal Register for August 13, 1960, 25 F.R. 7738)

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSION OF TIME FOR PAYMENT, OF TAX

26 CFR 301.6601-1: Interest on underpayment.

Guides and instruction for the computation of restricted interest. See Rev. Proc. 60-17, page 942.

SUBCHAPTER B.—INTEREST ON OVERPAYMENTS

SECTION 6611.—INTEREST ON OVERPAYMENTS

26 CFR 301.6611–1: Interest on overpayments.

Guides and instructions for computation of restricted interest. See See Rev. Proc. 60–17, page 942.

CHAPTER 68.—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

SUBCHAPTER B.—ASSESSABLE PENALTIES

SECTION 6674.—FRAUDULENT STATEMENT OR FAILURE TO FURNISH STATEMENT TO EMPLOYEE

26 CFR 31.6674: Statutory provisions; fraudulent statement or failure to furnish statement to employee.

Regulations under the Internal Revenue Code of 1954 relating to penalties for furnishing fraudulent, or failure to furnish, employee statements with respect to certain employment taxes. See T.D. 6472, page 351.

CHAPTER 70.—JEOPARDY, BANKRUPTCY AND RECEIVERSHIPS

SUBCHAPTER A.—JEOPARDY

PART I.—TERMINATION OF TAXABLE YEAR

SECTION 6851.—TERMINATION OF TAXABLE YEAR

26 CFR 1.6851–2: Certificates of compliance with income tax laws by departing aliens.

Simplified procedures for obtaining Certificates of Compliance by certain aliens departing from the United States. See Rev. Proc. 60–35, page 1014.

CHAPTER 74.—CLOSING AGREEMENTS AND COMPROMISES

SECTION 7121.—CLOSING AGREEMENTS

26 CFR 301.7121–1: Closing agreements.

Finality with respect to an agreement entered into between a taxpayer and the Commissioner of Internal Revenue as a determination

of the taxpayer's liability for personal holding company tax under section 547 of the Code. See Rev. Rul. 60–287, page 188.

SECTION 7122.—COMPROMISES

26 CFR 301.7122–1: Compromises.

Jurisdiction of District Directors of Internal Revenue and Regional Counsel with respect to the processing and disposition of certain offers to compromise liabilities under $25,000 and certain specific penalties. See Rev. Proc. 60–22, page 942.

CHAPTER 75.—CRIMES, OTHER OFFENSES, AND FORFEITURES

SUBCHAPTER C.—FORFEITURES

PART II.—PROVISIONS COMMON TO FORFEITURES

SECTION 7325.—PERSONAL PROPERTY VALUED AT $2,500 OR LESS

26 CFR 172.9: Commercial crimes. T.D. 6482 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 172.—DISPOSITION OF SEIZED PERSONAL PROPERTY

Miscellaneous amendments

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

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

On May 11, 1960, a notice of proposed rulemaking to amend 26 CFR Part 172, with respect to the disposition of seized personal property, was published in the Federal Register (25 F.R. 4182).

In accordance with the notice, interested persons were afforded an opportunity to submit written data, views, or arguments pertaining thereto. No comments or objections having been received, the following amendments are hereby adopted.

In order to implement and set forth the policy of the Treasury Department in regard to the action taken on petitions for remission or mitigation of forfeitures, 26 CFR Part 172 is amended as follows:

[1] The publications of this Treasury Decision in 25 F.R. 6756, dated July 16, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 4182, dated May 11, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations. The individual instructions have been omitted.

§ 172.9 [Amendment]

PARAGRAPH 1. Section 172.9 is amended by adding the following new sentence to the end thereof:

Addiction to narcotic drugs and use of marihuana will be treated as if such were commercial crime.

§ 172.16 [Amendment]

PAR. 2. Section 172.16 is amended by changing the section to read as follows:

§ 172.16 EQUITY.—The term "equity", as used in administrative action on petitions for remission or mitigation of forfeitures, shall mean that interest which a petitioner has in the personal property or carrier petitioned for at the time of final administrative action on the petition, but such interest shall not be considered to include any unearned finance charges from the date of seizure or the date of default, if later; any amount rebatable on account of paid insurance premiums; attorney's fees for collection; any amount identified as dealers's reserve; or any amount in the nature of liquidated damages that may have been agreed upon by the buyer and the petitioner.

§ 172.26 [Amendment]

PAR. 3. Section 172.26 is amended by changing the section to read as follows:

§ 172.26 FORFEITURE OF SEIZED PERSONAL PROPERTY.—(a) *Administrative forfeiture.*—(1) Personal property seized as subject to forfeiture under the internal revenue laws which has an appraised value of $2,500.00 or less, any carrier appraised by the seizing officer at $2,500.00 or less under the custom laws shall be forfeited to the United States in administrative or summary forfeiture proceedings.

(2) In respect of personal property seized as subject to forfeiture under the internal revenue laws which, in the opinion of the seizing officer, has an appraised value of $2,500.00 or less, such officer shall cause a list containing a particular description of the seized property to be prepared in duplicate, and an appraisement thereof to be made by three sworn appraisers, selected by the seizing officer, who shall be respectable and disinterested citizens of the United States residing within the internal revenue district wherein the seizure was made. Such list and appraisement shall be properly attested to by the seizing officer and such appraisers.

(3) In respect of personal property seized as subject to forfeiture under the internal revenue laws and found by the appraisers to have a value of $2,500.00 or less, the Supervisor in Charge shall publish a notice once a week for three consecutive weeks, in some newspaper of the judicial district where the seizure was made, describing the articles and stating the time, place, and cause of their seizure, and requiring any person claiming them to appear and make such claim within 30 days from the date of the first publication of such notice.

(4) In respect of carriers seized as subject to forfeiture under the provisions of the custom laws and appraised by the seizing officer as having a value of $2,500.00 or less, the Supervisor in Charge shall publish notice of seizure in the same manner as required by (3) above; provided that the time for making claim shall be within 20 days from the date of first publication.

(5) Any person claiming the personal property or carrier so seized, within the time specified in the notice, may file with the Supervisor in Charge a claim, stating his interest in the articles seized, and may execute a bond to the United States in the penal sum of $250.00, conditioned that, in case of condemnation of the articles so seized, the obligors shall pay all the costs and expenses of the proceedings to obtain such condemnation. Both the claim and the cost bond should be executed in quadruplicate.

(b) *Judicial condemnation.*—(1) The Assistant Regional Commissioner or the Supervisor in Charge shall authorize the United States Attorney to institute libel proceedings in those instances where the appraised value of the seized personal property or carrier exceeds $2,500.00, or where a claim and cost bond are filled as provided above.

§ 172.38 [Amendment]

PAR. 4. Section 172.38 is amended by changing the section to read as follows:

§ 172.38 CONTENTS OF THE PETITION.—(a) *Description of property.*—The petition should contain such a description of the property and such facts of the seizure as will enable the officers of the Internal Revenue Service concerned to identify the property.

(b) *Statement regarding knowledge of seizure.*—In the event the petition is filed for the restoration of the proceeds derived from sale of the property pursuant to summary forfeiture, it should also contain, or be supported by, satisfactory proof that the petitioner did not know of the seizure prior to the declaration or condemnation of forfeiture, and that he was in such circumstances as prevented him from knowing of the same. (See also § 172.39.)

(c) *Interest of petitioner.*—The petition should state in clear and concise terms the nature and amount of the present interest of the petitioner in the property, and the facts relied upon to show that the forfeiture was incurred without willful negligence or without any intention upon the part of the petitioner to defraud the revenue or to violate the law, or such other mitigating circumstances as, in the opinion of the petitioner, would justify the remission or mitigation of the forfeiture.

(d) *Petitioner innocent party.*—If the petitioner is not the one who in person committed the act which caused the seizure, the petition should state how the property came into the possession of such other person, and that the petitioner had no knowledge or reason to believe, if such be the fact, that the property would be used in violation of law.

(e) *Results of investigation.*—The petition should also state what investigation, if any, was made of such other person, through principal Federal, State, or local law enforcement officers, to determine whether such other person had either a record or a reputation, or both, as a liquor law violator in a case involving a seizure for violation of the internal revenue laws relating to liquor; or as a violator in the field of commercial crime in all other types of seizures. The petition should further state the information obtained from said investigation, and whether such information was received before the petitioner acquired his interest in the property, or such other person acquired his right in the property, whichever ocurred later.

(f) *Documents supporting claim.*—The petition should also be accompanied by copies, certified by the petitioner under oath as correct, of contracts, bills of sale, chattel mortgages, reports of investigators or credit reporting agencies, affidavits, and any other papers or documents that would tend to support the claims made in the petition.

(g) *Costs.*—The petition should also contain an undertaking to pay the costs, if costs are assessed as a condition of allowance of the petition. Costs shall include all the expenses incurred in seizing and storing the property; the costs borne or to be borne by the United States; the taxes, if any, payable by the petitioner or imposed in respect of the property to which the petition relates; the penalty, if any, asserted by the Director, Alcohol and Tobacco Tax Division; and, if the property has been sold, or is in the course of being sold, the expenses so incurred.

§ 172.39 [Amendment]

4(a). Section 172.39 is amended by changing "§ 172.38(c)" in the first sentence to read "§ 172.38(b)."

PAR. 5. Section 172.41 is amended by changing the section to read as follows:

§ 172.41 DISCONTINUANCE OF ADMINISTRATIVE PROCEEDINGS.—If the petition is filed prior to administrative sale or retention for official use, proceedings to effect such sale or retention will be discontinued.

§ 172.43 [Amendment]

PAR. 6. Section 172.43 is amended by changing the section to read as follows:

§ 172.43 FINAL ACTION.—(a) *Petitions for remission or mitigation of forfeiture.*—(1) The Director, Alcohol and Tobacco Tax Division, shall take final action on any petition filed pursuant to these regulations. Such final action shall consist either of the allowance or denial of the petition. In the case of allowance, the Director shall state the conditions of the allowance.

(2) In the case of an allowed petition, the Director, Alcohol and Tobacco Tax Division, may order the property returned to the petitioner, sold for the account of the petitioner, or, pursuant to agreement, acquired for official use.

(3) The Assistant Regional Commissioner shall notify the petitioner of the allowance or denial of the petition and, in the case of allowance, the conditions under which the Director, Alcohol and Tobacco Tax Division, allowed the petition.

(b) *Offers in compromise of liability to forfeiture.*—(1) The Director, Alcohol and Tobacco Tax Division, shall take final action on any offer in compromise of the liability to forfeiture of personal property seized as provided in section 172.25. Such action shall consist either of the acceptance or rejection of the offer.

(2) The Assistant Regional Commissioner shall notify the proponent of the acceptance or rejection of the offer.

§ 172.44 [Amendment]

PAR. 7. Section 172.44 is amended to read as follows:

§ 172.44 ACQUISITION FOR OFFICIAL USE AND SALE FOR ACCOUNT OF PETITIONER IN ALLOWED PETITIONS.—(a) *Acquisition for official use.*—(1) The property may be purchased by the United States pursuant to agreement and retained for official use. Where the petitioner is the owner, the purchase price is the appraised value of the property less all costs. Where the petitioner is a creditor, the purchase price is whichever one of these amounts is the smaller: (1) the petitioner's equity, or (2) the appraised value of the property less the amount of all costs.

(b) *Sale for account of petitioner.*—(1) The petitioner may elect not to comply with the condition on which the property may be returned. In this event, the Supervisor in Charge is authorized to sell it. Where the petitioner is the owner of the property, there is deducted from the proceeds of the sale all costs, and the Regional Commissioner pays to the petitioner, out of the proper appropriation, an amount equal to the balance, if any. Where the petitioner is a creditor, there is deducted from the proceeds of the sale all costs, and the Regional Commissioner pays to the petitioner, out of the proper appropriation, an amount equal to the balance, if any; *provided* that if that amount exceeds the amount of the equity, only the latter amount is paid to the petitioner.

§ 172.55 [Amendment]

PAR. 8. Section 172.55 is amended by substituting, in the first sentence, the phrase "in the judicial district" for the phrase "in the internal revenue collection district."

This Treasury Decision shall become effective 30 days after the date of its publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in 68A Stat. 917, 62 Stat. 761, as amended; 52 Stat. 1252, 53 Stat. 1292; 26 U.S.C. 7805, 18 U.S.C. 1261, 15 U.S.C. 907, 49 U.S.C. 788.

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved July 12, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 15, 1960, 8:51 a.m., and published in the issue of the Federal Register for July 16, 1960, 25 F.R. 6756)

CHAPTER 76.—JUDICIAL PROCEEDINGS

SUBCHAPTER A.—CIVIL ACTIONS BY THE UNITED STATES

SECTION 7405.—ACTION FOR RECOVERY OF ERRONEOUS REFUNDS

(Also Section 613.) Rev. Rul. 60–375 [1]

The Internal Revenue Service will proceed to institute suits under the provisions of section 7405 of the Internal Revenue Code of 1954 to recover refunds from taxpayers mining calcium carbonates or other minerals used by them in making cement where the following three conditions exist:

(1) Refunds based upon percentage depletion deductions have been made to such taxpayers by the Service;

(2) The bases of such refunds are inconsistent with the principles enunciated in the recent decision of the Supreme Court of the United States in *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76 (1960), Ct. D. 1849, page 452, this Bulletin; and

(3) Such taxpayers did not make an election under section 4 of Public Law 86–781, page 726, this Bulletin.

Revenue Ruling 60–320, page 198, this Bulletin, supplemented.

CHAPTER 77.—MISCELLANEOUS PROVISIONS

SECTION 7503.—TIME FOR PERFORMANCE OF ACTS WHERE LAST DAY FALLS ON SATURDAY, SUNDAY, OR LEGAL HOLIDAY

26 CFR 1.7503–1: Time for performance of acts where last day falls on Saturday, Sunday, or legal holiday.

Time for filing of return where filing date falls on Good Friday. See Rev. Proc. 60–29, page 1008.

CHAPTER 78.—DISCOVERY OF LIABILITY AND ENFORCEMENT OF TITLE

SUBCHAPTER D.—POSSESSIONS

SECTION 7651.—ADMINISTRATION AND COLLECTION OF TAXES IN POSSESSIONS

(Also Section 911; 26 CFR 1.911–1.) Rev. Rul. 60–291

For taxable years for which income tax returns are due on or after July 22, 1954, citizens of the United States who are inhabi-

[1] Based on Technical Information Release 267, dated November 9, 1960.

tants of the Virgin Islands, as defined in section 28(a) of the Revised Organic Act of the Virgin Islands, are required to satisfy their income tax obligations to the United States under the applicable taxing statutes of the United States by filing their returns with the taxing authority of the Virgin Islands and paying into the treasury of the Virgin Islands their tax on income derived from all sources, both within and without the Virgin Islands.

Advice has been requested whether a United States citizen, domiciled in the Virgin Islands, is relieved of all income tax obligations to the United States with respect to his income from United States sources.

Section 28(a) of the Revised Organic Act of the Virgin Islands, 48 U.S.C. Supp. V. 1642, C.B. 1954–2, 595, provides, in part:

The proceeds of customs duties, the proceeds of the United States income tax, the proceeds of any taxes levied by the Congress on the inhabitants of the Virgin Islands, and the proceeds of all quarantine, passport, immigration, and naturalization fees collected in the Virgin Islands, less the cost of collecting all of said duties, taxes, and fees, shall be covered into the treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide: *Provided*, That the term "inhabitants of the Virgin Islands" as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands: * * *

The Revised Organic Act of the Virgin Islands was approved on July 22, 1954, and its provisions became generally operative as of such date. See section 34 of that Act, 48 U.S.C. Supp. V 1541. However, insofar as it is pertinent here, section 7651(5)(B) of the Internal Revenue Code of 1954 provides, "For the purposes of this title [Title 26], section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section had been enacted subsequent to the enactment of this title." It is clear, therefore, that section 28(a) of the Act was not revoked by the enactment of the 1954 Code.

Accordingly, although section 6151 of the Code requires, in general, that payments of Federal tax be made to the principal internal revenue officer for the internal revenue district in which the return is required to be filed and section 6091 of the Code requires, in general, that returns be filed in the district in which is located the residence or principal place of business of the taxpayer, by reason of section 28(a) of the Act inhabitants of the Virgin Islands are required to file their income tax returns due on or after July 22, 1954, with and pay their tax on income from all sources to the taxing authorities of the Virgin Islands.

Under the above provisions of the Act, the term "inhabitants of the Virgin Islands" includes all persons whose "permanent residence" is in the Virgin Islands. In determining whether an individual's "permanent residence" is in the Virgin Islands, the same tests are to be applied as are applied in determining whether a citizen of the United States is a "bona fide resident of a foreign country or countries" under section 911(a)(1) of the Code and section 1.911–1(a)(2) of the Income Tax Regulations. See section 871 of the Code which by reference is, to the extent applicable, made part of section 1.911–1(a)(2) of the regulations. Also, see Rev. Rul. 55–171, C.B. 1955–1, 80.

Accordingly, for taxable years for which income tax returns are due on or after July 22, 1954, United States citizens domiciled in the

Virgin Islands who qualify as inhabitants of the Virgin Islands, as defined in section 28(a) of the Revised Organic Act of the Virgin Islands, are required to satisfy their income tax obligations under the applicable taxing statutes of the United States by filing their returns with the taxing authorities of the Virgin Islands and paying into the treasury of the Virgin Islands their tax on income derived from all sources, both within and without the Virgin Islands. Status as an inhabitant of the Virgin Islands is determined as of the last day of the taxable year of the taxpayer.

CHAPTER 79.—DEFINITIONS

SECTION 7701.—DEFINITIONS

26 CFR 301.7701: Statutory provisions; definitions. T. D. 6503 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Regulations under chapter 79 of the Internal Revenue Code of 1954, relating to definitions.

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

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

On December 23, 1959, notice of proposed rulemaking with respect to the regulations under chapter 79 of the Internal Revenue Code of 1954, relating to definitions, was published in the Federal Register (24 F.R. 10450). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. Such regulations supersede paragraph 22 of Treasury Decision 6118 (19 F.R. 9896) [C.B. 1955–1, 698] approved December 30, 1954, as added by Treasury Decision 6208 (21 F.R. 8082) [C.B. 1956–2, 1369] approved October 16, 1956.

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AUTHORITY: §§ 301.7701 to 301.7701–11, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

[1] 25 F.R. 10928.

§ 301.7701 STATUTORY PROVISIONS; DEFINITIONS.

SEC. 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) PERSON.—The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

(2) PARTNERSHIP AND PARTNER.—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) CORPORATION.—The term "corporation" includes associations, joint-stock companies, and insurance companies.

(4) DOMESTIC.—The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or any State or Territory.

(5) FOREIGN.—The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(6) FIDUCIARY.—The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(7) STOCK.—The term "stock" includes shares in an association, joint-stock company, or insurance company.

(8) SHAREHOLDER.—The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

(9) UNITED STATES.—The term "United States" when used in a geographical sense includes only the States and the District of Columbia.

(10) STATE.—The term "State" shall be construed to include the District of Columbia, where such construction is necessary to carry out provisions of this title.

(11) SECRETARY.—The term "Secretary" means the Secretary of the Treasury.

(12) DELEGATE.—

(A) IN GENERAL.—The term "Secretary or his delegate" means the Secretary of the Treasury, or any officer, employee, or agency of the Treasury Department duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform the function mentioned or described in the context, and the term "or his delegate" when used in connection with any other official of the United States shall be similarly construed.

(B) PERFORMANCE OF CERTAIN FUNCTIONS IN GUAM OR AMERICAN SAMOA.—The term "delegate", in relation to the performance of functions in Guam or American Samoa with respect to the taxes imposed by chapters 2 and 21, also includes any officer or employee of any other department or agency of the United States, or of any possession thereof, duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform such functions.

(13) COMMISSIONER.—The term "Commissioner" means the Commissioner of Internal Revenue.

(14) TAXPAYER.—The term "taxpayer" means any person subject to any internal revenue tax.

(15) MILITARY OR NAVAL FORCES AND ARMED FORCES OF THE UNITED STATES.—The term "military or naval forces of the United States" and the term "Armed Forces of the United States" each includes all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and each term also includes the Coast

Guard. The members of such forces include commissioned officers and personnel below the grade of commissioned officers in such forces.

(16) WITHHOLDING AGENT.—The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of sections 1441, 1442, 1443, 1451, or 1461.

(17) HUSBAND AND WIFE.—As used in sections 71, 152(b)(4), 215, and 682, if the husband and wife therein referred to are divorced, wherever appropriate to the meaning of such sections, the term "wife" shall be read "former wife" and the term "husband" shall be read "former husband"; and, if the payments described in such sections are made by or on behalf of the wife or former wife to the husband instead of vice versa, wherever appropriate to the meaning of such sections, the term "husband" shall be read "wife" and the term "wife" shall be read "husband".

(18) INTERNATIONAL ORGANIZATION.—The term "international organization" means a public international organization entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act (22 U.S.C. 288–288f).

(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.

(20) EMPLOYEE.—For the purpose of applying the provisions of sections 104, 105, and 106 with respect to accident and health insurance or accident and health plans, for the purpose of applying the provisions of section 101(b) with respect to empolyees' death benefits, and for the purpose of applying the provisions of subtitle A with respect to contributions to or under a stock bonus, pension, profit-sharing, or annuity plan, and with respect to distributions under such a plan, or by a trust forming part of such a plan, the term "employee" shall include a full-time life insurance salesman who is considered an employee for the purpose of chapter 21, or in the case of services performed before January 1, 1951, who would be considered an employee if his services were performed during 1951.

(21) LEVY.—The term "levy" includes the power of distraint and seizure by any means.

(22) ATTORNEY GENERAL.—The term "Attorney General" means the Attorney General of the United States.

(23) TAXABLE YEAR.—The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the taxable income is computed under subtitle A. "Taxable year" means, in the case of a return made for a fractional part of a year under the provisions of subtitle A or under regulations prescribed by the Secretary or his delegate, the period for which such return is made.

(24) FISCAL YEAR.—The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December.

(25) PAID OR INCURRED, PAID OR ACCRUED.—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the taxable income is computed under subtitle A.

(26) TRADE OR BUSINESS.—The term "trade or business" includes the performance of the functions of a public office.

(27) TAX COURT.—The term "Tax Court" means the Tax Court of the United States.

(28) OTHER TERMS.—Any term used in this subtitle with respect to the application of, or in connection with, the provisions of any other subtitle of this title shall have the same meaning as in such provisions.

(29) INTERNAL REVENUE CODE.—The term "Internal Revenue Code of 1954" means this title, and the term "Internal Revenue

Code of 1939" means the Internal Revenue Code enacted February 10, 1939, as amended.

(b) INCLUDES AND INCLUDING.—The terms "includes" and "including" when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

(c) COMMONWEALTH OF PUERTO RICO.—Where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, references in this title to possessions of the United States shall be treated as also referring to the Commonwealth of Puerto Rico.

(d) CROSS REFERENCES.—

(1) OTHER DEFINITIONS.—For other definitions, see the following sections of Title 1 of the United States Code:

(1) Singular as including plural, section 1.
(2) Plural as including singular, section 1.
(3) Masculine as including feminine, section 1.
(4) Officer, section 1.
(5) Oath as including affirmation, section 1.
(6) County as including parish, section 2.
(7) Vessel as including all means of water transportation, section 3.
(8) Vehicle as including all means of land transportation, section 4.
(9) Company or association as including successors and assigns, section 5.

(2) EFFECT OF CROSS REFERENCES.—For effect of cross references in this title, see section 7806(a).

[Sec. 7701, as amended by sec. 22 (g), (h), Alaska Omnibus Act (73 Stat. 146, 147) [P.L. 86–70, C.B. 1959–2, 678]; sec. 18 (i), (j), Hawaii Omnibus Act (74 Stat. 416) [P.L. 86–624, page 686, this Bulletin]; sec. 103(t), Social Security Amendments 1960 (74 Stat. 941) [P.L. 86–778, page 693, this Bulletin]]

§ 301.7701–1 CLASSIFICATION OF ORGANIZATIONS FOR TAX PURPOSES.—(a) *Person.*—The term "person" includes an individual, a corporation, a partnership, a trust or estate, a joint-stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization or group. Such term also includes a guardian, committee, trustee, executor, administrator, trustee in bankruptcy, receiver, assignee for the benefit of creditors, conservator, or any person acting in a fiduciary capacity.

(b) *Standards.*—The Internal Revenue Code prescribes certain categories, or classes, into which various organizations fall for purposes of taxation. These categories, or classes, include associations (which are taxable as corporations), partnerships, and trusts. The tests, or standards, which are to be applied in determining the classification in which an organization belongs (whether it is an association, a partnership, a trust, or other taxable entity) are determined under the Internal Revenue Code. Sections 301.7701–2 through 301.7701–4 set forth these tests, or standards, which are to be applied in determining whether an organization is (1) an association (see § 301.7701–2), (2) a partnership (see § 301.7701–3), or (3) a trust (see § 301.7701–4).

(c) *Effect of local law.*—As indicated in paragraph (b) of this section, the classes into which organizations are to be placed for purposes of taxation are determined under the Internal Revenue Code. Thus, a particular organization might be classified as a trust under the law of one State and a corporation under the law of another State. However, for purposes of the Internal Revenue Code, this organization would be uniformly classed as a trust, an association (and, therefore,

taxable as a corporation), or some other entity, depending upon its nature under the classification standards of the Internal Revenue Code. Similarly, the term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. See § 1.761–1 of this chapter (Income Tax Regulations) and § 301.7701–3. The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, and an insurance company. Although it is the Internal Revenue Code rather than local law which establishes the tests or standards which will be applied in determining the classification in which an organization belongs, local law governs in determining whether the legal relationships which have been established in the formation of an organization are such that the standards are met. Thus, it is local law which must be applied in determining such matters as the legal relationships of the members of the organization among themselves and with the public at large, and the interests of the members of the organization in its assets.

§ 301.7701–2 Associations.—(a) *Characteristics of corporations.*—(1) The term "association" refers to an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than as another type of organization such as a partnership or a trust. There are a number of major characteristics ordinarily found in a pure corporation which, taken together, distinguish it from other organizations. These are: (i) Associates, (ii) an objective to carry on business and divide the gains therefrom, (iii) continuity of life, (iv) centralization of management, (v) liability for corporate debts limited to corporate property, and (vi) free transferability of interests. Whether a particular organization is to be classified as an association must be determined by taking into account the presence or absence of each of these corporate characteristics. The presence or absence of these characteristics will depend upon the facts in each individual case. In addition to the major characteristics set forth in this subparagraph, other factors may be found in some cases which may be significant in classifying an organization as an association, a partnership, or a trust. An organization will be treated as an association if the corporate characteristics are such that the organization more nearly resembles a corporation than a partnership or trust. See *Morrissey et al* v. *Commissioner* (1935) 296 U.S. 344 [Ct. D. 1064, C.B. XV–I, 264 (1936)].

(2) Since associates and an objective to carry on business for joint profit are essential characteristics of all organizations engaged in business for profit (other than the so-called one-man corporation and the sole proprietorship), the absence of either of these essential characteristics will cause an arrangement among co-owners of property for the development of such property for the separate profit of each not to be classified as an association. Some of the major characteristics of a corporation are common to trusts and corporations, and others are common to partnerships and corporations. Characteristics common to trusts and corporations and not material in attempting to distinguish between a trust and an association, and characteristics common to partnerships and corporations are not material in attempting to distinguish between an association and a partner-

ship. For example, since centralization of management, continuity of life, free transferability of interests, and limited liability are generally common to trusts and corporations, the determination of whether a trust which has such characteristics is to be treated for tax purposes as a trust or as an association depends on whether there are associates and an objective to carry on business and divide the gains therefrom. On the other hand, since associates and an objective to carry on business and divide the gains therefrom are generally common to both corporations and partnerships, the determination of whether an organization which has such characteristics is to be treated for tax purposes as a partnership or as an association depends on whether there exists centralization of management, continuity of life, free transferability of interests, and limited liability.

(3) An unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics. In determining whether an organization has more corporate characteristics than noncorporate characteristics, all characteristics common to both types of organizations shall not be considered. For example, if a limited partnership has centralized management and free transferability of interests but lacks continuity of life and limited liability, and if the limited partnership has no other characteristics which are significant in determining its classification, such limited partnership is not classified as an association. Although the limited partnership also has associates and an objective to carry on business and divide the gains therefrom, these characteristics are not considered because they are common to both corporations and partnerships.

(4) The rules of this section and §§ 301.7701–3 and 301.7701–4 are applicable only to taxable years beginning after December 31, 1960. However, for any taxable year beginning after December 31, 1960, but before October 1, 1961, any amendment of the agreement establishing the organization will, in the case of an organization in existence on November 17, 1960, be treated for purposes of determining the classification of the organization as being in effect as of the beginning of such taxable year (i) if the amendment of the agreement is made before October 1, 1961, and (ii) if the amendment results in the classification of the organization under the rules of this section and §§ 301.7701–1, 301.7701–3, and 301.7701–4 in the same manner as the organization was classified for tax purposes on November 17, 1960.

(b) *Continuity of life.*—(1) An organization has continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization. On the other hand, if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the organization, continuity of life does not exist. If the retirement, death, or insanity of a general partner of a limited partnership causes a dissolution of the partnership, unless the remaining general partners agree to continue the partnership or unless all remaining members agree to continue the partnership, continuity of life does not exist. See *Glensder Textile Company* (1942) 46 B.T.A. 176 (A., C.B. 1942–1, 8).

(2) For purposes of this paragraph, dissolution of an organization means an alteration of the identity of an organization by reason of a

change in the relationship between its members as determined under local law. For example, since the resignation of a partner from a general partnership destroys the mutual agency which exists between such partner and his copartners and thereby alters the personal relation between the partners which constitutes the identity of the partnership itself, the resignation of a partner dissolves the partnership. A corporation, however, has a continuing identity which is detached from the relationship between its stockholders. The death, insanity, or bankruptcy of a shareholder or the sale of a shareholder's interest has no effect upon the identity of the corporation and, therefore, does not work a dissolution of the organization. An agreement by which an organization is established may provide that the business will be continued by the remaining members in the event of the death or withdrawal of any member, but such agreement does not establish continuity of life if under local law the death or withdrawal of any member causes a dissolution of the organization. Thus, there may be a dissolution of the organization and no continuity of life although the business is continued by the remaining members.

(3) An agreement establishing an organization may provide that the organization is to continue for a stated period or until the completion of a stated undertaking or such agreement may provide for the termination of the organization at will or otherwise. In determining whether any member has the power of dissolution, it will be necessary to examine the agreement and to ascertain the effect of such agreement under local law. For example, if the agreement expressly provides that the organization can be terminated by the will of any member, it is clear that the organization lacks continuity of life. However, if the agreement provides that the organization is to continue for a stated period or until the completion of a stated transaction, the organization has continuity of life if the effect of the agreement is that no member has the power to dissolve the organization in contravention of the agreement. Nevertheless, if, notwithstanding such agreement, any member has the power under local law to dissolve the organization, the organization lacks continuity of life. Accordingly, a general partnership subject to a statute corresponding to the Uniform Partnership Act and a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act both lack continuity of life.

(c) *Centralization of management.*—(1) An organization has centralized management if any person (or any group of persons which does not include all the members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed. Thus, the persons who are vested with such management authority resemble in powers and functions the directors of a statutory corporation. The effective operation of a business organization composed of many members generally depends upon the centralization in the hands of a few of exclusive authority to make management decisions for the organization, and therefore, centralized management is more likely to be found in such an organization than in a smaller organization.

(2) The persons who have such authority may, or may not, be members of the organization and may hold office as a result of a selection by the members from time to time, or may be self-perpetuating

in office. See *Morrissey et al.* v. *Commissioner* (1935) 296 U.S. 344 [Ct. D. 1064, C.B. XV–I, 264 (1936)]. Centralized management can be accomplished by election to office, by proxy appointment, or by any other means which has the effect of concentrating in a management group continuing exclusive authority to make management decisions.

(3) Centralized management means a concentration of continuing exclusive authority to make independent business decisions on behalf of the organization which do not require ratification by members of such organization. Thus, there is not centralized management when the centralized authority is merely to perform ministerial acts as an agent at the direction of a principal.

(4) There is no centralization of continuing exclusive authority to make management decisions, unless the managers have sole authority to make such decisions. For example, in the case of a corporation or a trust, the concentration of management powers in a board of directors or trustees effectively prevents a stockholder or a trust beneficiary, simply because he is a stockholder or beneficiary, from binding the corporation or the trust by his acts. However, because of the mutual agency relationship between members of a general partnership subject to a statute corresponding to the Uniform Partnership Act, such a general partnership cannot achieve effective concentration of management powers and, therefore, centralized management. Usually, the act of any partner within the scope of the partnership business binds all the partners; and even if the partners agree among themselves that the powers of management shall be exclusively in a selected few, this agreement will be ineffective as against an outsider who had no notice of it. In addition, limited partnerships subject to a statute corresponding to the Uniform Limited Partnership Act, generally do not have centralized management, but centralized management ordinarily does exist in such a limited partnership if substantially all the interests in the partnership are owned by the limited partners.

(d) *Limited liability.*—(1) An organization has the corporate characteristics of limited liability if under local law there is no member who is personally liable for the debts of or claims against the organization. Personal liability means that a creditor of an organization may seek personal satisfaction from a member of the organization to the extent that the assets of such organization are insufficient to satisfy the creditor's claim. A member of the organization who is personally liable for the obligations of the organization may make an agreement under which another person, whether or not a member of the organization, assumes such liability or agrees to indemnify such member for any such liability. However, if under local law the member remains liable to such creditors notwithstanding such agreement, there exists personal liability with respect to such member. In the case of a general partnership subject to a statute corresponding to the Uniform Partnership Act, personal liability exists with respect to each general partner. Similarly, in the case of a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act, personal liability exists with respect to each general partner, except as provided in subparagraph (2) of this paragraph.

(2) In the case of an organization formed as a limited partnership, personal liability does not exist, for purposes of this paragraph, with respect to a general partner when he has no substantial assets (other

than his interest in the partnership) which could be reached by a creditor of the organization and when he is merely a "dummy" acting as the agent of the limited partners. Notwithstanding the formation of the organization as a limited partnership, when the limited partners act as the principals of such general partner, personal liability will exist with respect to such limited partners. Also, if a corporation is a general partner, personal liability exists with respect to such general partner when the corporation has substantial assets (other than its interest in the partnership) which could be reached by a creditor of the limited partnership. A general partner may contribute his services, but no capital, to the organization, but if such general partner has substantial assets (other than his interest in the partnership), there exists personal liability. Furthermore, if the organization is engaged in financial transactions which involve large sums of money, and if the general partners have substantial assets (other than their interests in the partnership), there exists personal liability although the assets of such general partners would be insufficient to satisfy any substantial portion of the obligations of the organization. In addition, although the general partner has no substantial assets (other than his interest in the partnership), personal liability exists with respect to such general partner when he is not merely a "dummy" acting as the agent of the limited partners.

(e) *Free transferability of interests.*—(1) An organization has the corporate characteristic of free transferability of interests if each of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same organization a person who is not a member of the organization. In order for this power of substitution to exist in the corporate sense, the member must be able, without the consent of other members, to confer upon his substitute all the attributes of his interest in the organization. Thus, the characteristic of free transferability of interests does not exist in a case in which each member can, without the consent of other members, assign only his right to share in profits but cannot so assign his rights to participate in the management of the organization. Furthermore, although the agreement provides for the transfer of a member's interest, there is no power of substitution and no free transferability of interest if under local law a transfer of a member's interest results in the dissolution of the old organization and the formation of a new organization.

(2) If each member of an organization can transfer his interest to a person who is not a member of the organization only after having offered such interest to the other members at its fair market value, it will be recognized that a modified form of free transferability of interests exists. In determining the classification of an organization, the presence of this modified corporate characteristic will be accorded less significance than if such characteristic were present in an unmodified form.

(f) *Cross reference.*—See paragraph (b) of § 301.7701–3 for the application to limited partnerships of the rules relating to corporate characteristics.

(g) *Examples.*—The application of the rules described in this section may be illustrated by the following examples:

Example (1). A group of seven doctors forms a clinic for the purpose of furnishing, for profit, medical and surgical services to the public. They each transfer assets to the clinic, and their agreement provides that except upon complete liquidation of the organization on the vote of three-fourths of its members, no member has any individual interest in its assets. Their agreement also provides that neither the death, insanity, bankruptcy, retirement, resignation, nor expulsion of a member shall cause the dissolution of the organization. Under the applicable local law, on the occurrence of such an event, no member has the power to dissolve the organization. The management of the clinic is vested exclusively in an executive committee of four members elected by all the members, and under the applicable local law, no one acting without the authority of this committee has the power to bind the organization by his acts. Members of the clinic are personally liable for all debts of, or claims against, the clinic. Every member has the right to transfer his interest to a doctor who is not a member of the organization, but he must first advise the organization of the proposed transfer and give it the opportunity on a vote of the majority to purchase the interest at its fair market value. The organization has associates and an objective to carry on business and divide the gains therefrom. While it does not have the corporate characteristics of limited liability, it does have the characteristics of centralized management, continuity of life, and a modified form of free transferability of interests. The organization will be classified as an association for all the purposes of the Internal Revenue Code.

Example (2). A group of seven doctors forms a clinic for the purpose of furnishing, for profit, medical and surgical services to the public. They each transfer assets to the clinic, and their agreement provides that except upon complete liquidation of the organization on the vote of three-fourths of its members, no member has any individual interest in its assets. Their agreement also provides that neither the death, insanity, bankruptcy, retirement, resignation, nor expulsion of a member shall cause the dissolution of the organization. However, under the applicable local law, a member who withdraws does have the power to dissolve the organization. While the agreement provides that the management of the clinic is to be vested exclusively in an executive committee of four members elected by all the members, this provision is ineffective as against outsiders who had no notice of it; and, therefore, the act of any member within the scope of the organization's business binds the organization insofar as such outsiders are concerned. While the agreement declares that each individual doctor alone is liable for acts of malpractice, members of the clinic are, nevertheless, personally liable for all debts of the clinic including claims based on malpractice. No member has the right, without the consent of all the other members, to transfer his interest to a doctor who is not a member of the clinic. The organization has associates and an objective to carry on business and divide the gains therefrom. However, it does not have the corporate characteristics of continuity of life, centralized management, limited liability, and free transferability of interests. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (3). A group of twenty-five lawyers forms an organization for the purpose of furnishing, for profit, legal services to the pub-

lic. Their agreement provides that the organization will dissolve upon the death, insanity, bankruptcy, retirement, or expulsion of a member. While their agreement provides that the management of the organization is to be vested exclusively in an executive committee of five members elected by all the members, this provision is ineffective as against outsiders who had no notice of it; and, therefore, the act of any member within the scope of the organization's business binds the organization insofar as such outsiders are concerned. Members of the organization are personally liable for all debts, or claims against, the organization. No member has the right, without the consent of all the other members, to transfer his interest to a lawyer who is not a member of the organization. The organization has associates and an objective to carry on business and divide the gains therefrom. However, the four corporate characteristics of limited liability, centralized management, free transferability of interests, and continuity of life are absent in this case. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (*4*). A group of twenty-five persons forms an organization for the purpose of engaging in real estate investment activities. Each member has the power to dissolve the organization at any time. The management of the organization is vested exclusively in an executive committee of five members elected by all the members, and under the applicable local law, no one acting without the authority of this committee has the power to bind the organization by his acts. Under the applicable local law, each member is personally liable for the obligations of the organization. Every member has the right to transfer his interest to a person who is not a member of the organization, but he must first advise the organization of the proposed transfer and give it the opportunity on a vote of the majority to purchase the interest at its fair market value. The organization has associates and an objective to carry on business and divide the gains therefrom. While the organization does have the characteristics of centralized management and a modified form of free transferability of interests, it does not have the corporate characteristics of continuity of life and limited liability. Under the circumstances presented, the organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (*5*). A group of twenty-five persons forms an organization for the purpose of engaging in real estate investment activities. Under their agreement, the organization is to have a life of twenty years, and under the applicable local law, no member has the power to dissolve the organization prior to the expiration of that period. The management of the organization is vested exclusively in an executive committee of five members elected by all the members, and under the applicable local law, no one acting without the authority of this committee has the power to bind the organization by his acts. Under the applicable local law, each member is personally liable for the obligations of the organization. Every member has the right to transfer his interest to a person who is not a member of the organization, but he must first advise the organization of the proposed transfer and give it the opportunity on a vote of the majority to purchase the interest at its fair market value. The organization has associates and an objective to carry on business and divide the gains there-

from. While the organization does not have the corporate characteristic of limited liability, it does have continuity of life, centralized management, and a modified form of free transferability of interests. The organization will be classified as an association for all purposes of the Internal Revenue Code.

Example (6). A group of twenty-five persons form an organization for purposes of engaging in real estate investment activities. Each member has the power to dissolve the organization at any time. The management of the organization is vested exclusively in an executive committee of five members elected by all the members, and under the applicable local law, no one acting without the authority of this committee has the power to bind the organization by his acts. Under the applicable local law, the liability of each member for the obligations of the organization is limited to paid and subscribed capital. Every member has the right to transfer his interest to a person who is not a member of the organization, but he must first advise the organization of the proposed transfer and give it the opportunity on a vote of the majority to purchase the interest at its fair market value. The organization has associates and an objective to carry on business and divide the gains therefrom. While the organization does not have the characteristic of continuity of life, it does have limited liability, centralized management, and a modified form of free transferability of interests. The organization will be classified as an association for all purposes of the Internal Revenue Code.

Example (7). A group of twenty-five persons forms an organization for the purpose of investing in securities so as to educate the members in principles and techniques of investment practices and to share the income from such investments. While the agreement states that the organization will operate until terminated by a three-fourths vote of the total membership and will not terminate upon the withdrawal or death of any member, under the applicable local law, a member has the power to dissolve the organization at any time. The business of the organization is carried on by the members at regular monthly meetings and buy or sell action may be taken only when voted by a majority of the organization's membership present. Elected officers perform only ministerial functions such as presiding at meetings and carrying out the directions of the members. Members of the organization are personally liable for all debts of, or claims against the organization. No member may transfer his membership. The organization has associates and an objective to carry on business and divide the gains therefrom. However, the organization does not have the corporate characteristics of limited liability, free transferability of interests, continuity of life, and centralized management. The organization will be treated as a partnership for all purposes of the Internal Revenue Code.

§ 301.7701-3 PARTNERSHIPS.—(a) *In general.*—The term "partnership" is broader in scope than the common law meaning of partnership and may include groups not commonly called partnerships. Thus, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation or a trust or estate within the meaning of the Internal Revenue Code of 1954. A joint undertaking merely to share

expenses is not a partnership. For example, if two or more persons jointly construct a ditch merely to drain surface water from their properties, they are not partners. Mere co-ownership of property which is maintained, kept in repair, and rented or leased does not constitute a partnership. For example, if an individual owner, or tenants in common, of farm property lease it to a farmer for a cash rental or a share of the crops, they do not necessarily create a partnership thereby. Tenants in common, however, may be partners if they actively carry on a trade, business, financial operation, or venture and divide the profits thereof. For example, a partnership exists if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent.

(b) *Limited partnerships.*—(1) *In general.*—An organization which qualifies as a limited partnership under State law may be classified for purposes of the Internal Revenue Code as an ordinary partnership or as an association. Such a limited partnership will be treated as an association if, applying the principles set forth in § 301.7701–2, the organization more nearly resembles a corporation than an ordinary partnership or other business entity.

(2) *Examples.*—The principles of this paragraph may be illustrated by the following examples:

Example (1). Three individuals form an organization which qualifies as a limited partnership under the laws of the State in which the organization was formed. The purpose of the organization is to acquire and operate various pieces of commercial and other investment property for profit. Each of the three individuals who are general partners invests $100,000 in the enterprise. Five million dollars of additional capital is raised through contributions of $100,000 or more by each of thirty limited partners. The three general partners are personally capable of assuming a substantial part of the obligations to be incurred by the organization. While a limited partner may assign his right to receive a share of the profits and a return of his contribution, his assignee does not become a substituted limited partner except with the unanimous consent of the general partners. The life of the organization as stated in the certificate is 20 years, but the death, insanity, or retirement of a general partner prior to the expiration of the 20-year period will dissolve the organization. The general partners have exclusive authority to manage the affairs of the organization but can act only upon the unanimous consent of all of them. The organization has associates and an objective to carry on business and divide the gains therefrom, which characterize both partnerships and corporations. While the organization has the corporate characteristic of centralized management since substantially all of the interests in the organization are owned by the limited partners, it does not have the characteristics of continuity of life, free transferability of interests, or limited liability. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (2). Three individuals form an organization which qualifies as a limited partnership under the laws of the State in which the organization was formed. The purpose of the organization is to acquire and operate various pieces of commercial and other investment property for profit. The certificate provides that the life of the or-

ganization is to be 40 years, unless a general partner dies, becomes insane, or retires during such period. On the occurrence of such death, insanity, or retirement, the remaining general partners may continue the business of the partnership for the balance of the 40-year period under a right so to do stated in the certificate. Each of the three individuals who is a general partner invests $50,000 in the enterprise and has means to satisfy the business obligations of the organization to a substantial extent. Five million dollars of additional capital is raised through the sale of freely transferable interests in amounts of $10,000 or less to limited partners. Nine hundred such interests are sold. The interests of the 900 limited partners are fully transferable, that is, a transferee acquires all the attributes of the transferor's interest in the organization. The general partners have exclusive control over management of the business, their interests are not transferable, and their liability for debts of the organization is not limited to their capital contributions. The organization has associates and an objective to carry on business and divide the gains therefrom. It does not have the corporate characteristics of limited liability and continuity of life. It has centralized management, however, since the three general partners exercise exclusive control over the management of the business, and since substantially all of the interests in the organization are owned by the limited partners. While the interests of the general partners are not transferable, the transferability test of an association is met since substantially all of the interests in the organization are represented by transferable interests. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

(c) *Partnership associations.*—The laws of a number of States provide for the formation of organizations commonly known as partnership associations. Such a partnership association will be treated as an association if, applying the principles set forth in § 301.7701–2 the organization more nearly resembles a corporation than the other types of business entities.

(d) *Partner.*—The term "partner" means a member of a partnership.

§ 301.7701–4 TRUSTS.—(a) *Ordinary trusts.*—In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

(b) *Business trusts.*—There are other arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Internal Revenue Code because they are not simply arrangements to protect or conserve the property for the beneficiaries. These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code. However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or partnership. The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if, applying the principles set forth in §§ 301.7701–2 and 301.7701–3, the organization more nearly resembles an association or a partnership than a trust.

(c) *Certain investment trusts.*—An "investment" trust of the type commonly known as a management trust is an association, and a trust of the type commonly known as a fixed investment trust is an association if there is power under the trust agreement to vary the investment of the certificate holders. See *Commissioner* v. *North American Bond Trust* (C.C.A. 2d 1941) 122 F. 2d 545, cert. denied, 314 U.S. 701. However, if there is no power under the trust agreement to vary the investment of the certificate holders, such fixed investment trust shall be classified as a trust.

(d) *Liquidating trusts.*—Certain organizations which are commonly known as liquidating trusts are treated as trusts for purposes of the Internal Revenue Code. An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose. A liquidating trust is treated as a trust for purposes of the Internal Revenue Code because it is formed with the objective of liquidating particular assets and not as an organization having as its purpose the carrying on of a profit-making business which normally would be conducted through business organizations classified as corporations or partnerships. However, if the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust. Bondholders' protective committees, voting trusts, and other agencies formed to protect the interests of security holders during insolvency, bankruptcy, or corporate reorganization proceedings are analogous to liquidating trusts but if subsequently utilized to further the control or profitable operation of a going business on a permanent continuing basis, they will lose their classification as trusts for purposes of the Internal Revenue Code.

§ 301.7701–5 DOMESTIC, FOREIGN, RESIDENT, AND NONRESIDENT PERSONS.—A domestic corporation is one organized or created in the United States, including only the States (and during the periods

when not States, the Territories of Alaska and Hawaii), and the District of Columbia, or under the law of the United States or of any State or Territory. A foreign corporation is one which is not domestic. A domestic corporation is a resident corporation even though it does no business and owns no property in the United States. A foreign corporation engaged in trade or business within the United States is referred to in the regulations in this chapter as a resident foreign corporation, and a foreign corporation not engaged in trade or business within the United States, as a nonresident foreign corporation. A partnership engaged in trade or business within the United States is referred to in the regulations in this chapter as a resident partnership, and a partnership not engaged in trade or business within the United States, as a nonresident partnership. Whether a partnership is to be regarded as resident or nonresident is not determined by the nationality or residence of its members or by the place in which it was created or organized. The term "nonresident alien", as used in the regulations in this chapter, includes a nonresident alien individual and a nonresident alien fiduciary.

§ 301.7701–6 FIDUCIARY.—"Fiduciary" is a term which applies to persons who occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators. A fiduciary is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another, as in the case of receivers. A committee or guardian of the property of an incompetent person is a fiduciary.

§ 301.7701–7 FIDUCIARY DISTINGUISHED FROM AGENT.—There may be a fiduciary relationship between an agent and a principal, but the word "agent" does not denote a fiduciary. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the Internal Revenue Code. In cases where no legal trust has been created in the estate controlled by the agent and attorney, the liability to make a return rests with the principal.

§ 301.7701–8 MILITARY OR NAVAL FORCES AND ARMED FORCES OF THE UNITED STATES.—The term "military or naval forces of the United States" and the term "Armed Forces of the United States" each includes all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force. The terms also include the Coast Guard. The members of such forces include commissioned officers and the personnel below the grade of commissioned officer in such forces.

§ 301.7701–9 SECRETARY OR HIS DELEGATE.—(a) The term "Secretary or his delegate" means the Secretary of the Treasury, or any officer, employee, or agency of the Treasury Department duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform the function mentioned or described in the context, and the term "or his delegate" when used in connection

with any other official of the United States shall be similarly construed.

(b) In any case in which a function is vested by the Internal Revenue Code of 1954 or any other statute in the Secretary or his delegate, and Treasury regulations or Treasury decisions approved by the Secretary or his delegate provide that such function may be performed by the Commissioner, assistant commissioner, regional commissioner, assistant regional commissioner, district director, or by a designated officer or employee in the office of any such officer, such provision in the regulations or Treasury decision shall constitute a delegation by the Secretary of the authority to perform such function to the designated officer or employee. If such authority is delegated to any officer or employee performing services under the supervision and control of the Commissioner, such provision in the regulations or Treasury decision shall constitute a delegation by the Secretary to the Commissioner of the authority to perform such function and a redelegation thereof by the Commissioner to the designated officer or employee.

(c) An officer or employee, including the Commissioner, authorized by regulations or Treasury decision to perform a function shall have authority to redelegate the performance of such function to any officer or employee performing services under his supervision and control, unless such power to so redelegate is prohibited or restricted by proper order or directive. The Commissioner may also redelegate authority to perform such function to other officers or employees under his supervision and control and, to the extent he deems proper, may authorize further redelegation of such authority.

(d) The Commissioner may prescribe such limitations as he deems proper on the extent to which any officer or employee under his supervision and control shall perform any such function, but, in the case of an officer or employee designated in regulations or Treasury decision as authorized to perform such function, such limitations shall not render invalid any performance by such officer or employee of the function which, except for such limitations, such officer or employee is authorized to perform by such regulations or Treasury decision in effect at the time the function is performed.

§ 301.7701–10 District Director.—The term "district director" means the district director of internal revenue for an internal revenue district. The term also includes the Director of International Operations.

§ 301.7701–11 Other Terms.—Any terms which are defined in section 7701 and which are not defined in §§ 301.7701–1 through 301.7701–10 shall, when used in this chapter, have the meanings assigned to them in section 7701.

Dana Latham,
Commissioner of Internal Revenue.

Approved November 14, 1960.

Fred C. Scribner, Jr.,
Acting Secretary of the Treasury.

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CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

Restricted stock option agreements which contain a provision for a price redetermination by the Commissioner for qualification. See Rev. Rul. 60–242, page 158.

PART II

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939, AND OTHER PUBLIC LAWS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939

Rulings and decisions published in Part II, Subpart A, of the Internal Revenue Bulletin are based on the applications of provisions of the Internal Revenue Code of 1939 and unless otherwise noted therein are published without consideration to any application of the provisions of the Internal Revenue Code of 1954, or other public laws.

SUBTITLE A.—TAXES SUBJECT TO THE JURISDICTION OF THE BOARD OF TAX APPEALS

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

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REGULATIONS 118, SECTION 39.22(a)–15: Acquisition or disposition by a corporation of its own capital stock. Rev. Rul. 60–328

Where the acquisition and disposition of treasury stock by a corporation is limited to a wholly intracorporate purpose with no element of speculation or gain envisioned, it does not constitute

dealing by the corporation in its own shares as it might deal in the shares of another corporation within the meaning of section 39.22(a)-15 of Regulations 118. No taxable gain will be realized from the sales thereof.

G.C.M. 16651, C.B. XV-2, 130 (1936), revoked.

In view of the decision in *United States* v. *Anderson Clayton & Co.*, 350 U.S. 55, Ct. D. 1788, C.B. 1955-2, 524, reconsideration has been given to G.C.M. 16651, C.B. XV-2, 130 (1936), with respect to the treatment afforded the acquisition and disposition by a corporation of its own capital stock (treasury stock) under section 39.22(a)-15 of Regulations 118.

G.C.M. 16651, *supra*, held that the gain derived by a corporation through the sale of its stock to its employees under a stock purchase plan, the stock having been acquired by the corporation in the open market to provide shares of stock for the plan, constitutes taxable income under section 22(a) of the Internal Revenue Code of 1939.

Under the provisions of section 1032(a) of the Internal Revenue Code of 1954, the issue involved in G.C.M. 16651, *supra*, and the *Anderson Clayton & Co.*, decision is made moot for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

In the light of the decision in the *Anderson Clayton & Co.*, case, nonacquiescences in the following cases are withdrawn and acquiescences are substituted: *Rollins Burdict Hunter Company* v. *Commissioner*, 9 T.C. 169, nonacquiescence C.B. 1948-1, 4; *Batten, Barton, Durstine & Osborn, Inc.* v. *Commissioner*, 9 T.C. 448, nonacquiescence C.B. 1948-1, 4; *H. W. Porter & Company* v. *Commissioner*, 14 T.C. 307, nonacquiescence C.B. 1950-1, 7; *The Timken-Detroit Axle Company* v. *Commissioner*, 21 T.C. 769, nonacquiescence C.B. 1954-2, 6. See page 3, this Bulletin.

G.C.M. 16651, C.B. XV-2, 130 (1936), is revoked.

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

REGULATIONS 111, SECTION 29.22(b)(3)-1: Gifts and bequests. Ct. D. 1850

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. GROSS INCOME—COMPENSATION VS. GIFT—AUTOMOBILE RECEIVED FROM BUSINESS FRIEND—"GRATUITY" TO CORPORATE OFFICER—TEST FOR DETERMINING WHEN TRANSFERS IS GIFT.

Whether a transfer is an excludable gift or taxable compensation is a question of fact to be determined by the trier of fact. The proper criterion for making such determination is one that inquires what the basic reason for the transferor's conduct was in fact—the dominant reason that explains his action in making the transfer. This is not to be measured by a specific test for determining when a transfer is a gift, as urged by the Government, but is to be "based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case." Thus:

(1) In the *Duberstein* case the Court holds that the Tax Court was warranted in concluding that the transfer of a Cadillac automobile to taxpayer by a corporation to which he had gratuitously furnished names of potential customers was a recompense for past services or an inducement to be of further service in the future

rather than a gift. The Supreme Court of the United States could not say with the Court of Appeals for the Sixth Circuit that such a conclusion on the Tax Court's part was "mere suspicion."

(2) In the *Stanton* case, the District Court's simple and unelaborated finding that a "gratuity" awarded a corporate officer on his voluntary retirement was a nontaxable gift is inadequate and further proceedings are required looking toward new and adequate findings of fact.

2. Judgement of United States Court of Appeals for Sixth Circuit, 265 Fed. (2d) 28, reversed; judgement of the United States Court of Appeals for the Second Circuit, 268 Fed. (2d) 727, vacated and case remanded.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, petitioner v. *Mose Duberstein, et al.*

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

Alden D. Stanton, et al., petitioners v. *United States of America*

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

[June 13, 1960]

MR. JUSTICE BRENNAN delivered the opinion of the Court.

These two cases concern the provision of the Internal Revenue Code which excludes from the gross income of an income taxpayer "the value of property acquired by gift."[1] They pose the frequently recurrent question whether a specific transfer to a taxpayer in fact amounted to a "gift" to him within the meaning of the statute. The importance to decision of the facts of the cases requires that we state them in some detail.

No. 376, *Commissioner* v. *Duberstein.* The taxpayer, Duberstein,[2] was president of the Duberstein Iron & Metal Company, a corporation with headquarters in Dayton, Ohio. For some years the taxpayer's company had done business with Mohawk Metal Corporation, whose headquarters were in New York City. The president of Mohawk was one Berman. The taxpayer and Berman had generally used the telephone to transact their companies' business with each other, which consisted of buying and selling metals. The taxpayer testified without elaboration, that he knew Berman "personally" and had known him for about seven years. From time to time in their telephone conversations, Berman would ask Duberstein whether the latter knew of potential customers for some of Mohawk's products in which Duberstein's company itself was not interested. Duberstein provided the names of potential customers for these items.

One day in 1951 Berman telephoned Duberstein and said that the information Duberstein had given him had proved so helpful that he wanted to give the latter a present. Duberstein stated that Berman owed him nothing. Berman said that he had a Cadillac as a gift for Duberstein, and that the latter should send to New York for it; Berman insisted that Duberstein accept the car, and the latter finally did so, protesting however that he had not intended to be compensated for the information. At the time Duberstein already had a Cadillac and an Oldsmobile, and felt that he did not need another car. Duberstein testified that he did not think Berman would have sent him the Cadillac if he had not furnished him with information about the customers. It appeared that Mohawk later deducted the value of the Cadillac as a business expense on its corporate income tax return.

Duberstein did not include the value of the Cadillac in gross income for 1951, deeming it a gift. The Commissioner asserted a deficiency for the car's value against him, and in proceedings to review the deficiency the Tax Court affirmed the Commissioner's determination. It said that "The record is significantly barren of evidence revealing any intention on the part of the payor to make a gift. * * * The only justifiable inference is that the automobile was intended

[1] The operative provision in the cases at bar is sec. 22(b)(3) of the 1939 Internal Revenue Code. The corresponding provision of the present Code is sec. 102(a).

[2] In both cases the husband will be referred to as the taxpayer although his wife joined with him in joint tax returns.

by the payor to be remuneration for services rendered to it by Duberstein." The Court of Appeals for the Sixth Circuit reversed. 265 F. 2d 28.

No. 546, *Stanton* v. *United States*. The taxpayer Stanton had been for approximately 10 years in the employ of Trinity Church in New York City. He was comptroller of the Church corporation, and president of a corporation the church set up as a fully owned subsidiary, Trinity Operating Company, to manage its real estate holdings, which were more extensive than simply the church property. His salary by the end of his employment there in 1942 amounted to $22,500 a year. Effective November 30, 1942, he resigned from both positions to go into business for himself. The Operating Company's directors, who seem to have included the rector and vestrymen of the church passed the following resolution upon his resignation: "Be it resolved that in appreciation of the services rendered by Mr. Stanton . . . a gratuity is hereby awarded to him of Twenty Thousand Dollars, payable to him in equal installments of Two Thousand Dollars at the end of each and every month commencing with the month of December, 1942; provided that, with the discontinuance of his services, the Corporation of Trinity Church is released from all rights and claims to pension and retirement benefits not already accrued up to November 30, 1942."

The Operating Company's action was later explained by one of its directors as based on the fact that, "Mr. Stanton was liked by all of the Vestry personally. He had a pleasing personality. He had come in when Trinity's affairs were in a difficult situation. He did a splendid piece of work, we felt. Besides that * * * he was liked by all of the members of the Vestry personally." And by another: "[W]e were all unanimous in wishing to make Mr. Stanton a gift. Mr. Stanton had loyally and faithfully served Trinity in a very difficult time. We thought of him in the highest regard. We understood that he was going in business for himself. We felt that he was entitled to that evidence of good will."

On the other hand, there was a suggestion of some ill-feeling between Stanton and the directors, arising out of the recent termination of the services of one Watkins, the Operating Company's treasurer, whose departure was evidently attended by some acrimony. At a special board meeting on October 28, 1942, Stanton had intervened on Watkins' side and asked reconsideration of the matter. The minutes reflect that "resentment was expressed as to the 'presumptuous' suggestion that the action of the Board, taken after long deliberation, should be changed." The Board adhered to its determination that Watkins be separated from employment, giving him an opportunity to resign rather than be discharged. At another special meeting two days later it was revealed that Watkins had not resigned; the previous resolution terminating his services was then viewed as effective; and the Board voted the payment of six months' salary to Watkins in a resolution similar to that quoted in regard to Stanton, but which did not use the term "gratuity." At the meeting, Stanton announced that in order to avoid any such embarrassment or question at any time as to his willingness to resign if the Board desired, he was tendering his resignation. It was tabled, though not without dissent. The next week, on November 5, at another special meeting, Stanton again tendered his resignation which this time was accepted.

The "gratuity" was duly paid. So was a smaller one to Stanton's (and the Operating Company's) secretary, under a similar resolution, upon her resignation at the same time. The two corporations shared the expense of the payments. There was undisputed testimony that there were in fact no enforceable rights or claims to pension and retirement benefits which had not accrued at the time of the taxpayer's resignation, and that the last proviso of the resolution was inserted simply out of an abundance of caution. The taxpayer received in cash a refund of his contributions to the retirement plans, and there is no suggestion that he was entitled to more. He was required to perform no further services for Trinity after his resignation.

The Commissioner asserted a deficiency against the taxpayer after the latter had failed to include the payments in question in gross income. After payment of the deficiency and administrative rejection of a refund claim, the taxpayer sued the United States for a refund in the District Court for the Eastern District of New York. The trial judge, sitting without a jury, made the simple finding that the payments were a "gift,"[3] and judgment was entered for the taxpayer. The Court of Appeals for the Second Circuit reversed. 268 F. 2d 727.

The Government, urging that clarification of the problem typified by these two cases was necessary, and that the approaches taken by the Courts of Appeals for the Second and the Sixth Circuits were in conflict, petitioned for certiorari

[3] See note 14, *infra*

in No. 376, and acquiesced in the taxpayer's petition in No. 546. On this basis, and because of the importance of the question in the administration of the income tax laws, we granted certiorari in both cases. 361 U.S. 923.

The exclusion of property acquired by gift from gross income under the federal income tax laws was made in the first income tax statute[4] passed under the authority of the Sixteenth Amendment, and has been a feature of the income tax statutes ever since. The meaning of the term "gift" as applied to particular transfers has always been a matter of contention.[5] Specific and illuminating legislative history on the point does not appear to exist. Analogies and inferences drawn from other revenue provisions, such as the estate and gift taxes, are dubious. See *Lockard* v. *Commissioner*, 166 F. 2d 409. The meaning of the statutory term has been shaped largely by the decisional law. With this, we turn to the contentions made by the Government in these cases.

First. The Government suggests that we promulgate a new "test" in this area to serve as a standard to be applied by the lower courts and by the Tax Court in dealing with the numerous cases that arise.[6] We reject this invitation. We are of the opinion that the governing principles are necessarily general and have already been spelled out in the opinions of this Court, and that the problem is one which, under the present statutory framework, does not lend itself to any more definitive statement that would produce a talisman for the solution of concrete cases. The cases at bar are fair examples of the settings in which the problem usually arises. They present situations in which payments have been made in a context with business overtones—an employer making a payment to a retiring employee; a businessman giving something of value to another businessman who has been of advantage to him in his business. In this context, we review the law as established by the prior cases here.

The course of decision here makes it plain that the statute does not use the term "gift" in the common-law sense, but in a more colloquial sense. This Court has indicated that a voluntary executed transfer of his property by one to another, without any consideration or compensation therefor, though a common-law gift, is not necessarily a "gift" within the meaning of the statute. For the Court has shown that the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift. *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716, 730 [Ct. D. 80, C.B. VIII–2, 222 (1929)]. And, importantly, if the payment proceeds primarily from "the constraining force of any moral or legal duty," or from "the incentive of anticipated benefit" of an economic nature, *Bogardus* v. *Commissioner*, 302 U.S. 34, 41 [Ct. D. 1281, C.B. 1937–2, 258], it is not a gift. And, conversely, "[w]here the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it." *Robertson* v. *United States*, 343 U.S. 711, 714.[7] A gift in the statutory sense, on the other hand, proceeds from a "detached and disinterested generosity," *Commissioner* v. *LoBue*, 351 U.S. 243, 246 [Ct. D. 1798, C.B. 1956–2, 967]; "out of affection, respect, admiration, charity or like impulses." *Robertson* v. *United States*, *supra*, at 714. And in this regard, the most critical consideration, as the Court was agreed in the leading case here, is the transferor's "intention." *Bogardus* v. *Commissioner*, 302 U.S. 34, 43 [Ct. D. 1281, C.B. 1937–2, 258]. "What controls is the intention with which payment, however voluntary, has been made." *Id.*, at 45 (dissenting opinion).[8]

The Government says that this "intention" of the transferor cannot mean what the cases on the common-law concept of gift call "donative intent." With that we are in agreement, for our decisions fully support this. Moreover, the *Bogardus* case itself makes it plain that the donor's characterization of his action

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[4] § II.B., c. 16, 38 Stat. 167.

[5] The first case of the Board of Tax Appeals officially reported in fact deals with the problem. *Parrott* v. *Commissioner*, 1 B.T.A. 1.

[6] The Government's proposed test is stated: "Gifts should be defined as transfers of property made for personal as distinguished from business reasons."

[7] The cases including "tips" in gross income are classic examples of this. See, *e.g.*, *Roberts* v. *Commissioner*, 176 F. 2d 221.

[8] The parts of the *Bogardus* opinion which we touch on here are the ones we take to be basic to its holding, and the ones that we read as stating those governing principles which it establishes. As to them we see little distinction between the views of the Court and those taken in dissent in *Bogardus*. The fear expressed by the dissent at 302 U.S., at 44, that the prevailing opinion "seems" to hold "that every payment which in any aspect is a gift is * * * relieved of any tax" strikes us now as going beyond what the opinion of the Court held in fact. In any event, the Court's opinion in *Bogardus* does not seem to have been so interpreted afterwards. The principal difference, as we see it, between the Court's opinion and the dissent lies in the weight to be given the findings of the trier of fact.

is not determinative—that there must be an objective inquiry as to whether what is called a gift amounts to it in reality. 302 U.S., at 40. It scarcely needs adding that the parties' expectations or hopes as to the tax treatment of their conduct in themselves have nothing to do with the matter.

It is suggested that the *Bogardus* criterion would be more apt if rephrased in terms of "motive" rather than "intention." We must confess to some skepticism as to whether such a verbal mutation would be of any practical consequence. We take it that the proper criterion, established by decision here, is one that inquires what the basic reason for his conduct was in fact—the dominant reason that explains his action in making the transfer. Further than that we do not think it profitable to go.

Second. The Government's proposed "test," while apparently simple and precise in its formulation, depends frankly on a set of "principles" or "presumptions" derived from the decided cases, and concededly subject to various exceptions; and it involves various corollaries, which add to its detail. Were we to promulgate this test as a matter of law, and accept with it its various presuppositions and stated consequences, we would be passing far beyond the requirements of the cases before us, and would be painting on a large canvas with indeed a broad brush. The Government derives its test from such propositions as the following: That payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable; That the concept of a gift is inconsistent with a payment's being a deductible business expense; That a gift involves "personal" elements; That a business corporation cannot properly make a gift of its assets. The Government admits that there are exceptions and qualifications to these propositions. We think, to the extent they are correct, that these propositions are not principles of law but rather maxims of experience that the tribunals which have tried the facts of cases in this area have enunciated in explaining their factual determinations. Some of them simply represent truisms: it doubtless is, statistically speaking, the exceptional payment by an employer to an employee that amounts to a gift. Others are overstatements of possible evidentiary inferences relevant to a factual determination on the totality of circumstances in the case: it is doubtless relevant to the over-all inference that the transferor treats a payment as a business deduction, or that the transferor is a corporate entity. But these inferences cannot be stated in absolute terms. Neither factor is a shibboleth. The taxing statute does not make nondeductibility by the transferor a condition on the "gift" exclusion; nor does it draw any distinction, in terms, between transfers by corporations and individuals, as to the availability of the "gift" exclusion to the transferee. The conclusion whether a transfer amounts to a "gift" is one that must be reached on consideration of all the factors.

Specifically, the trier of fact must be careful not to allow trial of the issue whether the receipt of a specific payment is a gift to turn into a trial of the tax liability, or of the propriety, as a matter of fiduciary or corporate law, attaching to the conduct of someone else. The major corollary to the Government's suggested "test" is that, as an ordinary matter, a payment by a corporation cannot be a gift, and, more specifically, there can be no such thing as a "gift" made by a corporation which would allow it to take a deduction for an ordinary and necessary business expense. As we have said, we find no basis for such a conclusion in the statute; and if it were applied as a determinative rule of "law," it would force the tribunals trying tax cases involving the donee's liability into elaborate inquiries into the local law of corporations or into the peripheral deductibility of payments as business expenses. The former issue might make the tax tribunals the most frequent investigators of an important and difficult issue of the laws of the several States, and the latter inquiry would summon one difficult and delicate problem of federal tax law as an aid to the solution of another.[9] Or perhaps there would be required a trial of the vexed issue whether there was a "constructive" distribution of corporate property, for income tax purposes, to the corporate agents who had sponsored the transfer.[10] These considerations, also, reinforce us in our conclusion that while the principles urged by the Government may, in nonabsolute form as crystallizations of experi-

[9] Justice Cardozo once described in memorable language the inquiry into whether an expense was an "ordinary and necessary" one of a business: "One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." *Welch* v. *Helvering*, 290 U.S. 111, 115 [Ct. D. 755, C.B. X II–2, 112 (1933)]. The same comment well fits the issue in the cases at bar.

[10] Cf., *e.g.*, *Nelson* v. *Commissioner*, 203 F. 2d 1.

ence, prove persuasive to the trier of facts in a particular case, neither they, nor any more detailed statement than has been made, can be laid down as a matter of law.

Third. Decision of issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case. The nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of ascribing the proper force to each, confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact. *Baker* v. *Texas & Pacific R. Co.*, 359 U.S. 227; *Commissioner* v. *Heininger*, 320 U.S. 467, 475 [Ct. D. 1596, C.B. 1944, 484]; *United States* v. *Yellow Cab Co.*, 338 U.S. 338, 341; *Bogardus* v. *Commissioner*, *supra*, at 45 (dissenting opinion).[11]

This conclusion may not satisfy an academic desire for tidiness, symmetry and precision in this area, any more than a system based on the determinations of various fact-finders ordinarily does. But we see it as implicit in the present statutory treatment of the exclusion for gifts, and in the variety of forums in which federal income tax cases can be tried. If there is fear of undue uncertainty or overmuch litigation, Congress may make more precise its treatment of the matter by singling out certain factors and making them determinative of the matter, as it has done in one field of the "gift" exclusion's former application, that of prizes and awards.[12] Doubtless diversity of result will tend to be lessened somewhat since federal income tax decisions, even those in tribunals of first instance turning on issues of fact, tend to be reported, and since there may be a natural tendency of professional triers of fact to follow one another's determinations, even as to factual matters. But the question here remains basically one of fact, for determination on a case-by-case basis.

One consequence of this is that appellate review of determinations in this field must be quite restricted. Where a jury has tried the matter upon correct instructions, the only inquiry is whether it cannot be said that reasonable men could reach differing conclusions on the issue. *Baker* v. *Texas & Pacific R. Co.*, *supra*, at 228. Where the trial has been by a judge without a jury, the judge's findings must stand unless "clearly erroneous." Fed. Rules Civ. Proc., 52(a). "A finding is 'clearly erroneous' when although there is evidence to support it, the reveiwing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395. The rule itself applies also to factual inferences from undisputed basic facts, *id.*, at 394, as will on many occasions be presented in this area. Cf. *Graver Tank & Mfg. Co.* v. *Linde Air Products Co.*, 339 U.S. 605, 609–610. And Congress has in the most explicit terms attached the identical weight to the findings of the Tax Court. I.R.C., section 7482(a).[13]

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[11] In *Bogardus*, the Court was divided 5 to 4 as to the scope of review to be extended the fact-finder's determination as to a specific receipt, in a context like that of the instant cases. The majority held that such a determination was "a conclusion of law or at least a determination of a mixed question of law and fact." 302 U.S., at 39. This formulation it took as justifying it in assuming a fairly broad standard of review. The dissent took a contrary view. The approach of this part of the Court's ruling in *Bogardus*, which we think was the only part on which there was real division among the Court, see note 8, *supra*, has not been afforded subsequent respect here. In *Heininger*, a question presenting at the most elements no more factual and untechnical than those here—that of the "ordinary and necessary" nature of a business expense—was treated as one of fact. Cf. note 9, *supra*. And in *Dobson* v. *Commissioner*, 320 U.S. 489, 498, n. 22, *Bogardus* was adversely criticized, insofar as it treated the matter as reviewable as one of law. While *Dobson* is, of course, no longer the law insofar as it ordains a greater weight to be attached to the findings of the Tax Court than to those of any other fact-finder in a tax litigation, see note 13, *infra*, we think its criticism of this point in the *Bogardus* opinion is sound in view of the dominant importance of factual inquiry to decision of these cases.

[12] I.R.C., sec. 74, which is a provision new with the 1954 Code. Previously, there had been holdings that such receipts as the "Pot O'Gold" radio giveaway, *Washburn* v. *Commissioner*, 5 T.C. 1333, and the Ross Essay Prize, *McDermott* v. *Commissioner*, 80 U.S. App. D.C. 176, 150 F. 2d 585, were "gifts." Congress intended to obviate such rulings. S. Rep. No. 1622, 83d Cong. 2d Sess., p. 178. We imply no approval of those holdings under the general standard of the "gift" exclusion. Cf. *Robertson* v. *United States*, *supra*.

[13] The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court * * * in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury * * *" The last words first came into the statute through an amendment to sec. 1141(a) of the 1939 Code in 1948 (§ 36 of the Judicial Code Act, 62 Stat. 991). The purpose of the 1948 legislation was to remove from the law the favored position (in comparison with District Court and Court of Claims rulings in tax matters) enjoyed by the Tax Court under this Court's ruling in *Dobson* v. *Commissioner*, 320 U.S. 489. Cf. note 11, *supra*. See *Grace Bros., Inc.*, v. *Commissioner*, 173 F. 2d 170, 173.

Fourth. A majority of the Court is in accord with the principles just outlined. And, applying them to the *Duberstein* case, we are in agreement, on the evidence we have set forth, that it cannot be said that the conclusion of the Tax Court was "clearly erroneous." It seems to us plain that as trier of the facts it was warranted in concluding that despite the characterization of the transfer of the Cadillac by the parties and the absence of any obligation, even of a moral nature, to make it, it was at bottom a recompense for Duberstein's past services, or an inducement for him to be of further service in the future. We cannot say with the Court of Appeals that such a conclusion was "mere suspicion" on the Tax Court's part. To us it appears based in the sort of informed experience with human affairs that fact-finding tribunals should bring to this task.

As to *Stanton*, we are in disagreement. To four of us, it is critical here that the District Court as trier of fact made only the simple and unelaborated finding that the transfer in question was a "gift." [14] To be sure, conciseness is to be strived for, and prolixity avoided, in findings; but, to the four of us, there comes a point where findings become so sparse and conclusory as to give no revelation of what the District Court's concept of the determining facts and legal standard may be. See *Matton Oil Transfer Corp.* v. *The Dynamic*, 123 F. 2d 999, 1000–1001. Such conclusory general findings do not constitute compliance with Rule 52's direction to "find the facts specially and state separately * * * conclusions of law thereon." While the standard of law in this area is not a complex one, we four think the unelaborated finding of ultimate fact here cannot stand as a fulfillment of these requirements. It affords the reviewing court not the semblance of an indication of the legal standard with which the trier of fact has approached his task. For all that appears, the District Court may have viewed the form of the resolution or the simple absence of legal consideration as conclusive. While the judgment of the Court of Appeals cannot stand, the four of us think there must be further proceedings in the District Court looking toward new and adequate findings of fact. In this, we are joined by MR. JUSTICE WHITTAKER, who agrees that the findings were inadequate, although he does not concur generally in this opinion.

Accordingly, in No. 376, the judgment of this Court is that the judgment of the Court of Appeals is reversed, and in No. 546, that the judgment of the Court of Appeals is vacated, and the case is remanded to the District Court for further proceedings not inconsistent with this opinion.

It is so ordered.

MR. JUSTICE HARLAN concurs in the result in No. 376. In No. 546, he would affirm the judgment of the Court of Appeals for the reasons stated by MR. JUSTICE FRANKFURTER.

MR. JUSTICE WHITTAKER, agreeing with *Bogardus* that whether a particular transfer is or is not a "gift" may involve a "mixed question of law and fact," 302 U.S. at 39, concurs only in the result of this opinion.

MR. JUSTICE DOUGLAS dissents, since he is of the view that in each of these two cases there was a gift under the test which the Court fashioned nearly a quarter of a century ago in *Bogardus* v. *Commissioner*, 302 U.S. 34 [Ct. D. 1281, C.B. 1937–2, 258].

REGULATIONS 118, SECTION 39.22(b)(1)–2: Death payment by employer; amounts paid by reason of the death of an employee.

Taxability of payments received from the United States Civil Service Retirement Fund under the authority of Public Law 85–465. See Rev. Rul. 60–235, page 25.

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[14] The "Findings of Fact and Conclusions of Law" were made orally, and were simply: "The Resolution of the Board of Directors of the Trinity Operating Company, Incorporated, held November 18, 1942, after the resignations had been accepted of the plaintiff from his positions as controller of the corporation of the Trinity Church, and the president of the Trinity Operating Company, Incorporated, whereby a gratuity was voted to the plaintiff, Allen [*sic*] D. Stanton, in the amount of $2,000 payable to him in monthly installments of $2,000 each, commencing with the month of December, 1942, constituted a gift to the taxpayer, and therefore need not have been reported by him as income for the taxable years 1942, or 1943."

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

REGULATIONS 118, SECTION 39.22(k)-1: Alimony and separate maintenance payments; income to former wife. Rev. Rul. 60-250

(Also Section 23(u); Regulations 118, Section 39.23(u)-1.)

Installment payments of alimony subject to the contingencies of death of either spouse, remarriage of the wife, or a change in the economic status of either spouse, qualify as periodic payments without limitation under section 22(k) of the Internal Revenue Code of 1939, whether or not such payments are payable for a period of more than ten years.

Revenue Ruling 59-45, C.B. 1959-1, 666, is amplified by extending its application to installment payments of alimony payable for periods in excess of ten years.

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

REGULATIONS 111, SECTION 29.23(a)-1: Business expenses. Ct. D. 1854

(Also Sections 23(l), 24; Regulations 111, Sections 29.23(l)-1, 29.24-1.)

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. DEDUCTIONS FROM GROSS INCOME—EXPENSES—DEPRECIATION—RESORT PROPERTY MAINTAINED BY CORPORATION FOR BENEFIT OF STOCKHOLDERS.

A family corporation, engaged in the brewery supply business, owned summer resort property, which at times was used for entertaining, but was maintained primarily for the personal benefit of its stockholders. The Commissioner of Internal Revenue allowed deductions covering both maintenance expenses and depreciation to the extent of income received from stockholders for use of the property. The property was purchased and improved with the knowledge that it would not earn a profit, and was not expected to earn a profit, but was maintained primarily for the personal benefit of the families of stockholders, without a corresponding benefit to the corporation.

The court holds that the allowances made by the Commissioner were generous and more than the corporation was entitled to on the showing made, since the expenses for maintenance were not incurred in the corporation's trade or business, within the meaning of section 23(a)(1)(A) of the 1939 Code, although it owned other commercial rental property. Likewise, depreciation claimed was not on property used in the corporation's trade or business nor on property held for the production of income within the meaning of subsections (1)(1) and (a)(2) of such section.

2. DECISION AFFIRMED.

Decision of The Tax Court of the United States, T.C. Memo. 1958-104, affirmed.

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

International Trading Co., petitioner-appellant v. *Commissioner of Internal Revenue, respondent*

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

[March 7, 1960]

Before DUFFY and SCHNACKENBERG, Circuit Judges, and STECKLER, District Judge.

STECKLER, District Judge. This is a petition for review of the decision of the Tax Court of the United States determining deficiencies in the petitioner's income tax for its taxable years ending August 31, 1951 and August 31, 1952.

The issue before this court is whether the Tax Court erred in disallowing a portion of the maintenance expenses and depreciation claimed by the corporate taxpayer under sections 23(a)(1)(A) and (l) (1) and (2) of the Internal Revenue Code of 1939.[1]

The Tax Court found and concluded that although certain residential property owned by the corporation at Beaver Lake, Wisconsin, some thirty miles from Milwaukee, may have been used at times for entertaining, in the taxable years ending in 1951, 1952 and 1953, it was maintained primarily for the personal benefit of the stockholders and had little or no business use.

The taxpayer, International Trading Co., is a Wisconsin corporation. In the fiscal years ended in 1948 through 1952, the corporation was engaged in the brewery supply business, and sold containers on a commission basis. The corporation also held real estate and collected rents therefrom. In the years 1950 and 1951, it was also engaged in licensed warehousing. In each of the years involved, the officers of the corporation were Michael Shapiro, Julius Rubin, Bernard Libowsky and Jack LaKam, the latter three being sons-in-law of Michael Shapiro. In the taxable years ending August 31, 1951 and August 31, 1952, all of the stock in the corporation was held in the names of Doris Libowsky, Lillian LaKam and Beatrice Rubin, daughters of Michael Shapiro; Cynthia Libowsky, Nancy Libowsky, Patricia LaKam, Bruce LaKam, David Rubin and Harley Rubin, grandchildren of Michael Shapiro; and by Michael Shapiro, Beatrice Rubin, Lillian LaKam and Doris Libowsky, as trustees of a voting trust for the benefit of the grandchildren of Michael Shapiro.

The parties stipulated in the proceedings before the Tax Court that the Beaver Lake property was purchased by the taxpayer in 1944 for the sum of $23,875.36, but the record shows that the corporation was not organized until May 19, 1946. The buildings on the property were remodeled and new buildings erected, making the property usable for summer residences and entertainment. The cost of additions and improvements prior to August 31, 1952, amounted to $344,953.62, including boating equipment in the amount of $3,082.50, landscaping in the amount of $42,564.66, and furniture and fixtures in the amount of $58,569.46. The property included a large residence consisting of living room and dining room combination, three bedrooms, kitchen, bathroom, two washrooms, and porch; a small house, consisting of two bedrooms, living room, kitchen, and bathroom; one apartment located over a boat house, consisting of two bedrooms, living room, kitchen, breakfast room and bath; one small dwelling house, consisting of four bedrooms, two baths, and a kitchen which had attached to it a community entertainment room with complete facilities for entertaining large groups; and at a lower level of that house, several

[1] The pertinent parts of the section read as follows:

Sec. 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

(a) [As amended by sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] Expenses.

(1) Trade or business expenses.

(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *.

* * * * * * *

(l) [As amended by sec. 121(c) of the 1942 Act] Depreciation. A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * * * *

(26 U.S.C.A. 1952 ed., sec. 23.)

dressing rooms with showers for guests and a rest room; a guest house capable of accommodating six people; a horse stable with caretaker's loft above; a boat house; a rock garden; a playground; a floodlighted tennis court; and a small screen house.

The large house was occupied by Michael Shapiro and his wife for about three months during each summer in 1950, 1951 and 1952. The small house was occupied by Jack LaKam and his family consisting of his wife and two small children during the years 1950, 1951 and 1952 for periods of about nine or ten weeks. The apartment above the boat house was occupied by Ben Libowsky and his family consisting of his wife and three small children during the years 1950, 1951 and 1952 for similar periods. The small dwelling house was occupied for similar periods by Julius Rubin and his family consisting of his wife and two small children during the years 1950 and 1951, and three small children during the year 1952.

During the years 1950, 1951 and 1952, when the premises were occupied by the above-named individuals and their families, they paid the following as rental to the corporation: Michael Shapiro, $3,600; Julius Rubin, $2,400; Jack LaKam, $1,200; and Ben Libowsky, $1,200. The Tax Court found that the fair rental value of such premises for a three-month summer period was not in excess of the amounts paid.

During its fiscal years ended August 31, 1951, 1952 and 1953, the taxpayer incurred expenses for the upkeep and maintenance of the Beaver Lake property, in addition to interest expenses and taxes, for caretaker salaries, repairs and maintenance, insurance, light and heat, and stable supplies. These expenses amounted to $14,294.15 for 1951, $15,219.96 for 1952, and $18,227.28 for 1953. In addition to the expenses for upkeep and maintenance, the taxpayer deducted depreciation on the Beaver Lake property in its 1951, 1952 and 1953 federal income tax returns in the amounts of $20,002.87, $19,761.90 and $20,021.00, respectively. The combined expenses for maintenance and depreciation thus amounted to $34,297.02 for 1951, $34,981.86 for 1952, and $38,248.28 for 1953.

The taxpayer attempted to sell the Beaver Lake property in 1950, and listed it for sale in the summer of 1951 for $200,000. An offer of $105,000 was received and rejected.

The taxpayer's merchandise sales for the years ended August 31, 1951, 1952 and 1953 amounted to $362,919.73, $17,834.51 and $1,615.13 respectively.

In the fiscal year ended August 31, 1951, the corporation collected rents in the amount of $75,867.04, and in the year ended August 31, 1952, in the amount of $18,533.30.

With respect to the Beaver Lake property, the Commissioner allowed the taxpayer to deduct $9,000 in each of the taxable years, that is, to the extent of the aggregate rent received from its stockholders and included in the corporation's income, disallowing all other deductions for maintenance and upkeep and depreciation. Subsequently, the Tax Court, affirming in part the Commissioner's action, found that the taxpayer could not deduct the maintenance expenses and depreciation on the Beaver Lake property for its 1951 to 1953 fiscal years in excess of the deductions allowed by the Commissioner, because the property had little or no business use and was held primarily for the personal use of the taxpayer's stockholders.

The decisions of the Tax Court are to be reviewed in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury. The findings and decision of the Tax Court must be accepted as correct unless, of course, they are not based upon substantial evidence or if the proper rules of law are not applied.

Although the Tax Court simply found that the Beaver Lake property in the taxable years was maintained primarily for the personal benefit of the stockholders and had little or no business use, it did not specifically find that the claimed expenses were not *incurred in the taxpayer's trade or business* or with respect to *property held for the production of income.* From a reading of the Tax Court's Memorandum Findings of Fact and Opinion, it is implicit that that court found that the property was not used in the trade or business of the taxpayer, nor held for the production of income, within the meaning of section 23(a)(1)(A), and (1) (1) and (2). The question presented here is whether the Tax Court upon the factual record before it, correctly so found.

This court is mindful of the rule that substance controls over form in the application of Internal Revenue laws which are regarded as having a practical, not theoretical application. *Western Maryland Ry. Co.* v. *Commissioner,* 33

F. 2d 695, 698 (4th Cir. 1929). As the Supreme Court has repeatedly held, it is the underlying essence of a transaction that determines its taxability. *Helvering* v. *Tex-Penn Oil Co.*, 300 U.S. 481, 493 (1937); *Bowers* v. *Lawyers' Mtge. Co.*, 285 U.S. 182 (1932); *United States* v. *Phellis*, 257 U.S. 156, 168 (1921); [Ct. D. 19, C.B. 5, 37 (1921)]; *United States* v. *Merchants Nat. Trust & Savings Bank*, 101 F. 2d 399 (9th Cir. 1939). It is the origin and nature and not the legal form of the expense sought to be deducted that determines the applicability of the statute. *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, *rehearing denied*, 320 U.S. 809 (1943) [Ct. D. 1586, C.B. 1943, 1016].

In the Tax Court, the petitioner's contentions were that it purchased and maintained the property as an investment and for the purpose of entertaining its customers and suppliers in connection with its brewery supply business. Thus, it argued, the maintenance expenses and depreciation were incurred in its trade or business and in maintaining the investment in good condition as a high grade piece of resort property.

Here on appeal the petitioner does not press the theory that the Beaver Lake property was purchased principally for the entertainment of customers and suppliers. Rather, it now posits its case on the proposition that it was engaged in the business of holding real estate and collecting rents therefrom, and that it received a rental income from the Beaver Lake property of an amount equal to its fair rental value; that this, as a matter of law, entitles petitioner to the deductions claimed. Further, in oral argument, petitioner's counsel argued that there is no such thing as a non-business activity of a corporation. With respect to corporations, as distinguished from individuals, petitioner urges there is a "statutory assumption" that transactions entered into by corporations are in connection with their business, and, as a corollary, a profit motive is assumed.

It is apparent from petitioner's argument that it contends it is entitled to all maintenance expenses and depreciation claimed on the Beaver Lake property, without regard to its actual use, merely because the respondent allowed the claimed deductions, both as to business expenses and depreciation, to the extent of the rentals of $9,000 per year received from the shareholders. Petitioner states that this allowance is tantamount to an acknowledgment that the deductions were allowable items to the full extent claimed. It says: "Presumably, if more rent had been collected, more of these deductions claimed would have been allowed, and if rent equal to or exceeding the deductions would have been received, all the deductions would have been allowed." Petitioner states there is no provision in the Code which authorizes this treatment or limits the deductions to the amount of rent received. At first blush this argument appears to be plausible. However, it overlooks the exclusion of deductions of expenses incurred in purely personal pursuits, or in respect to property held primarily for personal use.

Section 23(a)(1)(A) and corresponding sections in the earlier revenue acts, authorize the deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

The statute should be broadly construed to facilitate business, but the statute does not make deductible all expenses of every business transaction, whether of an individual, *Higgins* v. *Commissioner*, 312 U.S. 212 (1941) [Ct. D. 1486, C.B. 1941–1, 339]; *United States* v. *Pyne*, 313 U.S. 127 (1941) [Ct. D. 1509, C.B. 1941–1, 342], or whether of a corporation, *Greenspon* v. *Commissioner*, 229 F. 2d 947 (8th Cir. 1956); *Interstate Transit Lines* v. *Commissioner*, *supra*; *A. Giurlani & Bro., Inc.*, v. *Commissioner*, 119 F. 2d 852 (9th Cir. 1941).

A corporation is normally deemed to be engaged in a "trade or business"; however, to the extent that it is operated solely for the pleasure or recreation of its stockholders, it is not engaged in a "trade or business." 4 Mertens, *Law of Federal Income Taxation* § *25.08* (Zimet & Diamond Rev. 1954); *American Properties, Inc.* v. *Commissioner*, 28 Tax Court 1100 (1957), *affirmed* 262 F. 2d 150 (9th Cir. 1958).

All deductions, whether with respect to individuals, or corporations, are a matter of legislative grace, and unless the claimed deductions come clearly within the scope of the statute, they are not to be allowed. The burden to make that showing rests upon the taxpayer. *Deputy* v. *duPont*, 308 U.S. 488, 493 (1939); *Bradley* v. *Commissioner*, 184 F. 2d 860 (7th Cir. 1950); *Greenspon* v. *Commissioner*, *supra*.

Whether activities of a taxpayer amount to "carrying on a trade or business" within the statute is largely a matter of degree, and for a determination requires

and examination of the facts in each case. There are certain factors of evidentiary importance which must be regarded in determining whether a taxpayer is engaged in "trade" or "business" or "in carrying on a trade or business" within the meaning of the statute. Prominent among these factors are the profit motive and the presence of businesslike policies, especially such as those customarily evidenced by the taxpayer in other business activities. "In order that the taxpayer's activities may constitute the carrying on of a 'trade or business,' he need not have a reasonable expectation of a profit. He must, however, initiate or conduct the enterprise in good faith with an intention of making a profit or of producing income. Thus, the profit factor is really only significant in so far as it affords a means of distinguishing between an enterprise carried on in good faith as a 'trade or business' and an enterprise merely carried on as a hobby." 4 Mertens, *supra*, p. 18. This principle can be applied equally to the case at hand in determining whether the taxpayer's Beaver Lake property had little or no business use and was held primarily for the personal use of the taxpayer's stockholders. *American Properties, Inc.* v. *Commissioner, supra.*

The taxpayer's general business was that of a brewery supplier. Its largest customer was the Schlitz Brewing Company. There is no evidence in the record to indicate that the Beaver Lake property was ever maintained to be rented at a profit. Indeed the entire record indicates the contrary. The taxpayer's board of directors and its employees never attempted to rent the property to others than Michael Shapiro's family. The property never was advertised for rent nor was it placed on the market for that purpose. The record is completely barren of any evidence indicating commercial activity with respect to the resort. In fact, outsiders regarded the property as a family estate.

The evidence shows that the taxpayer expended in purchasing and improving the property the sum of $368,828.98. Each year it expended substantially more on the property than the rent it received from the members of the family. In some years it expended more than twice as much as it received by way of such rents. There is no evidence of the terms of any lease between the taxpayer and its shareholders. Still, the shareholders were entitled to occupy the property at will and at any time to their liking; and there is no evidence of any dividends having been paid the shareholders.[2]

Another factor that looms largely as to whether this was a business activity, is that the Beaver Lake property was not economically integrated with any other commercial property of the taxpayer. All of the taxpayer's rental income other than that received from its stockholders in connection with the Beaver Lake property was derived from commercial properties in the City of Milwaukee. Its commercial rent receipts came from the property that it originally acquired or bought for its general business of dealing in brewery supplies but by reason of business conditions, could not use for that purpose. Even the testimony of Michael Shapiro indicates no expectation of profits from rents on the Beaver Lake property. It was his testimony that the property was purchased primarily for the purpose of entertaining customers and suppliers in connection with the brewery supply business. As heretofore stated, with respect to the years here in question, that theory is no longer urged. In passing it should be said there is no substantial evidence that the property was used for business entertainment in these years nor in earlier years. The living facilities on the premises were kept heated during the winter months. The shareholders were entitled to, and did at times, occupy the premises during the winter. It was held, as the Tax Court properly found, for the personal benefit of the stockholders and at the expense of the corporation. The evidence before the Tax Court clearly indicated a history of continuous losses with no hope of profit from the alleged renting business in so far as the Beaver Lake property was concerned.

Since we agree that the Tax Court was correct in its findings and conclusion that the Beaver Lake property was maintained in the taxable years here in question primarily for the personal benefit of the stockholders, and that it had little or no business use, it follows that the claimed expenses under section 23(a)(1)(A) were not ordinary and necessary expenses incurred in carrying on the taxpayer's trade or business.

"Ordinary and necessary" expenses within the meaning of the statute are all ordinary and necessary expenses directly connected with or proximately resulting from, carrying on any trade or business. *Northern Trust Co.* v. *Campbell*, 211

[2] "Whether the Tax Court erred in overruling the Commissioner's determination that the benefits otherwise received from the use of the property were taxable to the individual shareholders is an issue not here presented." Resp.'s Brief, p. 23, n. 9.

F. 2d 251 (7th Cir. 1954); *Mills Estate, Inc.* v. *Commissioner*, 206 F. 2d 244 (2d Cir. 1953); *Friedman* v. *Delaney*, 171 F. 2d 269 (1st Cir. 1948), *cert. denied* 336 U.S. 936 (1949); *Deputy* v. *duPont, supra; Welch* v. *Helvering*, 290 U.S. 111 (1933) [Ct. D. 755, C.B. XII–2, 112 (1933)]. "Ordinary," as the term is used in the statute, has the connotation of normal, usual, or customary in the type of business involved. *Deputy* v. *duPont, supra*, at 494–496; *Hales-Mullaly, Inc.* v. *Commissioner*, 131 F. 2d 509, 511 (10th Cir. 1942); *A. Giurlani & Bro., Inc.* v. *Commissioner, supra*. The word "necessary" has been construed to mean "appropriate and helpful." See *Welch* v. *Helvering, supra*, at 113; *Commissioner* v. *Heininger*, 320 U.S. 467, 471 (1943).

Even though the evidence shows that the taxpayer had rental income from its commercial properties in Milwaukee, and to that extent was engaged in carrying on a rental business for profit, nevertheless, as respects the Beaver Lake property, the expense of maintaining it, in view of the evidence, cannot be said to be an "ordinary" and "necessary" expense within the meaning of section 23(a)(1)(A). Where, as here, the property was purchased and improved with the knowledge that it would not earn a profit, and was not expected to earn a profit, but was maintained primarily for the personal benefit of the families of the corporation's stockholders, without a corresponding benefit to the corporation, as to the deficit between rents received and expenses incurred (see *Interstate Transit Lines* v. *Commissioner*, 130 F. 2d 136, 139 (8th Cir. 1942), *affirmed* 319 U.S. 590, *supra*), the expenses of maintaining it were not "ordinary" and "necessary" expenses incurred in the taxpayer's rental business.

True, the Tax Court found that under the circumstances the fair rental values of the premises for the time the families made use of the property were not in excess of the rentals they paid. Still this does not overcome the court's finding that the property had little or no business use and was maintained primarily for the personal use of the stockholders, and thus, implicitly, any expenses incurred in its maintenance were not in connection with its trade or business.

We conclude, then, with respect to the claimed deductions under section 23(a)(1)(A), on the evidence before the Tax Court, that the taxpayer failed to satisfy the burden of clearly showing its right to the deductions for maintenance expenses in the fiscal years 1951 and 1952.

The petitioner likewise failed to satisfy its burden of showing that it was entitled to the depreciation deductions under section 23(l).

Section 23(l) allows depreciation deductions only with respect to (1) property used in the taxpayer's trade or business, or (2) property held for the production of income. What we have already said with regard to the taxpayer's failure to satisfy the burden of proving its entitlement to maintenance expense deductions under section 23(a)(1)(A) applies equally to its claim for depreciation deductions under section 23(l)(1).

Moreover, it is well settled that a taxpayer cannot take depreciation deductions on property to the extent that it is devoted to personal purposes, whether those purposes are personal benefits to the stockholders of a corporate taxpayer or whether they are personal benefits to an individual who is the taxpayer. *Bradley* v. *Commissioner, supra; Greenspon* v. *Commissioner, supra; American Properties, Inc.* v. *Commissioner, supra; Leadbetter* v. *Commissioner*, 39 B.T.A. 629 (1939). Here again, as in the case of all deductions, allowance for depreciation is a matter of legislative grace. *Detroit Edison Co.* v. *Commissioner*, 131 F. 2d 619, 622 (6th Cir. 1942), *affirmed* 319 U.S. 98 (1943) [Ct. D. 1582, C.B. 1943, 1019].

Nor will it be assumed that property was held for the production of income; it is the taxpayer's burden to show that the property was actually held primarily to produce income. *Estate of Fuller* v. *Commissioner*, 9 Tax Court 1069, 1076 (1947), *affirmed per curiam*, 171 F. 2d 704 (3d Cir. 1948), *cert. denied*, 336 U.S. 961 (1949); *Morton* v. *Commissioner*, 174 F. 2d 302, 304 (2d Cir.), *cert. denied*, 338 U.S. 828 (1949).

Whether the Beaver Lake property was "held for the production of income" within the meaning of subsection (1)(2) of section 23, presents a question of greater complexity, the answer to which is more elusive than the answer to the other questions dealt with herein. The answer depends largely upon the taxpayer's intent, and, of course, it is difficult to prove what existed in a taxpayer's mind at a given time. Therefore, it is often necessary to prove such intent by acts and conduct. Also, intent is a question of fact and its ascertainment must be left to the finder of facts. If there is any reasonable basis in fact in the evidence to support the Tax Court's finding as to whether the

property was, or was not held for the production of income, such finding must be sustained. It is not for a court of review to weigh the evidence.

In this case, as we have already indicated, the record indicates a history of continuous losses with no expectations of a profit from the renting of the Beaver Lake property. It is apparent that the property was acquired by part of the shareholders prior to the time the taxpayer was organized as a corporation, and that some of the improvements were made prior to the time the corporation acquired it. At the time the property was acquired, it was a personal residential property. From that time on, improvements were made for the personal benefit of the shareholders. Playgrounds for the children, lighted tennis courts, boating facilities, et cetera, were provided. All the while, the property was withheld from the rental market.

Petitioner bases a part of its claim for depreciation expenses on the ground that the property was held as an investment and that the expenses were ordinary and necessary in order to preserve it as a high grade piece of property in case it should later wish to sell it at a profit. Also, that in 1951 it placed the property in the hands of a real estate broker in order to sell it. These arguments, although quantitative, fall far short in the taxpayer's attempt to convert the Beaver Lake property into property held for the production of income within the meaning of the statute. This is especially so when the taxpayer's transactions with respect to the property are viewed as a whole, and not fragmentized for convenient and self-serving purposes.

In view of the foregoing evidentiary factors, the Tax Court committed no error in finding that the Beaver Lake property was maintained primarily for the personal benefit of the taxpayer's shareholders and, implicitly, that it was not held for the production of income within the meaning of subsection (1) (2) of section 23.

It was not necessary for the Commissioner or the Tax Court to disallow the claimed deductions by reason of the prohibition of section 24 of the Internal Revenue Code on the ground they constituted "personal . . . expenses." For unless the expenses claimed conveniently came within section 23(a) (1) (A) and (1) (1) and (2), they were not deductible. To have done otherwise would have disregarded the explicit restrictions of section 23 confining deductible expenses solely to outlays in carrying on the taxpayer's trade or business or in respect to property used in the trade or business or held for the production of income. *McDonald* v. *Commissioner*, 323 U.S. 57 (1944).

In certain cases, an allocation may be permissible. The taxpayer in this case made no allocation and offered no evidence upon which the Commissioner could make a proper allocation, either with respect to business expenses or claims for depreciation. When expenditures are incurred covering items which are non-deductible as business expenses to the taxpayer, and also items which constitute a part of the carrying on of a taxpayer's business, it is incumbent upon the taxpayer to introduce evidence upon which a reasonable allocation of charges between the two types of items can be made; otherwise no deduction will be allowed. *Interstate Transit Lines* v. *Commissioner, supra; Nowland* v. *Commissioner*, 244 F. 2d 450, 454 (4th Cir. 1957); *Harden Mortgage Loan Co.* v. *Commissioner*, 137 F. 2d 282, 284 (10th Cir.), *cert. denied*, 320 U.S. 791 (1943). Cf. *Estate of Fuller* v. *Commissioner, supra; Chesbro* v. *Commissioner*, 225 F. 2d 674 (2d Cir. 1955), *cert. denied*, 350 U.S. 995 (1956). The petitioner likewise failed to show any basis for an allocation of claimed depreciation. *Morton* v. *Commissioner, supra*, at 304; *Estate of Fuller* v. *Commissioner, supra; Greenspon* v. *Commissioner, supra.*

Notwithstanding the taxpayer's failure to establish a basis for a proper allocation, the Commissioner, as previously stated, allowed deductions covering both maintenance expenses and depreciation in the aggregate amount of $9,000, an amount equal to the income received from the Beaver Lake property for the shareholders' use of it in each of the taxable years in question. Thus, even though there was no reasonable basis to hold that the property was held for the production of income, or that it was used in the taxpayer's trade or business, the Commissioner allowed a complete setoff against the total amount of income received from the property. Such a generous treatment of the claimed deductions was more than the taxpayer was entitled to on the strength of the showing it made.

We therefore conclude that the finding of the Tax Court is supported by reasonable and substantial evidence and there is warrant in the record and a basis in law for the Tax Court's conclusion that the expenses for maintenance

of the Beaver Lake property were not incurred in the taxpayer's trade or business within the meaning of section 23(a)(1)(A), and likewise that the depreciation claimed was not on property used in the taxpayer's trade or business nor on property held for the production of income within the meaning of subsection (1) (1) and (2) of that section.

The decision of the Tax Court is affirmed.

Ct. D. 1857

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. DEDUCTIONS FROM GROSS INCOME—BUSINESS EXPENSES—LITIGATION EXPENSES—DEFENSE OF CRIMINAL TAX EVASION CHARGES.

Legal expenses incurred in the *successful* defense of a criminal tax evasion charge against the taxpayer-wife are deductible under section 23(a) of the Internal Revenue Code of 1939. The court, after a review of all relevant cases involving deductions for legal expenses arising from non-tax litigation and those arising from tax litigation, concluded that there is no essential distinction between legal expenses arising in civil and criminal cases, subject to proper limitations for "public policy" in *unsuccessful* criminal defenses, since in both instances there is basically involved the "determination" of tax liability referred to in the applicable regulation under the Code.

2. DECISION AFFIRMED.

Decision of The Tax Court of the United States, T.C. Memo. 1958–104, affirmed.

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Commissioner of Internal Revenue, petitioner v. *Michael Shapiro and Rae Shapiro, respondents*

On petition for review of the decisions of the Tax Court of the United States

[June 3, 1960]

Before HASTINGS, *Chief Judge*, SCHNACKENBERG, *Circuit Judge* and MERCER, *District Judge.*

HASTINGS, *Chief Judge.* The Commissioner of Internal Revenue here petitions for review of a decision of the Tax Court of the United States which granted certain income tax deductions to respondents Michael Shapiro and his wife, Rae Shapiro. The deductions concerned legal expenses arising from the successful defense of a criminal tax evasion charge brought against Rae Shapiro. This appears to be a case of first impression in a court of appeals.

The facts pertinent to this review are not in dispute. As revealed by the record, they may be summarized as follows: Rae Shapiro filed federal income and victory tax returns for the years 1941 through 1944, including therein the income from the business she conducted under the name of "Shapiro's." An investigation of these returns resulted in the Commissioner's determination in December, 1946, that the returns were incorrect; and he assessed a deficiency and an addition to the tax for fraud. Rae Shapiro filed a petition with the Tax Court for a redetermination of her liabilities; and subsequently, a substantial jeopardy assessment was levied.

In 1950, a criminal indictment was returned against Michael and Rae Shapiro, charging that they attempted to evade the applicable tax by Rae's filing fraudulent returns in 1943 and 1944. Both defendants pleaded not guilty to this charge. In November, 1951, Michael entered a plea of *nolo contendere* to the charge relating to 1944 and was adjudged guilty and sentenced. The court dismissed the indictment as to Rae.[1] Subsequently, the civil case before the Tax Court involving tax liabilities for the years 1941 to 1944 was settled by compromise in 1955.

[1] The Commissioner does not differentiate the issue before us (a successful criminal defense arising from the dismissal of the indictment) from an acquittal on the merits.

From 1948 through 1952 Michael and Rae employed and paid large sums to several attorneys and accountants to adjust their tax liability in the civil case and also to defend them in the criminal actions. The Shapiros claimed deductions for most of these fees in their tax returns for those years. The Commissioner agreed that all fees expended in the civil case were deductible but disagreed as to the amount. Further, he contended that, as a matter of public policy, none of the expense in connection with the defense of the criminal cases was deductible.

The Tax Court allocated the claimed deductions of legal fees to the civil tax case, the defense of Michael, the defense of Rae, and to other unexplained deductions. It granted deductions for all legal expenses in the civil suit and for the successful defense of Rae and disallowed the unexplained expenses and those in the unsuccessful defense of Michael. A petition was filed by the Commissioner to review the granting of the deductions for expenses incurred in the defense of the criminal action against Rae, and that is the sole issue before us. Michael Shapiro is a party here only because he filed joint returns with Rae during the taxable years in question.

The Tax Court allowed a deduction for Rae's legal expenses in the criminal action as a business expense. It found that the income reported on Rae's tax returns for 1943 and 1944 came from a business operated by her as a sole proprietorship, income which had to be reported on individual or joint returns. The court said, "The litigation concerned business income and the costs of such litigation are business expenses and are deductible except where a conviction results and the public policy denies the deduction." The critical element in the Tax Court's analysis is that the *source* of income reported is from taxpayer's business.

The Commissioner's position here is primarily that the expense of defending a criminal tax charge is "personal" in any case and therefore non-deductible; and, in the alternative, if certain legal expenses are deductible, only those expenses relating to cases which directly affect taxpayer's business meet the test of "ordinary and necessary" expenses. The Commissioner argues that the Tax Court must find that the acts charged as criminal were business acts and that in this case such requisite finding was not made.

We agree with the Tax Court's result that the deduction in question should be granted, but we allow the deduction on more broad grounds than those of the Tax Court.

The disposition of this case is governed by Sections 23 and 24 of the Internal Revenue Code of 1939, 26 U.S.C.A., and the appropriate regulations relating thereto. Section 23, Deductions from Gross Income, states in part:

> "(1) TRADE OR BUSINESS EXPENSES.—
>
> (A) IN GENERAL.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *
>
> "(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."

Section 24(a)(1), Items Not Deductible, disallows deductions for:

> "(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under section 23(x); * * *"

The proper deduction of legal expenses has presented a continuing problem to the Commissioner and the courts for many years.[2] An examination of relevant cases reveals the following decisional pattern. Generally, the legal expenses for which deductions are claimed fall into two categories—expenses arising from non-tax litigation and those arising from tax litigation. Deductions are claimed as business or non-business expenses.[3]

[2] See generally, Brooks, Litigation Expenses and the Income Tax, 12 Tax L. Rev. 241 (1956); McDonald, Deduction of Attorneys' Fees, 103 U. Pa. L. Rev. 168 (1954). See text and cases collected in 4 Mertens, Law of Federal Income Taxation, sec. 25 A. 10, sec. 25.50, and sec. 25.57; CCH 1960 Stand. Fed. Tax Rep. par. 1348.4615 and par. 2006.384.

[3] Under the 1954 Code, deductions are allowed "in connection with the determination, collection, or refund of any tax." 26 U.S.C.A. sec. 212(3). In 1952, the Supreme Court had held that expenses in contesting gift tax liability were not within the scope of Section 23(a)(2). *Lykes* v. *United States*, 343 U.S. 118 (1952) [Ct. D. 1743, C.B. 1952–1, 32].

In the first category, non-tax litigation, the test of deductibility as a business expense has been defined in terms of proximate cause. That is, whether the taxpayer brings an action or defends it, the analysis proceeds in terms of the relationship of the particular lawsuit to the business of the taxpayer. *Kornhauser* v. *United States*, 276 U.S. 145, 152–53 (1928) [T.D. 4222, C.B. VII–2, 267 (1928)]. If the trier of fact finds that the litigation is not directly connected with the business of the taxpayer, then the expense is a non-deductible personal item. As examples, suits involving slander,[4] criminal assault,[5] conspiracy to obstruct justice[6] and incompetency proceedings[7] can all be rationalized in terms of proximate cause. Similar cases have arisen where deductions are claimed as non-business expenses for the production of income or maintenance and conservation of income producing property.[8]

Additionally, on the grounds of "public policy," courts have denied deductions in non-tax cases for legal expenses arising from unsuccessful defenses in criminal cases.[9] The Supreme Court, however, allowed a deduction for legal expenses in an unsuccessful defense of a civil fraud order brought by the Post Office Department, where the effect of the order was to curtail the taxpayer's mail order business. *Commissioner* v. *Heininger*, 320 U.S. 467 (1943) [Ct. D. 1596, C.B. 1944, 484].

In the category of legal expenses arising from tax litigation, the element of proximate cause is of less importance. A regulation promulgated under the 1939 Code stated that "[e]xpenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible."[10] The 1954 Code expanded this deduction to ordinary and necessary expenses in the determination of any tax. 26 U.S.C.A. Section 212(3). In civil suits to determine taxpayer's liability, deductions for legal expenses have been allowed,[11] whether the civil case s a taxpayer's suit for recovery of an overpayment,[12] resisting a deficiency successfully[13] or unsuccessfully,[14] the compromise of charges giving rise to liability for criminal and civil fraud,[15] or in attempts to determine and settle tax liability prior to an indictment and conviction for crim-

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[4] *Lloyd* v. *Commissioner of Internal Revenue*, 7 Cir., 55 F. 2d 842 (1932) [Ct. D. 542, C.B. XI–2, 268 (1932)]. The taxpayer here brought and won a suit for a slander made at a trade association convention. This court denied his requested business deductions for attorney fees, holding that a slander action is a personal injury and that his corporation neither profited nor lost by the suit. *But cf. Commissioner of Int. Rev.* v. *People's-Pittsburgh Trust Co.*, 3 Cir., 60 F. 2d 187 (1932).

[5] *John W. Clark*, 30 T.C. 1330 (1958) (prosecutor withdrew warrant in criminal case; business deduction allowed.) *Cf. Pantages Theatre Co.* v. *Welch*, 9 Cir., 71 F. 2d 68 (1934) (rape charge against president of corporation which paid for defense fees; corporate business deduction disallowed).

[6] *Morgan S. Kaufman*, 12 T.C. 1114 (1949) (successful defense to charge of conspiracy to obstruct justice, the charge directly resulting from taxpayer's practice of law; deduction allowed).

[7] *Lewis* v. *Commissioner of Internal Revenue*, 2 Cir., 253 F. 2d 821 (1958) (author defended himself against incompetency proceedings. Argued that such adjudication would harm sale of his books. Held that, distinguished from the direct attack on taxpayer's business in *Commissioner* v. *Heininger*, 320 U.S. 467 (1943), here the charge was not directed at destroying his trade or business, but was directed at the totality of the individual. Denied business deduction.)

[8] *Trust of Bingham* v. *Comm'r*, 325 U.S. 365 (1945) [Ct. D. 1643, C.B. 1945, 103] (expenses incurred for legal advice as to the proper methods of distributing trust property; held a non-business deduction).

[9] *Thomas A. Joseph*, 26 T.C. 562 (1956) (attorney convicted of felony, jailed, then disbarred; legal expenses in defense not deductible). *Cf. National Outdoor Advertising Bureau* v. *Helvering*, 2 Cir., 89 F. 2d 878 (1937) (consent decree in Sherman Act action; expenses not deductible).

[10] Treas. Reg. 111, sec. 29.23(a)–15 (1939), as amended, T.D. 5513, 1946–1 Cum. Bull. 61. See 4 Mertens, *op. cit. supra* note 2, sec. 25 A. 11, for a discussion of the history and scope of this regulation.

[11] In *Commissioner of Internal Revenue* v. *Standing*, 4 Cir., 259 F. 2d 450 (1958), the issue was whether the admittedly deductible legal expense was a business or non-business expense, a determination which controlled whether the deduction could be taken from gross income in arriving at adjusted gross income or whether it must be taken from adjusted gross income in lieu of the standard deduction. Such an issue is not before the court here.

[12] *Williams* v. *McGowan*, 2 Cir., 152 F. 2d 570 (1945); *Howard E. Cammack*, 5 T.C. 467 (1945).

[13] *Northern Trust Co.* v. *Campbell*, 7 Cir., 211 F. 2d 251 (1954) (deficiency charged on estate tax return); *Norbert H. Wiesler*, 6 T.C. 1148 (1946); *Stoddard* v. *Commissioner of Internal Revenue*, 2 Cir., 152 F. 2d 445 (1945) (accountant fees).

[14] *Trust of Bingham* v. *Comm'r*, 325 U.S. 365 (1945) [Ct. D. 1643, C.B. 1945, 103]; *James A. Connelly*, 6 T.C. 744 (1946).

[15] *Greene Motor Co.*, 5 T.C. 314 (1945) (compromise agreement).

inal fraud.[16] Thus broad deductions are allowed for reasonable attorney's fees in civil tax litigation.

Cases involving expenses arising from criminal tax charges complete the pattern. In three cases where taxpayer was convicted, deductions for legal expenses were denied, either on the basis of "public policy" [17] or on the theory that the tax suit related directly to taxpayer's personal misconduct.[18] In one case in which the defendant was acquitted, the court granted a deduction, rejecting the argument that the legal expenses were personal, and holding that they were necessary and deductible because "a criminal quality was attributed to acts which were performed by the taxpayer in carrying on his trade or business." [19]

In surveying the pattern of cases, we conclude that there is no essential difference between legal expenses arising in civil and criminal tax cases. Noting that deductions are granted freely for legal expenses arising in contesting civil tax suits, it is proper that a deduction is allowable for similar expenses in criminal suits. Both instances basically involve the "determination" of tax liability referred to in the applicable regulation under the 1939 Code, *supra*. It logically follows that reasonable legal expenses incident to the determination of income tax liability—whether the litigation be civil or criminal—are deductible expenses under Section 23, subject to proper limitations of "public policy" in unsuccessful criminal defenses.

In the instant case, implicit in the Tax Court's allowance of the deduction is the assumption that the expenses were ordinary and necessary. There was no need here explicitly to so find. Parenthetically, it is difficult to conceive of a case in which it would not be ordinary and necessary for a taxpayer defending a criminal tax charge to employ counsel to assist him.

We hold that the legal expenses incurred by the taxpayer in the successful defense of the criminal charge against her were properly deductible in the tax years in question.

The decision of the Tax Court appealed from herein is

Affirmed.

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

REGULATIONS 111, SECTION 29.23(l)–1: Depreciation. Ct. D. 1847

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. DEDUCTIONS FROM GROSS INCOME—DEPRECIATION—BASIS—USEFUL LIFE—SALVAGE.

Where taxpayers are engaged in the business of leasing automobiles to corporations which in turn lease and rent such automobiles to the public, and where, because the corporations' customers demand late model automobiles, taxpayers customarily sold their automobiles before the end of their physical life for a substantial price, the leased automobiles are depreciable on the basis of their estimated useful life in the taxpayers' business, using a depreciation base consisting of cost less the substan-

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[16] *Commissioner of Internal Revenue* v. *Schwartz*, 5 Cir., 232 F. 2d 94 (1956). *Cf. Cecil R. Hopkins*, 30 T.C. 1015 (1958) (deduction disallowed where found that the primary purpose of legal expenditures was to avoid criminal prosecution in which taxpayer later pleaded guilty). The Court of Appeals has remanded *Hopkins* to the Tax Court to take additional evidence. CCH 1960 Stand. Fed. Tax Rep. par. 9030.

[17] *Acker* v. *Commissioner of Internal Revenue*, 6 Cir. 258 F. 2d 568 (1958) (citing *Heininger* as authority to deny the deduction).

[18] *Port* v. *United States*, Ct. Cl., 163 F. Supp. 645 (1958); In *Richard F. Smith*, 31 T.C. 1 (1958), the taxpayer was indicted for evading taxes in five separate years. He was adjudged guilty for two years and acquitted for three. Taxpayer tried to deduct all expenses or at least apportion for those years for which he was acquitted. The Tax Court allowed no deductions at all, stating that the acts charged (knowingly evading taxes) were not directly connected with or normally incidental to the carrying on of taxpayer's business of dentistry. Commissioner makes a similar argument here—that the act of filing a tax return is a personal act.

[19] *Commissioner of Int. Rev.* v. *People's-Pittsburgh Trust Co.*, 3 Cir., 60 F. 2d 187, 189 (1932). However, in that case, the tax returns were not personal returns but those of a corporation which the defendant, as chairman of the board, was required to file.

tial resale value of the automobiles at the end of their useful life in taxpayers' business.

The intent of Congress that the depreciation deduction should allow a taxpayer to recover only the cost of an asset over its salvage value, which includes estimated resale or second-hand value rather than junk value, requires that depreciation be computed over the period of the useful life of the asset to the taxpayer, and not over the period of its longer economic life.

2. JUDGMENT AFFIRMED AND JUDGMENT REVERSED.

Judgment of the United States Court of Appeals for the Fifth Circuit, 264 Fed. (2d) 552, affirmed; judgment of the United States Court of Appeals for the Ninth Circuit, 264 Fed. (2d) 502, reversed.

SUPREME COURT OF THE UNITED STATES

Massey Motors, Inc., petitioner v. *United States of America*

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

Commissioner of Internal Revenue, petitioner v. *Robley H. Evans and Julia M. Evans*

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

[June 27, 1960]

MR. JUSTICE CLARK delivered the opinion of the Court.

These consolidated cases involve the depreciation allowance for automobiles used in rental and allied service, as claimed under section 23(l) of the Internal Revenue Code of 1939, which permits the deduction for income tax purposes of a "reasonable allowance for the exhaustion, wear and tear * * * of property used in the trade or business." The applicable Treasury Regulation 111, section 29–23(l)–1, defines such allowance to be "that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan * * * whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property." The Courts of Appeals have divided on the method of depreciation which is permissible in relation to such assets, and we therefore granted certiorari to resolve this conflict. 361 U.S. 810, 812. We have concluded that the reasonable allowance for depreciation of the property in question used in the taxpayer's business is to be calculated over the estimated useful life of the asset while actually employed by the taxpayer, applying a depreciation base of the cost of the property to the taxpayer less its resale value at the estimated time of disposal.

In No. 143, *Commissioner* v. *R. H. and J. M. Evans*, the taxpayers are husband and wife. In 1950 and 1951, the husband, Robley Evans, was engaged in the business of leasing new automobiles to Evans U-Drive, Inc., at the rate of $45 per car per month. U-Drive in turn leased from 30% to 40% of the cars to its customers for long terms ranging from 18 to 36 months, while the remainder were rented to the public on a call basis for shorter periods. Robley Evans normally kept in stock a supply of new cars with which to service U-Drive and which he purchased at factory price from local automobile dealers. The latest model cars were required because of the demands of the rental business for a fleet of modern automobiles.

When the U-Drive service had an oversupply of cars that were used on short-term rental, it would return them to the taxpayer and he would sell them, disposing of the oldest and least desirable ones first. Normally the ones so disposed of had been used about 15 months and had been driven an average of 15,000 to 20,000 miles. They were ordinarily in first-class condition. It was likewise customary for the taxpayer to sell the long-term rental cars at the termination of their leases, ordinarily after about 50,000 miles of use. They also were usually in good condition. The taxpayer could have used the cars for a longer period, but customer demand for the latest model cars rendered the older styles of little value to the rental business. Because of this, taxpayer found it more profitable to sell the older cars to used car dealers, jobbers or brokers at current wholesale prices. Taxpayer sold 140 such cars in 1950 and

147 in 1951. On all cars leased to U-Drive, taxpayer claimed on his tax returns depreciation calculated on the basis of an estimated useful life of four years with no residual salvage value. The return for 1950, for example, indicated that each car's cost to taxpayer was around $1,650; after some 15 months use he sold it for $13,380; he charged depreciation of $515 based on a useful life of four years, without salvage value; which left him a net gain of $245, on which he calculated a capital gains tax. In 1951, the net gain based on the same method of calculation was approximately $350 per car, on which capital gains were computed. The Commissioner denied the depreciation claims, however, on the theory that useful life was not the total economic life of the automobile (*i.e.*, the four years claimed), but only the period it was actually used by the taxpayer in his business; and that salvage value was not junk value but the resale value at the time of disposal. On this basis he estimated the useful life of each car at 17 months and salvage value at $1,325; depreciation was permitted only on the difference between this value and the original cost. The Tax Court accepted the Commissioner's theory but made separate findings. The Court of Appeals reversed, holding that useful life was the total physical or economic life of the automobiles—not the period while useful in the taxpayer's business. 264 F. 2d 502.

In No. 141, *Massey Motors, Inc.*, v. *United States*, the taxpayer, a franchised Chrysler dealer, withdrew from shipments to it a certain number of new cars which were assigned to company officials and employees for use in company business. Other new cars from these shipments were rented to an unaffiliated finance company at a substantial profit.

The cars assigned to company personnel were uniformly sold at the end of 8,000 to 10,000 miles' use or upon receipt of new models, whichever was earlier. The rental cars were sold after 40,000 miles or upon receipt of new models. For the most part, cars assigned to company personnel and the rental cars sold for more than they cost the taxpayer. During 1950 and 1951, the tax years involved here, the profit resulting from sale of company personnel cars was $11,272.80 and from rental cars, $525.84. The taxpayer calculated depreciation on the same theory as did taxpayer Evans, computing the gains on the sales at capital gain rates with a basis of cost less depreciation. The Commissioner disallowed the depreciation claimed. After paying the tax and being denied a refund, the taxpayer filed this suit. The trial court decided against the Commissioner. The Court of Appeals for the Fifth Circuit, however, reversed, sustaining the Commissioner's views as to the meaning of useful life and salvage value. 264 F. 2d 552.

First, it may be well to orient ourselves. The Commissioner admits that the automobiles involved here are, for tax purposes, depreciable assets rather than ordinary stock in trade. Such assets, employed from day to day in business, generally decrease in utility and value as they are used. It was the design of the Congress to permit the taxpayer to recover, tax free, the total cost to him of such capital assets; hence it recognized that this decrease in value—depreciation—was a legitimate tax deduction as business expense. It was the purpose of section 23(l) and the regulations to make a meaningful allocation of this cost to the tax periods benefited by the use of the asset. In practical life, however, business concerns do not usually know how long an asset will be of profitable use to them or how long it may be utilized until no longer capable of functioning. But, for the most part, such assets are used for their entire economic life, and the depreciation base in such cases has long been recognized as the number of years the asset is expected to function profitably in use. The asset being of no further use at the end of such period, its salvage value, if anything, is only as scrap.

Some assets, however, are not acquired with intent to be employed in the business for their full economic life. It is this type of asset, where the experience of the taxpayers clearly indicates a utilization of the asset for a substantially shorter period than its full economic life, that we are concerned with in these cases. Admittedly, the automobiles are not retained by the taxpayers for their full economic life and, concededly, they do have a substantial salvage, resale or second-hand value. Moreover, the application of the full-economic-life formula to taxpayers' businesses here results in the receipt of substantial "profits" from the resale or "salvage" of the automobiles, which contradicts the usual application of their full-economic-life concept. There, the salvage value, if anything, is ordinarily nominal. Furthermore, the "profits" of the taxpayers here

are capital gains and incur no more than a 25% tax rate. The depreciation, however, is deducted from ordinary income. By so translating the statute and the regulations, the taxpayers are able, through the deduction of this depreciation from ordinary income, to convert the inflated amounts from income taxable at ordinary rates to that taxable at the substantially lower capital gains rates. This, we believe, was not in the design of Congress.

It appears that the governing statute has at no time defined the terms "useful life" and "salvage value." In the original Act, Congress did provide that a reasonable allowance would be permitted for "wear and tear of property *arising out of its use or employment in the business.*" (Emphasis added.) Act of Oct. 3, 1913, 38 Stat. 167. This language, particularly that emphasized above, may be fairly construed to mean that the wear and tear to the property must arise from its use *in the business* of the taxpayer—*i.e.*, useful life is measured by the use in a taxpayer's business, not by the full abstract economic life of the asset in any business. In 1918, the language of section 23(1) was amended so that the words emphasized above would read "used in the trade or business," section 214(a)(8), Revenue Act of 1918, 40 Stat. 1067, and the section carried those words until 1942. Meanwhile, Treas. Reg. 45, Art. 161, was promulgated in 1919 and continued in substantially the same form until 1941. It provided:

> "The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the *useful life of the property in the business* will suffice, with the *salvage value, at the end of such useful life* to provide in place of the property its cost * * *" (Emphasis added.)

It, too, may be construed to provide that the use and employment of the property *in the business* relates to the trade or business of the taxpayer—not, as is contended, to the type or class of assets subject to depreciation. The latter contention appears to give a strained meaning to the phrase. This might be particularly true of the language in Treasury Regulation 103, promulgated January 29, 1940, under the Internal Revenue Code of 1939. Its section 19–23(l)–1 and section 19–23(l)–(2)[1] complement each other and seem to advise the taxpayer how to compute depreciation and what property is subject to it. The first section not only describes the proper allowance, but sets out how it is to be computed so that depreciation "plus the salvage value, will, *at the end of the useful life of the property in the business*, equal the cost * * *" (Emphasis added.) The second section specifically defines the type of assets to which the depreciation allowance is applicable. It may be said that the taxpayer's arguments as to this regulation fail completely, since it not only specifically provides that "useful life" relates to property while used "in the business," but also details the type or class of property included within the allowance. It appears to cut from under the taxpayers the argument that the term "property used in the trade or business" relates to the type or class of assets that are included within the allowance. It would be strange to say that both of these sections of Regula-

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[1] "SEC. 19.23(l)–1. DEPRECIATION.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value will, at the end of the useful life of the property in the business, equal the cost or other basis of the property determined in accordance with section 113 * * *"

"SEC. 19.23(l)–2. DEPRECIABLE PROPERTY.—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this being made in the Internal Revenue Code. (See sections 23(m) and 114.) Property kept in repair may, nevertheless, be the subject of a depletion allowance. (See section 19.23(a)–4.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, or in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance."

tion 103 defined the same thing, viz., the type or class of assets subject to depreciation. On the other hand, the taxpayers point out that Regulation 111, issued in 1942, deleted the words "property in the business" from section 19–23 (l)–1 and substituted the term "depreciable property." This might, as taxpayers claim, establish that the phrase "property used in the trade or business" merely referred to the type of property involved. Certainly when considered in isolation, this appears to be true. But the "depreciable property" phrase does refer back to the earlier identical language, still remaining in the section, of "property use in the trade or business." It does appear, however, as the Court of Appeals in No. 141, *Massey*, held, that this substitution was made because Congress expanded the depreciation allowance provision of section 23(l) to include property held for the production of income. The change in the Regulation only conformed it to this amendment of the basic statute.

It is true, as taxpayers contend and as we have indicated, that the language of the statute and the regulations as we have heretofore traced them may not be precise and unambiguous as to the term "useful life." It may be that the administrative practice with regard thereto may not be pointed to as an example of clarity, and that in some cases the Commissioner has acquiesced in inconsistent holdings. But from the promulgation of the first regulation in 1919, he has made it clear that salvage had some value and that it was to be considered as something other than zero in the depreciation equation. In fact many of the cases cited by the parties involved controversies over the actual value of salvage, not as scrap but on resale.[2] The consistency of the Commissioner's position in this regard is evidenced by the fact that the definition of salvage as now incorporated in the regulations is identical with that claimed at least since 1941. In the light of this, it appears that the struggle over the term "useful life" takes on less practical significance, for, if salvage is the resale value and a deduction of this amount from cost is required, the dollar-wise importance to the taxpayer of the breadth in years of "useful life" is diminished. It is only when he can successfully claim that salvage means junk and has no value that an interpretation of "useful life" as the functional, economic, physical life of the automobile brings money to his pocket. Moreover, in the consideration of the appropriate interpretation of the term, it must be admitted that there is administrative practice and judicial decision in its favor, as we shall point out. Furthermore, as we have said, Congress intended by the depreciation allowance not to make taxpayers a profit thereby, but merely to protect them from a loss. The concept is, as taxpayers say, but an accounting one and, we add, should not be exchangeable in the market place. Accuracy in accounting requires that correct tabulations, not artificial ones, be used. Certainly it is neither accurate nor correct to carry in the depreciation equation a value of nothing as salvage on the resale of the automobiles, when the taxpayers actually received substantial sums therefor. On balance, therefore, it appears clear that the weight of both fairness and argument is with the Commissioner.

Our conclusion as to this interpretation of the regulations is buttressed, we think, by a publication issued by the Commissioner in 1942, the same year as Regulation 111, and long before this controversy arose. It is known as Bulletin F and has been reissued as late as 1955. While it does not have the authority of a regulation, its significance is indicated clearly by the fact that both the taxpayers and the Commissioner point to it as conclusive of their respective views of the administrative practice. Likewise it is widely cited by tax authorities, as well as by the Courts of Appeals. A careful examination of the entire bulletin, however, indicates that it clearly supports the administrative practice claimed here by the Commissioner. For example, the title page warns that "[t]he estimated useful lives and rates of depreciation * * * are based on averages and are not prescribed for use in any particular case."[3] Again on page 2, Bulletin F, in discussing depreciation, emphasizes that it is based on "the useful life of the property in the business." What is more significant is the simple clarity with which, on page 7, it defines salvage value to be "the amount realizable from the sale * * * when property has become no longer useful in the taxpayer's business and is demolished, dismantled, or retired from service." It even goes further to say that salvage "should serve to reduce depreciation,

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[2] *E.g., L. A. Davidson*, 12 CCH Tax Ct. Mem. 1080 (1953); *W. H. Morris Lumber Co.*, 7 CCH Tax Ct. Mem. 728 (1948); *Bolta Co.*, 4 CCH Tax Ct. Mem. 1087 (1945); *Wier Long Leaf Lumber Co.*, 9 T.C. 990 (1947), rev'd on other grounds, 173 F. 2d 549 (1949).

[3] The bulletin sets out a schedule of the useful life of automobiles, listing passenger cars at five years and those used by salesmen at three years.

either through a reduction in the basis on which depreciation is computed or a reduction in rate."

Moreover, Congress was aware of this prior prevailing administrative practice as well as the concept of depreciation upon which it was based. Although the tax years involved here are 1950 and 1951, we believe that the action of Congress in adopting the 1954 Code should be noted, since it specifically recognized the existing depreciation equation. For the first time, the term "useful life" was inserted in the statutory provision. The accompanying House Report to the bill stated:

> "Depreciation allowances are the method by which the capital invested in an asset is recovered tax-free over the years it is used in a business. The annual deduction is computed by spreading the cost over its estimated useful life." H.R. Rep. No. 1337, 83d Cong., 2d Sess. 22.

It is also noteworthy that the report states that "The changes made by your Committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property." *Id.*, at 25.

Moreover, as we have said, there are numerous cases in the Tax Court in which depreciation was permitted only on the useful life of the property in the taxpayer's business.[4] The taxpayers point to others[5] which appear to be to the contrary. In most of these, however, the issue was factual, *i.e.*, the time lapse before the property would wear out from use or, as we have said, its salvage or resale value. They cannot be said to prove conclusively that the Commissioner was following a physically useful-life theory; for there is no affirmative showing or finding as to the length of the physically useful life. The most that can be said is that the element of compromise probably played a predominant role in the result in each case. Moreover, there is no indication in any of these cases that the amount of depreciation would have been changed by computing it on the basis of its useful life in the business. The cases do not seem to reflect considered judgments as to the proper meaning of the terms used in the depreciation equation and we find them of little value as precedents.

Finally, it is the primary purpose of depreciation accounting to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use (excluding maintenance expense) of the asset to the periods to which it contributes. This accounting system has had the approval of this Court since *United States* v. *Ludey*, 274 U.S. 295, 301 (1927) [T.D. 4046, C.B. VI–2, 157 (1927)], when Mr. Justice Brandeis said, "The theory underlying this allowance for depreciation is that by using up the plant, a gradual sale is made of it." The analogy applies equally to automobiles. Likewise in *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, 101 (1943) [Ct. D. 1582, C.B. 1943, 1019], this Court said:

> "The end and purpose of it all [depreciation accounting] is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets. For this purpose it is sound accounting practice annually to accrue * * * an amount which at the time it is retired will with its salvage value replace the original investment therein."

Obviously a meaningful annual accrual requires an accurate estimation of how much the depreciation will total. The failure to take into account a known estimate of salvage value prevents this, since it will result in an understatement of income during the years the asset is employed and an overstatement in the year of its disposition. The practice has therefore grown up of subtracting salvage value from the purchase price to determine the depreciation base.[6]

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[4] See note 2, *supra*.

[5] *E.g.*, *West Virginia & Pennsylvania Coal & Coke Co.*, 1 B.T.A. 790 (1925); *J. R. James*, 2 B.T.A. 1071 (1925); *Merkle Broom Co.*, 3 B.T.A. 1084 (1926); *Max Kurtz*, 8 B.T.A. 679 (1927); *Whitman-Douglas Co.*, 8 B.T.A. 694 (1927); *Sanford Cotton Mills*, 14 B.T.A. 1210 (1929). *General Securities Co.*, 11 P–H BTA–TC Mem. Dec. 547 (1942), seems to be the only case of the group that is directly contrary to the present position of the Commissioner, and there the end result money-wise would seem to be the same under either theory. Hence it only emphasizes that isolated instances of inconsistency can be found in most areas where the volume of cases is as large as it is here.

[6] This industry practice is emphasized by the *amicus curiae* brief of the American Automobile Leasing Association in *Charlie Hilliard*, 31 T.C. 961, now pending in the Court of Appeals for the Fifth Circuit. Comprising "about 65% of the long-term leasing industry in motor vehicles in the country" the Association takes the position that the depreciation allowance "is designed to return to the taxpayer, tax-free, the cost of his capital asset over the period during which it is useful to the taxpayer in his business." A copy of the brief is on file in this case.

On the other hand, to calculate arbitrarily the expected total expense entailed by the asset on the false assumption that the asset will be held until it has no value is to invite an erroneous depreciation base and depreciation rate, which may result in either an over- or an under-depreciation during the period of use. If the depreciation rate and base turn out to reflect the actual cost of employing the asset, it will be by accident only. The likelihood of presenting an inaccurate picture of yearly income from operations is particularly offensive where, as here, the taxpayers stoutly maintain that they are only in the business of renting and leasing automobiles, not of selling them. The alternative is to estimate the period the asset will be held in the business and the price that will be received for it on retirement. Of course, there is a risk of error in such projections, but prediction is the very essence of depreciation accounting. Besides, the possibility of error is significantly less where probabilities rather than accidents are relied upon to produce what is hoped to be an accurate estimation of the expense involved in utilizing the asset. Moreover, under a system where the real salvage price and actual duration of use are relevant, to further insure a correct depreciation base in the years after a mistake has been discovered, adjustments may be made when it appears that a miscalculation has been made.

Accounting for financial management and accounting for federal income tax purposes both focus on the need for an accurate determination of the net income from operations of a given business for a fiscal period. The approach taken by the Commissioner computes depreciation expense in a manner which is far more likely to reflect correctly the actual cost over the years in which the asset is employed in the business.[7]

We therefore conclude that the Congress intended that the taxpayer should, under the allowance for depreciation, recover only the cost of the asset less the estimated salvage, resale or second-hand value. This requires that the useful life of the asset be related to the period for which it may reasonably be expected to be employed in the taxpayer's business. Likewise salvage value must include estimated resale or second-hand value. It follows that No. 141, *Massey Motors, Inc.* v. *United States*, must be affirmed, and No. 143 *Commissioner* v. *R. H. and J. M. Evans*, reversed.

It is so ordered.

MR. JUSTICE HARLAN, whom MR. JUSTICE WHITTAKER and MR. JUSTICE STEWART join, dissenting, in a separate opinion.

Corporate deductions for depreciation of resort property held primarily for use of its stockholders. See Ct. D. 1854, page 435.

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[7] Several writers in the accounting field have addressed themselves, without reference to the income tax laws, to the problem of giving content to the terms "useful life" and "salvage value" and their conclusions support what has been said.

Grant and Norton, Depreciation (1949), 145–146:
"[Assets such as passenger automobiles] may be expected to have substantial positive salvage values. Average salvage values must therefore be estimated before straight-line depreciation rates can be established. Salvage values will depend on average lives which may in turn depend on the owner's policy with regard to disposal of such assets. For example, if it is company policy to trade in passenger automobiles after three years, the estimation of average salvage value is simply the estimation of the average trade-in value of a 3-year-old passenger automobile."

Kohler, A Dictionary for Accountants (1952), 371, defines salvage value as:
"Actual or prospective selling price, as second-hand material, or as junk or scrap, of fixed assets retired, or of product or merchandise unsalable through usual channels, less any cost, actual or estimated, of disposition; * * *"

Useful life is defined, *id.*, at 440, as follows:
"Normal operating life in terms of utility to the owner; said of a fixed asset or a fixed-asset group; the period may be more or less than physical life or any commonly recognized economic life; service life."

Saliers, Depreciation Principles (1939), 72:
"Salvage is the value an article possesses for some use other than that to which it has been devoted. When it can be so used it is said to possess another cycle of life. Junk or scrap value is that which an article is worth if broken up. In making allowance for depreciation the basis to be used is cost less whatever it is estimated that the salvage or scrap will amount to."

REGULATIONS 111, SECTION 29.23(l)–3: Depreciation of intangible property. Rev. Rul. 60–317[1]
(Also Regulations 118, Section 39.23(l)–3.)
(Also Part I, Section 167; 26 CFR 1.167(a)–3.)

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Eighth Circuit in *Northern Natural Gas Company* v. *O'Malley* and *Northern Natural Gas Company* v. *McCrory*, 277 Fed. (2d) 128.

The point at issue in these cases was whether the taxpayer was entitled, under section 23(l) of the Internal Revenue Code of 1939, to a depreciation deduction based upon exhaustion of its right-of-way easements for its pipelines used to transmit gas for considerable distances; the easements provided they shall continue "so long as such pipelines and appurtenances thereto shall be maintained."

It is the position of the Service that the assets were not entitled to a depreciation deduction because their useful life in the business could not be estimated with reasonable certainty as required by section 29.23(l)–3 of Regulations 111.

Accordingly, while it has been determined that review by the Supreme Court of the United States will not be requested, the decision in the *Northern Natural Gas Company* cases will not be followed as a precedent in the disposition of similar cases pending further developments on the issue.

Regulations 118, Section 39.23(l)–3: Depreciation of intangible property.

Depreciation deduction based upon exhaustion of right-of-way easements for pipelines used to transmit gas for considerable distances. See Rev. Rul. 60–317, above.

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

REGULATIONS 118, SECTION 39.23(m)–1: Depletion of mines, oil and gas well, other natural deposits, and timber; depreciation of improvements. Ct. D. 1849
(Also Section 114; Regulations 118, Section 39.114–1.)
(Also Part I, Section 613; 26 CFR 1.613–3.)

SUPREME COURT OF THE UNITED STATES

United States of America, petitioner v. *Cannelton Sewer Pipe Company*

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

[June 27, 1960]

MR. JUSTICE CLARK delivered the opinion of the Court.

This income tax refund suit involves the statutory percentage depletion allowance to which respondent, an integrated miner-manufacturer of burnt clay

[1] Based on Technical Information Release 251, dated September 6, 1960.

products from fire clay and shale, is entitled under the Internal Revenue Code of 1939.[1]

The percentage granted by the statute is on respondent's "gross income from mining." It defines "mining" to include the "ordinary treatment processes normally applied by mine owners * * * to obtain the commercially marketable mineral product or products." Respondent claimed that its first "commercially marketable mineral product" is sewer pipe and other vitrified articles. Alternatively, it contended that depletion should be based on the price of 80 tons of ground fire clay and shale actually sold during the tax year in question. The District Court agreed with respondent's first claim. The Court of Appeals affirmed, holding that respondent could not profitably sell its raw fire clay and shale without processing it into finished products, and that its statutory percentage depletion was therefore properly based on its gross sales of the latter. 268 F. 2d 334. The Government contends that the product from which "gross income from mining" is computed is an industry-wide test and cannot be reduced to a particular operation that a taxpayer might find profitable. The Government further argues that, while the statute permits ordinary treatment processes normally applied by miners to the raw product of their mines to produce a commercially marketable mineral product, it does not embrace the fabrication of the mineral product into finished articles. In view of the importance of the question to taxpayers as well as to the Government, we granted certiorari. 361 U.S. 923. We disagree with respondent's contention that the issue is not presented by this record, and we therefore reach the merits. We have concluded that, under the mandate of the statute, respondent's "gross income from mining" under the findings here is the value of its raw fire clay and shale, after the application of the ordinary treatment processes normally applied by nonintegrated miners engaged in the recovery of those minerals.[2]

I.

During the tax year ending November 30, 1951, the respondent owned and operated an underground mine from which it produced fire clay and shale in proportions of 60% fire clay and 40% shale. It transported the raw mineral product by truck to its plant at Cannelton, Indiana, about one and one-half miles distant. There it processed and fabricated the fire clay and shale into vitrified sewer pipe, flue lining and related products. In this process, the clay and shale is first ground into a pulverized form about as fine as talcum powder. The powder is then mixed with water in a pug mill and becomes a plastic mass, which is formed by machines into the shape of the finished ware desired. The ware is then placed in dryers where heat of less than 212° is applied to remove all of the water. This process takes from 12 hours to 3 weeks, depending on the size of the ware. Thereafter the ware is vitrified in kilns at 2,200° Fahrenheit, requiring from 60 to 210 hours. It is then cooled, graded and either shipped or stored.

Not all clays and shales are suitable for respondent's operations. They must have plasticity, special drying qualities and be able to withstand high temperatures. Respondent's clay, known as Cannelton clay, is the deepest clay mined in Indiana and, respondent says, yields the best sewer pipe. Its cost of removing and delivering the same to its plant was $2.418 per ton in 1951. Respondent used some 38.473 tons of clay and shale in its operations that year and sold approximately 80 tons of ground fire clay and shale in bags at a price of $22.88 per ton. Net sales of its finished wares amounted to approximately one and a half million dollars.

In connection with its tax assessment for the year in question, respondent filed a document in which it stated that "we used as a basis for calculating the gross income from our mining operations of shale and fire clay the point in our manufacturing operations at which we first arrive with a commercially marketable product, which is ground fire clay. This product arrives after the raw mineral is crushed and granulated to such extent that by the addition of water it can be made into a mortar for use in laying or setting fire or refractory

[1] The applicable provisions of the Code are sec. 23(m) and sec. 114(b)(4). In general, they provide for a depletion allowance based on a percentage of "gross income from mining," which is specifically defined. See note 8, *infra*. The percentage permitted on shale is 5%, and on fire clay, 15%.

[2] The quantity of ground and bagged fire clay and shale actually sold is too negligible to furnish an appropriate basis for computing depletion.

brick. This ground fire clay has a definite market and an ascertainable market value at any particular time and is the same product from which our end product, sewer tile, is made simply by the addition of water and the necessary baking process." In this return it based the value of the ground fire clay at $22.81 per ton, the price for which it sold some 80 tons of that material in bags during 1951. At this figure the depletion allowance would have been slightly above $2 per ton. Thereafter respondent claimed error and asserted that its mineral product, rather than being commercially marketable when it reached the stage of ground fire clay, only became commercially marketable when it became a finished product, *i.e.*, sewer pipe. On this basis, the depletion allowance on petitioner's gross income would be approximately $4 per ton, since the mineral would have a value of about $40 per ton. On the other hand, if the mineral it used in 1951 was valued at $1.60 to $1.90 per ton, the going price elsewhere in Indiana, the depletion allowance would be approximately 20¢ per ton.

The record shows and the District Court found that in 1951 there were substantial sales of raw fire clay and shale in Indiana, mostly in the vicinity of Brazil, about 140 miles from Cannelton. The average price there was $1.60 to $1.90 per ton for fire clay and $1 per ton for shale. Transportation costs from Brazil to Cannelton ran from $4.58 to $5.50 per ton. In Kentucky, across the river from respondent's plant, it appears that fire clay and shale of the same grade were mined and sold [3] before, during and subsequent to 1951. In fact, since 1957 respondent has secured all of its mineral requirements from this source on a lease basis under which the lessor mines and delivers the raw material to its plant. The exact cost is not shown, but the haul in 1957 from pit to plant, including the ferry crossing, was some seven miles.

II.

We have carefully studied the legislative history of the depletion allowance, including the voluminous materials furnished by the parties, not only in their briefs but in the exhaustive appendices and the record.[4] We shall not burden this opinion with its repetition.

In summary, mineral depletion for tax purposes is an allowance from income for the exhaustion of capital assets. *Anderson* v. *Helvering*, 310 U.S. 404 (1940). [Ct. D. 1456, C.B. 1940-1, 108]. In addition, it is based on the belief that its allowance encourages extensive exploration and increasing discoveries of additional minerals to the benefit of the economy and strength of the Nation. We are not concerned with the validity of this theory or with the statutory policy. Our sole function is application of the congressional mandate. A study of the materials indicates that percentage depletion first came into the tax structure in 1926, when the Congress granted it to oil and gas producers. The percentage allowed was based on "gross income from the property," which was described as "the gross receipts from the sale of oil and gas as it is delivered from the property." Preliminary Report, Joint Committee on Internal Revenue Taxation, Vol. I, Part 2 (1927). The report continued that, as to the integrated operator, "the gross income from the property must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease." The Treasury Regulations confirmed this understanding. Treas. Reg. 74 (1929 ed.). Arts. 221(i), 241.

Thereafter, in 1932, percentage depletion was extended to metal mines, coal, and sulphur. The representative of the American Mining Congress, Alex R. Shepherd, urged in a report to the Congress [5] that depletion for metal mines be

[3] The evidence indicates that, for $50, Owensboro Sewer Pipe Company bought from L. R. Chapman five acres of ground under which the shale and clay deposits lay. Contemporaneously it made a contract with L. R. Chapman, Inc., to mine and deliver shale and fire clay from this tract to the Owensboro plant for $1.40 per ton. Chapman also testified that in addition he furnished shale and fire clay to other manufacturers in the same area in Kentucky. The arrangements varied. Some were similar to the Owensboro agreement, while others were leases on a royalty basis with a contemporaneous agreement to mine and deliver the clay at a set price. The exact year or years are not clear, but appear to have been between 1949 and 1956. Respondent began using shale and fire clay from the same source by lease arrangement in 1957. The reason for lease arrangements and paper transfer of title is not shown. However, Chapman testified that the manufacturers "didn't seem to want to do the prospecting or the sampling until they were sure they could get either a lease or a deed."

[4] The briefs cover 294 pages and the appendices an additional 685, not including 10 charts. The record is 276 pages.

[5] Preliminary Report on Depletion, Staff Report to the Joint Committee on Internal Revenue Taxation (1930), Appendix XXXI (Shepherd Report).

computed, as in the oil and gas industry, on a percentage-of-income basis, and the Revenue Act of 1932 was so drawn. The Shepherd Report pointed out that the percentage basis for oil and gas depletion had been in force for over a year and had "functioned satisfactorily both from economical and administrative viewpoints and without loss of revenue." It added that "careful study of this method as applied to metal mines indicates that the same results will be attained in practice as in the case of oil and gas," but that, because of varied practices in the mining industry, it would be necessary to determine "the point in accounting at which" gross income from the property mined could be calculated. It recommended that "it is logical to peg 'gross income from the property' f.o.b. cars at mine," *i.e.*, net smelter returns, recognizing that processing beyond this point should not be included in calculating "gross income from the property." While as to certain metals, *viz.*, gold, silver, or copper, the report suggested "the sale of the crude, partially beneficiated or refined" product, this was but to make provision for the specific operations of miners in those metals. In this regard the report also proposed that the depreciation base "in the case of all other metals, coal and oil and gas, [should be] the competitive market receipts, or its equivalent, received from the sale of the crude products, or concentrates on an f.o.b. mine, mill, or well basis."

The Congress in fashioning the 1932 Act took into account these recommendations of the industry. It incorporated a provision in the Act allowing percentage depletion for coal and metal mines and sulphur, based on the "gross income from the property." Section 114(b)(4), Revenue Act of 1932, 47 Stat. 169. On the following February 10, 1933, the Treasury issued its Regulation 77, which defined "gross income from the property" as "the amount for which the taxpayer sells (a) the crude mineral product or (b) the product derived therefrom, not to exceed in the case of (a) the representative market or field price * * * or in the case of (b) the representative market or field price * * * of a product of like kind and grade from which the product sold was derived, before the application of any processes * * * with the exception of the processes listed * * *" Treas. Reg. 77, Art. 221(g). These exceptions listed processes normally in use in the mining industry for preparing the mineral as a marketable shipping product. The regulation was of unquestioned validity and, in 1943, at the instance of the industry, the Congress substantially embodied it into the statute itself, 48 Stat. 21, 44, including the basic definition of the term "gross income from the property"[6] Since that time the section on percentage depletion—section 114(b)(4)(B) of the 1939 Code—has remained basically the same.[7] Additional minerals have been added from time to time—shale and fire clay in 1951—until practically all minerals are included.

As now enacted, the section provides that "mining" includes "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," plus transportation from the place of extraction to the "plants or mills in which the ordinary treatment processes are applied thereto," not exceeding 50 miles.[8] It then defines

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[6] See *e.g.*, Hearings before Senate Committee on Finance on H.R. 3687, 78th Cong., 1st Sess. 528; S. Rep. No. 627, 78th Cong., 1st Sess. 23–24; Hearings before House Committee on Ways and Means on Revenue Revisions, 80th Cong., 1st Sess., part 3, at 1857; Hearings before Senate Committee on Finance on H.R. 8920, 81st Cong., 2d Sess. 771; S. Rep. No. 2375, 81st Cong., 2d Sess. 52–53.

[7] The present statute, sec. 613 of the Internal Revenue Code of 1954, is essentially unchanged.

[8] Internal Revenue Code of 1939, sec. 114(b)(4)(B):
"*Definition of Gross Income From Property.*—As used in this paragraph the term 'gross income from property' means the gross income from mining. 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. The term 'ordinary treatment processes,' as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorospar ores, potash, and ores which are not customarily sold in the form of crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation

"ordinary treatment processes" by setting out specifically in four categories those covering some 17 named minerals. Fire clay and shale are not within these specific enumerations. The Government, however, contends that they should come within clause (iii) of the section, which provides that, "in the case of iron ore, bauxite, ball and sagger clay, rock asphalt *and minerals which are customarily sold in the form of a crude mineral product*—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment * * *" are included in "ordinary treatment processes." (Italics added.) Clause (iv) lists specific metals such as lead, zinc, copper, etc., "and ores which are not customarily sold in the form of crude mineral product," and specifically excludes from the permissible processes certain ones used in connection with these metals. To recapitulate, the section contains four categories of dealing with "ordinary treatment processes": the first enumerating those permissible as to the mining of coal; the second, as to sulphur; the third, as to minerals customarily sold in the form of the crude mineral product; and the fourth, as to those minerals not customarily so sold. We note that the Congress even states the steps in each permissible process, and in addition specifically declares some processes not to be "ordinary treatment" ones, *viz.*, "electrolytic deposition, roasting, thermal or electric smelting, or refining." Furthermore, none of the permissible processes destroy the physical or chemical identity of the minerals or permit them to be transformed into new products.

From this legislative history, we conclude that Congress intended to grant miners a depletion allowance based on the constructive income from the raw mineral product if marketable in that form, and not on the value of the finished articles.

III.

The findings are that three-fifths of the fire clay produced in Indiana in 1951 was sold in its raw state. This indicates a substantial market for the raw mineral. In addition, large sales of raw fire clay and shale were made across the river in Kentucky. This indicates that fire clay and shale were "commercially marketable" in their raw state unless that phrase also implies marketability at a profit. We believe it does not. Proof of these sales is significant not because it reveals an ability to sell profitably—which the respondent could not do—but because the substantial tonnage being sold in a raw state provides conclusive proof that, when extracted from the mine, the fire clay and shale are in such a state that they are ready for industrial use or consumption—in short, they have passed the "mining" state on which the depletion principles operates. It would be strange, indeed, to ascribe to the Congress an intent to permit each miner to adopt processes peculiar to his individual operation. Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high-cost mine operator. The value of respondent's vitrified clay products, obtained by expensive manufacturing processes, bears little relation to the value of its minerals. The question in depletion is what allowance is necessary to permit tax-free recovery of the capital value of the minerals.

Respondent insists that its miner-manufacturer status makes some difference. We think not. It is true that the integrated miners in Indiana outnumbered the nonintegrated ones. But in each of the three basic percentage depletion Acts the Congress indicated that integrated operators should not receive preferred treatment. Furthermore, in Regulation 77, discussed above, the Treasury specifically provided that depletion was allowable only on the crude mineral product. And, as we have said, this regulation was substantially enacted into the 1943 Act. We need not tarry to deal with any differences which are said to have existed in administrative interpretation, for here we have authoritative congressional action itself. Ever since the first percentage depletion statute, the cut-off point where "gross income from mining" stopped has been the same, *i.e.*, where the ordinary miner shipped the product of his mine. Respondent's formula would not only give it a preference over the ordinary nonintegrated miner, but also would grant it a decided competitive advantage over its non-

(but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of section 450 and 453." 26 U.S.C. (1952 ed.) sec. 114.

integrated manufacturer competitor. Congress never intended that depletion create such a discriminatory situation. As we see it, the miner-manufacturer is but selling to himself the crude mineral that he mines, insofar as the depletion allowance is concerned.

IV.

We now reach what "ordinary treatment processes" are available to respondent under the statute. As the principal industry witness put it at hearings before the Congress: "Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered, as the basis for depletion." [9] But respondent says that the processes it uses are the ordinary ones applied in the industry. As to the miner-manufacturer, that is true. But they are not the "ordinary" normal ones applied by the nonintegrated miner. It was he whom the Congress made the object of the allowance. The fabrication processes used by respondent in manufacturing sewer pipe would not be employed by the run-of-the-mill miner—only an integrated miner-manufacturer would have occasion to use them.

Respondent further contends, however, that it must utilize these processes in order to obtain a "commercially marketable mineral product or products." It points out that its underground method of mining prevents it from selling its raw fire clay and shale. This position leads to the conclusion that respondent's mineral product has no value to it in the ground. If this be true, then there could be no depletion. One cannot deplete nothing. On the other hand, respondent alleges that its minerals "yield the best sewer pipe which is made in Indiana." If this be true, then respondent's problem is one purely of cost of recovery, an item which, as we have said, has nothing to do with value in the depletion formulae. Depletion, as we read the legislative history, was designed not to recompense for costs of recovery but for exhaustion of mineral assets alone. If it were extended as respondent asks, the miner-manufacturer would enjoy, in addition to a depletion allowance on his minerals, a similar allowance on his manufacturing costs, including depreciation on his manufacturing plant, machinery and facilities. Nor do we read the use by the Congress of the plural word "products" in the "commercially marketable" phrase as indicating that normal processing techniques might include the fabrication of different products from the same mineral. We believe that the Congress was only recognizing that in mining operations often more than one mineral product was recovered in its raw state.

In view of the finding that substantial quantities—in fact, the majority—of the tonnage production of fire clay and shale were sold in their raw state, we believe that respondent's mining activity during the year in question would come under clause (iii) of the section here involved. That clause includes "minerals which are customarily sold in the form of a crude mineral product." We believe that the Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication. It would, of course, be permissible for such an operator to calculate his "gross income from mining" at the point where "ordinary" miners—not integrated—disposed of their product. All processes used by the nonintegrated miner before shipping the raw fire clay and shale would under such a formula be available to the integrated miner-manufacturer to the same extent but no more.

Nor do we believe that the District Court and Court of Appeals cases involving percentage depletion and cited by respondent are opposite here.[10] We do not, however, indicate any approval of their holdings. It is sufficient to say that on their facts they are all distinguishable.

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[9] Robert M. Searls, Attorney, San Francisco. Silver Subcommittee Hearings, 1942, p. 764.

[10] Respondent's cases are based on *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (adhered to in *United States* v. *Merry Bros. Brick & Tile Co.*, 242 F. 2d 708), which went off on factual concessions not present here. They have been pyramided into a statistically imposing number of cases, predicated upon one another. Close analysis indicates that they either go off on concessions or findings not present here, or deal with controversies over particular treatment processes claimed as "ordinary" in the industry involved. For our purposes, we need not reach the question of whether in those cases the minerals in place had any "value" to be depleted. Other than the decision here under review, only two of the Court of Appeals cases cited by respondent, both from the same Circuit (*Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398; *Bookwalter* v. *Centropolis Crusher Co.*, 272 F. 2d 391), adopt the profitability test, which we find unacceptable.

In view of these considerations, neither of respondent's alternate claims for depletion allowance is appropriate. The judgment of the Court of Appeals is therefore reversed, and the cause remanded for further proceedings in conformity with this opinion.

It is so ordered.

MR. JUSTICE HARLAN, concurring in the result in a separate opinion.

REGULATIONS 118, SECTION 39.23(m)–5: Computation of depletion based on percentage of income in case of certain mines or other natural deposits. (Also Regulations 111, Section 29.23(m)–5.) T. D. 6510[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PARTS 39 AND 29

Regulations 118 and 111 amended with respect to definitions of certain minerals.

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

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

On February 10, 1959, notice of proposed rulemaking regarding amendments to Regulations 118 (26 CFR (1939) Part 39) and Regulations 111 (26 CFR (1939) Part 29) with respect to definitions of certain minerals was published in the Federal Register (24 F.R. 975). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments are hereby adopted:

REGULATIONS 118

PARAGRAPH 1. Paragraph (b) of § 39.23(m)–5 is amended—

(A) By striking that part of the first sentence which precedes the colon and inserting in lieu thereof the following:

For the purpose of identifying the minerals listed in paragraph (a), such minerals shall be given their commonly understood commercial meanings. If a mineral of a taxpayer is within both a specific and a general mineral classification listed in paragraph (a), such mineral shall be considered to fall within the more specific classification. If the name of a mineral listed in paragraph (a) has no commonly understood commercial meaning but the name implies a particular use or uses, such mineral is to be defined in terms of such use or uses. Certain of the minerals listed in paragraph (a) are defined below in accordance with the foregoing criteria set forth in this paragraph

(B) By striking the term "Calcium carbonates" and the definition of such term and inserting in lieu thereof the following:

Calcium carbonates—Miscellaneous limestones and other calcium carbonate rocks (not specifically provided for at a 5 percent or 15 percent rate of percentage allowance) which are used or sold for use for purposes for which the calcium carbonate content is a major requirement. For example, the term "calcium carbonates" includes limestone which is not of chemical or metallurgical grade and which is used or sold for use for cement manufacture or soil treatment. However, the term "calcium carbonates" does not include any carbonate mineral which is identifiable as dolomite, marble, stone, oyster shells, or clam shells within the commonly understood commercial meaning of those terms.

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[1] 25 F.R. 12239.

(C) By inserting immediately after the term "Clay, brick and tile" and the definition of such term the following:

Clay, refractory, and fire—Clay which has a pyrometric cone equivalent of 19 or higher.

(D) By striking the terms "Limestone, chemical grade" and "Limestone, metallurgical grade" and the definitions of such terms and inserting in lieu thereof the following:

Dolomite—Any carbonate rock which contains substantial amounts of the mineral dolomite and which is considered to be dolomite within the commonly understood commercial meaning of the term.

Limestone, chemical, and metallurgical grade—Limestone which contains a calcium carbonate and magnesium carbonate content totaling 95 percent or higher by weight. For this purpose, the term "limestone" does not include any carbonate mineral which is identifiable as a mineral falling within a more specific classification such as dolomite, marble, oyster shells, or clam shells.

(E) By inserting immediately after the term "Pumice" and the definition of such term the following:

Quartzite—Metamorphosed or silica-cemented sandstone which is so firmly cemented that it has the characteristic of breaking across rather than around the original sand grains. The term "quartzite" is not applicable to any mineral which constitutes sand or gravel within the commonly understood commercial meaning of those terms.

(F) By striking the term "Stone" and the definition of such term and inserting in lieu thereof the following:

Stone—Common dimension, crushed or broken stone within the ordinary meaning of these terms. However, the term "stone" does not include any mineral which is identifiable as a mineral falling within a more specific classification such as dolomite, quartzite, or chemical or metallurgical grade limestone.

REGULATIONS 111

PAR. 2. The second undesignated paragraph of § 29.23(m)–5, as amended by Treasury Decision 6031 [C.B. 1953–2, 120], approved July 14, 1953, is further amended—

(A) By striking that part of the first sentence which precedes the colon and inserting in lieu thereof the following:

For the purpose of identifying the minerals listed in the preceding paragraph, such minerals shall be given their commonly understood commercial meanings. If a mineral of a taxpayer is within both a specific and a general mineral classification listed in the preceding paragraph, such mineral shall be considered to fall within the more specific classification. If the name of a mineral listed in the preceding paragraph has no commonly understood commercial meaning but the name implies a particular use or uses, such mineral is to be defined in terms of such use or uses. Certain of the minerals listed in the preceding paragraph are defined below in accordance with the foregoing criteria set forth in this paragraph

(B) By striking the term "Calcium carbonates" and the definition of such term and inserting in lieu thereof the following:

Calcium carbonates—Miscellaneous limestones and other calcium carbonate rocks (not specifically provided for at a 5 percent or 15 percent rate of percentage allowance) which are used or sold for use for purposes for which the calcium carbonate content is a major requirement. For example, the term "calcium carbonates" includes limestone which is not of chemical or metallurgical grade and which is used or sold for use for cement manufacture or soil treatment. However, the term "calcium carbonates" does not include

any carbonate mineral which is identifiable as dolomite, marble, stone, oyster shells, or clam shells within the commonly understood commercial meaning of those terms.

(C) By inserting immediately after the term "Clay, brick and tile" and the definition of such term the following:

Clay, refractory, and fire—Clay which has a pyrometric cone equivalent of 19 or higher.

(D) By striking the terms "Limestone, chemical grade" and "Limestone, metallurgical grade" and the definitions of such terms and inserting in lieu thereof the following:

Dolomite—Any carbonate rock which contains substantial amounts of the mineral dolomite and which is considered to be dolomite within the commonly understood commercial meaning of the term.

Limestone, chemical, and metallurgical grade—Limestone which contains a calcium carbonate and magnesium carbonate content totaling 95 percent or higher by weight. For this purpose, the term "limestone" does not include any carbonate mineral which is identifiable as a mineral falling within a more specific classification such as dolomite, marble, oyster shells, or clam shells.

(E) By inserting immediately after the term "Pumice" and the definition of such term the following:

Quartzite—Metamorphosed or silica-cemented sandstone which is so firmly cemented that it has the characteristic of breaking across rather than around the original sand grains. The term "quartzite" is not applicable to any mineral which constitutes sand or gravel within the commonly understood commercial meaning of those terms.

(F) By striking the term "Stone" and the definition of such term and inserting in lieu thereof the following:

Stone—Common dimension, crushed or broken stone within the ordinary meaning of these terms. However, the term "stone" does not include any mineral which is identifiable as a mineral falling within a more specific classification such as dolomite, quartzite, or chemical or metallurgical grade limestone.

(This Treasury Decision is issued under the authority contained in sections 62 and 3791 of the Internal Revenue Code of 1939 (53 Stat. 32, 467; 26 U.S.C. 62, 3791).)

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved November 29, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 1, 1960, 8:48 a.m., and published in the issue of the Federal Register for December 2, 1960, 25 F.R. 12339)

REGULATIONS 111, SECTION 29.23(m)–5: Computation of depletion based on percentage of income in case of certain mines or other natural deposits.

Regulations 111 amended with respect to the definitions of certain minerals. See T.D. 6510, page 458.

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

REGULATIONS 118, SECTION 39.23(u)–1:
Periodic Alimony Payments.

Deductibility of alimony payments to former wife, subject to contingencies, payable over a period exceeding ten years. See Rev. Rul. 60–250, page 435.

SECTION 24.—ITEMS NOT DEDUCTIBLE

REGULATIONS 111, SECTION 29.24–1: Personal and family expenses.

Corporate deductions for depreciation and maintenance expenses of resort property held primarily for use of its stockholders. See Ct. D. 1854, page 435.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SECTION 44.—INSTALLMENT BASIS

REGULATIONS 118, SECTION 39.44–1: Sale of personal property on installment plan.

Department store chain's sales under a revolving credit plan. See Rev. Rul. 60–293, page 163.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—RATES OF TAX

SECTION 109.—WESTERN HEMISPHERE TRADE CORPORATIONS

REGULATIONS 111, SECTION 29.109–1: Western Hemisphere trade corporations.

Source of gain included in insurance proceeds received by a Western Hemisphere trade corporation. See Rev. Rul. 60–278, page 214.

REGULATIONS 118, SECTION 39.109–1: Western Hemisphere trade corporations.

Source of gain included in insurance proceeds received by a Western Hemisphere trade corporation. See Rev. Rul. 60–278, page 214.

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

REGULATIONS 118, SECTION 39.112(b)(6)–1: Distributions in liquidation of subsidiary corporation.

Purchase of stock of several unrelated corporations for the purpose of liquidating such corporations and acquiring their "going businesses." See Rev. Rul. 60–246, below.

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

REGULATIONS 118, SECTION 39.113(a)(15)–1: Basis of property received by corporation in complete liquidation of another. Rev. Rul. 60–246 [1]

(Also Section 112(b); Regulations 118, Section 39.112(b)(6)–1.)

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Fifth Circuit in *United States* v. *M. O. J. Corporation*, 274 Fed. (2d) 713, in substantially similar cases.

In this case the court held that the purchase by the taxpayer of the stock of several corporations for the purpose of liquidating such corporations and acquiring their "going businesses", to be operated by the taxpayer with as little change as possible, was in substance the purchase of the assets, and that, accordingly, the basis of the property acquired by the taxpayer upon the liquidation of such corporations was the amount paid for the stock.

The court concluded, "The justification for so construing the language of Section 112(b)(6) [of the Internal Revenue Code of 1939] as to exclude the purchase of specific property through the purchase of stock in its corporate owner is that what results in the 'receipt by a corporation of property' is not a 'distribution in complete liquidation of another corporation,' but is in real substance the purchase of the property, which is accomplished, for reasons beyond the control of the purchaser, by the purchase of stock and dissolution of the corporate owner. This is just as true if 'the property' is the going business of the transferor as if it is a flour mill or oil well or other specific property of the transferor."

The acquisition of assets through the purchase-liquidation method in the instant case was by a corporation owned by an entirely different group of stockholders from the group which owned the acquired corporations.

[1] Based on Technical Information Release 235, dated June 9, 1960.

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS

REGULATIONS 111, SECTION 29.113(b)(1)–1: Adjusted basis; general rule.
(Also Regulations 118, Section 39.113(b)(1)–1.)
(Also Part I, Sections 167, 1016; 26 CFR 1.167(e)–1, 1.1016–4.)

Rev. Rul. 60–390 [1]

The Commissioner of Internal Revenue acquiesced in the decision of the Tax Court of the United States in *Chicago and North Western Railway Company* v. *Commissioner*, 29 T.C. 989 (1958), acquiescence, page 3.

The Tax Court held that a railroad, which has consistently employed the retirement method of accounting with respect to its roadway property, is not required under section 113(b)(1)(c) of the Internal Revenue Code of 1939 to reduce the adjusted basis of such property, upon its retirement, by depreciation sustained prior to March 1, 1913.

The Internal Revenue Service will follow the Tax Court's decision in other cases involving similar factual situations. However, the acquiescence in this decision has no bearing on the pre-March 1, 1913, adjustments which are required by reason of a taxpayer's change from the retirement method to another method of accounting for depreciation.

REGULATIONS 118, SECTION 39.113(b)(1)–1; Adjusted basis; general rule.

Adjustments to basis for pre-1913 depreciation by a taxpayer using the retirement method of computing depreciation. See Rev. Rul. 60–390, above.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion.

Rev. Rul. 60–332 [2]

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Fourth Circuit in *United States* v. *W. R. Bonsal Company*, 279 Fed. (2d) 465, dated May 31, 1960.

In determining that the taxpayer's sand and gravel deposit was a "quartzite" deposit entitled to a 15 percent rate of depletion under the provisions of section 114(b)(4)(A)(iii) of the Internal Revenue Code of 1939, the Court of Appeals affirmed the decision of the District Court for the Western District of North Carolina. Technical Information Release 183, dated October 26, 1959, and Revenue Ruling 59–384, C.B. 1959–2, 474, state that the decision of the District Court in the *Bonsal* case will not be followed.

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[1] Based upon Technical Information Release 270, dated November 29, 1960.
[2] Based on Technical Information Release 254, dated September 21, 1960.

It is the position of the Internal Revenue Service that "sand" and "gravel" are size terms and that material of sand and gravel size cannot qualify as quartzite. See Revenue Ruling 59–385, C.B. 1959–2, 474. This position was accepted relative to "sand" by the United States Court of Appeals for the Third Circuit in *South Jersey Sand Company* v. *Commissioner*, 267 Fed. (2d) 591, wherein the Court of Appeals, in part, stated, "all ordinary definitions of quartzite and sand stress the visibly, readily discernible dissimilarities between the two. Quartzite, the hard compact rock. Sand, hard small grains."

While it has been determined that review by the Supreme Court of the United States will not be requested in the *Bonsal* case, the decision will not be followed as a precedent in the disposition of similar cases pending further judicial test of Revenue Ruling 59–385.

Percentage depletion in the case of an integrated miner-manufacturer of vitrified clay products. See Ct. D. 1849, page 452.

SECTION 117(a).—CAPITAL GAINS AND LOSSES: DEFINITIONS

REGULATIONS 118, SECTION 39.117(a)–1: Meaning of terms.

Whether a Motor Carrier Claims Commission award constitutes ordinary rental income or a capital gain from the involuntary conversion of a capital asset. See Ct. D. 1853, page 466.

SECTION 117(c).—CAPITAL GAINS AND LOSSES: ALTERNATIVE TAXES

REGULATIONS 118, SECTION 39.117(c)–1: Alternative tax in case net long-term capital gain exceeds net short-term capital loss.

Deductibility of alternative tax paid by a personal holding company in determining subchapter A net income under section 505(a)(1). See Rev. Rul. 60–285, page 473.

SECTION 117(f).—CAPITAL GAINS AND LOSSES, RETIREMENT OF BONDS, ETC.

REGULATIONS 118, SECTION 39.117(f): Capital gains and losses; retirement of bonds, etc. (Also Section 22(a); Regulations 118, Section 39.22(a)–1.) — Rev. Rul. 60–284

Where a taxpayer purchased interest-bearing bonds "flat" and subsequently received payments of defaulted interest accrued on

the bonds before the date of their purchase, the payments constitute amounts received "upon the retirement of bonds" within the meaning of section 117(f) of the Internal Revenue Code of 1939 and are hence considered as amounts received in exchange therefore for the purposes of the capital-gain treatment provided in that section, regardless of any expectancy that the principal or face amount of the bonds ultimately will be collected. Interest accruing after acquisition of such bonds by the taxpayer represents interest taxable as ordinary income.

Revenue Ruling 55–433, C. B. 1955–2, 515, revoked.

In view of the decision in *Estate of Hamilton C. Rickaby*, 27 T.C. 886, acquiescence page 3, this Bulletin, reconsideration has been given to Revenue Ruling 55–433, C.B. 1955–2, 515.

Revenue Ruling 55–433 holds that where a taxpayer who has purchased "flat" interest-bearing bonds with certain unpaid accrued interest recovers aggregate payments of the accrued interest in excess of basis, at a time when there is reasonable expectancy that the principal or face amount of the bonds will ultimately be collected, the excess amount, although not interest income to him since the interest involved accrued before he purchased the bonds, constitutes gain that is taxable as ordinary income under section 22(a) of the Internal Revenue Code of 1939 and not as "capital gain" under section 117 thereof, since the gain is not from a "sale or exchange" and the payments involved are not "amounts received by the holder upon the retirement of bonds."

In the *Rickaby* case, the taxpayer had purchased bonds "flat," that is, bonds which were in default of interest and which were traded without any accrued interest included, the market price of the bonds being their full price. The Tax Court of the United States held that payments to the taxpayer of unpaid accrued interest applicable to periods before the date of acquisition of the bonds by him, resulting in recoveries in excess of the taxpayer's basis for the bonds, were "in retirement of the bonds" and consequently taxable at capital-gain rates regardless of whether, at the time of these payments, there was reasonable expectancy that the principal or face amount of the bonds would ultimately be collected.

Accordingly, it is held that payments of defaulted interest, accrued before the taxpayer purchased "flat" bonds otherwise qualifying for the treatment provided for in section 117(f) of the 1939 Code, constitute amounts received "upon the retirement of bonds" within the meaning of that section and are hence considered as amounts received in exchange therefor for purposes of the capital-gain treatment provided in said section 117 of the Code, regardless of any expectancy that the principal or face amount of the bonds ultimately will be collected. Interest accruing after acquisition of such bonds by the taxpayer represents interest taxable as ordinary income.

Revenue Ruling 55–433, C.B. 1955–2, 515, is hereby revoked.

SECTION 117(j).—CAPITAL GAINS AND LOSSES: GAINS AND LOSSES FROM INVOLUNTARY CONVERSION AND FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS

REGULATIONS 118, SECTION 39.117(j)–1: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in trade or business. (Also Sections 22(a), 117(a); Regulations 118, Sections 39.22(a)–1, 39.117(a)–1.) Ct. D. 1853

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. CAPITAL GAIN VS. ORDINARY INCOME—MOTOR CARRIER CLAIMS COMMISSION AWARD—RENTAL VS. INVOLUNTARY CONVERSION PAYMENT.

A fair rental value award granted by the Motor Carrier Claims Commission to a common carrier as the result of the Government's having taken over temporary control and operation of its transportation system during World War II, where such facilities had ceased to operate because of a drivers' strike, was rental income taxable as ordinary income, as was also the interest received on such sum. The nature of the property taken was the right to use the taxpayer's facilities. This right to use is not a capital asset within the meaning of sections 117(a)(1) and 117(j) of the Internal Revenue Code of 1939, "but is simply an incident of the underlying physical property, the recompense for which is commonly regarded as rent." The fact that the transaction was involuntary on the taxpayer's part does not change the nature of the case.

2. JUDGMENT REVERSED.

Judgment of the United States Court of Appeals for the Fifth Circuit, 265 Fed. (2d) 648, reversed.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, petitioner, v. *Gillette Motor Transport, Inc.*

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

[June 27, 1960]

MR. JUSTICE HARLAN delivered the opinion of the Court.

The question in this case is whether a sum received by respondent from the United States as compensation for the temporary taking by the Government of its business facilities during World War II represented ordinary income or a capital gain. The issue involves the construction and application of section 117(j) of the Internal Revenue Code of 1939.

In 1944, respondent was a common carrier of commodities by motor vehicle. On August 4, 1944, respondent's drivers struck, and it completely ceased to operate. Shortly thereafter, because of the need for respondent's facilities in the transportation of war materiel, the President ordered the Director of the Office of Defense Transportation to "take possession and assume control of" them. The Director assumed possession and control as of August 12, and appointed a Federal Manager, who ordered respondent to resume normal operations. The Federal Manager also announced his intention to leave title to the properties in respondent and to interfere as little as possible in the management of them. Subject to certain orders given by the Federal Manager from time to time, respondent resumed normal operations and continued so to function until the termination of all possession and control by the Government on June 16, 1945.

Pursuant to an Act of Congress creating a Motor Carrier Claims Commission, 62 Stat. 1222, respondent presented its claim for just compensation. The Government contended that there had been no "taking" of respondent's property but only a regulation of it. The Commission, however, determined that by assuming actual possession and control of respondent's facilities, the United States had deprived respondent of the valuable right to determine freely what

use to be made of them. In ascertaining the fair market value of that right, the Commission found that one use to which respondent's facilities could have been put was to rent them out and that therefore their rental value represented a fair measure of respondent's pecuniary loss. The Commission noted that in other cases of temporary takings, it has typically been held that the market value of what is taken is the sum which would be arrived at by a willing lessor and a willing lessee. Accordingly, it awarded, and the respondent received in 1952, the sum of $122,926.21, representing the fair rental value of its facilities from August 12, 1944, until June 16, 1945, plus $34,917.78 representing interest on the former sum, or a total of $157,843.99.

The Commissioner of Internal Revenue asserted that the total compensation award represented ordinary income to respondent in 1952. Respondent contended that it constituted an amount received upon an "involuntary conversion" of property used in its trade or business and was therefore taxable as long-term capital gain pursuant to section 117(j) of the Internal Revenue Code of 1939.*

The Tax Court, adopting its opinion in *Midwest Motor Express, Inc.*, 27 T.C. 167, aff'd, 251 F. 2d 405 (C.A. 8th Cir.), which involved substantially identical facts, held that the award represented ordinary income. The Court of Appeals, one judge dissenting, in this instance reversed. 265 F. 2d 648. We granted certiorari because of the conflict between the decisions of the two Circuits. 361 U.S. 881.

Respondent stresses that the Motor Carrier Claims Commission, rejecting the Government's contention that only a regulation, rather than a taking, of its facilities had occurred, found that respondent had been deprived of *property*, and awarded compensation therefor. That is indeed true. But the fact that something taken by the Government is property compensable under the Fifth Amendment does not answer the entirely different question whether that thing comes within the capital-gains provisions of the Internal Revenue Code. Rather, it is necessary to determine the precise nature of the property taken. Here the Commission determined that what respondent had been deprived of, and what the Government was obligated to pay for, was the right to determine freely what use to make of its transportation facilities. The measure of compensation adopted reflected the nature of that property right. Given these facts, we turn to the statute.

Section 117(j), under which respondent claims, is an integral part of the statute's comprehensive treatment of capital gains and losses. Long-established principles govern the application of the more favorable tax rates to long-term capital gains: (1) There must be first, a "capital asset," and second, a "sale or exchange" of that asset (§ 117(a)); (2) "capital asset" is defined as "property held by the taxpayer," with certain exceptions not here relevant (§ 117(a)(1)); and (3) for purposes of calculating gain, the cost or other basis of the property (§ 113(b)) must be subtracted from the amount realized on the sale or exchange (§ 111(a)).

Section 117(j), added by the Revenue Act of 1942, effects no change in the nature of a capital asset. It accomplishes only two main objectives. First, it extends capital-gains treatment to real and depreciable personal property used in the trade or business, the type of property involved in this case. Second, it accords such treatment to involuntary conversions of both capital assets, strictly defined, and property used in the trade or business. Since the net effect of the first change is merely to remove one of the exclusions made to the definition of

*Section 117(j) provides as follows:

"Gains and losses from involuntary conversion and 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, plus the recognized gains from the compulsory or involuntary conversion (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) of property used in the trade or business and capital assets held for more than 6 months into other property or money, 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 * * *."

capital assets in section 117(a)(1), it seems evident that "property used in the trade or business," to be eligible for capital gains treatment, must satisfy the same general criteria as govern the definition of capital assets. The second change was apparently required by the fact that this Court had given a narrow construction to the term "sale or exchange." See *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247 [Ct. D. 1510, C.B. 1941–1, 324]. But that change similarly had no effect on the basic notion of what constitutes a capital asset.

While a capital asset is defined in section 117(a)(1) as "property held by the taxpayer," it is evident that not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset. This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year. *Burnet* v. *Harmel*, 287 U.S. 103, 106 [Ct. D. 611, C.B. XI–2, 210 (1932)]. Thus the Court has held that an unexpired lease, *Hort* v. *Commissioner*, 313 U.S. 28 [Ct. D. 1502, C.B. 1941–1, 319], corn futures, *Corn Products Co.* v. *Commissioner*, 350 U.S. 46 [Ct. D. 1787, C.B. 1955–2, 511], and oil payment rights, *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260 [Ct. D. 1823, C.B. 1958–1, 516], are not capital assets even though they are concededly "property" interests in the ordinary sense. And see Survey, Definitional Problems in Capital Gains Taxation, 69 Harv. L. Rev. 985, 987–989 and Note 7.

In the present case, respondent's right to use its transportation facilities was held to be a valuable property right compensable under the requirements of the Fifth Amendment. However, that right was not a capital asset within the meaning of sections 117(a)(1) and 117(j). To be sure, respondent's facilities were themselves properly embraceable as capital assets under section 117(j). Had the Government taken a fee in those facilities, or damaged them physically beyond the ordinary wear and tear incident to normal use, the resulting compensation would no doubt have been treated as gain from the involuntary conversion of capital assets. See, *e.g.*, *Guy L. Waggoner*, 15 T.C. 496; *Walter A. Henshaw*, 23 T.C. 176. But here the Government took only the right to determine the use to which those facilities were to be put.

That right is not something in which respondent had any investment, separate and apart from its investment in the physical assets themselves. Respondent suggests no method by which a cost basis could be assigned to the right; yet it is necessary, in determining the amount of gain realized for purposes of section 117, to deduct the basis of the property sold, exchanged, or involuntarily converted from the amount received. Section 111(a). Further, the right is manifestly not of the type which gives rise to the hardship of the realization in one year of an advance in value over cost built up in several years, which is what Congress sought to ameliorate by the capital-gains provisions. See cases cited, *ante*, p. 134. In short, the right to use is not a capital asset, but is simply an incident of the underlying physical property, the recompense for which is commonly regarded as rent. That is precisely the situation here, and the fact that the transaction was involuntary on respondent's part does not change the nature of the case.

Respondent lays stress on the use of the terms "seizure" and "requisition" in section 117(j). More specifically, the section refers to the "involuntary conversion (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 of imminence thereof) *of property used in the trade or business and capital assets* * * *." (Emphasis added.) It is contended that the Government's action in the present case is perhaps the most typical example of a seizure or requisition, and that therefore, Congress must have intended to treat it as a capital transaction. This argument, however, overlooks the fact that the seizure or requisition must be "of property used in the trade or business [or] capital assets." We have already shown that section 117(j) does not change the long-standing meaning of those terms and that the property taken by the Government in the present case does not come within them. The words "seizure" and "requisition" are not thereby deprived of effect, since they equally cover instances in which the Government takes a fee or damages or otherwise impairs the value of physical property.

We conclude that the amount paid to respondent as the fair rental value of its facilities from August 12, 1944, to June 16, 1945, represented ordinary income to

it. *A fortiori*, the interest on that sum is ordinary income. *Kieselbach* v. *Commissioner*, 317 U.S. 399 [Ct. D. 1570, C.B. 1943, 1008].

Reversed.

MR. JUSTICE DOUGLAS dissents.

SECTION 119.—INCOME FROM SOURCES WITHIN UNITED STATES

REGULATIONS 111, SECTION 29.119–1: Income from sources within the United States.

Gain included in insurance proceeds received by a Western Hemisphere trade corporation. See Rev. Rul. 60–278, page 214.

REGULATIONS 118, SECTION 39.119(a)–7: Other income from sources within the United States.

Gain included in insurance proceeds received by a Western Hemisphere trade corporation. See Rev. Rul. 60–278, page 214.

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX

SECTION 292.—INTEREST ON DEFICIENCIES

Guides and instructions for computation of restricted interest. See Rev. Proc. 60–17, page 942.

SECTION 294.—ADDITIONS TO THE TAX IN CASE OF NONPAYMENT

REGULATIONS 118, SECTION 39.294–1: Additions to the tax.

Guides and instructions for computation of restricted interest. See Rev. Proc. 60–17, page 942.

SUPPLEMENT O.—OVERPAYMENTS

SECTION 322.—REFUNDS AND CREDITS

REGULATIONS 118, SECTION 39.322–11: Limitations upon crediting and refunding of taxes paid—overpayment on account of net operating loss carrybacks and unused excess profits credit carry-backs. T. D. 6487 [1]

TITLE 26.—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER A, PART 39.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951

Extension of period for filing claims for credit or refund of overpayments of income taxes arising as a result of renegotiation of Government contracts.

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[1] 25 F.R. 7732.

DEPARTMENT OF THE TREASURY,
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 118 (26 CFR (1939) Part 39), relating to income taxes, to section 1(b) of the Act of September 16, 1959 (Public Law 86–280, 73 Stat. 564 [C.B. 1959–2, 689]), such regulations are amended as follows:

PARAGRAPH 1. Section 39.321–322 is amended by revising subsection (b)(6) of section 322 and the historical note following section 322 to read as follows:

§ 39.321–322 STATUTORY PROVISIONS; OVERPAYMENT OF INSTALLMENT OF TAX; REFUNDS AND CREDITS.

* * * * * * *

SEC. 322. REFUNDS AND CREDITS. * * *

(b) LIMITATION ON ALLOWANCE. * * *

(6) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO NET OPERATING LOSS CARRY-BACKS AND UNUSED EXCESS PROFITS CREDIT CARRY-BACKS.—If the claim for credit or refund relates to an overpayment attributable to a net operating loss carry-back or to an unused excess profits credit carry-back, in lieu of the three-year period of limitation prescribed in paragraph (1), the period shall be that period which ends with the expiration of the fifteenth day of the thirty-ninth month following the end of the taxable year of the net operating loss or the unused excess profits credit which results in such carry-back, or the period prescribed in paragraph (3) in respect to such taxable year, whichever expires later; except that, with respect to an overpayment attributable to the creation of or an increase in a net operating loss carry-back as a result of the elimination of excessive profits by a renegotiation (as defined in section 3806(a)(1)(A), the period shall not expire before September 1, 1959, or the expiration of the twelfth month following the month in which the agreement or order for the elimination of such excessive profits becomes final, whichever is the later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in paragraph (2) or (3), whichever is applicable, to the extent of the amount of the overpayment attributable to such carry-back.

* * * * * * *

[Sec. 322 as amended by secs. 169 and 172(e), Rev. Act 1942; secs. 2(b)(2) and (4) (a) and (b), Current Tax Payment Act 1943 [P.L. 68, 78th Cong., C.B. 1943, 1239]; secs. 6(b) (9) and (10) and 14(d), Individual Income Tax Act 1944 [P.L. 315, 78th Cong., C.B. 1944, 734]; sec. 5 (a), (b), (c), and (d), Tax Adjustment Act 1945 [P.L. 172, 79th Cong., C.B. 1945, 532]; sec. 122(e)(1), Rev. Act 1945 [P.L. 214, 79th Cong., C.B. 1945, 546]; sec. 1, Pub. Law 716 (81st Cong.) [C.B. 1950–2, 217]; sec. 206(b)(1), Social Security Act Amendments 1950 [P.L. 734, 81st Cong., C.B. 1950–2, 217]; sec. 1(b), Act of Sept. 16, 1959 (Pub. Law 86–280, 73 Stat. 564) [C.B. 1959–2, 689]

PAR. 2. Section 39.322–11 is amended to read as follows:

§ 39.322–11 LIMITATIONS UPON CREDITING AND REFUNDING OF TAXES PAID.—OVERPAYMENT ON ACCOUNT OF NET OPERATING LOSS CARRY-BACKS AND UNUSED EXCESS PROFITS CREDIT CARRY-BACKS.—(*a*) *Special period of limitation.*—(1) If the claim for credit or refund relates to an overpayment attributable to a net operating loss carry-back, provided in section 122(b), or to an unused excess profits credit carry-back, provided in section 432(c), then in lieu of the 3-year period from the date the return was filed in which the claim may be filed or credit or refund allowed or made, as prescribed in § 39.322–7, the period shall be whichever of the following two periods expires later:

(i) The period which ends with the expiration of the fifteenth day of the thirty-ninth month following the end of the taxable year of the net operating loss which resulted in the carry-back; or

(ii) The period which ends with the expiration of the period prescribed in § 39.322-8 within which a claim for credit or refund may be filed with respect to the taxable year of the net operating loss which resulted in the carry-back;

except that, with respect to an overpayment attributable to the creation of or an increase in a net operating loss carry-back as a result of the elimination by a renegotiation (as defined in section 3806(a)(1)(A)) of excessive profits received or accrued for taxable years ending after December 31, 1952, the period shall not expire before September 1, 1959, or the expiration of the twelfth month following the month in which the agreement or order for the elimination of such excessive profits becomes final, whichever is the later.

* * * * * * *

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

(This Treasury Decision is issued under the authority contained in sections 62 and 3791 of the Internal Revenue Code of 1939 (53 Stat. 32, 467; 26 U.S.C. 62, 3791).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved August 9, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register for August 12, 1960, 8:51 a.m., and published in the issue of the Federal Register for August 13, 1960, 25 F.R. 7732)

SUBCHAPTER D.—EXCESS PROFITS TAX

PART I.—RATE AND COMPUTATION OF TAX

SECTION 448.—EXCESS PROFITS CREDIT-REGULATED PUBLIC UTILITIES

REGULATIONS 130, SECTION 40.448-2: Definitions. T.D. 6509[1]

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 of 1939.

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

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

On September 24, 1960, a notice of proposed rulemaking conforming § 40.448-2 of Regulations 130 (26 CFR (1939) Part 40) to the

[1] 25 F.R. 12340.

decision in *Louisville Gas and Electric Company* v. *United States* (1960) Ct. Cl. No. 65–59, was published in the Federal Register (25 F.R. 9180). No objection to the rules proposed having been received during the 30-day period prescribed in the notice, the regulations as so published are hereby adopted.

§ 40.448–2 DEFINITIONS.

* * * * * * *

(e) *Adjusted invested capital.* * * *

(2) In the case of a corporation described in paragraph (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 surplus and earned surplus accounts for such 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 capital surplus and earned surplus accounts shall be based upon the amounts properly recorded on the corporate books of account and made in accordance with the system of accounts so maintained.

(ii) The term "an appropriate regulatory body" as used in this section means a regulatory body described in section 448(c)(1) and in paragraph (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.

(This Treasury Decision is issued under the authority contained in section 3791 of the Internal Revenue Code of 1939 (53 Stat. 467; 26 U.S.C. (1952 ed.) 3791).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved November 29, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 1, 1960, 8:49 a.m., and published in the issue of the Federal Register for December 2, 1960, 25 F.R. 12340)

CHAPTER 2.—ADDITIONAL INCOME TAXES

SUBCHAPTER A.—PERSONAL HOLDING COMPANIES

SECTION 505.—SUBCHAPTER A NET INCOME

REGULATIONS 118, SECTION 39.505–1: Subchapter A net income. (Also Section 117(c); Regulations 118, Section 39.117(c)–1.) — Rev. Rul. 60–285 [1]

The Internal Revenue Service will follow the decision of the United States Court of Claims in *Woodbury Farms & Realty Corporation* v. *United States*, 278 Fed. (2d) 333.

The court held that the corporate taxpayer, in computing its personal holding company subchapter A net income for the years 1951 and 1953, was entitled under section 505(a)(1) of the Internal Revenue Code of 1939 to deduct the entire alternative tax paid for the years 1950 and 1952 pursuant to section 117(c)(1) of the 1939 Code.

This decision is in accord with the decision in *Delaware Realty & Investment Company* v. *Commissioner*, 234 Fed. (2d) 911.

For taxable years governed by the Internal Revenue Code of 1954 the issue presented is controlled by sections 1201 and 545(b) thereof.

SECTION 506.—DEFICIENCY DIVIDENDS—CREDITS AND REFUNDS

REGULATIONS 118, SECTION 39.506–1: Purpose and scope of deficiency dividend credit.

Finality with respect to an agreement entered into between a taxpayer and the Commissioner of Internal Revenue as a determination of the taxpayer's liability for personal holding company tax. See Rev. Rul. 60–287, page 188.

[1] Based on Technical Information Release 245, dated August 4, 1960.

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(g).—GROSS ESTATE: PROCEEDS OF LIFE INSURANCE

REGULATIONS 105, SECTION 81.27: Insurance receivable by other beneficiaries. Ct. D. 1852

ESTATE TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. GROSS ESTATE—INSURANCE PROCEEDS—PAYMENT OF PREMIUMS AFTER ASSIGNMENT OF POLICIES—CONSTITUTIONALITY OF CODE PROVISION AS APPLIED.

Where decedent divested himself of policy rights in four policies of insurance on his life by assigning them to his wife who was the named beneficiary, but continued to pay the premiums until his death in 1954, the proceeds of such policies were properly included in decedent's gross estate. Section 811(g)(2)(A) of the Internal Revenue Code of 1939, providing for inclusion of insurance policies in the estate of an insured if he pays the premiums, irrespective of his rights under the policies, is not unconstitutional as applied to decendent's estate.

The Court held that the taxable event is the maturing of the beneficiary's right to the proceeds upon the death of the insured. The tax laid on the "ripening" at death of rights paid for by decedent is not a direct tax within the meaning of the Constitution. The tax is not retroactive in its impact and, on the facts presented, did not offend the Due Process Clause of the Fifth Amendment to the Constitution.

2. Judgment of United States District Court for the Eastern District of Michigan, 175 Fed. Supp. 291, reversed.

SUPREME COURT OF THE UNITED STATES

United States of America, appellant v. *Manufacturers National Bank of Detroit, etc.*

On appeal from the United States District Court for the Eastern District of Michigan

[June 13, 1960]

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

The question here is whether Section 811(g)(2)(A) of the Internal Revenue Code of 1939 is constitutional as applied in this case. That section, the "payment of premiums" provision in the 1939 Code, requires inclusion of insurance proceeds in the gross estate of an insured where the proceeds are receivable by beneficiaries other that the executor but are attributable to premiums paid by the insured.[1] Inclusion is required regardless of whether the insured

[1] These provisions were enacted, through amendment of sec. 811(g), by sec. 404(a) of the Revenue Act of 1942, 56 Stat. 798, 944. As amended, sec. 811 provides in pertinent part 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 of the United States—

* * * * * * *

"(g) PROCEEDS OF LIFE INSURANCE.—

"(1) RECEIVABLE BY THE EXECUTOR.—To the extent of the amount receivable by the executor as insurance under policies upon the life of the decedent.

"(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)

retained any policy rights. However, if the insured possessed no "incidents of ownership" after January 10, 1941, the premiums paid by him before that date are excluded in determining the portion of the proceeds for which he paid the premiums.[2]

The facts in the case are stipulated. The insured died testate on July 15, 1954. The taxpayer is his executor. On the estate tax return, the taxpayer included, as part of the gross estate, the proceeds of four insurance policies payable to the wife of the insured. These policies were originally issued to the insured, but he divested himself of the policy rights by assigning them to his wife on December 18, 1936. However, he continued to pay the premiums on the policies until he died. After his death, the proceeds were retained by the insurer for the benefit of the family, pursuant to the provisions of a settlement option selected by the wife.

In auditing the return, the Revenue Service determined that only the portion of the proceeds attributable to premiums paid by the insured after January 10, 1941, should be included in his estate.[3] Accordingly, the tax was adjusted and a refund was made. The executor then filed a claim for refund of the rest of the tax attributable to the inclusion of the proceeds. The executor claimed that because the decedent had divested himself of all interest in the policies in 1936, the tax constituted an unapportioned direct tax on property, invalid under Article I, Sections 2 and 9, of the Constitution.[4] However, the Commissioner refused to allow the claim, and the present suit for refund followed. In the District Court, the executor added a claim that the tax is also invalid under the Due Process Clause of the Fifth Amendment "because it is retroactive and discriminatory in its operation."

The District Court sustained the taxpayer's contention that, as applied in this case, Section 811(g)(2)(A) is unconstitutional. It held that because the decedent retained no incidents of ownership in the policies after 1936, "no transfer of the property herein sought to be included in the estate of this decedent occurred at the time of his death." The court concluded that the tax was therefore a direct tax on the proceeds themselves and could not be levied without apportionment.[5] The Government appealed directly to this Court under Sections 1252 and 2101 of Title 28, and we noted jurisdiction. 361 U.S. 880.

The first objection to the tax is that it is a direct tax—that is, that it is not a tax upon a transfer or other taxable event but is, instead, a tax upon property—which Congress cannot exact without apportionment.

This argument does not do justice to the evident intent of Congress to tax events, "as distinguished from [their] tangible fruits." *Tyler* v. *United States*, 281 U.S. 497, 502. From its inception, the estate tax has been a tax on a class of events which Congress has chosen to label, in the provision which actually

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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. . . ."

[2] Sec. 404(c), Revenue Act of 1942, 56 Stat. 798, 945. Section 404(c) provides that:

"The amendments made by subsection (a) [see note 1, *supra*] shall be applicable only to estates of decedents dying after the date of the enactment of this Act [October 21, 1942]; but in determining the proportion of the premiums or other consideration paid directly or indirectly by the decedent (but not the total premiums paid) the amount so paid by the decedent on or before January 10, 1941, shall be excluded if at no time after such date the decedent possessed an incident of ownership in the policy."

January 10, 1941, was the effective date of a Treasury Regulation, T.D. 5032, 1941-1 Cum. Bull. 427, which provided for use of the "payment of premiums" test under sec. 811(g) as it existed prior to the 1942 amendments, see note 1, *supra*, regardless of whether the decedent retained any incidents of ownership. The regulation also provided, however, that premiums paid by the decedent before its effective date were to be excluded if the decedent did not thereafter possess any incidents of ownership.

It should be noted that the "payment of premiums" test was abandoned in the 1954 Code, which reverted to the exclusive use of the "incidents of ownership" test. See 26 U.S.C. sec. 2042.

[3] See note 2, *supra*.

[4] Article I, sec. 2, provides in pertinent part that:

"Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers * * *."

Article I, sec. 9, provides in pertinent part that:

"No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken."

[5] This result is in accord with *Kohl* v. *United States*, 226 F. 2d 381 (C.A. 7th Cir.), the reasoning of which the District Court "adopted" as its own. As the District Court recognized, *Kohl* is in conflict with *Estate of Loeb* v. *Commissioner*, 261 F. 2d 232 (C.A. 2d Cir.), affirming 29 T.C. 22; *Schwarz* v. *United States*, 170 F. Supp. 2; cf. *Colonial Trust Co.* v. *Kraemer*, 63 F. Supp. 866; *Estate of Baker* v. *Commissioner*, 30 T.C. 776.

imposes the tax, "the *transfer of* the net estate of every decedent."[6] See *New York Trust Co.* v. *Eisner*, 256 U.S. 345. If there is any taxable event here which can fairly be said to be a "transfer" under this language in Section 810 of the 1939 Code, the tax is clearly constitutional without apportionment. For such a tax has always "been treated as a duty or excise, because of the particular occasion which gives rise to its levy." *Knowlton* v. *Moore*, 178 U.S. 41, 81; *New York Trust Co.* v. *Eisner, supra*, at 349.

Under the statute, the occasion for the tax is the maturing of the beneficiaries' right to the proceeds upon the death of the insured. Of course, if the insured possessed no policy rights, there is no transfer of any interest *from him* at the moment of death. But that fact is not material, for the taxable "transfer," the maturing of the beneficiaries' right to the proceeds, is the crucial last step in what Congress can reasonably treat as a testamentary disposition by the insured in favor of the beneficiaries. That disposition, which began with the payment of premiums by the insured, is completed by his death. His death creates a genuine enlargement of the beneficiaries' rights. It is the "generating source" of the full value of the proceeds. See *Schwarz* v. *United States*, 170 F. Supp. 2, 6. The maturing of the right to proceeds is therefore an appropriate occasion for taxing the transaction to the estate of the insured. Cf. *Tyler* v. *United States*, 281 U.S. 497, 503, 504.

There is no inconsistency between such a view of the taxable event and the basic definition of the subject of the tax in Section 810. "Obviously, the word 'transfer' in the statute, or the privilege which may consitutionally be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. It must * * * at least include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another." *Chase National Bank* v. *United States*, 278 U.S. 327, 337.

It makes no difference that the payment of premiums occurred during the lifetime of the insured and indirectly affected an *inter vivos* transfer of property to the owner of the policy rights. Congress can properly impose excise taxes on wholly *inter vivos* gifts. *Bromley* v. *McCaughn*, 280 U.S. 124. It may impose an estate tax on *inter vivos* transfers looking toward death. *Milliken* v. *United States*, 283 U.S. 15. Surely, then, it may impose such a tax on the final step—the maturing of the right to proceeds—in a partly *inter vivos* transaction completed by death. The question is not whether there has been, in the strict sense of the word, a "transfer" of property owned by the decedent at the time of his death, but whether "the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result * * *." *Tyler* v. *United States, supra*, at 503.

Therefore, this tax, laid on the "ripening," at death, of rights paid for by the decedent, is not a direct tax within the meaning of the Constitution. Cf. *Chase National Bank* v. *United States, supra; Fernandez* v. *Wiener*, 326 U.S. 340; *Tyler* v. *United States, supra; United States* v. *Jacobs*, 306 U.S. 363.[7]

Further objections to the statute as applied in this case are predicated on the Due Process Clause of the Fifth Amendment.

It is said that the statute operates retroactively. But the taxable event—the maturing of the policies at death—occurred long after the enactment of Section 811(g)(2)(A) in 1942. Moreover, the payment of all but a few of the premiums in question occured after the effective date of the statute, and those few were paid during the period after January 10, 1941, when regulations gave the insured fair notice of the likely tax consequences. See T. D. 5032, 1941–1 Cum. Bull. 427.[8] Therefore, the statute cannot be said to be retroactive in its impact. It is not material that the policies were purchased and the policy rights were

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[6] Compare sec. 201 of the Internal Revenue Act of 1916, 39 Stat. 756, 777, with sec. 810 of the Internal Revenue Code of 1939, 53 Stat. 120. In the 1954 Code, the word "taxable" was substituted for the word "net" in this provision. 26 U.S.C. sec. 2001.

[7] Our view of the nature of the taxable event here involved makes it unnecessary to discuss *United States* v. *Bess*, 357 U.S. 51 [Ct.D 1829, C.B. 1958–2, 934], and other similar cases relied on by the District Court. Nor do we find it necessary to consider at length *Lewellyn* v. *Frick*, 268 U.S. 238, or its progeny. The Court in *Frick* did not reach the constitutional issue.

[8] We do not agree with the holding in *Kohl* v. *United States*, 226 F. 2d 381, that T.D. 5032 "transcended" sec. 811(g) as it existed in 1941 and that it was therefore "illegal and void." T.D. 5032, in effect, construed the controlling language in the earlier statute—"taken out by the decedent," 53 Stat. 122—as meaning paid for by the insured. Such a construction was clearly not unreasonable.

assigned before the statute was enacted. The tax is not laid on the creation or transfer of the policy rights, and it "does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax." *United States* v. *Jacobs*, *supra*, at 367.

The taxpayer argues, however, that the enactment of the statute subjected the insured to a choice between unpleasant alternatives: "[H]e could stop paying the premiums—in which case the policies would be destroyed; or, he could continue paying premiums—in which case they would be included in his estate." But when he gave away the policy rights, the possibility that he would eventually be faced with that choice was an obvious risk, in view of the administrative history of the "payment of premiums" test. See 1 Paul, Federal Estate and Gift Taxation, section 10.13. The executor should not complain because his decedent gambled and lost. And, while it may be true that the insured could have avoided the tax only at the price of a loss on an investment already made, that fact alone does not prove that the lawmakers did "a wholly arbitrary thing," or that they "found equivalence where there was none," or that they "laid a burden unrelated to privilege or benefit." *Burnet* v. *Wells*, 289 U.S. 670, 679 [Ct. D. 688, C.B. XII-1, 261 (1933)]. Without such a showing, it cannot be held that the tax offends due process.

Reversed.

MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case.

SUBTITLE D.—GENERAL ADMINISTRATIVE PROVISIONS

CHAPTER 36.—COLLECTION

SUBCHAPTER B.—LIEN FOR TAXES

SECTION 3670.—PROPERTY SUBJECT TO LIEN

Ct. D. 1856

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. COLLECTION OF TAXES—LIENS—DETERMINATION OF TAXPAYER'S PROPERTY RIGHTS—CONSTRUCTION OF STATE LAW—NEW YORK.

The determination of what property rights a general contractor has in funds owed by the owner of real estate upon which construction has been performed, where the general contractor is indebted to subcontractors for labor and materials, must be decided under state law. The lower court's failure to indicate the nature of the general contractor's (the taxpayer) rights to the funds requires that the case be remanded for a determination of whether the federal tax lien takes precedence over the rights of subcontractors claiming under section 36-a of the New York Lien Law.

2. JUDGMENT VACATED.

Judgment of the Court of Appeals of the State of New York, 146 N.E. 2d 774, vacated and case remanded.

SUPREME COURT OF THE UNITED STATES

Robert Aquilino and Joseph Spero, d/b/a Home Maintenance Company, and Colonial Sand and Stone Co., Inc., Petitioners, v. *United States of America, Ada Bottone, et al.*

On writ of certiorari to the Court of Appeals of the State of New York

[June 20, 1960]

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

In this case we are asked to determine which of two competing claimants—the Federal Government by virtue of its tax lien, or certain petitioning subcon-

tractors by virtue of their rights under Section 36–a of the New York Lien Law—is entitled to a sum of money owed under a general construction contract which was performed by the taxpayer.

The taxpayer, Fleetwood Paving Corporation, is a general contractor, which in July or August 1952, agreed to remodel a restaurant belonging to one Ada Bottone, herein referred to as the owner. The petitioners in August and September of that year entered into a subcontract with the taxpayer to supply labor and materials for the remodeling job. Shortly thereafter, the petitioners performed their obligations under the subcontract, but were not fully compensated by the contractor-taxpayer. Therefore, on November 3, 1952, and on November 10, 1952, they filed notices of their mechanic's liens on the owner's realty in the office of the Clerk of Westchester County. In June 1953, they instituted actions in the New York Supreme Court to foreclose those liens.

By order of court, the owner was permitted to deposit with the Clerk of the court the $2,200 which she still owed under the original construction contract, and she was thereafter dismissed as a defendant in the action. The Government, having previously levied upon the owner's alleged indebtedness to the taxpayer, was permitted by the court to enter the case as a party defendant.

The Government asserted precedence over the claims of petitioners because of the following facts: The Director of Internal Revenue in December 1951 and March 1952 received assessment lists containing assessments against the taxpayer for unpaid federal withholding and social security taxes. On October 31, 1952, the Director filed a notice of federal tax liens in the office of the Clerk of the City of Mount Vernon, New York, which is the city wherein the taxpayer maintained its principal place of business. The Government claimed priority for its tax lien under Sections 3670 and 3671 of the Internal Revenue Code of 1939.[1] The petitioners contended that since the contractor-taxpayer owed them more than $2,200 for labor and materials supplied to the job, under the New York Lien Law, Section 36–a[2] he had no property interest in the $2,200 which the owner still owed under the original remodeling contract.

The New York Supreme Court, Special Term, 140 N.Y.S. 2d 355, granted petitioners' motion for summary judgment. The ground for the decision was that the Government's tax lien was ineffective since it had not been filed in the office designated by New York law for the filing of liens against realty. On appeal, the Appellate Division affirmed, but on the ground that there was no debt due from the owner to the taxpayer to which the Government's lien could attach. 2 App. Div. 2d 747, 153 N.Y.S. 2d 268. The court reasoned that the fund deposited by the owner was a substitute for her realty to which the mechanic's liens had attached; and that since the Government had no lien on the owner's property, it could have no lien on the fund substituted for that property. On appeal, the New York Court of Appeals held that the tax lien had taken effect prior to the petitioners' claims. It therefore reversed the lower New York courts, and ruled that the motion of the United States for summary judgment, rather than that of petitioners, should

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[1] Section 3670:
"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."
Section 3671:
"Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time."
These provisions also appear in the 1954 Code. Int. Rev. Code of 1954, secs 6321, 6322.

[2] McKinney's N.Y. Laws, Lien Law (1958 Supp.), sec. 36–a, provides as follows:
"The funds received by a contractor from an owner for the improvement of real property are hereby declared to constitute trust funds in the hands of such contractor to be applied first to the payment of claims of subcontractors, architects, engineers, surveyors, laborers and materialmen arising out of the improvement, and to the payment of premiums on surety bond or bonds filed and premiums on insurance accruing during the making of the improvement and any contractor and any officer, director or agent of any contractor who applies or consents to the application of such funds for any other purpose and fails to pay the claims hereinbefore mentioned is guilty of larceny and punishable as provided in section thirteen hundred and two of the penal law. Such trust may be enforced by civil action maintained as provided in article three-a of this chapter by any person entitled to share in the fund, whether or not he shall have filed, or had the right to file, a notice of lien or shall have recovered a judgment for a claim arising out of the improvement. For the purpose of a civil action only, the trust funds shall include the right of action upon an obligation for moneys due or to become due to a contractor, as well as moneys actually received by him."
Section 36–a was repealed on September 1, 1959. N.Y. Laws 1959, c. 696, sec. 14. The subject matter covered by sec. 36–a is now included in McKinney's N.Y. Laws, Lien Law (1959 Supp.), secs. 70, 71.

have been granted by the Supreme Court, Special Term. 3 N.Y. 2d 511, 146 N. E. 2d 774. We granted certiorari, 359 U.S. 904.

The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had "property" or "rights to property" to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property * * * sought to be reached by the statute." [3] *Morgan* v. *Commissioner*, 309 U.S. 78, 82 [Ct. D. 1441, C.B. 1940–1, 229]. Thus, as we held only two Terms ago, Section 3670 "creates no property rights but merely attaches consequences, federally defined, to rights created under state law * * *." *United States* v. *Bess*, 357 U.S. 51, 55 [Ct. D. 1829, C.B. 1958–2, 934].[4] However, once the tax lien has attached to the taxpayer's state-created interests, we enter the province of federal law, which we have consistently held determines the priority of competing liens asserted against the taxpayer's "property" or "rights to property." [5] *United States* v. *Vorreiter*, 355 U.S. 15, reversing 134 Colo. 543, 307 P. 2d 475; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010, reversing 227 F. 2d 359; *United States* v. *Colotta*, 350 U.S. 808, reversing 224 Miss. 33, 79 So. 2d 474; *United States* v. *Scovil*, 348 U.S. 218 [Ct. D. 1779, C.B. 1955–1, 548]; *United States* v. *Liverpool & London & Globe Ins. Co.*, 348 U.S. 215 [Ct. D. 1780, C.B. 1955–1, 549]; *United States* v. *Acri*, 348 U.S. 211 [Ct. D. 1778, C.B. 1955–1, 547]; *United States* v. *City of New Britain*, 347 U.S. 81 [Ct. D. 1764; C.B. 1954–1, 277]; *United States* v. *Gilbert Associates*, 345 U.S. 361 [Ct. D. 1757, C.B. 1953–1, 474]; *United States* v. *Security Trust & Sav. Bank*, 340 U.S. 47 [Ct. D. 1736, C.B. 1950–2, 151]; *Illinois* v. *Campbell*, 329 U.S. 362; *United States* v. *Waddill, Holland & Flinn, Inc.*, 323 U.S. 353 Ct. D. 1624, C.B. 1945, 459]. The application of state law in ascertaining the taxpayer's property rights and of federal law in reconciling the claims of competing lienors is based both upon logic and sound legal principles. This approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes.

Petitioners contend that the New York Court of Appeals did not make its determination in the light of these settled principles. Relying upon the express language of Section 36–a of the Lien Law and upon a number of lower New York court decisions interpreting that statute, petitioners conclude that the money actually received by the contractor-taxpayer and his right to collect amounts still due under the construction contract constitute a direct trust for the benefit of subcontractors, and that the only property rights which the contractor-taxpayer has in the trust are bare legal title to any money actually received and a beneficial interest in so much of the trust proceeds as remain after the claims of subcontractors have been settled. The Government, on the other hand, claims that Section 36–a merely gives the subcontractors an ordinary

[3] It is suggested that the definition of the taxpayer's property interests should be governed by federal law, although supplying the content of this nebulous body of federal law would apparently be left for future decisions. We think that this approach is unsound because it ignores the long-established role that the States have played in creating property interests and places upon the courts the task of attempting to ascertain a taxpayer's property rights under an undefined rule of federal law. It would indeed be anomalous to say that the taxpayer's "property and rights to property" included property in which, under the relevant state law, he had no property interest at all.

[4] It is said that because of the unique circumstances which existed in *Bess*, that case does not control here. However, aside from the fact that *Bess* involved proceeds payable under an insurance policy, whereas this case involves proceeds payable under a construction contract, it is apparent that the relevant circumstances of the two cases are essentially identical. In both cases the Government was attempting to assert its tax lien against what it thought to be the "property and rights to property" of the taxpayer. In both cases an adverse party claimed the right to the property in question on the theory that the taxpayer had never acquired a state-created property interest to which the Government's tax lien could attach. Finally, in both cases, the Government attempted to characterize the problem as one involving a conflict between competing claimants to be settled solely by the application of federal law.

Bess held that state law determines the property interests of a taxpayer in the cash surrender value of an insurance policy, as well as in the proceeds payable upon death. The same considerations which lead to our conclusion in *Bess* require that we look to state law in determining the general contractor's property interests in this case.

[5] It is suggested that the rule announced by *Bess* and applied in this case is inconsistent with the mandate that federal law governs the relative priority of federal tax liens and state-created liens. However, we fail to perceive wherein lies the inconsistency. It is one thing to say that a taxpayer's property rights have been and should be created by state law. It is quite another thing to declare that in the interest of efficient tax administration one must look to federal law to resolve the conflict between competing claimants of the taxpayer's state-created property interests.

lien, and that the contractor-taxpayer's property rights encompass the entire indebtedness of the owner under the construction contract.

This conflict should not be resolved by this Court, but by the highest court of the State of New York. We cannot say from the opinion of the Court of Appeals that it has been satisfactorily resolved.[6] We find no discussion in the court's opinion to indicate the nature of the property rights possessed by the taxpayer under state law. Nor is the application to be made of federal law clearly defined. We believe that it is in the interests of all concerned to have these questions decided by the state courts of New York. We therefore vacate the judgment of the Court of Appeals, and remand the case to that court so that it may ascertain the property interests of the taxpayer under state law and then dispose of the case according to established principles of law.

Vacated and remanded.

MR. JUSTICE HARLAN, whom MR. JUSTICE BLACK joins, dissenting, in a separate opinion.

CHAPTER 37.—ABATEMENTS, CREDITS, AND REFUNDS

SECTION 3771.—INTEREST ON OVERPAYMENTS

Guides and instructions for computation of restricted interest. See Rev. Proc. 60–17, page 942.

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[6] Subsequent to the Court of Appeals' decision in the instant case, and after this Court's decision in *United States* v. *Bess*, 357 U.S. 51 [Ct. D. 1829, C.B. 1958–2, 934], the New York Court of Appeals decided the case of *In the Matter of the City of New York*, 5 N.Y. 2d 300, 157 N. E. 2d 587, pending on petition for a writ of certiorari *sub nom. United States* v. *Coblentz*, No. 259, this Term. The *Coblentz* case is not authority for the disposition of the instant case. The latter involves a determination of property rights under sec. 36–a of the New York Lien Law, whereas the *Coblentz* case was concerned with the taxpayer's property interests under an assignment contract, sec. 475 of the New York Judiciary Law, and sec. B15–37.0 of the New York City Administrative Code.

SUBPART B.—RULINGS AND DECISIONS UNDER OTHER PUBLIC LAWS

Rulings and decisions published in Part II, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of other public laws on internal revenue matters, except those relating to the various alcohol taxes, which appear in Part III.

DEALER RESERVE INCOME ADJUSTMENT ACT OF 1960

26 CFR 1.9002: Statutory provisions; Dealer Reserve Income Adjustment Act of 1960 (74 Stat. 124).
(Also Part 1, Section 481; 1.481–2.)

T. D. 6490 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under the Dealer Reserve Income Adjustment Act of 1960 and amendment to regulations under section 481 of the Internal Revenue Code of 1954.

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

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

On August 9, 1960, notice of proposed rulemaking regarding regulations under the Dealer Reserve Income Adjustment Act of 1960 [P.L. 86–459, C.B. 1960–1, 795] and amendment to regulations under section 481 of the Internal Revenue Code of 1954 was published in the Federal Register (25 F.R. 7498). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed and the amendment of the regulations concerned, the following regulations are hereby adopted. Such regulations supersede Treasury Decision 6483 (26 CFR Part 17), approved July 14, 1960 (25 F.R. 6879) [page 932, this Bulletin]

INCOME TAX REGULATIONS

PARAGRAPH 1. The following regulations are hereby prescribed under the Dealer Reserve Income Adjustment Act of 1960, approved May 13, 1960:

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Section	
1.9002	Statutory provisions; Dealer Reserve Income Adjustment Act of 1960 (74 Stat. 124).
1.9002–1	Purpose, applicability, and definitions.
1.9002–2	Election to have the provisions of section 481 of the Internal Revenue Code of 1954 apply.

[1] The publication of this Treasury Decision in 25 F.R. 8369, dated September 1, 1960, contains (1) instructions for modifying the notice of proposed rulemaking in 25 F.R. 7498, dated August 9. 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

Section
1.9002–3 Election to have the provisions of section 481 of the Internal Revenue Code of 1954 not apply.
1.9002–4 Election to pay net increase in tax in installments.
1.9002–5 Special rules relating to interest.
1.9002–6 Acquiring corporation.
1.9002–7 Statute of limitations.
1.9002–8 Manner of exercising elections.

§ 1.9002 Statutory Provisions; Dealer Reserve Income Adjustment Act of 1960 (74 Stat. 124).

SECTION 1. SHORT TITLE.

This Act may be cited as the "Dealer Reserve Income Adjustment Act of 1960".

SEC. 2. PERSONS TO WHOM THIS ACT APPLIES.

This Act shall apply to any person who, for his most recent taxable year ending on or before June 22, 1959—

(1) Computed, or was required to compute, taxable income under an accrual method of accounting,

(2) Treated any dealer reserve income, which should have been taken into account (under the accrual method of accounting) for such taxable year, as accruable for a subsequent taxable year, and

(3) Before September 1, 1960, makes an election under section 3(a) or 4(a) of this Act.

SEC. 3. ELECTION TO HAVE SECTION 481 APPLY.

(a) General Rule.—If—

(1) For the year of the change (determined under subsection (b)), the treatment of dealer reserve income by any person to whom this Act applies is changed to a method proper under the accrual method of accounting (whether or not such person initiated the change),

(2) Such person makes an election under this subsection, and

(3) Such person does not make the election provided by section 4(a),

then, for purposes of section 481 of the Internal Revenue Code of 1954, the change described in paragraph (1) shall be treated as a change in method of accounting not initiated by the taxpayer.

(b) Year of Change, etc. In applying section 481 of the Internal Revenue Code of 1954 for purposes of this section, the "year of the change" in the case of any person is—

(1) Except as provided in paragraph (2), the first taxable year ending after June 22, 1959, or

(2) The earliest taxable year (whether the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939 applies to such year) for which—

(A) On or before June 22, 1959—

(i) The Secretary of the Treasury or his delegate issued a notice of deficiency, or a written notice of a proposed deficiency, with respect to dealer reserve income, or

(ii) Such person filed with the Secretary or his delegate a claim for refund or credit with respect to dealer reserve income, and

(B) The assessment of any deficiency, or the refund or credit of any overpayment, whichever is applicable, was not, on June 21, 1959, prevented by the operation of any law or rule of law.

For purposes of this section, section 481 of such Code shall be treated as applying to any year of the change to which the Internal Revenue Code of 1939 applies.

SEC. 4. ELECTION TO HAVE SECTION 481 NOT APPLY; PAYMENT IN INSTALLMENTS.

(a) General Rule.—If a person to whom this Act applies makes an election under this subsection, then for purposes of chapter 1 of the

Internal Revenue Code of 1954 (and the corresponding provisions of prior law) a change in the treatment of dealer reserve income to a method proper under the accrual method of accounting shall be treated as not a change in method of accounting in respect of which section 481 of the Internal Revenue Code of 1954 applies. Any election under this subsection shall apply to all taxable years ending on or before June 22, 1959 (whether the provisions of the Internal Revenue Code of 1954 or the corresponding provisions of prior law apply), for which the assessment of any deficiency, or for which refund or credit of any overpayment, whichever is applicable, was not, on June 21, 1959, prevented by the operation of any law or rule of law.

(b) ELECTION TO PAY TAX IN INSTALLMENTS.—

(1) ELIGIBILITY.—If the net increase in tax (as defined in paragraph (2)) which results solely from the effect of the election provided by subsection (a) exceeds $2,500, then the taxpayer may elect (at the time the election is made under subsection (a)) to pay in two or more (but not to exceed 10) equal annual installments any portion of such net increase which (on the date of such election) is unpaid.

(2) NET INCREASE IN TAX DEFINED.—For purposes of this section, the term "net increase in tax" means the amount (if any) by which—

(A) The sum of the increases in tax (including interest) for all taxable years to which the election applies and which is attributable to the election, exceeds

(B) The sum of the decreases in tax (including interest) for all taxable years to which the election applies and which is attributable to the election.

For purposes of this paragraph, interest for the period before the date of the election shall be computed as provided in chapter 67 of the Internal Revenue Code of 1954 (or the corresponding provisions of prior revenue laws).

(c) DUE DATE FOR INSTALLMENTS.—If an election is made under subsection (b), the first installment shall be paid on or before the date prescribed by section 6151(a) of the Internal Revenue Code of 1954 for payment of the tax for the taxable year in which the election was made, and each succeeding installment shall be paid on or before the date which is one year after the date prescribed by this subsection for payment of the preceding installment.

(d) EFFECT OF SUBSEQUENT REDETERMINATION OF TAX.—

(1) REDETERMINATION.—If—

(A) The taxpayer makes an election under subsection (b), and

(B) There is a redetermination of the taxpayer's tax for any taxable year to which the election provided by subsection (a) applies,

then the net increase in tax (as defined in subsection (b)(2)) shall be redetermined.

(2) EFFECT OF INCREASE.—If the redetermination described in paragraph (1)(B) results in an increase in the net increase in tax (as defined in subsection (b)(2)), the resulting increase shall be prorated to all the installments. The part of such resulting increase so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of such resulting increase so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary of the Treasury or his delegate.

(3) EFFECT OF DECREASE.—For treatment of a decrease in the net increase in tax as the result of a redetermination described in paragraph (1)(B), see section 6403 of the Internal Revenue Code of 1954 (relating to overpayment of installment).

(e) SUSPENSION OF INTEREST.—

(1) IN GENERAL.—If an election under subsection (a) applies and there is a net increase in tax (as defined in subsection (b)(2), no interest shall be imposed on any underpayment, and no interest shall

be paid on any overpayment) attributable to such election for the period beginning on the date of such election and ending on the date prescribed by section 6151(a) of the Internal Revenue Code of 1954 for payment of the tax for the taxable year in which the election was made.

(2) NO INTEREST DURING INSTALLMENT PERIOD.—If an election under subsection (b) applies, no interest shall be imposed for the period on or after the date fixed for payment of the first installment unless payment of unpaid installments is accelerated under subsection (f) or (g).

(3) INTEREST WHERE PAYMENT IS ACCELERATED.—If payment is accelerated under subsection (f) or (g), interest determined in accordance with the provisions of section 6601 of the Internal Revenue Code of 1954 on the entire unpaid tax shall be payable—

(A) If payment is accelerated under subsection (f), from the date of notice and demand provided by such subsection to the date such tax is paid, or

(B) If payment is accelerated under subsection (g), from the date fixed for paying the unpaid installment to the date such tax is paid.

(f) TERMINATION OF INSTALLMENT PAYMENT PRIVILEGE.—The extension of time provided by this section for payment of tax shall cease to apply, and any unpaid installments shall be paid upon notice and demand from the Secretary of the Treasury or his delegate, if—

(1) In the case of a taxpayer who is an individual, he dies or ceases to engage in a trade or business,

(2) In the case of a taxpayer who is a partner, the entire interest of such partner is transferred or liquidated or the partnership terminates, or

(3) In the case of a taxpayer which is a corporation, the taxpayer ceases to engage in a trade or business, unless the unpaid portion of the tax payable in installments is required to be taken into account by the acquiring corporation under section 5(d).

(g) FAILURE TO PAY INSTALLMENT.—If any installment under this section is not paid on or before the date fixed for its payment by this section (including any extension of time for payment of such installment), the unpaid installments shall be paid upon notice and demand from the Secretary of the Treasury or his delegate.

(h) SUSPENSION OF RUNNING OF PERIODS OF LIMITATION.—The running of the periods of limitation provided by section 6502 of the Internal Revenue Code of 1954 (or corresponding provision of prior law) for the collection of any amount of tax payable in installments under this section shall be suspended for the period of any extension of time for payment granted under this section.

SEC. 5. DEFINITIONS; SPECIAL RULES.

(a) DEALER RESERVE INCOME.—For purposes of this Act, the term "dealer reserve income" means—

(1) That part of the consideration derived by any person from the sale or other disposition of customers' sales contracts, notes, and other evidences of indebtedness (or derived from customers' finance charges connected with such sales or other dispositions) which is—

(A) Attributable to the sale by such person to such customers, in the ordinary course of his trade or business, of real property or tangible personal property, and

(B) Held in a reserve account, by the financial institution to which such person disposed of such evidences of indebtedness, for the purpose of securing obligations of such person or of such customers, or both; and

(2) That part of the consideration—

(A) Derived by any person from a sale described in paragraph (1)(A) in respect of which part or all of the purchase price of the property sold is provided by a financial institution to or for the customer to whom such property is sold, or

(B) Derived by such person from finance charges connected with the financing of such sale,

which is held in a reserve account by such financial institution for the purpose of securing obligations of such person or of such customer, or both.

(b) FINANCIAL INSTITUTION.—For purposes of this Act, the term "financial institution" means any person regularly engaged in the business of acquiring evidences of indebtedness of the kind described in subsection (a)(1), or of financing sales of the kind described in subsection (a)(2), or both.

(c) OTHER TERMS; APPLICATION OF OTHER LAWS.—Except where otherwise distinctly expressed or manifestly intended, terms used in this Act shall have the same meaning as when used in the Internal Revenue Code of 1954 and all provisions of law shall apply with respect to this Act as if this Act were a part of such Code.

(d) ACQUIRING CORPORATION.—In the case of the acquisition of assets of a corporation by another corporation in a distribution or transfer described in section 381(a) of the Internal Revenue Code of 1954, the acquiring corporation shall, for purposes of this Act, be treated as if it were the distributor or transferor corporation.

(e) STATUTES OF LIMITATIONS.—

(1) EXTENSION OF PERIOD FOR ASSESSMENT AND REFUND OR CREDIT.—For purposes of applying sections 3 and 4 of this Act, if the assessment of any deficiency, or the refund or credit of any overpayment, for any taxable year was not prevented on June 21, 1959, by the operation of any law or rule of law, but would be so prevented prior to September 1, 1961, the period within which such assessment, or such refund or credit, may be made shall not expire prior to September 1, 1961. An election by a taxpayer under section 3 or 4 of this Act shall be considered as a consent to the application of the provisions of this subsection.

(2) YEARS CLOSED BY CLOSING AGREEMENT OR COMPROMISE.—For purposes of this Act, if the assessment of any deficiency, or the refund or credit of any overpayment, for any taxable year is prevented on the date of an election under section 3 or 4 of this Act by the operation of the provisions of chapter 74 of the Internal Revenue Code of 1954 (relating to closing agreements and compromises) or by the corresponding provisions of the Internal Revenue Code of 1939, such assessment, or such refund or credit, shall be considered as having been prevented on June 21, 1959.

(f) REGULATIONS.—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this Act, including regulations relating to—

(1) The application of the provisions of this Act in the case of partnerships, and

(2) The manner in which the elections provided by this Act are to be made.

§ 1.9002–1 PURPOSE, APPLICABILITY, AND DEFINITIONS.—(a) *In general.*—The "Dealer Reserve Income Adjustment Act of 1960" (approved May 13, 1960) contains transitional provisions relating to adjustments to income resulting from a change in the income tax treatment of dealer reserve income. The purpose of the Act is to provide eligible taxpayers who elect to have its provisions apply with two alternatives for accounting for the adjustments to income resulting from a change to a proper method of reporting dealer reserve income. The Act also provides certain taxpayers with an election to pay in installments any net increase in tax. Eligible taxpayers must make any election under the provisions of the Act prior to September 1, 1960. If any election is made, then the applicable provisions of the Act and §§ 1.9002 to 1.9002–8, inclusive, shall apply.

(b) *Eligibility to elect.*—In order to be eligible to make any of the elections provided by the Act, a taxpayer must have, for his most recent taxable year ending on or before June 22, 1959, (1) computed, or been required to compute, taxable income under an accrual method

of accounting, and (2) treated dealer reserve income (or portions thereof) which should have been taken into account (under the accrual method of accounting) for such most recent taxable year as accruable for a subsequent taxable year. Thus, the elections provided by the Act are not available to a person who, for his most recent taxable year ending on or before June 22, 1959, reported dealer reserve income under a method proper under the accrual method of accounting or who was not required to compute taxable income under the accrual method of accounting. An election may be made even though the taxpayer is litigating his liability for income tax based upon his treatment of dealer reserve income, whether in The Tax Court of the United States or any other court, and an election filed by a taxpayer who is litigating his liability for income tax based upon his treatment of dealer reserve income does not constitute a waiver of his right to continue pending litigation until final judicial determination. He must, however, comply with the provisions of the Act and the regulations thereunder.

(c) *Definitions.*—For purposes of the Act and §§ 1.9002 to 1.9002–8, inclusive—

(1) *The Act.*—The term "the Act" means the Dealer Reserve Income Adjustment Act of 1960, approved May 13, 1960.

(2) *Dealer reserve income.*—The term "dealer reserve income" means—

(i) That part of the consideration derived by any person from the sale or other disposition of customers' sales contracts, notes, and other evidences of indebtedness (or derived from customers' finance charges connected with such sales or other dispositions) which is—

(*a*) Attributable to the sale by such person to such customers, in the ordinary course of his trade or business, of real property or tangible personal property, and

(*b*) Held in a reserve account, by the financial institution to which such person disposed of such evidences of indebtedness, for the purpose of securing obligations of such person or of such customers, or both; and

(ii) That part of the consideration—

(*a*) Derived by any person from a sale described in subdivision (i) (*a*) of this subparagraph in respect of which part or all of the purchase price of the property sold is provided by a financial institution to or for the customer to whom such property is sold, or

(*b*) Derived by such person from finance charges connected with the financing of such sale,

which is held in a reserve account by such financial institution for the purpose of securing obligations of such person or of such customer, or both. Thus, the term includes amounts held in a reserve account by a financial institution in transactions in which the customer becomes obligated to the institution as well as such amounts so held by a financial institution in transactions in which the taxpayer is the obligee on the contract, note, or other evidence of indebtedness. For purposes of the definition of the term "dealer reserve income" it is immaterial whether or not the taxpayer guarantees the customer's obligation in excess of the reserve retained by the financial institution. The term does not include the consideration derived from transactions relating to the sale of intangible property such as stocks, bonds, copyrights,

patents, etc. Further, the term does not include consideration derived by the taxpayer from transactions relating to the sale of property by a person not the taxpayer or to casual sales of property not in the ordinary course of the taxpayer's trade or business.

(3) *Financial institution.*—The term "financial institution" means any person regularly engaged in the business of acquiring evidences of indebtedness of the kind described in section 5(a)(1) of the Act, or of financing sales of the kind described in section 5(a)(2) of the Act, or both. It thus includes banking institutions, finance companies, building and loan associations, and other similar type organizations, as well as an individual or partnership regularly engaged in the described business.

(4) *Taxpayer.*—The term "taxpayer" means any person to whom the Act applies.

(5) *Other terms.*—All other terms which are not specifically defined shall have the same meaning as when used in the Internal Revenue Code of 1954 except where otherwise distinctly expressed or manifestly intended.

§ 1.9002–2 Election To Have the Provisions of Section 481 of the Internal Revenue Code of 1954 Apply.—(a) *In general.*—Section 3(a) of the Act provides that if the income tax treatment of dealer reserve income by the taxpayer is changed (whether or not such change is initiated by the taxpayer) to a proper method under the accrual method of accounting, then the taxpayer may elect to have such change treated as a change in method of accounting not initiated by the taxpayer to which the provisions of section 481 of the Code apply. This election may be made only when the alternative election under section 4(a) of the Act has not been exercised.

(b) *Year of change.*—Where an election has been made under section 3(a) of the Act to have section 481 of the Code apply, then for purposes of applying section 481 of the Code the year of change shall be determined in accordance with the provisions of section 3(b) of the Act. Section 3(b) provides that the year of change is the earlier of (1) the first taxable year ending after June 22, 1959, or (2) the earliest taxable year for which, on or before June 22, 1959,

(i) There was issued a notice of deficiency or written notice of a proposed deficiency attributable to the erroneous treatment of dealer reserve income, or

(ii) The taxpayer filed a claim for refund or credit with respect to the treatment of such income,

and in respect of which the assessment of any deficiency, or the refund or credit of any overpayment, was not prevented on June 21, 1959, by the operation of any law or rule of law. The written notice of proposed deficiency includes a 15- or 30-day letter issued under established procedure or other similar written notification.

(c) *Application to pre-1954 Code years.*—If the earliest year described in paragraph (b) of this section is a year subject to the Internal Revenue Code of 1939 in respect of which assessment of any deficiency or refund or credit of any overpayment was not prevented on June 21, 1959, by the operation of any law or rule of law, section 481 of the Internal Revenue Code of 1954 shall be treated as applying

in the same manner it would have applied had it been enacted as part of the Internal Revenue Code of 1939.

(d) *Examples.*—The operation of this section in determining the year of change may be illustrated by the following examples:

Example (1). D, a taxpayer on the calendar year basis who employs the accrual method of accounting, voluntarily changed to the proper method of accounting for dealer reserve income for the taxable year 1959. A statutory notice of deficiency, however, was issued prior to June 23, 1959, relating to the erroneous treatment of such income for the taxable year 1956, which was the earliest taxable year in respect of which assessment of a deficiency or credit or refund of an overpayment was not prevented on June 21, 1959. Prior to September 1, 1960, D properly exercises his election under section 3 of the Act to have the change in the treatment of dealer reserve income treated as a change in method of accounting not initiated by the taxpayer to which section 481 of the Code applies. Under these facts, 1956 is the year of the change for purposes of applying section 481. Accordingly, the net amount of any adjustment found necessary as a result of the change in the treatment of dealer reserve income which is attributable to taxable years subject to the 1954 Code shall be taken into account for the year of change in accordance with section 481. The net amount of the adjustments attributable to pre-1954 Code years is to be disregarded. The income of each taxable year succeeding the year of change in respect of which the assessment of any deficiency or refund or credit of any overpayment is not prevented will be recomputed under the proper method of accounting initiated by the change.

Example (2). Assume the same facts as set forth in example (1), except that no notice of a proposed deficiency of any type has been issued, and assume further that no claim for refund has been filed. Since there was no earlier year open on June 21, 1959, for which the taxpayer either was notified of a proposed deficiency attributable to the erroneous treatment of leader reserve income or for which he had filed a claim for refund or credit with respect to the treatment of such income, the year of change is 1959, the first taxable year ending after June 22, 1959. Accordingly, the net amount of any adjustment found necessary as a result of the change in the treatment of dealer reserve income which is attributable to taxable years subject to the 1954 Code shall be taken into account for the year of the change in accordance with section 481. The net amount of the adjustments attributable to pre-1954 Code years is to be disregarded.

Example (3). Assume the same facts as set forth in example (1), except that a refund claim specifying adjustments relative to dealer reserve income was timely filed for the taxable year 1951, which was the earliest taxable year for which a refund or credit of an overpayment or assessment of a deficiency was not prevented on June 21, 1959. Under this factual situation, the year of change for purposes of applying section 481 would be 1951. Section 481 would be applied to 1951 and be given effect for that year in the same manner as it would have applied had it been enacted as a part of the 1939 Code and as if the change to the proper method of accounting had not been initiated by the taxpayer. Any adjustment with regard to dealer reserve income attributable to pre-1951 years is disregarded. The income of each taxa-

ble year succeeding the year of change in respect of which the assessment of any deficiency or refund or credit of any overpayment is not prevented will be recomputed under the proper method of accounting initiated by the change.

§ 1.9002–3 ELECTION TO HAVE THE PROVISIONS OF SECTION 481 OF THE INTERNAL REVENUE CODE OF 1954 NOT APPLY.—Section 4(a) of the Act provides that if the treatment of dealer reserve income by the taxpayer is changed to a method proper under the accrual method of accounting, then the taxpayer may elect to have such change treated as not a change in method of accounting to which the provisions of section 481 of the Code apply. This election shall apply to all taxable years ending on or before June 22, 1959, for which the assessment of any deficiency, or for which refund or credit of any overpayment, was not prevented on June 21, 1959, by the operation of any law or rule of law. This election may be made only if the alternative election under section 3(a) of the Act has not been exercised. If an election is made under section 4(a) of the Act, taxable income (or net income in the case of a taxable year to which the Internal Revenue Code of 1939 applies) shall be recomputed under a proper method of accounting for dealer reserve income for each taxable year to which the election applies, without regard to section 481.

§ 1.9002–4 ELECTION TO PAY NET INCREASE IN TAX IN INSTALLMENTS.—(a) *Election.*—If an election is made under section 4(a) of the Act and if the net increase in tax determined in accordance with paragraph (b) of this section exceeds $2,500, the taxpayer may also make an election under section 4(b) of the Act prior to September 1, 1960, to pay any portion of such net increase in tax, unpaid on the date of the election, in 2 or more, but not to exceed 10, equal annual installments. If the taxpayer making the election under section 4(a) of the Act is a partnership or a small business corporation electing under subchapter S, chapter 1 of the Code, the determination as to whether the net increase in tax exceeds $2,500 shall be made separately as to each partner or shareholder, respectively, with regard to his individual liability. Thus, if a partnership makes an election under section 4(a) of the Act, and partners A and B had a net increase in tax of $3,000 and $2,000, respectively, as a result of dealer reserve income adjustments to partnership income, partner A may elect under section 4(b) of the Act to pay the net increase in 2 or more, but not exceeding 10, equal annual installments to the extent that such tax was unpaid on the date of the election. Partner B may not make the election since his net increase in tax does not exceed $2,500.

(b) *Net increase in tax.*—(1) The term "net increase in tax" means the amount by which the sum of the increases in tax (including interest) for all taxable years to which the election under section 4(a) of the Act applies and which is attributable to the election exceeds the sum of the decreases in tax (including interest) for all taxable years to which the election under such section applies and which is attributable to the election.

(2) In determining the net increase in tax, the tax and interest for each taxable year to which the election applies is computed by taking into account all adjustments necessary to reflect the change to the proper treatment of dealer reserve income. If the computation re-

sults in additional tax for a taxable year, then interest is computed under section 6601 of the Code (or corresponding provisions of prior law) on such additional tax for the taxable year involved from the last date prescribed for payment of the tax for such taxable year to the date the election is made. The interest so computed is then added to the additional tax determined for such taxable year. The sum of these two items (tax plus interest) represents the increase in tax for such taxable year. If the computation of the tax after taking into account the appropriate dealer reserve income adjustments results in a reduction in tax for any taxable year to which the election applies, interest under section 6611 of the Code (or corresponding provisions of prior law) is computed from the date of the overpayment of the tax for such year to the date of the election. The amount of the interest so computed is then added to the reduction in tax to determine the total decrease in tax for such year. The net increase in tax is then determined by adding together the total increases in tax for each year to which the election applies and from the resulting total subtracting the sum of the total decreases in tax for each year. If the total increases in tax for all such years do not exceed the total decreases in tax, there is no net increase in tax for purposes of section 4(b) of the Act. For purposes of determining the net increase in tax, net operating losses affecting the computation of tax for any prior taxable year not otherwise affected shall be taken into account.

(c) *Time for paying installments.*—If the election under this section is made to pay the unpaid portion of the net increase in tax in installments, the first installment shall be paid on or before the date prescribed by section 6151(a) of the Code for payment of the tax for the taxable year in which such election is made. Each succeeding installment shall be paid on or before the date which is one year after the date prescribed for the payment of the preceding installment.

(d) *Termination of installment privilege.*—(1) *For nonpayment of installment.*—The extension of time provided by section 4(b) of the Act for payment of the net increase in tax in installments shall terminate, and any unpaid installments shall be paid upon notice and demand from the district director if any installment under such section is not paid by the taxpayer on or before the date fixed for its payment, including any extension of time for payment of any such installment.

(2) *For other reasons.*—The extension of time provided by section 4(b) of the Act for payment of the net increase in tax in installments shall terminate, and any unpaid installments shall be paid upon notice and demand from the district director if—

(i) In the case of an individual, he dies or ceases to engage in any trade or business,

(ii) In the case of a partner, his entire interest in the partnership is transferred or liquidated or the partnership terminates, or

(iii) In the case of a corporation, it ceases to engage in a trade or business, unless the unpaid portion of the tax payable in installments is required to be taken into account by an acquiring corporation under section 5(d) of the Act.

The installment privilege is not terminated under this subparagraph even though the taxpayer terminates the trade or business in respect of which the dealer reserve income is attributable provided the taxpayer continues in a trade or business. Further, the privilege is not

terminated by a transfer of a part of a partnership interest so long as the partner retains any interest in the partnership. Also, the privilege is not terminated by a transaction falling within the provisions of section 381(a) of the Code if, under section 5(d) of the Act, the acquiring corporation is required to take into account the unpaid portion of the net increase in tax. In such a case the privilege may be continued by the acquiring corporation in the same manner and under the same conditions as though it were the distributor or transferor corporation.

(e) *Redetermination of tax subsequent to exercise of installment election.*—Section 4(d) of the Act provides that where a taxpayer has elected to pay the net increase in tax in installments and thereafter it becomes necessary to redetermine the taxpayer's tax for any taxable year to which the election provided by section 4(a) of the Act applies, then the net increase in tax shall be redetermined. Where the redetermination does not involve adjustments affecting the treatment of dealer reserve income, then the net increase in tax previously computed will not be disturbed. The net increase in tax is limited to the amount of tax computed under section 4(b)(2) of the Act as a result of the change in treatment accorded dealer reserve income. If the redetermination of tax for any taxable year to which the election applies results in an addition to the net increase in tax previously computed, then such addition shall be prorated to all of the installments whether paid or unpaid. The part of the addition, prorated to installments which are not yet due, shall be collected at the same time as, and as a part of, such installments. The part of the addition prorated to installments, the time for payment of which has arrived, shall be paid upon notice and demand from the district director. Under section 4(g) of the Act, failure to make such payment within 10 days after issuance of notice and demand will terminate the installment privilege. The imposition of interest on the addition to the net increase in tax as a result of the redetermination will be determined in the same manner as interest on the previously computed net increase in tax. Thus, no interest will be imposed on the amount of the addition to the net increase in tax prorated to installments not yet due unless the installment privilege is terminated under subsection (f) or (g) of section 4 of the Act. If a reduction in the net increase in tax results from a redetermination of tax for any taxable year to which the election applies, the entire amount of such reduction shall, in accordance with the provisions of section 6403 of the Code (relating to overpayment of installments), be prorated to the installments which are not yet due, resulting in a pro rata reduction in each of such installments. Where the redetermination does not involve adjustments pertaining to dealer reserve income, then any resulting deficiency pertaining to the year to which the election applies will be assessed and collected, in accordance with the applicable provisions of the Code (or corresponding provisions of prior law) without regard to any election made under the Act.

(f) *Periods of limitation.*—Section 4(h) of the Act provides that where there is an extension of time for payment of tax under the provisions of section 4(b) of the Act, the running of the periods of limitation provided by section 6502 of the Code (or corresponding provisions of prior law) for collection of such tax is suspended for the period of time for which the extension is granted.

§ 1.9002–5 SPECIAL RULES RELATING TO INTEREST.—(a) *In general.*—Where an election is made under section 4(a) of the Act interest is computed under section 6601 of the Code (or corresponding provisions of prior law) on any increase in tax attributable to such election for each taxable year involved for the period from the last date prescribed for payment of the tax for such year (determined without regard to any extensions of time for filing the return) through the date preceding the date on which the election is made. Where the election under section 4(a) of the Act results in a decrease in tax for any year to which the election applies, interest is computed in accordance with section 6611 of the Code (or corresponding provisions of prior law) from the date of overpayment through the date preceding the date on which the election is made. Where there is a net increase in tax as a result of the election under section 4(a) of the Act, no interest shall be imposed on any underpayment (and no interest shall be paid on any overpayment) attributable to the dealer reserve income adjustment for any year to which the election applies for the period commencing with the date such election is made and ending on the date prescribed for filing the return (determined without regard to extensions of time) for the taxable year in which the election is made. This rule applies regardless of whether the election under section 4(b) of the Act is made. If there is no net increase in tax, interest on any underpayment or overpayment attributable to the dealer reserve income adjustment for any taxable year to which the election applies for the period commencing with the date of the election shall be determined in accordance with §§ 301.6601–1 and 301.6611–1 of this chapter (Regulations on Procedure and Administration).

(b) *Installment period.*—(1) *Where payment is not accelerated.*—If the election under section 4(b) of the Act is made to pay the net increase in tax in installments, no interest will be imposed on such net increases in tax for the period beginning with the due date fixed under section 4(c) of the Act for the first installment payment and ending with the date fixed under such section for the last installment payment unless payment of the unpaid installments is accelerated under other provisions of the Act. See subsections (f) and (g) of section 4 of the Act.

(2) *Where payment is accelerated.*—Where payment of the unpaid installments is accelerated because of the termination of the installment privilege, interest will be computed under section 6601 of the Code on the entire unpaid net increase in tax for the applicable period set forth below:

(i) In the case of acceleration under section 4(f) of the Act for reasons other than nonpayment of an installment, from the date of the notice and demand for payment of the unpaid tax to the date of payment; or

(ii) In the case of acceleration under section 4(g) of the Act for nonpayment of an installment, from the date fixed for payment of the installment to the date of payment.

When payment is accelerated under section 4(f) of the Act, however no interest will be charged where payment of the unpaid installments is made within 10 days of issuance of the notice and demand for such payment.

§ 1.9002–6 ACQUIRING CORPORATION.—Section 5(d) of the Act provides that for purposes of such Act in the case of the acquisition of the assets of a corporation by another corporation in a distribution or transfer described in section 381(a) of the Code the acquiring corporation shall be treated as if it were the distributor or transferor corporation.

§ 1.9002–7 STATUTE OF LIMITATIONS.—(a) *Extension of period for assessment and refund or credit.*—Under section 5(e) of the Act, if an election is made to have the Act apply, and if the assessment of any deficiency, or the refund or credit of any overpayment attributable to the election, for any taxable year to which the Act applies was not prevented on June 21, 1959, by the operation of any law or rule of law (except as provided in paragraph (b) of this section, relating to closing agreements and compromises), but would be so prevented prior to September 1, 1961, the period within which such assessment, or such refund or credit, may be made with respect to such taxable year shall not expire prior to September 1, 1961. An election under either section 3 or 4 of the Act will be considered to be a consent to the extension of the period of limitation for purposes of assessment for any year to which the Act applies. Thus, for example, if, as the result of an election under section 4(a) of the Act, assessment of a deficiency for the taxable year 1955 was not prevented by the statute of limitations, a judicial decision that had become final, or otherwise, on June 21, 1959, but would (except for section 5(e) of the Act) be prevented on a later date, as for instance September 1, 1959, then for purposes of applying section 4 of the Act assessment may be made at any time prior to September 1, 1961, with respect to such year if the taxpayer made an election under the Act prior to September 1, 1960. Section 5(e) of the Act will, in no event, operate to shorten the period of limitation otherwise applicable with respect to any taxable year.

(b) *Years closed by closing agreement or compromise.*—For purposes of the Act, if the assessment of any deficiency or a refund or credit of any overpayment for any taxable year was not prevented on June 21, 1959, but is prevented on the date of an election under section 3 or 4 of the Act by the operation of the provisions of chapter 74 of the Code (relating to closing agreements and compromises), assessment, refund, or credit will, nevertheless, be considered as being prevented on June 21, 1959.

§ 1.9002–8 MANNER OF EXERCISING ELECTIONS.—(a) *By whom election is to be made.*—(1) *In general.*—Generally, the taxpayer to whom the Act applies will exercise the elections provided therein. In the case of a partnership or a corporation electing under the provisions of subchapter S, chapter 1 of the Code, the election shall be exercised by the persons specified in subparagraphs (2) and (3) of this paragraph, respectively.

(2) *Partnerships.*—In the case of a partnership, the election under section 3 or 4(a) of the Act shall be exercised by the partnership. If an election is made by the partnership under section 4(a) of the Act, any election under section 4(b) of the Act to pay the net increase in tax in installments shall be made by each partner separately. The determination as to whether the net increase in tax resulting from the election under section 4(a) of the Act exceeds $2,500 shall be made with

reference to the increase or decrease in the tax of each partner attributable to the adjustment to his distributive share of the partnership income resulting from the election.

(3) *Subchapter S corporations.*—In the case of an electing small business corporation under subchapter S, chapter 1 of the Code, the election under section 3 or 4(a) of the Act shall be made by such corporation. An election under section 4(b) of the Act to pay the net increase in tax in installments shall, to the extent the net increase in tax resulting from the election is attributable to adjustments to income for taxable years for which the corporation was not an electing small business corporation, be made by the corporation. The determination as to whether the net increase in tax for such taxable years exceeds $2,500 shall be made with reference to the increase or decrease in tax of the corporation. Any election under section 4(b) of the Act to pay the net increase in tax in installments shall, to the extent the increase in tax is attributable to years for which the corporation was an electing small business corporation, be made by the shareholders separately. The determination in such a case as to whether the net increase in tax for such taxable years exceeds $2,500 shall be made with reference to the increases or decreases in the tax of each shareholder attributable to the adjustments to taxable income of the electing small business corporation resulting from the election.

(b) *Time and manner of making elections.*—(1) *In general.*—Any election made under the Act shall be made by the taxpayers described in paragraph (a) of this section before September 1, 1960, by filing a statement with the district director with whom such taxpayer's income tax return for the taxable year in which the election is made is required to be filed. A copy of the statement of election shall be attached to and filed with such taxpayer's income tax return for such taxable year.

(2) *Election to have section 481 apply.*—An election under section 3 of the Act shall be made in the form of a statement which shall include the following:

(i) A clear indication that an election is being made under section 3 of the Act;

(ii) Information sufficient to establish eligibility to make the election; and

(iii) The year of change as defined in section 3(b) of the Act.

An amended income tax return reflecting the increase or decrease in tax attributable to the election shall be filed for the year of change together with schedules showing how the tax was recomputed under section 481 of the Code. If income tax returns have been filed for any taxable years subsequent to the year of change, amended returns reflecting the proper treatment of dealer reserve income for such years shall also be filed. In the case of partnerships and electing small business corporations under subchapter S, chapter 1 of the Code, amended returns shall be filed by the partnership or electing small business corporation, as well as by the partners or shareholders, as the case may be. Any amended return shall be filed with the office of the district director with whom the taxpayer files his income tax return for the taxable year in which the election is made and, if practicable, on the same date the statement of election is filed, but amended returns shall be filed in no event later than November 30, 1960, unless an extension of time is granted under section 6081 of the Code. When-

ever the amended returns do not accompany the statement of election, a copy of the statement shall be submitted with the amended returns.

(3) *Election not to have section 481 apply.*—An election under section 4(a) of the Act shall be made in the form of a statement which shall include the following:

(i) A clear indication that an election is being made under section 4(a) of the Act;

(ii) Information sufficient to establish eligibility to make the election; and

(iii) The taxable years to which the election applies.

Amended income tax returns reflecting the increase or decrease in tax attributable to the election shall be filed for the taxable years to which the election applies. If income tax returns have been filed for any subsequent taxable years, amended returns reflecting the proper treatment of dealer reserve income for such years shall also be filed. In the case of partnerships and electing small business corporations under subchapter S, chapter 1 of the Code, amended returns shall be filed by the partnership or electing small business corporation, as well as by the partners or shareholders, as the case may be. Any amended return shall be filed with the office of the district director with whom the taxpayer files his income tax return for the taxable year in which the election is made and, if practicable, on the same date the statement of election is filed, but amended returns shall be filed in no event later than November 30, 1960, unless an extension of time is granted under section 6081 of the Code. Whenever the amended returns do not accompany the statement of election, a copy of the statement shall be submitted with the amended return.

(4) *Election to pay tax in installments.*—(i) Except as otherwise provided in subdivision (ii) of this subparagraph, if the taxpayer making the election under section 4(a) of the Act also desires to make the election under section 4(b) of the Act to pay the increase in tax in installments, then the statement of election shall include the following additional information:

(*a*) A clear indication that an election is also being made under section 4(b) of the Act;

(*b*) A summary of the total increases and decreases in tax, together with interest thereon, in sufficient detail to establish eligibility to make the election; and

(*c*) The number of annual installments in which the taxpayer elects to pay the net increase in tax.

(ii) Where a partnership or electing small business corporation under subchapter S, chapter 1 of the Code, has made an election under section 4(a) of the Act, and any partner or shareholder, as the case may be, desires to make an election under section 4(b) of the Act, a statement of election shall be filed by such partner or shareholder containing the following information:

(*a*) A clear indication that an election is being made under section 4(b) of the Act;

(*b*) A summary of the total increases and decreases in tax, together with interest thereon, of such partner or shareholder in sufficient detail to establish eligibility to make the election;

(*c*) The number of annual installments in which the partner or shareholder elects to pay the net increase in tax; and

(*d*) The office of the district director and the date on which the election under section 4(a) of the Act was filed by such partnership or corporation.

The statement of election under section 4(b) of the Act shall be accompanied by a copy of the statement of election under section 4(a) of the Act made by the partnership or electing small business corporation under subchapter S, chapter 1 of the Code, as the case may be.

(c) *Effect of election.*—An election made under section 3 or 4 of the Act shall become irrevocable on September 1, 1960, and shall be binding on the taxpayer for all taxable years to which it applies.

AMENDMENT OF INCOME TAX REGULATIONS

PAR. 2. Paragraph (c)(5) of § 1.481–2 is amended to read as follows:

§ 1.481–2 LIMITATION ON TAX.—

* * * * * * *

(c) *Rules for computation of tax.* * * *

(5)(i) In the case of a change in method of accounting by a partnership, the adjustments required by section 481 shall be made wth respect to the taxable income of the partnership but the limitations on tax under section 481(b) shall apply to the individual partners. Each partner shall take into account his distributive share of the partnership items, as so adjusted, for the taxable year of the change. Section 481(b) applies to a partner whose taxable income is so increased by more than $3,000 as a result of such adjustments to the partnership taxable income. It is not necessary for the partner to have been a member of the partnership for the two taxable years immediately preceding the taxable year of the change of the partnership's accounting method in order to have the limitation provided by section 481(b)(1) apply. Further, a partner may apply section 481(b)(2) even though he was not a member of the partnership for all the taxable years affected by the computation thereunder.

(ii) In the case of a change in method of accounting by an electing small business corporation under subchapter S, chapter 1 of the Code, the adjustments required by section 481 shall be made with respect to the taxable income of such electing corporation in the year of the change, but the limitations on tax under section 481(b) shall apply to the individual shareholders. Section 481(b) applies to a shareholder of an electing small business corporation whose taxable income is so increased by more than $3,000 as a result of such adjustments to such corporation's taxable income. It is not necessary for the shareholder to have been a member of the electing small business corporation, or for such corporation to have been an electing small business corporation, for the two taxable years immediately preceding the taxable year of the change of the corporation's accounting method in order to have the limitation provided by section 481(b)(1) apply. Further, a shareholder may apply section 481(b)(2), even though he was not a shareholder, or the corporation was not an electing small business corporation, for all the taxable years affected by the computation thereunder.

(This Treasury Decision is issued under the authority contained in paragraph (f), section 5, of the Dealer Reserve Income Adjustment Act of 1960, 74 Stat. 128, and section 7805 of the Internal Revenue Code of 1954; 68A Stat. 917; 26 U.S.C. 7805.)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved August 30, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 30, 1960, 2:15 p.m., and published in the issue of the Federal Register for September 1, 1960, 25 F.R. 8369)

PUBLIC DEBT AND TAX RATE EXTENSION ACT OF 1960

26 CFR 1.9003: Statutory provisions; section 4 of Public Law 86–781 (74 Stat. 1017). (Also Part I, Section 613.)

T. D. 6492 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under section 302(c)(2) of the Public Debt and Tax Rate Extension Act of 1960, as amended.

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

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

The regulations set forth below are hereby prescribed under section 302(c)(2) of the Public Debt and Tax Rate Extension Act of 1960 [P.L. 86–564, page 681, this Bulletin], as amended:

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1.9003	Statutory provisions; section 4 of Public Law 86–781 (74 Stat. 1017).
1.9003–1	Election to have the provisions of section 613(c) and (2) and (4) of the 1954 Code, as amended, apply for past years.
1.9003–2	Effect of election.
1.9003–3	Statutes of limitation.
1.9003–4	Manner of exercising election.
1.9003–5	Terms; applicability of other laws.

§ 1.9003 STATUTORY PROVISIONS; SECTION 4 OF PUBLIC LAW 86–781 (74 STAT. 1017), APPROVED SEPTEMBER 14, 1960.

Sec. 4. Subsection (c) of section 302 of the Public Debt and Tax Rate Extension Act of 1960 (Public Law 86–564 [I.R.B. 1960–35, 32]; 74 Stat. 293) is amended to read as follows:

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by subsections (a) and (b) shall be applicable only with respect to taxable years beginning after December 31, 1960.

(2) CALCIUM CARBONATES, ETC.—

(A) ELECTION FOR PAST YEARS.—In the case of calcium carbonates or other minerals when used in making cement, if an election is made by the taxpayer under subparagraph (C)—

(i) The amendments made by subsection (b) shall apply to taxable years with respect to which such election is effective, and

(ii) Provisions having the same effect as the amendments made by subsection (b) shall be deemed to be included in the Internal Revenue Code of 1939 and shall apply to taxable years with respect to which such election is effective in lieu of the corresponding provisions of such Code.

(B) YEARS TO WHICH APPICABLE.—An election made under subparagraph (C) to have the provisions of this paragraph apply shall be effective for all taxable years beginning before January 1, 1961, in respect of which—

(i) The assessment of a deficiency,

(ii) The refund or credit of an overpayment, or

[1] 25 F.R. 8904.

(iii) The commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954,

is not prevented on the date of the enactment of this paragraph by the operation of any law or rule of law. Such election shall also be effective for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before the date of the enactment of this paragraph.

(C) TIME AND MANNER OF ELECTION.—An election to have the provisions of this paragraph apply shall be made by the taxpayer on or before the 60th day after the date of publication in the Federal Register of final regulations issued under authority of subparagraph (F), and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election, if made, may not be revoked.

(D) STATUTES OF LIMITATION.—Notwithstanding any other law, the period within which an assessment of a deficiency attributable to the application of the amendments made by subsection (b) may be made with respect to any taxable year to which such amendments apply under an election made under subparagraph (C), and the period within which a claim for refund or credit of an overpayment attributable to the application of such amendments may be made with respect to any such taxable year, shall not expire prior to one year after the last day for making an election under subparagraph (C). An election by a taxpayer under subparagraph (C) shall be considered as a consent to the application of the provisions of this subparagraph.

(E) TERMS; APPLICABILITY OF OTHER LAWS.—Except where otherwise distinctly expressed or manifestly intended, terms used in this paragraph shall have the same meaning as when used in the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939) and all provisions of law shall apply with respect to this paragraph as if this paragraph were a part of such Code (or corresponding provisions of the Internal Revenue Code of 1939).

(F) REGULATIONS.—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this paragraph.

§ 1.9003–1 ELECTION TO HAVE THE PROVISIONS OF SECTION 613(c)(2) AND (4) OF THE 1954 CODE, AS AMENDED, APPLY FOR PAST YEARS.—(a) *In general.*— Section 4 of Public Law 86–781, amended section 302(c) of the Public Debt and Tax Rate Extension Act of 1960 [P.L. 86–564, page 681, this Bulletin] to permit certain taxpayers for taxable years beginning before January 1, 1961, to apply the provisions of section 302(b) of that Act. Section 302(b) of the Act amended section 613(c) (2) and (4) of the Internal Revenue Code of 1954 to read in part as follows:

(2) MINING.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), 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 such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate 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.

* * * * * * *

(4) TREATMENT PROCESSES CONSIDERED AS MINING.—The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611

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(F) In the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kil

feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process;

* * * * * * *

(b) *Election.*—Under section 302(c)(2) of the Act, the taxpayer, in the case of calcium carbonates or other minerals when used by him in making cement, may elect to apply the provisions of section 613(c)(2) and (4) of the 1954 Code as amended in lieu of the corresponding provisions of prior law. The taxpayer must make the election in accordance with § 1.9003–4 on or before November 15, 1960 (the 60th day after the publication in the Federal Register of final regulations issued under section 302(c)(2) of the Act), and the election shall become irrevocable on such 60th day.

(c) *Years to which the election is applicable.*—If the election described in paragraph (b) of this section is made by the taxpayer, the provisions of section 613(c)(2) and (4) as amended by section 302(b) of the Act apply to all taxable years beginning before January 1, 1961, in respect of which—

(i) The assessment of any deficiency,

(ii) Refund or credit of any overpayment,

(iii) Commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954,

is not prevented on September 14, 1960, by the operation of any law or rule of law. The election also applies to taxable years beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before September 14, 1960.

§ 1.9003–2 Effect of Election.—(a) *In general.*—If a taxpayer makes the election described in paragraph (b) of § 1.9003–1, he shall be deemed to have consented to the application of section 302(b) of the Act with respect to all taxable years to which the election applies. Thus, subparagraph (F) of section 613(c)(4) of the 1954 Code as amended must be applied in determining gross income from mining for the taxable years to which the election applies (including years subject to the 1939 Code) whether or not the taxpayer is litigating the issue. Further, the election shall apply to all calcium carbonates or other minerals mined and used by the taxpayer in making cement.

(b) *Effect on gross income from mining.*—The election is only determinative of what constitutes "mining" for purposes of computing percentage depletion and has no effect on the method employed in determining the amount of gross income from mining. In applying the election to the years affected there shall be taken into account the effect that any adjustments resulting from the election shall have on other items affected thereby, such as charitable contributions, foreign tax credits, net operating loss, and the effect that adjustments to any such items shall have on other taxable years. The provisions of section 302(b) of the Act are applicable with respect to taxable years subject to the Internal Revenue Code of 1939 for purposes of applying sections 450 and 453 of that Code.

§ 1.9003–3 Statutes of Limitation.—Under section 302(c)(2) of the Act, the period within which the assessment of any deficiency or the credit or refund of any overpayment attributable to the election may be made shall not expire sooner than 1 year after November 15, 1960. Thus, if assessment of a deficiency or credit or refund of an

overpayment, whichever is applicable, is not prevented on September 14, 1960, the time for making assessment or credit or refund shall not expire for at least 1 year after November 15, 1960, notwithstanding any other provision of law to the contrary. Even though assessment of a deficiency is prevented on September 14, 1960, if commencement of a suit for recovery of a refund under section 7405 of the 1954 Code may be made on such date, then any deficiency resulting from the election may be assessed at any time within 1 year after November 15, 1960. If the taxpayer makes the election he shall be deemed to have consented to the application of the provisions of section 302(c)(2) of the Act extending the time for assessing a deficiency attributable to the election. Section 302(c)(2) of the Act does not shorten the period of limitations otherwise applicable. An agreement may be entered into under section 6501(c)(4) of the 1954 Code and corresponding provisions of prior law to extend the period for assessment.

§ 1.9003–4 MANNER OF EXERCISING ELECTION.—(a) *By whom election is to be made.*—Generally, the taxpayer whose tax liability is affected by the election shall make the election. In the case of a partnership, or a corporation electing under the provisions of subchapter S, chapter 1 of the 1954 Code, the election shall be exercised by the partnership or such corporation, as the case may be.

(b) *Time and manner of making election.*—The election shall be made on or before November 15, 1960, by filing a statement with the district director with whom the taxpayer's income tax return for the taxable year in which the election is made is required to be filed. The statement shall include the following:

(1) A clear indication that an election is being made under section 302(c)(2) of the Act, and

(2) The taxable years to which the election applies.

Amended income tax returns reflecting any increase or decrease in tax attributable to the election shall be filed for the taxable years to which the election applies. In the case of partnerships and electing small business corporations under subchapter S, chapter 1 of the 1954 Code, amended returns shall be filed by the partnership or electing small business corporations, as well as by the partners or shareholders, as the case may be. Any amended return shall be filed with the office of the district director with whom the taxpayer files his income tax return for the taxable year in which the election is made and, if practicable, on the same date the statement of election is filed, but amended returns shall be filed in no event later than February 28, 1961, unless an extension of time is granted under section 6081 of the Code. Whenever the amended returns do not accompany the statement of election, a copy of the statement shall be submitted with the amended returns. The amended returns shall be accompanied by payment of the additional tax (together with interest thereon) resulting from the election.

§ 1.9003–5 TERMS; APPLICABILITY OF OTHER LAWS.—All other terms which are not otherwise specifically defined shall have the same meaning as when used in the Internal Revenue Code of 1954 (or the corresponding provisions of prior law) except where otherwise distinctly expressed or manifestly intended to the contrary. Further, all provisions of law contained in the 1954 Code (or the corresponding provisions of prior law) shall apply to the extent that they can apply. Thus, all of the provisions of subtitle F of the 1954 Code and the

corresponding provisions of prior law shall apply to the extent they can apply, including the provisions of law relating to assessments, collection, credit or refund, and limitations. For purposes of this section and §§ 1.9003–1 to 1.9003–4, inclusive, the term "Act" means the Public Debt and Tax Rate Extension Act of 1960 [P.L. 86–564, page 681, this Bulletin] as amended.

Because this Treasury Decision is designed to inform taxpayers as to how, when, and where to perform certain acts required or permitted under section 302(c)(2) of the Public Dept and Tax Rate Extension Act of 1960 as amended, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in section 302(c)(2)(F) of the Public Debt and Tax Rate Extension Act of 1960 (74 Stat. 293) as amended by section 4 of Public Law 86–781 (74 Stat. 1017).)

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved September 14, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 15, 1960, 9:49 a.m., and published in the issue of the Federal Register for September 16, 1960, 25 F.R. 8904)

PUBLIC DEBT AND TAX RATE EXTENSION ACT OF 1960, AS AMENDED

(Also Part I, Section 613.) Rev. Rul. 60–319 [1]

Method or formula for allocating costs and profits between mining and non-mining operations by certain cement producers for taxable years beginning before January 1, 1961.

Advice has been requested by taxpayers mining calcium carbonates and other minerals used by them in making cement as to whether, if an election is made under section 4 of Public Law 86–781, page 726, this Bulletin, approved September 14, 1960, the method or formula previously acceptable to the Internal Revenue Service for allocating costs and profits between mining and non-mining operations in computing gross income from mining may continue to be used for that purpose for the taxable years affected by the election.

An election made by such taxpayers under section 4 of P.L. 86–781 requires the application of the provisions of section 302(b) of the Public Debt and Tax Rate Extension Act of 1960, P.L. 86–564, page 681, this Bulletin, approved June 30, 1960, in computing gross income from mining for purposes of the percentage depletion allowances, for certain taxable years beginning before January 1, 1961.

In a number of instances, in connection with the examination of income tax returns filed by certain taxpayers mining calcium carbonates and other minerals used by them in making cement, a particular method of, or a formula for, allocating costs and profits between

[1] Also released as Technical Information Release 258, issued September 23, 1960.

mining and non-mining operations in computing the taxpayer's gross income was found acceptable by the Service.

It is the position of the Service that, in computing the tax liability of such taxpayers who make the election under section 4 of P.L. 86–781 for the taxable years affected, the method or formula (based upon a determination that mining ceased prior to introduction of the kiln feed into the kiln) previously approved by the Service will not be disturbed if it was accepted after a thorough consideration of the matter on its merits. This position will not apply to the extent there has been a significant change in the facts and circumstances previously taken into account.

SECTION 3 OF THE VINSON ACT, AS AMENDED

26 CFR (1939) 16.5: Manner of determining liability. T. D. 6511[1]

TITLE 26—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER A, PART 16.—EXCESS PROFITS ON ARMY CONTRACTS FOR AIRCRAFT

Amendment of the Excess Profits Regulations relating to setoffs of deficiencies in profit against excess profits under section 14 of the Act of April 3, 1939, as amended, and other provisions.

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

DEPARTMENT OF THE ARMY,
DEPARTMENT OF THE AIR FORCE,
Washington 25, D.C.

To Officers and Employees of the Treasury Department, the Department of the Army, the Department of the Air Force, and Others Concerned:

On June 23, 1960, notice of proposed rulemaking regarding an amendment of the Excess Profits Regulations (26 CFR (1939) Part 16), relating to setoffs of deficiencies in profit against excess profits under section 14 of the Act of April 3, 1939 [C.B. 1939–1 (Part I, 430)], as amended, to conform to the decision in *Emerson Electric Manufacturing Company* (1957) 28 T.C. 1090, was published in the Federal Register (25 F.R. 5766). No objection to the rules proposed having been received during the 30-day period prescribed in the notice, the regulations as so proposed are hereby adopted.

PARAGRAPH 1. Section 16.5 is amended by revising paragraph (c) (2) and (3) to read as follows:

(2) The amount of any net loss allowable as a credit in determining the excess profit for the income-taxable year (see § 16.9); and

(3) The amount of any deficiency in profit allowable as a credit in determining excess profit for the income-taxable year (see § 16.9). The amount remaining after such subtraction is the amount of excess profit for the income-taxable year.

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[1] 25 F.R. 12442.

PAR. 2. Section 16.6 is amended by revising the example to read as follows:

Example. On September 1, 1939, the B Corporation, which keeps its books and makes its Federal income tax returns on a calendar year basis, entered into a contract for the construction of Army aircraft coming within the scope of the act, the total contract price of which was $200,000. On March 10, 1940, the corporation entered into another such contract, the total contract price of which was $40,000. Both contracts were completed within the calendar year 1940, the first at a cost of $155,000 and the second at a cost of $45,000. During the year 1940, the B Corporation also completed at a deficiency in profit of $2,000 a contract entered into after April 3, 1939, for the construction of naval aircraft coming within the scope of 10 U.S.C. 2382 (formerly section 3 of the Act of March 27, 1934 (48 Stat. 505)). For the year 1939, the B Corporation sustained a net loss of $1,500 and a deficiency in profit of $1,000 on all contracts and subcontracts entered into after April 3, 1939, for Army aircraft coming within the scope of the act and completed within the calendar year 1939. For the year 1939, the B Corporation also sustained a net loss of $1,000 on a contract, entered into after April 3, 1939, and completed within the calendar year 1939, for naval aircraft coming within the scope of 10 U.S.C. 2382 (formerly section 3 of the Act of March 27, 1934 (48 Stat. 505)). For purposes of the Federal income tax, the net income of the B Corporation for the year 1940, on which the tax was paid, amounted to $96,000, which included the total net profit of $40,000 upon the two contracts entered into on September 1, 1939, and March 10, 1940. The excess profit liability is $4,332, computed as follows:

Total contract prices:		
Contract No. 1	$200,000	
Contract No. 2	40,000	
		$240,000
Less: Cost of performing contracts:		
Contract No. 1	155,000	
Contract No. 2	45,000	
		200,000
Net profit on contracts		40,000
Less: 12 per cent of total contract prices (12 per cent of $240,000)	28,800	
Deficiency in profit (in naval aircraft contracts) in 1940	2,000	
Net loss (in Army aircraft contracts) from 1939	1,500	
Net loss (in naval aircraft contracts) from 1939	1,000	
Deficiency in profit (in Army aircraft contracts) from 1939	1,000	
		34,300
Excess profit for year 1940		5,700
Less: Credit for Federal income taxes (Federal income tax on $5,700 at rates for 1940)		1,368
Amount of excess profit payable to the United States		4,332

PAR. 3. Section 16.9 is amended—

(A) By revising paragraphs (a) and (b) to read as follows:

(a) The term "net loss" as used in the act and as applied to contracts and subcontracts for aircraft or portions thereof coming within the regulations prescribed under the act or under 10 U.S.C. 2382 (formerly section 3 of the Act of March 27, 1934 (48 Stat. 505)) means the amount by which the total cost of performing all such contracts and subcontracts for aircraft entered into after April 3, 1939, and completed by a particular contracting party within the income-taxable year exceeds the total contract prices of such contracts and subcontracts. As to the meaning of income-taxable year, see § 16.1.

(b) The term "deficiency in profit", as used in the acts and as applied to contracts and subcontracts for aircraft or portions thereof coming within the regulations prescribed under the act or under 10 U.S.C. 2382 (formerly section 3 of the Act of March 27, 1934 (48 Stat. 505)), means the amount by which 12

percent of the total contract prices of all such contracts and subcontracts for aircraft entered into after April 3, 1939, and completed by a particular contracting party within the income-taxable year exceeds the net profit upon all such contracts and subcontracts.

(B) By revising the first sentence of paragraph (c) to read as follows:

(c) A net loss or a deficiency in profit sustained by a contracting party for an income-taxable year is allowable as a credit in computing the contracting party's excess profit on contracts and subcontracts for aircraft coming within the regulations prescribed under the act or under 10 U.S.C. 2382 (formerly section 3 of the Act of March 27, 1934 (48 Stat. 505)) and completed during the four next succeeding income-taxable years.

(C) By revising the example in paragraph (e) to read as follows:

Example. For the calendar year 1939, the A Corporation, which keeps its books and makes its Federal income tax returns on a calendar year basis, sustained a net loss of $30,000 on the contracts and subcontracts for Army aircraft and portions thereof coming within the scope of the act and completed within that year. During the year 1939, the A Corporation also completed contracts for naval aircraft coming within the scope of 10 U.S.C. 2382 (formerly section 3 of the Act of March 27, 1934 (48 Stat. 505)) at a deficiency in profit of $10,000. In 1940, the A Corporation completed similar contracts for Army aircraft totaling $175,000 at a cost of $155,000, whereby the A Corporation realized a net profit of $20,000 but sustained a deficiency in profit of $1,000 (i.e., 12 percent of $175,000, or $21,000, less $20,000). During the year 1940, the A Corporation also completed contracts for naval aircraft coming within the scope of 10 U.S.C. 2382 (formerly section 3 of the Act of March 27, 1934 (48 Stat. 505)) at a net loss of $2,000. In 1941, the A Corporation completed contracts for Army aircraft coming with the scope of the act totaling $400,000 at a cost of $300,000, or at a net profit of $100,000. After deducting from the net profit of $100,000 for the year 1941 the amount of $48,000 (i.e., 12 percent of the total contract price of $400,000), there remains $52,000 in excess profit on the contracts completed in the year 1941. The A Corporation may deduct from such $52,000, in determining the amount of excess profit it must pay for the year 1941 with respect to the contracts completed in such year, the net loss of $30,000 and the deficiency in profit of $10,000 sustained in 1939 on Army and naval aircraft contracts, respectively, and the net loss of $2,000 and the deficiency in profit of $1,000 sustained in 1940 on naval and Army aircraft contracts, respectively.

(This Treasury Decision is issued under the authority contained in sec. 3, 48 Stat. 505, as amended, 53 Stat. 467, sec. 14, 53 Stat. 560; 34 U.S.C. 496, 26 U.S.C. 3791, 10 U.S.C. 311, 312.)

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved November 30, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

COURTNEY JOHNSON,
Asst. Secretary of the Army.
(Logistics) November 2, 1960.

P. B. TAYLOR,
Asst. Secretary of the Air Force.
November 17, 1960.

(Filed by the Division of the Federal Register on December 5, 1960, 8:54 a.m., and published in the issue of the Federal Register for December 6, 1960, 25 F.R. 12442)

26 CFR (1939) 17.7: Manner of determining liability with respect to contracts or subcontracts for complete naval aircraft or portions thereof. T. D. 6512 [1]

TITLE 26—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER A, PART 17.—EXCESS PROFITS ON NAVY CONTRACTS

Amendment of the Excess Profits Regulations relating to setoffs of deficiencies in profit against excess profits under section 3 of the Act of March 27, 1934, as amended.

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

DEPARTMENT OF THE NAVY,
Washington 25, D.C.

To Officers and Employees of the Treasury Department, the Department of the Navy, and Others Concerned:

On June 23, 1960, notice of proposed rulemaking regarding an amendment of the Excess Profits Regulations (26 CFR (1939) Part 17), relating to setoffs of deficiencies in profit against excess profits under section 3 of the Act of March 27, 1934, as amended, to conform to the decision in *Emerson Electric Manufacturing Company* (1957) 28 T.C. 1090, was published in the Federal Register (25 F.R. 5767). No objection to the rules proposed having been received during the 30-day period prescribed in the notice, the regulations as so proposed are hereby adopted.

PARAGRAPH 1. Section 17.7 is amended—

(A) By revising paragraph (c) (2) and (3) to read as follows:

(2) The amount of any net loss which was sustained in the same or a prior income-taxable year with respect to contracts or subcontracts for the construction or manufacture of any complete aircraft or any portion thereof, and which is allowable as a credit in determining the excess profit for the income-taxable year with respect to contracts and subcontracts entered into for the construction or manufacture of complete aircraft or any portion thereof (see § 17.10(b)); and

(3) The amount of any deficiency in profit which was sustained in the same or a prior income-taxable year with respect to contracts or subcontracts for the construction or manufacture of any complete aircraft or any portion thereof, and which is allowable as a credit in determining the excess profit for the income-taxable year with respect to contracts and subcontracts entered into for the construction or manufacture of complete aircraft or any portion thereof (see § 17.10(c)).

(B) By revising the example in paragraph (e) to read as follows:

Example. On September 1, 1939, the B Corporation, which keeps its books and makes its Federal income tax returns on a calendar year basis, entered into a contract with the Secretary of the Navy for the construction of naval aircraft coming within the scope of the act, the total contract price of which was $200,000. On March 10, 1940, the B Corporation entered into another such contract, the total contract price of which was $40,000. Both contracts were completed within the calendar year 1940, the first at a cost of $155,000 and the second at a cost of $45,000. During the year 1940, the B Corporation also completed at a deficiency in profit of $2,000 a contract entered into for the construction of Army aircraft coming within the scope of the act. During the year 1940, the B Corporation also completed at a loss of $10,000 two contracts entered into for the construction or manufacture of portions of a naval vessel coming within the scope of the act. For the year 1939, the B Corporation

[1] 25 F.R. 12443.

sustained a net loss of $2,500 and a deficiency in profit of $1,000 on all contracts and subcontracts for naval aircraft coming within the scope of the act and completed within the calendar year 1939. For the year 1939, the B Corporation also sustained a net loss of $1,800 on a contract for the construction of Army aircraft coming within the scope of the act which was completed within the calendar year 1939. For the purposes of the Federal income tax, the net income of the B Corporation for the year 1940, on which the tax was paid, amounted to $96,000, which included the net profit of $40,000 upon the contracts entered into on September 1, 1939, and March 10, 1940. The excess profit liability of the B Corporation for 1940 is payable with respect to the contracts for naval aircraft which were completed in 1940. The loss of $10,000 on the contracts for portions of a naval vessel completed in 1940 does not enter into the computation of such liability. Accordingly, the excess profit liability of the B Corporation for 1940 is $2,964 computed as follows:

Total contract prices:		
Contract No. 1	$200,000	
Contract No. 2	40,000	
		$240,000
Less: Cost of performing contracts:		
Contract No. 1	$155,000	
Contract No. 2	45,000	
		200,000
Net profit on contracts		40,000
Less: 12 percent of total contract prices (12 percent of $240,000)	$28,800	
Deficiency in profit (in Army aircraft contracts) in 1940	2,000	
Net loss (in naval aircraft contracts) from 1939	2,500	
Net loss (in Army aircraft contracts) from 1939	1,800	
Deficiency in profit (in naval aircraft contracts) from 1939	1,000	
		36,100
Excess profit for year 1940		3,900
Less: Credit for Federal income taxes (Federal income tax on $3,900 at rates for 1940)		936
Amount of excess profit payable to the United States		2,964

PAR. 2. Section 17.10 is amended—

(A) By revising paragraphs (b) and (c) to read as follows:

(b) *Net loss on contracts and subcontracts for aircraft or portions thereof.*—In the case of contracts or subcontracts for the construction or manufacture of any complete aircraft or any portion thereof coming within the scope of the act which are completed within an income-taxable year ending after April 3, 1939, the term "net loss" as used in the act and in these regulations means the amount by which the total costs of performing all such contracts and subcontracts completed within such income-taxable year exceeds the total contract prices of such contracts and subcontracts. Such net loss sustained by a contracting party for an income-taxable year ending after April 3, 1939, is allowable as a credit in computing the contracting party's excess profit on contracts and subcontracts for the construction or manufacture of any complete aircraft or any portion thereof which are completed within the four next succeeding income-taxable years.

(c) *Deficiency in profit.*—The term "deficiency in profit" as used in the act and in this part relates to contracts and subcontracts coming within the scope of the act which are for the construction or manufacture of any complete aircraft or any portion thereof and are completed within an income-taxable year ending after April 3, 1939. As so used, the term "deficiency in profit" means the amount by which 12 percent of the total contract prices of such contracts and subcontracts which are completed by a particular contracting party within the income-taxable year exceeds the net profit upon such contracts and subcontracts. A deficiency in profit sustained by a contracting party with respect to such contracts and subcontracts for the construction or manufacture of com-

plete aircraft or any portion thereof and completed within any income-taxable year ending after April 3, 1939, is allowable as a credit in computing the contracting party's excess profit on contracts and subcontracts for the construction or manufacture of complete aircraft or any portion thereof which are completed within the same or the four next succeeding income-taxable years.

(B) By revising example (2) in paragraph (e) to read as follows:

Example (2). For the calendar year 1939, the B Corporation, which keeps its books and makes its Federal income tax returns on a calendar year basis, sustained a net loss of $10,000 and a deficiency in profit of $35,000 upon all contracts and subcontracts for naval aircraft and portions thereof coming within the scope of the act and completed within that year. During the year 1939, the B Corporation also completed contracts for Army aircraft coming within the scope of the act at a net profit which was $15,000 in excess of 12 per cent of the total contract prices of such contracts. On all contracts and subcontracts for naval aircraft coming within the scope of the act and completed within the calendar year 1940, the B Corporation realized a net profit which was $25,000 in excess of 12 per cent of the total contract prices of such contracts and subcontracts while sustaining a deficiency in profit of $10,000 on like contracts and subcontracts for Army aircraft. On all contracts and subcontracts for naval aircraft coming within the scope of the act and completed within the calendar year 1941, the B Corporation realized a net profit which was $20,000 in excess of 12 per cent of the total contract prices of such contracts. The net loss of $10,000 and deficiency in profit of $35,000 (or a total of $45,000) sustained in 1939 with respect to contracts and subcontracts for naval aircraft completed within that year may be taken as a credit to the extent of $15,000 in computing the excess profit on the contracts and subcontracts for Army aircraft completed in 1939. The remainder of such net loss and such deficiency in profit ($45,000 minus $15,000, or $30,000) may be combined with the deficiency in profit of $10,000 sustained in 1940 on contracts for Army aircraft and taken as a credit to the extent of $25,000 in computing the excess profit on the contracts and subcontracts for aircraft completed during 1940. The sum of such net loss and such deficiency in profit then remaining ($40,000 minus $25,000, or $15,000) may be taken as a credit in computing the excess profit realized on the contracts and subcontracts for aircraft completed in the year 1941.

(This Treasury Decision is issued under the authority contained in sec. 3, 48 Stat. 505, as amended, 53 Stat. 467, 53 Stat. 112; 34 U.S.C. 496, 26 U.S.C. 3791, 26 U.S.C. 650, 651.)

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved November 30, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

WILLIAM B. FRANKE,
Secretary of the Navy.
October 19, 1960.

(Filed by the Division of the Federal Register on December 5, 1960, 8:54 a.m., and published in the issue of the Federal Register for December 6, 1960, 25 F.R. 12443)

PART III

ALCOHOL TAX RULINGS AND DECISIONS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

Rulings and decisions published in Part III, Subpart A, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939, the Federal Alcohol Administration Act, or other public laws.

SUBTITLE E.—ALCOHOL, TOBACCO, AND CERTAIN OTHER EXCISE TAXES

CHAPTER 51.—DISTILLED SPIRITS, WINES, AND BEER

SUBCHAPTER A.—GALLONAGE AND OCCUPATIONAL TAXES

PART I.—GALLONAGE TAXES

Subpart A.—Distilled Spirits

SECTION 5006.—DETERMINATION OF TAX

26 CFR 201.26: Time for tax determination. Rev. Rul. 60-381

Section 5006(a)(2) of the Internal Revenue Code of 1954 provides, in part, that, with certain specified exceptions, the internal revenue tax on distilled spirits entered for deposit in internal revenue bond must be determined within twenty years from the date of original entry for deposit in such storage. One of these exceptions covers spirits of 190 degrees or more of proof. *Held*, the twenty-year bonding period limitation is not applicable to spirits distilled and entered into bonded storage at 190 degrees or more of proof, even though such spirits are subsequently reduced in proof. Where spirits entered for storage in bond at 190 degrees or more of proof are subsequently reduced, such spirits should continue to be carried in the proprietor's records as

exempt from the twenty-year bonding period. However, a supplemental entry to show the quantity of such reduced spirits should be made at item six of Form 332, Statement by Kinds, Seasons, and Years of Production of Spirits in Bonded Warehouses.

SECTION 5008.—ABATEMENT, REMISSION, REFUND, AND ALLOWANCE FOR LOSS OR DESTRUCTION OF DISTILLED SPIRITS

26 CFR 201.434: Rinsing of packages. Rev. Rul. 60–295

Section 5008(c)(1) of the Internal Revenue Code of 1954 provides, in part, that whenever any distilled spirits withdrawn from bond on payment or determination of tax for rectification or bottling are lost before the completion of the bottling and casing, or other packaging of such spirits for removal from the bottling premises of the distilled spirits plant to which removed from bond, the Secretary of the Treasury or his delegate shall, under such regulations as he may prescribe, abate, remit, or without interest, credit or refund the tax imposed on such spirits under section 5001(a)(1) of the Code to the proprietor of the distilled spirits plant who withdrew the distilled spirits on payment or determination of tax for removal to his bottling premises. Section 201.434 of the Distilled Spirits Plants Regulations provides, in part, that all wooden packages (except packages treated so as to preclude contact of the spirits with the wood surface) emptied on bottling premises, and the char and wood chips therein, if any, shall be thoroughly rinsed after dumping. If the packages were not rinsed at the time of tax determination, the rinse water obtained at the bottling premises shall be destroyed or shall be taxpaid as provided in section 201.435. *Held*, distilled spirits taxpaid on bottling premises contained in rinsings are not withdrawn from bond on payment or determination of tax. Therefore, such distilled spirits are not eligible for loss allowance under section 5008(c) of the Code.

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26 CFR 201.482: Allowable losses.

The inclusion as bottling losses of additional taxable gallons of imported spirits resulting from difference between proof determined by a Bureau of Customs gauger and the true proof determined by a Customs' chemist. See Rev. Proc. 60–23, page 997.

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26 CFR 201.601: Samples for analysis or testing.

Refund or credit of tax on samples of distilled spirits removed for use of the United States. See Rev. Proc. 60–31, page 1010.

SECTION 5021.—IMPOSITION AND RATE OF TAX

26 CFR 170.616: Products classed as rectified liquors.

Provisions relating to the imposition of commodity tax on alcoholic preparations classed as rectified liquors, including cordials or liqueurs. See T.D. 6484, page 512.

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26 CFR 201.28: Rectification tax. Rev. Rul. 60–333
(Also Section 5207; 201.623.)

Section 5021 of the Internal Revenue Code of 1954 imposes a tax on each proof gallon and a proportionate tax at a like rate on all fractional parts thereof on all distilled spirits and wines rectified, purified, or refined in such manner, and on all mixtures produced in such manner, that the person rectifying, purifying, refining, or mixing the same is a rectifier. It is also provided by this section and by section 201.28 of the Distilled Spirits Plants Regulations that a rectifier shall not be required to pay such tax twice because of separate acts of rectification of a lot of spirits or wines, pursuant to an approved formula, between the time the spirits or wines are received on the bottling premises and the time they are removed therefrom. *Held*, at the time any of the rectified products of a distilled spirits plant become located on the general premises of that plant, whether by virtue of a curtailment of its bottling premises and redesignation as general premises, of the room in which the products are located, or by virtue of physical movement of the products, such products are considered as removed from the bottling premises for the purpose of section 5021 of the Code. Accordingly, the rectification tax due on such products must be paid or determined before such removal, and the records maintained pursuant to section 201.623 of the regulations must reflect such removal. *Held further*, a subsequent extension of the bottling premises to return a previously excluded room to the bottling premises does not change the fact that any of the plant's rectified products remaining in the room at the time of such extension are products which were previously removed from the bottling premises. Therefore, in the event such products are re-rectified, they will again be subject to the rectification tax.

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26 CFR 201.424: Use of alcoholic flavoring materials.

Refund or credit of tax on samples of distilled spirits removed for use of the United States. See Rev. Proc. 60–31, page 1010.

SECTION 5025.—EXEMPTION FROM RECTIFICATION TAX

26 CFR 170.611: Scope of subpart. T. D. 6484[1]
(Also Sections 5021, 5081; 170.616, 170.618.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 170 AND 235

Provisions of 26 CFR (1939) 171.1(a) are deleted and certain provisions of 26 CFR (1939) Part 171 and 26 CFR (1954) Part 235 are included in 26 CFR (1954) Part 170.

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

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

On June 7, 1960, a notice of proposed rulemaking (1) to delete 26 CFR (1939) 171.1(a), (2) to revise and include in 26 CFR (1954) Part 170 certain provisions of 26 CFR (1939) Part 171 and 26 CFR (1954) Part 235, and (3) to implement the changes in section 5025(i), I.R.C., was published in the Federal Register (25 F.R. 4995). In accordance with the notice, interested parties were afforded an opportunity to submit written comments or suggestions pertaining thereto. No comments or suggestions were received within the 30-day period prescribed in the notice. Accordingly, the following amendments are hereby adopted.

The purposes of this Treasury Decision are to delete certain obsolete material now contained in 26 CFR (1939) Part 171, to revise and include in 26 CFR Part 170 certain regulatory provisions now contained in 26 CFR (1939) Part 171 and in Subparts C, D, and E of 26 CFR Part 235, and to implement the changes in section 5025(i), I.R.C., as amended by Public Law 85–859, 72 Stat. 1313 [C.B. 1958–3, 92].

Pursuant to the above:

(A) 26 CFR (1939) Part 171 is amended by deleting—

(1) obsolete § 171.1(a); and

(2) §§ 171.6 and 171.7, the provisions of which are revised and incorporated in Subpart U of 26 CFR (1954) Part 170.

(B) 26 CFR (1954) Part 235 is amended and superseded in its entirety by deleting §§ 235.40 through 235.42, 235.50 through 235.61, 235.75, and 235.76, the provisions of which are revised and incorporated in subpart U of 26 CFR (1954) Part 170.

(C) 26 CFR Part 170 is amended by adding, immediately following § 170.585, a new Subpart U, as follows:

Subpart U.—Manufacture and Sale of Certain Compounds, Preparations, and Products Containing Alcohol

PREAMBLE: The regulations in this subpart shall not affect any act done or any liability or right accruing or accrued, or any suit or proceeding had or commenced before the effective date of the regulations in this subpart.

[1] The publication of this Treasury Decision in 25 F.R. 7100, dated July 27, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 4995, dated June 7, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations. The individual instructions have been omitted.

Section
170.611 Scope of subpart.
170.612 Meanings of terms.

COMMODITY TAX STATUS OF PRODUCTS

170.613 Products exempt from commodity taxes.
170.614 Other exempt U.S.P. and N.F. preparations.
170.615 Change of formula; when required.
170.616 Products classed as rectified products.

SPECIAL (OCCUPATIONAL) TAX STATUS OF APOTHECARIES AND MANUFACTURERS

170.617 Apothecaries and manufacturers exempt.
170.618 Sale of products for beverage use; special tax.

AUTHORITY: §§ 170.611–170.618 issued under 68A Stat. 917; 26 U.S.C. 7805. Other statutory provisions interpreted or applied are cited to text in parenthesis.

§ 170.611 SCOPE OF SUBPART.—This subpart contains provisions relating to the special tax status of persons who compound, mix, manufacture, or sell compounds, mixtures, preparations, or products containing taxpaid distilled spirits or wines, and the commodity tax status of such compounds, mixtures, preparations, and products.

§ 170.612 MEANINGS OF TERMS.—When used in this subpart, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meaning ascribed in this section. Words in the plural form shall include the singular, and vice versa, and words importing the masculine gender shall include the feminine. The terms "includes" and "including" do not exclude things not enumerated which are in the same general class.

Assistant regional commissioner.—An assistant regional commissioner (alcohol and tobacco tax) who is responsible to, and functions under the direction and supervision of, a regional commissioner of internal revenue.

Commodity tax.—The tax or taxes imposed by sections 5021 and 5022, I.R.C., on products of rectification.

Director.—The Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Treasury Department, Washington, D.C.

Distilled spirits, or spirits.—That substance known as ethyl alcohol, ethanol, or spirits of wine, including all dilutions and mixtures thereof.

I.R.C.—The Internal Revenue Code of 1954, as amended.

Liquors.—Distilled spirits and/or wines.

Person.—An individual, trust, estate, partnership, association, company or corporation.

Special tax.—The special (occupational) tax imposed by sections 5081, 5111, and 5121, I.R.C., on rectifiers and dealers in liquors.

Taxpaid distilled spirits, or wines.—Distilled spirits or wines, as the case may be, on which the distilled spirits tax imposed by section 5001, I.R.C., or the wine taxes imposed by section 5041, I.R.C., have been paid or determined.

This chapter.—Chapter I of Title 26 of the Code of Federal Regulations.

U.S.C.—The United States Code.

COMMODITY TAX STATUS OF PRODUCTS

§ 170.613 PRODUCTS EXEMPT FROM COMMODITY TAXES.—(a) *Products meeting requirements.*—Except as provided in § 170.616(b), apothecaries, pharmacists, and manufacturers are not required to pay commodity taxes on medicines, medicinal preparations, food products, flavors, and flavoring extracts manufactured or compounded by them, if the tax has been paid or determined on all of the distilled spirits and/or wines contained therein, as follows:

(1) *Medicines and medicinal preparations.*—Medicines and medicinal preparations (including such preparations manufactured in accordance with formulas prescribed by the United States Pharmacopoeia, the National Formulary, or the Homeopathic Pharmacopoeia of the United) that are unfit for use for beverage purposes.

(2) *Patent medicines.*—Patented, patent, and proprietary medicines that are unfit for use for beverage purposes.

(3) *Toilet preparations.*—Toilet, medicinal, and antiseptic preparations and solutions that are unfit for use for beverage purposes.

(4) *Flavoring extracts.*—Flavoring extracts, sirups, and concentrates that are unfit for use for beverage purposes.

(5) *Laboratory reagents.*—Laboratory reagents, stains, and dyes that are unfit for use for beverage purposes.

(6) *Salted wines.*—Salted wines which contain not in excess of 21 percent alcohol by volume and not less than 1.5 grams of salt per 100 cubic centimeters.

(7) *Sauces.*—Sauces, or sirups consisting of sugar solutions and liquors, in which the alcohol content is not more than 12 percent by volume and the sugar content is not less than 60 grams per 100 cubic centimeters.

(8) *Brandied fruits.*—Brandied fruits consisting of solidly packaged fruits either whole or segmented, and liquors not exceeding the quantity and alcohol content necessary for flavoring and preserving.

(9) *Food products.*—Food products such as mincemeat, plum pudding, and fruit cake, where only sufficient liquor is used for flavoring and preserving; and ice cream and ices where only sufficient liquor is used for flavoring purposes.

(b) *Formulas and samples; when required.*—On request of the Director, or when in doubt as to the classification of his product, the manufacturer shall submit to the Director the formula for and a sample of his product for examination to verify the manufacturer's claim of exemption from tax. (72 Stat. 1328; 26 U.S.C. 5025.)

§ 170.614 Other Exempt U.S.P. and N.F. Preparations.—The following United States Pharmacopoeia and National Formulary preparations which are used by physicians and pharmacists principally as vehicles may be made with distilled spirits without incurring liability for rectification and special taxes for their manufacture and sale:

Elixir aromaticum.
Elixir aromaticum rubrum.
Elixir aurantii amari.
Elixir cardamom compositum.
Elixir glycyrrhizae.
Elixir taraxaci compositum.
Elixir terpini hydratis.
Spiritus aetheris.
Spiritus myrciae compositus.
Tinctura aurantii dulcis.
Tinctura limonis.

§ 170.615 Change of Formula; When Required.—If the assistant regional commissioner finds at any time that any product manufactured under this subpart as an unfit product exempt from tax is being used for beverage purposes, or for mixing with beverage liquors other than by a rectifier, he shall notify the manufacturer to desist the manufacturing of such product until the formula is so changed as to render the product not susceptible of beverage use and such change is approved by the Director: *Provided*, That the provisions of this section shall not be so construed as to prohibit the use of such unfit products in small quantities for flavoring drinks at the time of serving for immediate consumption. Where, pursuant to notice, the manufacturer does not desist, or the formula is not so modified as to render the product unsusceptible of beverage use, the manufacturer shall immediately qualify as a rectifier and pay the rectification tax on such product.

§ 170.616 Products Classed as Rectified Liquors.—(a) *Rectified liquors.*—United States Pharmacopoeia tincture of ginger is held to be rectified liquor. Bitters, patent medicines, and similar alcholic preparations which are fit for beverage purposes, although held out as having certain medicinal properties, are also classed as rectified liquors. The commodity tax imposed by section 5021 or 5022, I.R.C., as the case may be, is required to be paid on alcholic preparations classed as rectified liquors (including cordials or liqueurs). Such preparations are required to be manufactured in the rectifying facilities of a distilled spirits plant, taxpaid, bottled or packaged, stamped, recorded, and disposed of in accordance with the procedure prescribed in Part 201 of this chapter for other rectified spirits or products. Sellers of such preparations will be subject to the provisions of Part 194 of this chapter with respect to special taxes.

(b) *Products sold for beverage use.*—Any product described in §§ 170.613–170.614, or any other product declared by the Director to be unfit for use for beverage purposes, or any taxpaid distilled spirits recovered from any such product, which is sold for beverage purposes, or is sold under circumstances from which it might reasonably appear that it is the intention of the purchaser to procure the same for sale or use for beverage purposes, is subject to commodity tax. (72 Stat. 1328; 26 U.S.C. 5021, 5022.)

SPECIAL TAX STATUS OF APOTHECARIES AND MANUFACTURERS

§ 170.617 APOTHECARIES AND MANUFACTURERS EXEMPT.—(a) *Compounders or manufacturers.*—An apothecary, a pharmacist, or a manufacturer is not required to qualify as a rectifier, or pay special (occupational) tax as a rectifier or, except as provided in § 170.618, to qualify as a dealer in liquors in order to prepare, manufacture, or sell products described in §§ 170.613–170.614, or products declared by the Director to be unfit for use for beverage purposes.

(b) *Manufacturers recovering taxpaid alcohol.*—A manufacturer who recovers taxpaid distilled spirits from dregs or marc of percolation or extraction, or from medicines, medicinal preparations, food products, flavors, or flavoring extracts, which do not meet the manufacturer's standards, is not required to qualify or pay special tax as a rectifier, if such manufacturer uses the recovered distilled spirits exclusively in the manufacture of medicine, medicinal preparations, food products, flavors, or flavoring extracts, which are unfit for use for beverage purposes.

(c) *Records.*—Each manufacturer intending to recover taxpaid distilled spirits under the provisions of paragraph (b) shall notify the assistant regional commissioner of his intention to do so and advise where such operations will be conducted. Such manufacturer shall keep a record of the distilled spirits recovered and the subsequent use to which they are put. The records shall show, (a) the date of recovery, (b) the commodity from which the spirits were recovered, (c) the amount of distilled spirits recovered, (d) The amount of recovered distilled spirits reused, (e) the commodity in which the recovered distilled spirits were reused, and (f) the date of such reuse. Such records shall be retained at the premises where the recovery operations are conducted for not less than two years, and shall be available during regular business hours for examination by internal revenue officers. (72 Stat. 1328; 26 U.S.C. 5025.)

§ 170.618 SALE OF PRODUCTS FOR BEVERAGE USE; SPECIAL TAX.—Any person (including the manufacturer) who sells for beverage purposes any of the products described in §§ 170.613–170.614, or any other product declared by the Director to be unfit for use for beverage purposes, or any distilled spirits recovered as provided in § 170.617(b), or who sells any such substance under circumstances from which it might reasonably appear that it is the intention of the purchaser to procure the same for sale or use for beverage purposes, is required to pay special tax as a wholesale dealer in liquors or a retail dealer in liquors, as the case may be, and, in the case of a manufacturer, may also be required to pay special tax as a rectifier (plus any penalties and interest due). (72 Stat. 1338, 1340, 1343; 26 U.S.C. 5081, 5111, 5113, 5121.)

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days after the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved July 22, 1960.

DAVID A. LINDSAY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 26, 1960, 8:49 a.m., and published in the issue of the Federal Register for July 27, 1960, 25 F.R. 7100)

SECTION 5056.—REFUND AND CREDIT OF TAX, OR RELIEF FROM LIABILITY

26 CFR 245.155: Return of undelivered beer. Rev. Rul. 60–297
(Also 245.163.)

Section 245.155 of the Federal Beer Regulations provides that undelivered beer returned to the brewery on the same business day it is removed shall be returned to stock, and need not be accounted for as having been removed for consumption or sale. *Held*, kegs or cases of beer which are undelivered because of having suffered losses less than their original contents and which are returned to the brewery on the same day that they were removed may be considered as coming within the scope of section 245.155 of the regulations. Upon the return of such containers to the brewery, the original contents should not be entered into the brewery record as a removal from the brewery, but the records should support the quantity of returned undelivered beer and also accurately reflect the losses. However, in the event the contents of a keg or case are completely destroyed, the loss should be considered as a casualty and a claim for such loss made under section 245.163 of the regulations.

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26 CFR 245.161: Notice by brewer. Rev. Rul. 60–382
(Also 245.225.)

Section 245.161 of the Beer Regulations provides, in part, that when a brewer possesses taxpaid beer (or beer on which the tax has been determined), which is removed from the market and which he desires to destroy, in his brewery or elsewhere, or which after return to the brewery he desires to recondition, use as material, or return to the stock of the racking room or bottling house, he shall give written notice of his intention, in triplicate to the Assistant Regional Commissioner, Alcohol and Tobacco Tax. *Held*, beer removed from the market and on which the brewer does not intend to file a claim for credit or refund of tax may be dumped by the brewer without the filing of a "Notice of Intent" and without supervision of the destruction of the beer. Brewers intending to dispose of beer in this manner must maintain the records required by section 245.225(h) of the regulations.

(Also 245.165.) Rev. Rul. 60–296

Revenue Ruling 60–82, C.B. 1960–1, 711, holds that a brewer may remove tapped kegs and leaking kegs of beer from the market, but that he may only claim credit or refund of the tax on the quantity of beer which he can prove was, in fact, returned to the brewery or, if not so returned, was destroyed under supervision as required in section 245.162 of the Federal Beer Regulations. The ruling further provided that if such kegs contain less than the original contents, and the brewer intends to claim credit or refund of the tax, the kegs must be weighed at the time of receipt at the brewery, or place of storage.

Held, other methods, including gauging by stick, or in the case of an accumulation tank by gauge glass, may be used in place of weighing as set forth in Revenue Ruling 60–82 to determine the quantity of beer in partly filled kegs withdrawn from the market and returned for credit or refund of tax provided that their use results in accuracy approximating that of weighing, and will not increase manpower requirements.

Revenue Ruling 60–82, C.B. 1960–1, 711, modified.

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26 CFR 245.163: Beer lost or destroyed by fire, casualty, or act of God.

Undelivered containers of beer returned to brewery on the same day on which they were removed. See Rev. Rul. 60–297, page 516.

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26 CFR 245.165: Claims for allowance of credit for tax.

Alternative methods for measuring quantity of beer in returned partially full kegs. See Rev. Rul. 60–295, page 510.

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26 CFR 245.225: Records.

Dumping of beer removed from the market without filing notice or having the destruction supervised. See Rev. Rul. 60–382, page 516.

Subpart E.—General Provisions

SECTION 5061.—METHOD OF COLLECTING TAX

26 CFR 170.402: General. T.D. 6473[1]
(Also 245.117a.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 170 AND 245

Miscellaneous amendments, including incorporation of semi-monthly or prepayment return system provisions in Part 245.

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

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

On April 15, 1960, a notice of proposed rulemaking to amend 26 CFR Parts 170, Miscellaneous Regulations Relating to Liquor, and 245, Beer, was published in the Federal Register (25 F.R. 3259).

[1] The publication of this Treasury Decision in 25 F.R. 5963, dated June 29, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 3259, dated April 15, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations. The individual instructions have been omitted.

In accordance with the notice, interested persons were afforded an opportunity to submit written data, views, or arguments pertaining thereto. No comments or objections having been received, the following amendments are hereby adopted.

In order to (1) provide rules in the beer regulations (Part 245) for the payment of beer tax by semimonthly or prepayment return, (2) provide a revised basis for calculation of the penal sum of a brewer's bond, (3) implement certain administrative changes, and (4) make certain technical changes, 26 CFR Part 170, Miscellaneous Regulations Relating to Liquor, and 26 CFR Part 245, Beer, are amended as follows:

26 CFR Part 170 is amended as follows:

§ 170.402 [Amendment]

Section 170.402 is amended by inserting immediately after the phrase "on and after June 24, 1959," the phrase "and before July 1, 1960,".

26 CFR Part 245 is amended as follows:

§ 245.5 [Amendment]

Section 245.5 is amended as follows:

1. By adding, immediately following the definition entitled "District Director," a new definition to read:

Executed under penalties of perjury.—"Executed under penalties of perjury" shall mean signed with the prescribed declaration under the penalties of perjury as provided on or with respect to the return, claim, form, or other document or, where no form of declaration is prescribed, with the declaration: "I declare under the penalties of perjury that this _____ (insert type of document such as statement, report, certificate, application, claim, or other document), including the documents submitted in support thereof, has been examined by me and, to the best of my knowledge and belief, is true, correct, and complete."

2. By adding, immediately following the definition entitled "Removed for consumption or sale," two new definitions to read:

Secretary.—"Secretary" shall mean the Secretary of the Treasury.
This chapter.—"This chapter" shall mean Chapter I, Title 26, Code of Federal Regulations.

§ 245.41 [Amendment]

Section 245.41 is amended as follows:

1. By changing the period at the end of paragraph (m) to a comma and adding the words "showing their residence and business addresses."; and

2. By changing the citation to read "(72 Stat. 1388; 26 U.S.C. 5401)".

§ 245.42 [Amendment]

Section 245.42 is amended by changing the period at the end thereof to a comma and adding the words "except that a certified true copy, in triplicate, of a resolution of the board of directors authorizing a person to sign or act on behalf of the brewer will be accepted as evidence of the authority of such person to so sign or act."

§ 245.45 [Amendment]

Section 245.45 is amended as follows:

1. By striking from the first sentence the words "in triplicate,"; and

2. By changing the citation to read "(72 Stat. 1388; 26 U.S.C. 5401)".

§ 245.46 [Amendment]

Section 245.46 is amended by striking, at the end thereof, the words "nor be less than $1,000.", and inserting in lieu thereof the words "where the tax on beer is to be prepaid, or $500,000 where payment of such tax is to be deferred as provided in § 245.117a, and that the penal sum of any such bond shall be not less than $1,000."

A new section, section 245.46a, is added, immediately following section 245.46, to read:

§ 245.46a TAX DEFERRAL; EXTENSION OF TERMS OF EXISTING BOND.—Where a brewer intends to commence deferring tax on beer as provided in § 245.117a and his existing bond (or bonds) is in a sufficient penal sum, or where a brewer files a strengthening bond to increase the total penal sum of the existing bond (or bonds) to a sufficient penal sum to defer the tax, a consent of surety, Form 1533, shall be filed to extend the terms of the existing bond (or bonds) to cover future transactions. In either case, the consent shall properly identify the bond (or bonds), Form 1566, to which it applies and shall contain the following statement of purpose:

> To continue in effect said bond (or bonds) (including all extension or limitations of terms and conditions previously consented to and approved), notwithstanding that the tax on beer removed for consumption or sale will be paid under a semimonthly return system.

Section 245.52 is amended to read:

§ 245.52 CORPORATE SURETY.—Surety bonds may be given only with surety companies holding certificates of authority from the Secretary as acceptable sureties on Federal bonds, subject to the limitations as set forth in the current revision of Treasury Department Circular 570. (61 Stat. 648; 6 U.S.C. 6.)

§ 245.53 [Amendment]

Section 245.53 is amended by striking from the proviso the words "Treasury Department Form 356–Revised." and by inserting in lieu thereof the words "the current revision of Treasury Department Circular 570."

Section 245.60 is amended to read:

§ 245.60 NOTICE OF BOND TERMINATION.—On termination of the surety's liability under the bond, as provided in § 245.58, the assistant regional commissioner will notify the principal and sureties.

A new section, section 245.111a, is added, immediately following section 245.111, to read:

§ 245.111a TYPES OF CONTAINERS.—Beer may be removed from a brewery for consumption or sale only in barrels, kegs, bottles, and similar containers, as provided in this part. Beer may be bottled only in bottles as defined in section 245.5. A container which the Director, Alcohol and Tobacco Tax Division, determines to be similar to a bottle or can shall be treated as a bottle for the purposes of this part. A container which the Director, Alcohol and Tobacco Tax Division, determines to be similar to a barrel or keg and which conforms to one of the sizes prescribed for barrels or kegs in § 245.113, shall be treated as such for the purposes of this part. (72 Stat. 1389, 1390; 26 U.S.C. 5412, 5416.)

§ 245.112 [Amendment]

Section 245.112 is amended as follows:

1. By striking the words "§§ 245.227 to 245.229" from the first sentence thereof and inserting in lieu thereof the words "§§ 245.117a, 245.117b, and 245.117c."; and

2. By changing the citation to read "(68A Stat. 777, 778, 72 Stat. 1335; 26 U.S.C. 6311, 6313, 5061)".

§ 245.115 [Amendment]

Section 245.115 is amended by inserting, as the first entries under the headings "Number of bottles per case," "Fluid contents (ounces) of each bottle", and "Barrel equivalent", the figures "1", "288", and "0.07258", respectively.

Section 245.116 is amended to read:

§ 245.116 TIME OF TAX DETERMINATION AND PAYMENT.—The tax on beer shall be determined at the time of its removal for consumption or sale, and shall be paid by return as provided in this part. (72 Stat. 1334, 1335; 26 U.S.C. 5054, 5061.)

§ 245.117 [Deletion]

Section 245.117 is revoked.

Three new sections, designated § 245.117a, § 245.117b, and § 245.117c, are added, immediately following § 245.116, to read as follows:

§ 245.117a SEMIMONTHLY RETURN.—The tax on beer shall (unless prepaid) be paid by semimonthly return on Form 2034, which shall be filed, with remittance, for the full amount of tax due as shown on the return. The quantities of keg and bottled beer removed daily for consumption or sale during the period covered by the return, and the aggregate quantity thereof, shall be reported in the tax return. Form 2034 shall be filed as a semimonthly return regardless of whether tax has been prepaid as provided in § 245.117c during the return period. The brewer shall include for payment on his return the full amount of tax required to be determined (and which has not been prepaid) on all beer removed for consumption or sale during the period covered by the return. Prepayments made by the brewer during the semimonthly period shall be separately shown on the return. The brewer shall file his tax return, Form 2034, semimonthly, covering the period from his business day beginning on the 9th day of a month through his business day beginning on the 23rd day of the same month, and the period from this business day beginning on the 24th day of a month through his business day beginning on the 8th day of the next succeeding month. The semimonthly tax return, Form 2034, shall be filed not later than the close of the third calendar day next succeeding the 8th or 23rd calendar day of the month, as the case may be, excluding Saturdays, Sundays, legal holidays of the District of Columbia, and Statewide legal holidays of the State in which the return is required to be filed: *Provided*, That the return for the period ending at the close of the brewer's business day which began on June 23rd of any year shall be filed not later than the close of the second next succeeding calendar day after June 23rd, excluding Saturdays, Sundays, legal holidays of the District of Columbia, and Statewide legal holidays of the particular State in which the return is required to be filed. Where the semimonthly return and remittance are delivered by United States mail to the office of the district director, the date of the official postmark of the United States Post Office stamped on the cover in which the return and remittance were mailed shall be deemed to be the date of delivery of of such return and remittance: *Provided*, That where the postmark on the cover is illegible, the burden of proving when the postmark was made will be on the brewer: *Provided further*, That where the return and remittance are sent by registered mail, the date of registry, or where the return and remittance are sent by certified mail, the date of the postmark on the sender's receipt, shall be treated as the postmark date of the return and remittance. A return, Form 2034, shall be filed covering each return period even though no beer was removed for consumption or sale during the period. (72 Stat. 1335; 26 U.S.C. 5061.)

§ 245.117b BREWER IN DEFAULT; TAX TO BE PREPAID.—Where a check or money order tendered in payment of taxes on beer is not paid on presentment, or where the brewer is otherwise in default in payment of tax under § 245.117a, no beer shall be removed for consumption or sale or taken from the brewery for removal for consumption or sale until the tax thereon has been prepaid as provided in § 245.117c. The brewer shall continue to so prepay during the time that he is in default and thereafter until the assistant regional commissioner finds

the revenue will not be jeopardized by deferred payment of tax as provided in § 245.117a. Any remittance made while the brewer is required to prepay under this section shall be in cash or shall be in the form of a certified, cashier's, or treasurer's check drawn on any bank or trust company incorporated under the laws of the United States, or under the laws of any State or possession of the United States, or a money order, as provided in § 301.6311–1 of this chapter.

§245.117c PREPAYMENT OF TAX.—Where a brewer is required to prepay tax under § 245.117b, or where the penal sum of the bond (or bonds), Form 1566, is insufficient for deferral of payment of tax on beer to be removed for consumption or sale, or where a brewer is not, because of the provisions of § 245.46a, entitled to defer the tax, the brewer shall prepay the tax before any beer is removed for consumption or sale, or taken out of the brewery for removal for consumption or sale. Prepayment shall be made by forwarding or delivering to the district director a tax return, Form 2034, with remittance, covering the tax on beer. The word "Prepayment" shall be prefixed to the title of such form. For the purpose of complying with this section the term "forwarding" shall mean depositing in the United States mail, properly addressed to the district director. (68A Stat. 777, 72 Stat. 1335; 26 U.S.C. 6311, 5061.)

§ 245.143 [Amendment]

Section 245.143 is amended as follows:

1. By striking the word "application" in paragraph (a) and inserting in lieu thereof the word "claim";

2. By striking the words "an application" in the first sentence of paragraph (b) and inserting in lieu thereof the words "a claim";

3. By striking the word "application" in the last sentence of paragraph (b) and inserting in lieu thereof the word "claim"; and

4. By changing the citation to read "(72 Stat. 1335, 1389; 26 U.S.C. 5056, 5414)".

Section 245.148 is amended to read as follows:

§ 245.148 CLAIMS FOR REMISSION OF TAX.—Claims for remission of tax on beer lost in transit between breweries of the same ownership shall be prepared on Form 2635 by the brewer or his duly authorized agent and submitted with Form 103 of the receiving brewery for the month in which the shipment is received. Where the loss is by casualty, the claim shall be submitted with the Form 103 for the month in which the loss is discovered. Where, for valid reason, the required claim cannot be submitted with such report, a statement shall be attached to the monthly report setting forth the reason why the claim cannot be filed at that time and specifying when it will be filed. No claim shall be allowed unless filed with the assistant regional commissioner within 6 months after the date of loss. The claim shall set out:

(a) The date and serial number of the shipment (as shown on the transfer paper).

(b) The quantity of beer lost (number and size of packages and their equivalent in barrels).

(c) The percent of loss.

(d) The specific cause of the loss.

(e) The nature of the loss (leakage, breakage, casualty, etc.).

(f) Full information as to whether the claimant has been indemnified by insurance or otherwise in respect of the tax or has any claim for indemnification. Full details shall be furnished on losses due to casualty or accident, supported if possible, by statements of the carrier or other parties having personal knowledge of the loss.

(72 Stat. 1335, 1389; 26 U.S.C. 5056, 5414.)

§ 245.158 [Amendment]

Section 245.158 is amended as follows:

1. By striking therefrom the first three sentences and inserting in lieu thereof two new sentences to read: "Beer on which the tax has been paid, or on which the tax has been determined and therefore is to be reported for payment, which is removed from the market, may be returned to and stored in the brewery, and refund or credit of tax

may be claimed thereon in accordance with the provisions of subpart T. Unless such beer is to be returned to the stock of the racking room or bottling house, it shall be identified as beer removed from the market, be completely segregated from all other beer, and be accessible for inspection by internal revenue officers."

§ 245.160 [Amendment]

Section 245.160 is amended by striking therefrom the second sentence, which begins "Such beer shall be".

§ 245.161 [Amendment]

Section 245.161 is amended as follows:

1. By striking from the first sentence the words "again remove for consumption or sale," and by inserting in lieu thereof the words "return to the stock of the racking room or bottling house,";

2. By changing the third sentence to read "The notice shall be executed under penalties of perjury as defined in § 245.5.";

2a. By inserting in § 245.161, immediately following the fourth sentence, which begins "If the beer is to be destroyed, reconditioned, or used as material," a new sentence to read. "In the event the brewer is not notified that the disposition described in the notice is to be supervised or an internal revenue officer has not visited the brewery for the purpose of supervising such disposition on or before the date stated, the brewer may, unless otherwise advised by the assistant regional commissioner, dispose of the beer in the manner stated in the notice on the day following the scheduled date if the scheduled date is 10 days subsequent to the date of the notice, or at any time after 12 noon of the scheduled date if such date is 11 or more days subsequent to the date of the notice.";

3. By changing the sentence immediately preceding paragraph (a) to read "The notice, which shall be serially numbered, shall contain the following information:";

4. By changing paragraph (a) to read "(a) The number and sizes of kegs and the actual quantity of beer contained therein expressed in barrels; or the number of cases, the number and size in ounces of the bottles comprising the cases, and the actual quantity of beer contained therein expressed in barrels. (The burden of proof of establishing the correct quantity of beer is on the brewer and where kegs or cases containing less than the original contents are involved, the actual quantity of beer shall be determined by weight unless the assistant regional commissioner has authorized the use of another method.)";

5. By redesignating paragraphs (d) and (e) as paragraphs (e) and (f), respectively, and by inserting a new paragraph (d) to read: "(d) If returned, the name of the person from whom returned."; and

6. By striking from redesignated paragraph (e) the words "again to be removed for consumption or sale.", and inserting in lieu thereof the words "to be returned to the stock of the racking room or bottling house.".

§ 245.162 [Amendment]

Section 245.162 is amended as follows:

1. By inserting in the first sentence, immediately following the words "destruction of the beer," the word "or" and by striking from such sentence the words "or its return to the stock of the racking room or bottling house,";

2. By striking the last sentence and inserting two new sentences to read "If the brewer desires to destroy such beer at some place other than the brewery, the assistant regional commissioner may require that the disposition of the beer be delayed pending arrangement of a convenient time for supervision, and, if the place of destruction is not readily accessible to an inspector, the assistant regional commissioner may require that the beer be moved to a more convenient location. The assistant regional commissioner may, at any time, to substantiate claims for refund or credit of tax on beer returned to the stock of the racking room or bottling house, notify the brewer that, until further notice, supervision will be required of any further return of beer to such stock."

Section 245.164 is amended to read:

§ 245.164 CLAIMS FOR REFUND OF TAX.—Claims for refund of tax shall be filed on Form 843. Such claims, if for refund of tax on beer removed from the market, shall show (a) the name and address of the brewer, (b) the quantity of beer covered by the claim, (c) the amount of tax for which the claim is filed, (d) the reason for removal of the beer from the market and the facts relating thereto, (e) whether the brewer is indemnified by insurance or otherwise in respect of the tax, and, if so, the nature of such indemnification and (f) the claimant's reasons for believing that the claim should be allowed. If the claim is for refund of tax on beer lost or destroyed by fire, casualty, or act of God, it shall contain the information specified in paragraphs (a), (b), (c), (e), and (f) of this section, and a statement of the circumstances surrounding the loss; the claim shall also show the date of the loss, and, if lost in transit, the name of the carrier. The brewer's notice required by § 245.161 or § 245.163 shall be incorporated, by reference, in the claim and, when feasible, the claim should be filed at the same time as the notice. Claims covering losses shall be supported, whenever possible, by affidavits of persons having knowledge of the loss, unless such affidavits are contained in the notice given under § 245.163. The assistant regional commissioner may require the submission of additional evidence in support of any claim filed under this section when deemed necessary for proper action on the claim. Any claim on Form 843 shall be filed with the assistant regional commissioner having jurisdiction over the region in which the tax was paid within 6 months after the date of removal from the market or loss or destruction by fire, casualty, or act of God. Such claims will not be allowed if filed after the prescribed time or if the claimant was indemnified by insurance or otherwise in respect of the tax. (72 Stat. 1335; 26 U.S.C. 5056.)

Section 245.165 is amended to read:

§ 245.165 CLAIMS FOR ALLOWANCE OF CREDIT FOR TAX.—In lieu of filing a claim for refund of tax as provided in § 245.164, a brewer may file with the assistant regional commissioner having jurisdiction over the region in which the tax was paid, a claim on Form 2635 for allowance of credit for the tax paid. Any claim for credit filed on Form 2635 shall include all of the information required under § 245.164 with respect to a claim for refund on Form 843. The brewer's notice required by § 245.161 or 245.163 shall be incorporated, by reference, in the claim on Form 2635, and, when feasible, the claim should be filed at the same time as the notice. The brewer shall not anticipate allowance of a credit or make an adjusting entry therefor in a tax return pending consideration and action on the claim by the assistant regional commissioner. When written notification of allowance of the credit or any part thereof is received from the assistant regional commissioner, the brewer may make a proper adjusting entry and explanatory statement in the next subsequent beer tax return (or returns) to the extent necessary to exhaust the credit. The assistant regional commissioner may require the submission of additional evidence in support of any claim filed under this section when deemed necessary for proper action on the claim. A claim for allowance of credit for tax paid on beer must be filed within 6 months after the date of removal from the market, loss, or destruction by fire, casualty, or act of God. A claim will not be allowed if filed after the prescribed time or if the brewer was indemnified by insurance or otherwise in respect of the tax. (72 Stat. 1335; 26 U.S.C. 5056.)

Section 245.170 is amended to read:

§ 245.170 GENERAL.—Beer may be removed from the brewery without payment of tax (a) for exportation, (b) for use as supplies on vessels and aircraft, or (c) for transfer to and deposit in foreign-trade zones for exportation or for storage pending exportation, in accordance with the provisions of Part 252 of this chapter. Taxpaid beer may be exported, delivered for use as supplies on certain vessels and aircraft, or transferred to and deposited in foreign-trade zones, with benefit of drawback, under the provisions of Part 252 of this chapter.

§§ 245.171–245.194 [Deletion]

Sections 245.171 to 245.194, inclusive, are revoked.

Subpart V [Deletion]

Subpart V, consisting of sections 245.195 to 245.200, inclusive, is revoked.

§ 245.225 [Amendment]

Section 245.225 is amended as follows:

1. By changing paragraph (e) to read: "(e) Cereal beverage removed from the brewery.";

2. By inserting a new paragraph (f) to read: "(f) Beer removed for consumption or sale and beer removed without payment of tax, showing with respect to each removal the date of removal, the identity of the person to whom the beer was shipped or delivered (not required in the case of sales in quantities of ½ barrel or less for delivery at the brewery), and the quantities of beer removed in kegs and bottles: *Provided*, That where the brewer keeps, at the brewery, copies of invoices or other commercial records containing the information required as to each such removal, such copies may be used in lieu of any other record required by this paragraph if they are maintained in such manner that the assistant regional commissioner is satisfied that the information may be readily ascertained therefrom by internal revenue officers.";

3. By redesignating paragraph (f) as paragraph (g);

4. By redesignating paragraph (b) as paragraph (h), and changing it to read: "(h) Beer returned to the brewery, showing separately such beer destroyed, used as material, reconditioned, and returned to the stock of the racking room or bottling house;

5. By redesignating paragraphs (h) through (l) as paragraphs (i) through (m);

6. By striking from the last sentence thereof the opening phrase which reads "Except as provided in the first proviso of § 245.116," and by capitalizing the word "all" so that the sentence will begin "All entries in the records"; and

7. By changing the citation to read "(68A Stat. 896, 72 Stat. 1390, 1395; 26 U.S.C. 7503, 5415, 5555)".

Section 245.227 is amended to read:

§ 245.227 BEER TAX RETURN, FORM 2034.—All entries in the return, Form 2034, shall be fully supported by accurate and complete records. The brewer shall file the copy returned to him by the district director as a part of his records at the brewery. (72 Stat. 1335, 1390, 1395; 26 U.S.C. 5061, 5415, 5555.)

§§ 245.228 and 245.229 [Deletion]

Sections 245.228 and 245.229 are revoked.

Section 245.231 is amended to read:

§ 245.231 EXECUTION UNDER PENALTIES OF PERJURY.—When a return, form, or other document called for under this part is required by this part or in the

instructions on or with the return, form, or other document to be executed under penalties of perjury, as defined in § 245.5, it shall be so executed, and shall be signed by the brewer or other duly authorized person.

Section 245.232 is amended to read:

§ 245.232 RETENTION OF RECORDS, REPORTS, AND RETURNS.—A brewer shall retain, at the brewery for a period of not less than four years, all records, reports, and returns required by this part. Such records, reports, and returns shall be readily available during the brewer's regular business hours for examination and taking abstracts therefrom by internal revenue officers. (72 Stat. 1390; 26 U.S.C. 5415.)

A new section, section 245.233 is added to read:

§ 245.233 PHOTOGRAPHIC COPIES OF RECORDS.—Brewers who desire to record, copy, or reproduce records required to be preserved under § 245.232, by any photographic, photostatic, microfilm, microcard, miniature photographic, or other process which accurately reproduces or forms a durable medium for so reproducing the original record, shall make application to the assistant regional commissioner, in triplicate, to do so, describing:

(a) The records to be reproduced.
(b) The reproduction process to be employed.
(c) The manner in which the reproductions are to be preserved.
(d) The provisions to be made for examining, viewing, and using such reproductions.

The assistant regional commissioner shall not approve any application, unless the Director, Alcohol and Tobacco Tax Division, has approved that type of record for reproduction and the reproduction process to be employed, and unless the manner of preservation of the reproductions and the provisions for examining, viewing, and using such reproductions are, in the assistant regional commissioner's opinion, satisfactory. Whenever records are reproduced under this section, the reproduced records shall be preserved in conveniently accessible files, and provisions shall be made for examining, viewing, and using the reproduced record the same as if it were the original record, and it shall be treated and considered for all purposes as though it were the original record; all provisions of law and regulations applicable to the original record shall be applicable to the reproduced record. As used in this section "original record" shall mean the record required by this part to be maintained or preserved by the brewer, even though it may be an executed duplicate or other copy of the document. (72 Stat. 1395; 26 U.S.C. 5555.)

Because this Treasury Decision is a part of an integrated recodification program under chapter 51, I.R.C., and in order that the entire program may be effective on July 1, 1960, it is found that it is contrary to the public interest to issue this Treasury Decision subject to the effective date limitation of section 4(c) of the Administrative Procedure Act (60 Stat. 238; 5 U.S.C. 1003). Accordingly, this Treasury Decision shall become effective on July 1, 1960.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code (68A Stat. 917; 26 U.S.C. 7805).)

WILLIAM H. LOEB,
Acting Commissioner of Internal Revenue.

Approved June 22, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 28, 1960, 8:45 a.m., and published in the issue of the Federal Register for June 29, 1960, 25 F.R. 5963)

26 CFR 170.452: General. T.D. 6475[1]
(Also 240.591.)
(Also Sections 5373, 5382; 240.490,
240.1041, 240.536.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 170 AND 240

Miscellaneous amendments

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

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

On May 12, 1960, a notice of proposed rulemaking to amend 26 CFR Part 170, Miscellaneous Regulations Relating to Liquor, and 26 CFR Part 240, Wine, was published in the Federal Register (25 F.R. 4244).

In accordance with the notice, interested parties were afforded an opportunity to submit written comments or suggestions or to request a public hearing. No written comments or suggestions or requests for a public hearing having been received, the following amendments are hereby adopted.

In order to (1) incorporate in permanent regulations the temporary regulations relating to the semimonthly return system for taxpayment of wine now in Subpart S of 26 CFR Part 170; (2) authorize the use of distillates containing aldehydes in the fermentation of wine for use as distilling material; (3) make certain clarifying, liberalizing, and simplifying changes; (4) provide for taking credit on tax returns of drawback allowed under section 5062, I.R.C.; (5) authorize the return to bond of certain wines withdrawn without payment of tax; and (6) in conformity with administrative decisions to incorporate into 26 CFR Part 252 all procedures relating to exportation of liquors, to remove from 26 CFR Part 240 those procedures relating to the exportation of wine, use on certain vessels and aircraft, transfers to customs manufacturing warehouses, class six, and transfer to and deposit in a foreign-trade zone, the regulations in 26 CFR Part 170, "Miscellaneous Regulations Relating to Liquor" and 26 CFR Part 240, "Wine", are amended as follows:

In Part 170, section 170.452 is amended to read:

§ 170.452 GENERAL.—Notwithstanding any other provision of Part 240 of this chapter relating to the payment of taxes on wines by proprietors of bonded wine cellars qualified under chapter 51, I.R.C., such taxes determined on and after June 24, 1959, and before July 1, 1960, shall be paid and collected on the basis of a semimonthly or prepayment return as provided in this Subpart.

[1] The publication of this Treasury Decision in 25 F.R. 6184, dated July 1, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 4244, dated May 12, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations. The individual instructions have been omitted.

26 CFR Part 240 is amended in the following respects:

Section 240.19a is amended to read:

§ 240.19a DISTILLED SPIRITS PLANT.—"Distilled spirits plant" shall mean an establishment qualified under Part 201 of this chapter for the production, bonded storage, or bottling of spirits, or for rectification, or for any combination of such operations.

By inserting a new section immediately after § 240.21:

§ 240.21a. EXECUTED UNDER PENALTIES OF PERJURY.—Signed with the prescribed declaration under the penalties of perjury as provided on or with respect to the return, claim, form, or other document or, where no form of declaration is prescribed, with the declaration: "I declare under the penalties of perjury that this _____ (insert type of document such as statement, report, certificate, application, claim, or other document), including the documents submitted in support thereof, has been examined by me and, to the best of my knowledge and belief, is true, correct, and complete."

Section 240.27 is amended to read:

§ 240.27 IN BOND.—When used with respect to wine spirits, "in bond" means such spirits possessed under bond to secure the payment of the internal revenue tax thereon and in respect to which the tax has not been determined as provided in this chapter, and includes such spirits withdrawn without payment of tax under section 5214(a)(5), I.R.C., and with respect to which relief from liability has not yet occurred. When used with respect to wine "in bond" means wine possessed under bond to secure the payment of the internal revenue tax thereon and in respect to which the tax thereon has not been determined as provided in this chapter, and includes such wines on the bonded premises of a bonded wine cellar, in transit to a bonded wine cellar, and such wine withdrawn without payment of tax under section 5362, I.R.C., and with respect to which relief from liability has not yet occurred.

Section 240.53 is amended to read:

§ 240.53 UNITED STATES WINE.—"United States wine" shall mean wine produced on bonded wine cellar premises in the United States.

Section 240.124 is amended to read:

§ 240.124 BOTTLING OF TAXPAID WINE.—Every person desiring to bottle or rebottle taxpaid wine at premises other than the bottling premises of a distilled spirits plant shall establish taxpaid wine bottling house premises in compliance with the provisions of regulations set forth in Part 231, Title 26, of the Code of Federal Regulations.

§ 240.133 [Amendment]

Section 240.133 is amended:

1. By striking the fourth sentence; and

2. By changing the citation to read "(72 Stat. 1380, 1381; 26 U.S.C. 5361, 5365)".

§ 240.140 [Amendment]

Section 240.140 is amended:

1. By changing the last sentence to read "Except for necessary openings for ventilation and for the passage of water, electric, sewer, or similar lines, the wine cellar must be separated from adjourning buildings or rooms by solid unbroken partition: *Provided*, That where a bonded wine cellar, a distilled spirits plant, a taxpaid wine bottling house, another bonded wine cellar, or a wine vinegar plant are located in contiguous buildings or rooms, pipelines may be installed for the transfer of wine or wine spirits, and, if approved by the assistant regional commissioner, doors may be placed in the partitions separating the bonded wine cellar from the production facility of a distilled spirits plant, taxpaid wine bottling house, wine vinegar plant, other

bonded wine cellar, or a contiguous taxpaid room operated by the proprietor"; and

2. By changing the citation to read "(72 Stat. 1379; 26 U.S.C. 5357)".

Section 240.143 is amended to read:

§ 240.143 OFFICE FACILITIES.—Where wine spirits are to be used in the production of wine, other than use in small quantities for dosages or preparation of essences, the proprietor shall provide and maintain on the wine cellar premises in a convenient location suitable office facilities, including a desk, chair, file case, and such other office furniture as may be necessary for the keeping of Government records, for the use of internal revenue officers: *Provided*, That where the proprietor operates a distilled spirits plant on adjacent premises, and a Government office conforming to the requirements specified in Part 201 of this chapter is provided on such premises, and such office is so located as to be suitable for the use of internal revenue officers assigned at the wine cellar, separate office facilities need not be provided on the wine cellar premises. There shall also be provided a metal cabinet of adequate strength and size, suitably equipped for locking with a Government seal lock, for use in safeguarding Government seals, keys, and other Government property. Each such cabinet shall contain shelving or compartments of proper size for the filing of Government records. Conveniently located toilet and lavatory facilities shall also be provided and made available for the use of internal revenue officers. Such facilities shall be subject to approval by the assistant regional commissioner. (72 Stat. 1379; 26 U.S.C. 5357.)

§ 240.144 [Revocation]

Section 240.144 is revoked.

§ 240.169 [Amendment]

Section 240.169 is amended:

1. By changing the first sentence to read, "Pipelines used for the conveyance of wine spirits from the bonded premises of a distilled spirits plant to wine spirits storage tanks, measuring tanks, weighing tanks, and wine spirits addition tanks shall be constructed in accordance with the requirements of regulations prescribed in Part 201 of Title 26, Code of Federal Regulations"; and

2. By changing the citation to read "(72 Stat. 1395; 26 U.S.C. 5552)".

§ 240.171 [Amendment]

Section 240.171 is amended:

1. By changing the first sentence to read "The pipeline used to transfer taxpaid wine from the bonded wine cellar to the bottling premises of a distilled spirits plant or to a taxpaid wine bottling house shall be a fixed unbroken line of permanent character, securely constructed and connected, and so arranged as to be exposed to view throughout its entire length"; and

2. By changing the citation to read "(72 Stat. 1395; 26 U.S.C. 5552)".

§ 240.172 [Amendment]

Section 240.172 is amended:

1. By striking in the first sentence immediately after the words "bonded wine cellars" the words "fruit distilleries" and inserting in lieu thereof the words "distilled spirits plants"; and

2. By changing the citation to read "(72 Stat. 1379; 26 U.S.C. 5357)".

§ 240.174 [Amendment]

Section 240.174 is amended:

1. By striking in the first sentence immediately after the words "an adjacent" the words "distillery or internal revenue warehouse" and inserting in lieu thereof the words "distilled spirits plant"; and

2. By changing the citation to read "(72 Stat. 1395; 26 U.S.C. 5552)".

§ 240.193 [Amendment]

Section 240.193 is amended:

1. By changing the first sentence to read "If the activities to be conducted on the bonded wine cellar premises are such that a wine producer's basic permit is required under the Federal Alcohol Administration Act and regulations, the applicant may request on Form 698, for designation of the premises as a bonded winery."; and

2. By changing the citation to read "(72 Stat. 1378; 26 U.S.C. 5351)".

Section 240.197 is amended to read:

§ 240.197 DESCRIPTION OF EQUIPMENT.—All equipment, including tanks, crushing and pressing equipment, instruments and measures for testing and measuring wine must be described on the Form 698. Each tank shall be listed by serial number and capacity. Barrels or other readily portable containers under sixty gallons capacity need not be listed but the approximate number of such containers used for the storage of wine shall be shown. Unless required by the assistant regional commissioner, hoses, filters, pumps, pasteurizer, coolers, and similar equipment need not be listed on the Form 698. (72 Stat. 1379; 26 U.S.C. 5356.)

Section 240.204 is amended to read:

§ 240.204. LIST OF OFFICERS, DIRECTORS, AND STOCKHOLDERS.—In the case of corporations and similar legal entities, there shall be submitted with Form 698 at the commencement of business, a list, in triplicate, giving the names and addresses (business and residence) of all officers, directors, stockholders and other persons interested in the corporation, or other legal entity, and the amount and nature of the stock holding or other interests of each, whether such interest appears in the name of the interested party or in the name of another for him: *Provided*, That if there are more than ten holders of any class of stock, only the names, addresses and holdings of the ten persons having the largest ownership or other interest in each of the classes of stock need be included in the list of stockholders.

Section 240.222 is amended to read:

§ 240.222 TAX DEFERRAL BOND, FORM 2053.—Each proprietor of a bonded wine cellar desiring to remove wine for consumption or sale, where the tax unpaid at any one time amounts to more than $100, shall file a bond, Form 2053, to insure payment of the tax on such wine. The penal sum of a tax deferral bond, Form 2053, (or the total penal sums where original and strengthening bonds are filed), shall be in an amount equal to the tax on the maximum quantity of wine to be removed for consumption or sale during any semimonthly return period: *Provided*, That the maximum penal sum of such bond shall not exceed $250,000, and in no case shall the penal sum be less than $500. (72 Stat. 1379; 26 U.S.C. 5354.)

§ 240.223 [Revocation]

Section 240.223 is revoked.

§ 240.224 [Revocation]

Section 240.224 is revoked.

Section 240.251 is amended to read:

§ 240.251 TERMINATION OF BOND, FORM 1676.—Bond on Form 1676, covering the removal of wine for transfer to a wine vinegar plant, will be terminated as to future liability (a) pursuant to application by the surety as provided

in § 240.252; (b) pursuant to approval of a superseding bond as provided in § 240.257; or (c) upon discontinuance of the business covered by the bond as provided in § 240.257. (72 Stat. 1380; 26 U.S.C. 5362.)

Section 240.255 is amended to read:

§ 240.255 EXTENT OF RELIEF, FORM 1676.—If notice has been filed as provided in § 240.252 in respect to a bond on Form 1676 and is not in writing withdrawn, the surety shall be relieved of liability for tax on wine withdrawn for manufacture of vinegar, after the date stated in the notice. Where such withdrawal is made wholly on or before the date named in the notice, the surety shall remain liable for the tax on wine so withdrawn, until the wine is fully accounted for. (72 Stat. 1380; 26 U.S.C. 5362.)

Section 240.256 is amended to read:

§ 240.256 RELEASE OR TERMINATION OF FORM 700 OR 2053.—When the proprietor of a bonded wine cellar discontinues business and the notice of discontinuance has been approved, the assistant regional commissioner will issue Notice of Termination or Release of Bond, Form 1490, and will forward copies to the principal and to the surety; or, in the case of bond, Form 2053, Notice of Termination or Release of Bond, Form 1490, will be issued upon receipt from the proprietor of writtten advice that he has discontinued removals of wine requiring a tax deferral bond. When a valid superseding bond has been approved, the assistant regional commissioner will issue Notice of Termination or Release of Bond, Form 1490, and will forward copies to the principal and to the surety. (72 Stat. 1379; 26 U.S.C. 5354.)

Section 240.257 is amended to read:

§ 240.257 RELEASE OR TERMINATION, FORM 1676.—When the principal on a bond, Form 1676, notifies the assistant regional commissioner that he has discontinued the withdrawal of wine without payment of tax for use in the manufacture of vinegar, the assistant regional commissioner will issue Notice of Termination or Release of Bond, Form 1490. When a superseding bond on Form 1676 is approved by the assistant regional commissioner, he will issue Notice of Termination or Release of Bond, Form 1490, for the superseded bond. (72 Stat. 1380; 26 U.S.C. 5362.)

Section 240.259 is amended to read:

§ 240.259 RELEASE OF COLLATERAL, FORM 1676.—Collateral pledged and deposited to support a bond on Form 1676 will ordinarily be released by the assistant regional commissioner upon issuance of Notice of Termination or Release of Bond, Form 1490, provided all liabilities under the bond have been satisfied. (61 Stat. 646; 6 U.S.C. 15.)

Section 240.273 is amended to read:

§ 240.273 CONTIGUOUS OR ADJACENT PREMISES.—Where a distilled spirits plant, taxpaid wine bottling house, wine vinegar plant, or another bonded wine cellar, is maintained on contiguous or adjacent premises, the relative position of such premises and the bonded wine cellar, communicating doors and other openings, and all pipeline connections for transfer of wine and wine spirits between the premises, must be shown on the plat. The pipeline used for conveying wine spirits from bonded premises of a distilled spirits plant to the bonded wine cellar, or for transfer of wine spirits within the bonded wine cellar premises shall be shown in blue on the plat. Pipelines for the conveyance of wine between noncontiguous portions of the bonded wine cellar will be shown.

Section 240.296 is amended to read:

§ 240.296 CHANGES IN OFFICERS, DIRECTORS, OR STOCKHOLDERS OF A CORPORATION.—Where there is a change in officers or directors, or in the stockholders required to be listed under § 240.204, the proprietor shall submit, within ten days of such change, a written notice to the assistant regional commissioner. The notice shall be filed in triplicate, shall describe the changes, and be prepared as required by § 240.204.

§ 240.312 [Amendment]

Section 240.312 is amended:

1. By striking in the first sentence the word "triplicate" and inserting in lieu thereof the word "duplicate";

2. By changing the third sentence to read "Upon approval, the assistant regional commissioner will return one copy of the report to the proprietor for attachment to the copy of Form 698 retained at the bonded premises and retain one copy in his office for filing with Form 698."; and

3. By changing the citation to read "(72 Stat. 1379; 26 U.S.C. 5356)".

§ 240.320 [Amendment]

Section 240.320 is amended:

1. By changing the first sentence to read "When the proprietor desires to discontinue operation of the bonded wine cellar, all wine and wine spirits must (except as provided herein) be lawfully removed from the premises or destroyed, and any outstanding approved Forms 257 authorizing the transfer of wine spirits to the wine cellar shall be procured from the distilled spirits plant to which they were sent and returned to the assistant regional commissioner for cancellation."; and

2. By striking the period at the end of the last sentence and inserting "and, in lieu of the statement that all wine and wine spirits have been lawfully removed from the premises or destroyed, that all wine and wine spirits will be transferred to the successor as of the date the discontinuance is to be effective. All wine and wine spirits so transferred shall be identified as "Transferred to successor" on the Form 702 filed by the outgoing proprietor (in accordance with § 240.321); and identified as "Received from predecessor" on the initial Form 702 filed by the successor.

§ 240.361 [Amendment]

Section 240.361 is amended:

1. By changing paragraph (c) to read "Yeast foods, sterilizing agents, or other fermentation adjuncts under the provisions of Subpart ZZ."; and

2. By changing the citation to read "(72 Stat. 1383, 1384; 26 U.S.C. 5381, 5382, 5383)".

§ 240.364 [Amendment]

Section 240.364 is amended:

1. By changing the fourth sentence to read "If it is desired to use other acids, the requirements of § 240.1052 shall be followed."; and

2. By changing the citation to read "72 Stat. 1383; 26 U.S.C. 5382)".

§ 240.365 [Amendment]

Section 240.365 is amended:

1. By striking in paragraph (b) "§§ 240.529 and 240.530" and inserting in lieu thereof "Subpart ZZ"; and

2. By changing the citation to read "(72 Stat. 1384; 26 U.S.C. 5383)".

Section 240.376 is amended to read:

§ 240.376 GAUGE OF WINE SPIRITS.—If the wine spirits to be used are on deposit in the bonded wine cellar, or are received immediately prior to use from a distilled spirits plant not adjacent to the bonded wine cellar, the proprietor, under the supervision of the internal revenue officer, will gauge the wine spirits released to him for use in wine production and shall prepare Form 2629, in triplicate, to cover each release of wine spirits; where the wine spirits are in packages he shall also prepare Form 2630, in triplicate. A copy of Form 2629 and Form 2630, if any, shall be attached to each copy of Form 275. (72 Stat. 1381; 26 U.S.C. 5367, 5368.)

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§ 240.377 [Amendment]

Section 240.377 is amended:

1. By changing the third sentence to read "If the wine spirits are received by pipeline from adjacent bonded premises of a distilled spirit plant, and are run directly into the wine spirits addition tank, the gauge of the wine spirits made on the adjacent premises will be used.";

2. By changing the last sentence to read "The internal revenue officer at the adjacent premises will deliver two copies of Form 2629 to the proprietor of the bonded wine cellar who shall acknowledge receipt of the wine spirits on both copies of the form and shall forward one copy to his assistant regional commissioner."; and

3. By changing the citation to read "(72 Stat. 1381, 1382; 26 U.S.C. 5367, 5373)".

§ 240.378 [Amendment]

Section 240.378 is amended:

1. By changing the third sentence to read "If the packages have been received from contiguous bonded premises of a distilled spirits plant for immediate use, the packages need not be regauged in the bonded wine cellar unless there is some indication that the contents of the packages may not be in agreement with the withdrawal gauge."; and

2. By changing the citation to read "(72 Stat. 1381, 1382; 26 U.S.C. 5366, 5367, 5368, 5373)".

§ 240.379 [Amendment]

Section 240.379 is amended:

1. By striking in the third sentence the number "1520" and inserting in lieu thereof the number "2629";

2. By striking in the parenthetical phrase of the fourth sentence the number "1520" and inserting in lieu thereof "2629 and Form 2630, if any,"; and

3. By changing the citation to read "(72 Stat. 1381, 1382, 1383; 26 U.S.C. 5367, 5373, 5382)".

§ 240.385 [Amendment]

Section 240.385 is amended:

1. By changing the second sentence to read "A statement of process on Form 698—Supplemental, in triplicate, giving details of the production process, shall be filed with the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C., and approved prior to the commencement of production."; and

2. By changing the citation to read "(72 Stat. 1382, 1383; 26 U.S.C. 5373, 5382)".

§ 240.401 [Amendment]

Section 240.401 is amended:

1. By changing paragraph (b) to read "Yeast foods, sterilizing agents, or other fermentation adjuncts under the provisions of Subpart ZZ."; and

2. By changing the citation to read "(72 Stat. 1383; 26 U.S.C. 5381)".

§ 240.404 [Amendment]

Section 240.404 is amended:

1. By changing the sixth sentence to read "If it is desired to use other acids, the requirements of § 240.1052 shall be followed."; and

2. By changing the citation to read "(72 Stat. 1383; 26 U.S.C. 5382)".

§ 240.405 [Amendment]

Section 240.405 is amended:

1. By striking in paragraph (b) "§§ 240.529 and 240.530" and inserting in lieu thereof "Subpart ZZ"; and

2. By changing the citation to read "(72 Stat. 1385; 26 U.S.C. 5384)".

§ 240.441 [Amendment]

Section 240.441 is amended:

1. By changing the second sentence to read "The formula and process will be described on Form 698—Supplemental, which will be filed, in triplicate with the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C.";

2. By changing the third sentence to read "Two 4/5 quart samples of the base wine used and two 4/5 quart samples of the finished special natural wine shall be submitted under separate cover at the time of filing the formula"; and

3. By changing the citation to read "(72 Stat. 1386; 26 U.S.C. 5386)".

§ 240.444 [Amendment]

Section 240.444 is amended by striking the third, fourth, and fifth sentences and inserting in lieu of such sentences "Caramel, pure dry sugar, liquid sugar, or invert sugar syrup, or pure dry sugar-water solution of not less than 60 degrees (Brix) may be used in special natural wine made under this section: *Provided*, That the minimum 60 degrees (Brix) limitation contained in §§ 240.40a and 240.40b, and in this section, shall not apply to such materials used in the manufacture of vermouth. Where vermouth is produced under this section the finished product shall contain not less than 80 percent by volume of natural wine."

Section 240.447 is amended to read:

§ 240.447 ESSENCES MADE ELSEWHERE.—Before an essence, not made on bonded wine cellar premises, may be used in the production of special natural wine, the manufacturer of such essence must secure approval from the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C., for its use in special natural wine. The manufacturer will file a statement, in duplicate, of the materials and processes used in the manufacture of the essence, with the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C. A sample, not less than four ounces in amount, will be submitted with the statement. The essence will be identified by the name of the manufacturer, and the name of the essence, or an identifying number. A separate statement and sample must be submitted for each essence to be used for special natural wine production. The required statement and sample shall be submitted for only those essences that are not manufactured pursuant to an approved formula on Form 1678, for a nonbeverage product. The Director, Alcohol and Tobacco Tax Division, will notify the manufacturer of approval or disapproval of the essence for use in wine production. If approved, the proprietor of a bonded wine cellar may describe the essence on Form 698—Supplemental by showing the name of the manufacturer, the manufacturer's nonbeverage draw-

back formula number, if any, and the date of approval by the Director; without submitting additional samples of the essence. (72 Stat. 1386; 26 U.S.C. 5386.)

§ 240.465 [Amendment]

Section 240.465 is amended:

1. By changing the last sentence to read "The formula and process will be described in detail on Form 698—Supplemental which will be filed in triplicate with the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C."; and

2. By changing the citation to read "(72 Stat. 1386; 26 U.S.C. 5387)".

§ 240.482 [Amendment]

Section 240.482 is amended by changing the second sentence to read "The formula will be filed on Form 698 Supplemental, in triplicate, with the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C."

§ 240.485 [Amendment]

Section 240.485 is amended:

1. By striking in the last sentence the words "assistant regional commissioner" and inserting in lieu thereof the words "Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C.,"; and

2. By changing the citation to read "(72 Stat. 1380, 1381, 1387; 26 U.S.C. 5361, 5364, 5388)".

§ 240.486 [Amendment]

Section 240.486 is amended:

1. By inserting, immediately after the second sentence, a new sentence reading, "Distillates containing aldehydes may be used in the fermentation of wine to be used as distilling material as provided in §§ 240.490 and 240.491 and Subpart YY of this part."; and

2. By changing the citation to read "(72 Stat. 1380, 1381, 1382; 26 U.S.C. 5361, 5364, 5373)".

§ 240.489 [Amendment]

Section 240.489 is amended:

1. By changing the parenthetical phrase in the second sentence to read "(49 Stat. 977; 27 U.S.C. 201)"; and

2. By changing the citation to read "(72 Stat. 1381, 1383; 26 U.S.C. 5364, 5381)".

By inserting immediately after § 240.489 an undesignated center heading and new §§ 240.490 and 240.491:

USE OF DISTILLATES CONTAINING ALDEHYDES

§ 240.490 GENERAL.—Distillates containing aldehydes, withdrawn under the provisions of 26 CFR Part 201, may be used in fermentation of wine to be used as distilling material at the distilled spirits plant from which such distillates were withdrawn. Distillates produced from one kind of fruit shall not be used in the fermentation of wine made from a different fruit. (72 Stat. 1382; 26 U.S.C. 5373.)

§ 240.491 APPLICATION.—Where a distillate containing aldehydes is to be used in fermentation of wine to be used as distilling material the proprietor of the bonded wine cellar, unless he is also the proprietor of the distilled spirits plant from which the distillates are to be withdrawn, shall submit an application, in duplicate, to the assistant regional commissioner, and state therein (a) the name, address, and registry number of the distilled spirits plant from which

the distillate is to be withdrawn, (b) the kind of distillate, (c) the kind of wine in which the distillate will be used, and (d) a statement describing the method by which such distillate will be added in fermentation of wine to be used as distilling material. Where the proprietor of the bonded wine cellar is also the proprietor of the distilled spirits plant, the approval of the application required under 26 CFR Part 201 will also authorize the receipt and use of the distillates at the bonded wine cellar. Distillates containing aldehydes will be procured under the provisions of Subpart YY of this part. Record of receipt and use of such distillates will be kept in accordance with Subpart UU of this part and reported on Form 702. (72 Stat. 1381, 1382; 26 U.S.C. 5367, 5373.)

Section 240.500 is amended to read:

§ 240.500 GENERAL.—Wine or wine lees may be refermented except that wine or wine lees in which sugar sweetening was used may not be refermented for use as distilling material at a distilled spirits plant for the production of brandy or wine spirits. (72 Stat. 1382; 26 U.S.C. 5373.)

§ 240.501 [Revocation]

Section 240.501 is revoked.

§ 240.510 [Amendment]

Section 240.510 is amended:

1. By striking the second sentence in its entirety; and

2. By changing the citation to read "(72 Stat. 1383; 26 U.S.C. 5382)".

§ 240.513 [Amendment]

Section 240.513 is amended:

1. By striking in the first sentence the words "assistant regional commissioner" and inserting in lieu thereof the words "Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D.C.,";

2. By striking in the fifth sentence the word "quadruplicate" and inserting in lieu thereof the word "triplicate"; and

3. By changing the citation to read "(72 Stat. 1383, 1387; 26 U.S.C. 5382, 5387)".

§ 240.524 [Amendment]

Section 240.524 is amended:

1. By changing the last sentence to read "Specifically authorized materials are listed in Subpart ZZ."; and

2. By changing the citation to read "(72 Stat. 1338, 1383; 26 U.S.C. 5082, 5382)".

§ 240.528 [Amendment]

Section 240.528 is amended:

1. By striking in the last sentence the numbers "§ 240.530" and inserting in lieu thereof "Subpart ZZ"; and

2. By changing the citation to read "(72 Stat. 1383; 26 U.S.C. 5382)".

§ 240.529 [Revocation]

Section 240.529 is revoked.

§ 240.530 [Revocation]

Section 240.530 is revoked.

By inserting immediately after § 240.535 an undesignated center heading and new §§ 240.536 to 240.539:

REDUCTION OF ACID CONTENT

§ 240.536 GENERAL.—Standard wine may have the acid content reduced below 5 parts per thousand by use of authorized neutralizing materials or methods: *Provided*, That such neutralizing materials or methods does not change the character of the wine to an extent inconsistent with good commercial practice and does not result in any increase in the volume of the wine. (72 Stat. 1383; 26 U.S.C. 5382.)

§ 240.537 APPLICATION.—Where a proprietor desires to reduce the acid content of wine below 5 parts per thousand he shall file an application with the assistant regional commissioner. The application shall be filed in letter form and in triplicate. The application shall contain the following information:

(a) name, address, and registry number of the proprietor;

(b) statement of process or method to be used in effecting the acid reduction;

(c) gallons of wine to be treated; and

(d) kind of wine to be treated.

A one pint sample of the wine prior to treatment shall be submitted by the properietor, direct to the Regional laboratory at the same time the application is filed. The sample will be labeled and marked in a manner that it may be readily identified. The proprietor shall not proceed to reduce the acid content of the wine until he receives approval of the application by the assistant regional commissioner. (72 Stat. 1383; 26 U.S.C. 5382.)

§ 240.538 SAMPLE OF TREATED WINE.—After completion of the acid reduction treatment a one pint sample of the wine shall be submitted by the proprietor to the Regional laboratory. The sample will be labeled and marked in a manner that it may be readily identified and associated with the sample submitted prior to treatment. (72 Stat. 1383; 26 U.S.C. 5382.)

§ 240.539 ADDITION OF ACID.—Acid may be added to wine treated under §§ 240.536–240.538 only for stabilization. (72 Stat. 1383; 26 U.S.C. 5382.)

§ 240.540 [Amendment]

Section 240.540 is amended:

1. By striking in the first sentence the word "still"; and

2. By changing the citation to read "(72 Stat. 1331; 26 U.S.C. 5042)".

§ 240.541 [Amendment]

Section 240.541 is amended:

1. By changing item (d) to read: "wine made by a partnership, except as provided in § 240.730, or produced at a bonded wine cellar by two or more heads of families jointly;"; and

2. By changing the citation to read "(72 Stat. 1331; 26 U.S.C. 5042)".

Section 240.561 is amended to read:

§ 240.561 SERIAL NUMBERS.—All containers used for removing wine shall be marked with a serial number at the time the containers are prepared for removal, except as provided herein. Serial numbers shall commence with "1" and continue in order until the number 1,000,000 is reached, when the series may start again with "1": *Provided*, That a new series may be commenced when 100,000 has been reached if no number will be used more than once during a 12-month period. If desired, separate series of numbers preceded by identifying letters may be used for bulk containers and for cases, or for cases filled on different bottling lines, or for removals from different loading docks. On filing a notice with the assistant regional commissioner the proprietor may, unless notified by the assistant regional commissioner to the contrary, (a) mark the serial numbers on the cases at the time of filling the cases or (b) mark the cases with the filling date in lieu of serially numbering the cases. The notice shall be filed in duplicate not less than 10 days prior to the date on which the proprietor intends to commence marking the serial numbers on the cases at the time of filling the cases or the date on which the proprietor intends to commence marking cases with the filling date. A proprietor who marks cases with the filling date shall maintain appropriate cellar records to identify the wine. A proprietor

who marks serial numbers on the cases at the time of filling shall maintain a daily record of cases filled, by serial number, and type of wine. A proprietor who marks serial numbers on containers at the time of removal shall maintain a daily record, by serial numbers, of containers removed. Where the assistant regional commissioner has approved the numbering of cases at the time of filling, such numbers need not be shown on Form 703 covering transfer of the cases in bond. A proprietor who has given notice of his intention to mark serial numbers on the cases at the time of filling the cases or to mark the filling dates on the cases shall use such procedure exclusively until the assistant regional commissioner requires or authorizes the case to be marked as otherwise provided in this section. Where domestic or foreign wine is recased in the taxpaid room the proprietor shall mark such cases preparatory to shipment with the date of repackaging, preceded by the letter "R", in lieu of serially numbering the cases. The serial numbering and alternate marking provisions of this section shall also apply to domestic or foreign wines reconditioned on the bonded wine cellar premises. The provisions of this section do not apply to foreign wines except as specifically stated herein.

§ 240.562 [Amendment]

Section 240.562 is amended:

1. By changing the first sentence to read "Each cask, barrel, keg, tank, tank truck, railroad tank car, or case, or other approved container, used to remove wine shall be marked in a plain and durable manner with (a) the serial number, or the alternate marks in lieu of the serial numbers as provided in § 240.561, or (if recased in the taxpaid room) with the marks authorized in § 240.561 in lieu of the serial number, (b) the name of the proprietor and the registry number and location (by State, or city or town and State) of the wine cellar, (c) the kind (class and type) and the alcohol content of the wine, (d) the contents of the container in wine gallons, and (e) except for cases, the date of removal or shipment."

2. By changing the period at the end of the last sentence to a colon followed by "*Provided*, That the serial number, or the alternate marks in lieu of a serial number, may be placed on a side other than the Government side as described in § 240.564 where such other side bears no marks in conflict with such serial numbers or alternate marks."; and

3. By changing the citation to read "(72 Stat. 1381, 1387, 1407; 26 U.S.C. 5368, 5388, 5662)".

Section 240.575 is amended to read:

§ 240.575 REMARKING, RESHIPPING, OR TAXPAYING CONTAINERS RECEIVED FROM OTHER PREMISES.—When wine received in bond from other premises is removed, in the containers in which received, for consumption or sale, the proprietor shall mark the containers with "Taxpaid" or "TP", followed by the registry number and State of the taxpaying premises on the same side of the container as the original marks. When containers of wine received in bond are reshipped in bond, the proprietor of the reshipping premises shall mark the containers with "Transferred", followed by the registry number and State of the bonded premises to which the wine is shipped on the same side of the container as the original marks. The transfer marks may be abbreviated, as "Trans. BW 100–NY".

Subpart AA consisting of §§ 240.590 through 240.597 is stricken and in lieu thereof a new subpart AA consisting of §§ 240.590 through 240.600 is inserted:

Subpart AA.—Taxpayment of Wine

§ 240.590 TIME FOR DETERMINATION OF TAX LIABILITY.—The tax on wine shall be determined at the time of removal from the bonded wine cellar premises (or transfer to a taxpaid room on the premises) for consumption or

sale. Upon determination, the quantity of wine removed will be entered on the record prescribed by § 240.920. (72 Stat. 1331; 26 U.S.C. 5041.)

§ 240.591 TIME FOR PAYMENT OF TAX.—The tax on wine shall be paid by return, Form 2050, which will be filed with remittance for the full amount of tax due as shown by the return. The quantities of wine by taxable grades removed daily for consumption or sale during the period covered by the return and the aggregate quantities thereof, shall be reported on the tax return, Form 2050, prepared in quadruplicate. All entries in the return shall be fully supported by accurate and complete records satisfactory to the assistant regional commissioner. The proprietor shall include for payment on his return, Form 2050, the full amount of tax required to be determined (and not prepaid) on all wine removed daily from the bonded wine cellar premises (or transferred to a taxpaid room on the premises) for consumption or sale during the period covered by the return. Prepayments of tax on wine during the period covered by the return shall be separately shown thereon. The proprietor shall file a tax return, Form 2050, with remittance for the full amount of tax due, semimonthly, covering the period from the 9th day of a month through the 23d day of the same month and the period from the 24th day of a month through the 8th day of the next succeeding month. The tax return shall be filed not later than the close of the 3d calendar day next succeeding the 8th or 23d calendar day of the month, as the case may be, excluding any Saturday, Sunday, or legal holiday of the District of Columbia or any statewide legal holiday of the State in which the return is required to be filed: *Provided*, That the return for the period ending on June 23d of each year shall be filed not later than the close of the 2d next succeeding calendar day after June 23d, excluding any Saturday, Sunday, or a legal holiday of the District of Columbia or a statewide legal holiday of the particular State in which the return is required to be filed. Except as provided in § 240.592 a return shall be filed covering each return period even though no wine was removed for consumption or sale during the period. (68A Stat. 896, 72 Stat. 1335; 26 U.S.C. 5061, 7503.)

§ 240.592 EXCEPTION.—Where a tax deferral bond is not given under the provisions of 26 CFR 240.222 and the proprietor has notified the assistant regional commissioner in writing that, until further notice, no wine in respect to which tax is required to be paid will be removed from the bonded wine cellar premises, and where no such wine is so removed, a proprietor will not be required to file a semimonthly return on Form 2050. This exception also applies where substandard wine only is removed for shipment to a vinegar plant for the production of vinegar. This exception shall not apply where intermittent removals subject to tax are made, but only where future removals subject to tax are not anticipated. Notices required under this section shall be filed in letter form, in duplicate.

§240.593 FAILURE TO PAY TAX OR FILE RETURN AT THE TIME REQUIRED.—The law provides penalties for failure to pay tax at the time required, for willful refusal to pay such tax and for fraudulent nonpayment of tax. In addition to such penalties, there is a penalty for the delinquent filing of tax returns imposed as an addition to the tax shown by such returns, amounting to 5 percent for each month or fraction thereof of delinquency, not exceeding 25 percent in the aggregate, unless it is shown that such delinquency is due to reasonable cause and not to willful neglect. (68A Stat. 821, 72 Stat. 1407, 1410; 26 U.S.C. 5661, 5684, 6651.)

§ 240.594 PREPAYMENT OF TAX.—Where a proprietor is required to prepay tax under § 240.595, or the penal sum of any tax deferral bond, Form 2053 (or the total penal sums where original and strengthening bonds are filed), is insufficient for deferral of payment of tax on wine to be removed for consumption or sale, the proprietor shall, before removal of the wine, file with the district director a wine tax return, Form 2052, with remittance: *Provided*, That where an approved tax deferral bond is not on file the tax need not be prepaid where the total amount of tax unpaid does not exceed $100. The return, with remittance, shall be filed by forwarding or delivering it to the district director before the wine is removed for consumption or sale. For the purpose of complying with this section, the term "forwarding" shall mean deposit in the United States mail, properly addressed to the district director. (68A Stat. 777, 72 Stat. 1335; 26 U.S.C. 5061, 6311.)

§ 240.595 PROPRIETOR IN DEFAULT; PREPAYMENT OF TAX.—Where a check or money order tendered in payment of taxes on wine is not paid on present-

ment, or where the proprietor is otherwise in default in payment of tax under § 240.591, no wine shall be removed for consumption or sale until the tax has been paid as provided in § 240.594, for the period of such default and until the assistant regional commissioner finds the revenue will not be jeopardized by payment of tax as provided in § 240.591. Any remittance made during the period of such default shall be in cash, or shall be in the form of a certified, cashier's, or treasurer's check drawn on any bank or trust company incorporated under the laws of the United States, or under the laws of any State, Territory, or possession of the United States, or money order, as provided in § 301.6311–1 of this chapter. (68A Stat. 777, 72 Stat. 1335; 26 U.S.C. 5061, 6311.)

§ 240.596. DATE OF MAILING AND DELIVERING OF RETURNS.—Where the return, Form 2052 or Form 2050, as the case may be, and remittance are delivered by United States mail to the office of the district director, the date of the official postmark of the United States Post Office stamped on the cover in which the return and remittance were mailed shall be deemed to be the date of delivery of such return and remittance: *Provided*, That where the postmark on the cover is illegible, the burden of proving when the postmark was made will be on the proprietor: *Provided further*, That where the return is sent by registered mail the date of registry, or where the return is sent by certified mail the date of the postmark on the sender's receipt shall be treated as the postmark date of the return and remittance.

§ 240.597 TAX ON WINE.—Section 5041, I.R.C., imposes a tax, at rates prescribed therein, on all wines (including imitation, substandard, or artificial wine, and compounds sold as wine, which contain 24 percent or less of alcohol by volume) in bond in, produced in, or imported into, the United States; such tax to be determined as of the time of removal for consumption or sale. Wine containing more than 24 percent of alcohol by volume shall be classed as distilled spirits and taxed accordingly. The tax shall be determined and paid on the quantity of wine required to be marked on the containers as provided in §§ 240.562 and 240.567, or (in case of pipeline removals) on the quantity determined as provided in § 240.600. (72 Stat. 1331; 26 U.S.C. 5041.)

§ 240.598 MARKING OF CONTAINERS.—All containers of wine removed taxpaid, except cases, will be marked with the word "Taxpaid" in addition to the marks required by § 240.562: *Provided*, That cases must be so marked when required by § 240.575. (72 Stat. 1381; 26 U.S.C. 5368.)

REMOVAL OF TAX DETERMINED WINE BY PIPELINE

§ 240.599 GENERAL.—The assistant regional commissioner may authorize the removal of tax determined wine by pipeline from a bonded wine cellar to the bottling premises of a distilling spirits plant or to a taxpaid wine bottling house, contiguous to, or in the immediate vicinity of the bonded wine cellar. Authorization will be given only if the proprietor has installed pipelines and tanks as prescribed by §§ 240.170 and 240.171. (72 Stat. 1331; 26 U.S.C. 5041.)

§ 240.600 PROCEDURE FOR DETERMINATION OF TAX.—When the proprietor desires to transfer wine to the taxpayment tank, he will make certain that the outlet valve is closed, and open the inlet valve of the taxpayment tank. When the tank is filled, or the desired quantity of wine has been run into the tank, the proprietor will close the inlet valve, accurately determine the quantity of wine in the tank, make entry in his cellar record showing the date, the wine taxpayment tank number; the kind, quantity, and alcohol content of the wine; and the plant to which the wine will be transferred. The proprietor shall close the outlet valve immediately after the tank has been emptied. The quantities of wine so removed will be shown in Form 2056 as taxable removals. The quantity of wine removed by pipeline will be recorded to the nearest whole gallon, 5 tenths gallon being converted to the next full gallon.

Section 240.611 is amended to read:

§ 240.611 MARKING CONTAINERS.—In addition to the marks required by § 240.562, each container, except cases, of wine transferred in bond from one bonded wine cellar to another shall be plainly marked "Transferred", followed by the registry number and state of the bonded premises to which the wine is shipped. The transfer marks may be abbreviated, as "Trans. BW 100–N.Y." Containers reshipped in bond shall be marked in accordance with § 240.575. (72 Stat. 1381; 26 U.S.C. 5368.)

§ 240.616 [Amendment]

Section 240.616 is amended:

1. By changing the last sentence to read: "Where there is a loss in transit from any shipment the consignee shall as required by § 240.785 file a claim for allowance of the loss."; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)".

Section 240.630 is amended to read:

§ 240.630 GENERAL.—Still wine may be removed without payment of tax, under the provisions of this Subpart, to the production facility of a distilled spirits plant for use as distilling material in the production of spirits. Form 703 will be prepared and handled in accordance with §§ 240.613 through 240.616 for all such removals. (72 Stat. 1380; 26 U.S.C. 5362.)

Section 240.631 is amended to read:

§ 240.631 PIPELINE TO PRODUCTION FACILITY OF A DISTILLED SPIRITS PLANT.—Where a bonded wine cellar and the production facilities of a distilled spirits plant are operated on adjacent premises, wine for use as distilling material may be transferred by fixed pipeline from the wine cellar to measuring or storage tanks in the plant. The quantity of distilling material may be determined at either the bonded wine cellar or the distilled spirits plant. Short detachable hose connections may be used between the tank and pipeline. (72 Stat. 1395; 26 U.S.C. 5552.)

Section 240.632 is amended to read:

§ 240.632 SPECIAL NATURAL WINE.—Special natural wine may not be removed for use as distilling material at a distilled spirits plant for the production of wine spirits or brandy. (72 Stat. 1364; 26 U.S.C. 5215.)

§ 240.634 [Amendment]

Section 240.634 is amended:

1. By changing the last sentence to read "Where wine made with sugar other than the kinds, or fermented with sugar in excess of the quantities, authorized for a standard wine is removed for distilling material, the composition of the material must be marked on the containers and such wine may be transferred only to the production facilities of distilled spirits plants for the production of spirits other than wine spirits or brandy."; and

2. By changing the citation to read "(72 Stat. 1364, 1381; 26 U.S.C. 5215, 5368)".

Subpart EE consisting of sections 240.670 through 240.681 is stricken and in lieu thereof a new subpart EE consisting of §§ 240.670 through 240.672 is inserted:

WITHDRAWAL OF WINE WITHOUT PAYMENT OF TAX FOR EXPORTATION, USE ON VESSELS AND AIRCRAFT, TRANSFER TO A FOREIGN-TRADE ZONE, OR TRANSPORTATION TO A MANUFACTURING BONDED WAREHOUSE CLASS SIX

§ 240.670 GENERAL.—Wine may be removed from bonded wine cellars without payment of tax for exportation, for use on vessels and aircraft, for transportation to and deposit in a manufacturing bonded warehouse class six, and for transfer to and deposit in a foreign-trade zone for exportation or for storage pending exportation. Such removals shall be in accordance with the procedures in Part 252 of this chapter. (72 Stat. 1380; 26 U.S.C. 5362.)

RETURN OF WINE TO BONDED STORAGE

§ 240.671 GENERAL.—Wines which have been lawfully withdrawn without payment of tax under the provisions of Part 252 of this chapter may, subject to

the provisions of Part 252 applicable thereto, be returned to the bonded wine cellar from which withdrawn for storage pending subsequent removal for lawful purposes. (72 Stat. 1380; 26 U.S.C. 5362.)

§ 240.672 RECEIPT AND RECORD OF RETURNED WINE.—On return of wine to the bonded wine cellar under the provisions of § 240.671 and receipt of an approved application therefor as provided in 26 CFR Part 252, the proprietor shall record the receipt on the records required by this part, showing the gallonage of each tax classification so received and returned to storage on the bonded wine cellar premises; and shall report such return in Part I of Form 702 for the month with an explanatory notation in Part X of Form 702. All provisions of this part applicable to wine in bond on the bonded premises of a bonded wine cellar and to removals thereof shall be applicable to such wine returned to such bonded premises. (72 Stat. 1380; 26 U.S.C. 5362.)

Subpart FF consisting of sections 240.690 through 240.701 and Subpart GG consisting of sections 240.710 through 240.715 are revoked.

§ 240.730 [Amendment]

Section 240.730 is amended:

1. By changing the first sentence to read "Where the head of a family as defined in § 240.541, operates a bonded wine cellar as an individual owner, or in partnership solely with members of such family, wine of his own production, not exceeding 200 gallons per year, may be removed without payment of tax for use of his family, the year to be reckoned as commencing on July 1."; and

2. By changing the citation to read "(72 Stat. 1331; 26 U.S.C. 5042)".

§ 240.760 [Amendment]

Section 240.760 is amended:

1. By striking in the last sentence immediately after the words "received on" the words "fruit distillery" and inserting in lieu thereof the words "distilled spirits plant"; and

2. By changing the citation to read "(72 Stat. 1380; 26 U.S.C. 5361)".

§ 240.771 [Amendment]

Section 240.771 is amended by adding at the end thereof, a new sentence, as follows: "The assistant regional commissioner may grant, until further notice, continuing authority to convert effervescent wine to still wine in amounts in excess of thirty gallons where he finds the revenue will not be jeopardized."

§ 240.780 [Amendment]

Section 240.780 is amended:

1. By changing the last sentence to read "Claim for allowance of losses by theft shall be filed as provided in this Subpart."; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)".

§ 240.782 [Amendment]

Section 240.782 is amended:

1. By striking in the last sentence immediately after the words "to file" the words "an application" and inserting in lieu thereof the word "claim"; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)".

§ 240.783 [Amendment]

Section 240.783 is amended:

1. By striking in the fourth sentence the word "application" and inserting in lieu thereof the word "claim"; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)".

Section 240.785 is amended to read:

§ 240.785 LOSSES IN TRANSIT.—Where the loss of wine in transit from any shipment in bond to another bonded wine cellar exceeds one percent (two percent on transcontinental shipments) of the quantity so shipped therein, the proprietor of the receiving wine cellar shall immediately notify the assistant regional commissioner or nearest designated internal revenue officer. A claim for allowance of the entire loss shall be prepared in accordance with § 240.787 and be attached to the report, Form 702, for the month in which the wine is received. If the loss does not exceed one percent (two percent of transcontinental shipments), claim for allowance of the loss will be required if there are circumstances indicating that the wine lost, or any part thereof, was diverted to an unlawful purpose. (72 Stat. 1381; 26 U.S.C. 5370.)

§ 240.786 [Amendment]

Section 240.786 is amended:

1. By striking in the last sentence the word "Application" and inserting in lieu thereof the word "Claim"; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)".

The undesignated center heading preceding § 240.787 is amended to read "CLAIM FOR ALLOWANCE".

§ 240.787 PREPARATION AND SUBMISSION.—Claim for allowance of wine reported lost shall be prepared by the proprietor or his duly authorized agent on Form 2635 and, except in the case of losses in transit, by fire or other casualty, or any other extraordinary or unusual losses, the claim shall be attached to and submitted with report, Form 702, for the month of June, or in the case of discontinuance of the premises or change in proprietorship, attached to the final report. Where for a valid reason the required claim cannot be submitted with the Form 702, a statement must be attached to the report setting forth the reason the claim cannot be filed at that time, and specifying when it will be filed with the assistant regional commissioner. (72 Stat. 1381; 26 U.S.C. 5370.)

§ 240.788 [Amendment]

Section 240.788 is amended:

1. By changing the headnote to read "Form 2635, Claim—Alcohol and Tobacco Taxes.";

2. By changing the first sentence to read "Claim for allowance of losses of wine in bond shall be made on Form 2635, in duplicate, and shall set forth the following information:";

3. By striking in paragraphs (b), (c), and (f) the word "application" and inserting in lieu thereof the word "claim"; and

4. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)".

§ 240.789 [Amendment]

Section 240.789 is amended:

1. By striking the word "Applications" and inserting in lieu thereof the word "Claims"; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)".

§ 240.800 [Amendment]

Section 240.800 is amended by adding after the last sentence "Tax may not be refunded or credited under the provisions of this Subpart in respect to tax paid on unmerchantable wine for which a claim has been or will be filed under Subpart O of Part 170 of this chapter."

Section 240.806 is amended to read:

§ 240.806 CLAIMS FOR ALLOWANCE OF CREDIT FOR TAX.—A proprietor may file with the assistant regional commissioner a claim, Form 2635, Claim—Alcohol and Tobacco Taxes, for allowance of credit for the tax paid on unmerchantable, tax-paid United States wine returned to bond. Such claim shall not be filed for a quantity on which credit of tax would be in an amount of less than $10.00: *Provided*, That, as to any returned wine on which the 6 month period for filing a claim will expire, a claim for allowance of tax on a lesser quantity of wine may be filed. Any such claim shall be submitted in triplicate and executed by the proprietor under penalties of perjury. The proprietor shall state in the body of the claim that the wine covered by the claim was returned to bond and so recorded on the records required by this part. A copy of each notice filed under § 240.802, covering wine for which the claim is filed, shall be attached to the claim. When allowance of the credit or any part thereof is made by the assistant regional commissioner, the proprietor shall make a proper adjusting entry and explanatory statement in the next subsequent wine tax return (or returns) to the extent necessary to exhaust the credit. (72 Stat. 1332; 26 U.S.C. 5044.)

§ 240.807 [Amendment]

Section 240.807 is amended by changing the next to last sentence to read "The proprietor shall state in the body of the claim that the wine covered by the claim was returned to bond and so recorded on the records required by this part."

By inserting immediately after § 240.808 a new section:

§ 240.809 INSURANCE COVERAGE.—The remission, abatement, or refund, or credit of, or other relief from, taxes on wine shall be allowed only to the extent that the proprietor is not indemnified or recompensed for such tax. (72 Stat. 1382; 26 U.S.C. 5371.)

§ 240.821 [Amendment]

Section 240.821 is amended:

1. By striking in the first sentence immediately after the word "from" the words "any registered fruit distillery or internal revenue bonded warehouse" and inserting in lieu thereof the words "the bonded premises of a distilled spirits plant"; and

2. By changing the citation to read "(72 Stat. 1382; 26 U.S.C. 5373)".

Section 240.822 is amended to read:

§ 240.822 APPLICATION, FORM 257.—Where it is desired to withdraw wine spirits for wine production, from the bonded premises of a distilled spirits plant, application will be made by the proprietor on Form 257. The proprietor shall specify in the application the approximate desired date of receipt of wine spirits and whether the wine spirits are to be withdrawn in packages, railroad tank cars, tank trucks, or by pipeline. The same application may not include wine spirits from more than one distilled spirits plant, nor two or more lots to be removed from the same bonded premises of a distilled spirits plant at different times, except where the bonded premises of the distilled spirits plant is adjacent to the bonded wine cellar, as provided in § 240.825. (72 Stat. 1382; 26 U.S.C. 5373.)

Section 240.823 is amended to read:

§ 240.823 FILING OF FORM 257.—Application, Form 257, shall be filed with the assistant regional commissioner or with such officer as he may designate. The assistant regional commissioner will notify each designated internal revenue

officer of the amount of the proprietor's bond. He will also notify each proprietor concerned where Forms 257 are to be submitted to a designated internal revenue officer. (72 Stat. 1382; 26 U.S.C. 5373.)

Section 240.824 is amended to read:

§ 240.824 TRANSFER OF WINE SPIRITS.—On receipt of the wine spirits at the bonded wine cellar they will be deposited in the wine spirits storage room or tank. If an internal revenue officer is not assigned to the bonded wine cellar, the proprietor will on receipt of the wine spirits request the assistant regional commissioner or designated officer to detail an officer to supervise the deposit or immediate use. (72 Stat. 1382; 26 U.S.C. 5373.)

§ 240.825 [Amendment]

Section 240.825 is amended:

1. By striking the words "distillery or warehouse" wherever they appear and inserting in lieu thereof the words "distilled spirits plant"; and

2. By changing the citation to read "(72 Stat. 1382; 26 U.S.C. 5373)".

Section 240.826 is amended to read:

§ 240.826 RECEIPT OF WINE SPIRITS IN PACKAGES.—When packages of wine spirits are received at the bonded wine cellar the proprietor will examine the packages and satisfy himself that the wine spirits are the same as described in Forms 2629 and 2630 (received from the distilled spirits plant) and then will deposit the wine spirits in the spirits storage room under the supervision of the internal revenue officer. The proprietor, under the supervision of the officer, will gauge any packages which appear to have been tampered with or from which wine spirits appear to have been abstracted or lost. The details of packages so regauged will be reported on Form 2630, in quadruplicate, by the proprietor with a statement setting forth fully the apparent cause of the loss. (72 Stat. 1381, 1382; U.S.C. 5368, 5373.)

Section 240.827 is amended to read:

§ 240.827 GENERAL.—Where the distilled spirits plant and the bonded wine cellar are located on adjacent premises wine spirits may be transferred from the bonded premises of the distilled spirits plant to the wine cellar by pipeline for immediate use in wine production, or may be transferred to wine spirits tanks for subsequent use. (72 Stat. 1360, 1362, 1382; 26 U.S.C. 5206, 5214, 5373.)

§ 240.828 [Amendment]

Section 240.828 is amended:

1. By striking the words "distillery or the warehouse" wherever they appear and inserting in lieu thereof the words "bonded premises of the distilled spirits plant"; and

2. By changing the citation to read "(72 Stat. 1382; 26 U.S.C. 5373)".

§ 240.829 [Amendment]

Section 240.829 is amended:

1. By striking the words "distillery or warehouse" wherever they appear and inserting in lieu thereof the words "bonded premises of the distilled spirits plant"; and

2. By changing the citation to read "(72 Stat. 1382; 26 U.S.C. 5373)".

§ 240.830 [Amendment]

Section 240.830 is amended:

1. By changing the first sentence to read "Wine spirits may be withdrawn in railroad tank cars (where shipping and receiving prem-

ises have suitable railroad siding facilities) and tank trucks, provided appropriate weighing tanks or tanks suitable for measuring the spirits are provided in both the bonded premises of a distilled spirits plant and the bonded wine cellar for gauging the wine spirits, or the wine spirits are transferred in accurately calibrated tank cars or tank trucks with calibration charts available at the distilled spirits plant and the wine cellar, and a wine spirits storage tank (or tanks) of sufficient capacity to hold the wine spirits is provided in the wine cellar."; and

2. By changing the citation to read "(72 Stat. 1360, 1362, 1382; 26 U.S.C. 5206, 5214, 5373)".

Section 240.831 is amended to read:

§ 240.831 TANK CAR AND TANK TRUCK REQUIREMENTS.—Railroad tank cars and tank trucks used to transport wine spirits for use in wine production must be constructed, marked, filled, labeled, and inspected, in the manner required by regulations in Part 201 of Title 26 of the Code of Federal Regulations. (72 Stat. 1360, 1362; 26 U.S.C. 5206, 5214.)

§ 240.832 [Amendment]

Section 240.832 is amended:

1. By changing the fourth sentence to read "In any case where a volume gauge is made, the actual measurements of the spirits in the gauging tank, tank car, or tank truck, and the temperature of the spirits, shall be recorded on Form 2629.";

2. By striking in the last sentence the words "distillery or warehouse" and inserting in lieu thereof the words "distilled spirits plant"; and

3. By changing the citation to read "(72 Stat. 1360, 1362, 1381; 26 U.S.C. 5206, 5214, 5366)".

Section 240.833 is amended to read:

§ 240.833 REPORT OF GAUGE AT WINE CELLAR.—The proprietor will prepare a report of his gauge on Form 2629, in quadruplicate, of the wine spirits received by tank car or tank truck, and will attach a copy of the form to each copy of Form 2629 received from the distilled spirits plant. If there is a loss in excess of one percent the proprietor will submit a report to the internal revenue officer supervising the receipt, stating the apparent cause of the loss and all circumstances having a bearing thereon. (72 Stat. 1360, 1362; 26 U.S.C. 5206, 5214.)

Section 240.834 is amended to read:

§ 240.834 DISPOSITION OF FORM 2629.—When the wine spirits have been deposited in the wine spirits storage room or storage tank, or run directly into a wine spirits addition tank, the proprietor will acknowledge receipt of the wine spirits on each copy of Form 2629, forward promptly one copy, with Form 2630, if any, to the assistant regional commissioner, and retain the remaining copy as a part of the bonded wine cellar records. (72 Stat. 1381; 26 U.S.C. 5368.)

§ 240.836 [Amendment]

Section 240.836 is amended:

1. By changing the headnote to read "Withdrawal from distilled sprits plant.";

2. By changing the third sentence to read "Such wine spirits shall be received by the proprietor and placed under his lock in a secure room or locker on the bonded premises, and he shall acknowledge receipt of such wine spirits on Form 2629."; and

3. By changing the citation to read "(72 Stat. 1381, 1383; 26 U.S.C. 5373, 5382)".

§ 240.837 [Amendment]

Section 240.837 is amended:

1. By striking the number "1520" wherever it appears and inserting in lieu thereof the number "2630"; and

2. By changing the citation to read "(72 Stat. 1382, 1383; 26 U.S.C. 5373, 5382)".

§ 240.838 [Amendment]

Section 240.838 is amended:

1. By changing the last sentence to read "All spirits produced at the same production facility of a distilled spirits plant on the same day, if received in the same shipment, will be considered as constituting a lot of spirits."; and

2. By changing the citation to read "(72 Stat. 1382; 26 U.S.C. 5373)".

§ 240.855 [Amendment]

Section 240.855 is amended:

1. By changing the first sentence to read "Where any loss by theft occurs, claim for remission of tax on Form 2635, Claim—Alcohol and Tobacco Taxes, shall be made by the proprietor."; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5370)

§ 240.857 [Amendment]

Section 240.857 is amended:

1. By changing the headnote to read "Form 2635, Claim—Alcohol and Tobacco Taxes.";

2. By changing the first sentence to read "Claim for remission of tax shall be made on Form 2635 and shall set forth the following information:";

3. By striking in paragraph (a) the word "Distillery" and inserting in lieu thereof the words "distilled spirits plant";

4. By striking in paragraph (f) the words "distiller, warehouseman" and inserting in lieu thereof the words "proprietor of a distilled spirits plant";

5. By changing the next to last sentence to read "The claim will be executed by the proprietor or his authorized agent under penalties of perjury.";

6. By striking the last sentence in its entirety; and

7. By changing the citation to read "(68A Stat. 649; 72 Stat. 1323; 26 U.S.C. 6065, 5008)".

Section 240.870 is amended to read:

§ 240.870 GENERAL.—Wine spirits withdrawn by the proprietor of a bonded wine cellar and not used in wine production may be disposed of by transfer to the bonded premises of a distilled spirits plant or another bonded wine cellar, or by taxpayment and removal to a person authorized to receive such spirits, or may be voluntarily destroyed without payment of tax as authorized in § 240.874: *Provided*, That packages from which a portion of the contents have been used may not be transferred to the bonded premises of a distilled spirits plant. (72 Stat. 1323, 1382; 26 U.S.C. 5011, 5373.)

§ 240.871 [Amendment]

Section 240.871 is amended:

1. By striking in the first sentence immediately after the words "wine spirits to" the words "an internal revenue bonded warehouse"

and inserting the words "the bonded premises of a distilled spirits plant";

2. By striking in the last sentence immediately after the words "number of the" the word "distiller" and inserting in lieu thereof the words "distilled spirits plant."; and

3. By changing the citation to read "(72 Stat. 1382; 26 U.S.C. 5373)".

Section 240.872 is amended to read:

§ 240.872 TRANSFER TO A DISTILLED SPIRITS PLANT OR WINE CELLAR.—When it is desired to transfer wine spirits to the bonded premises of a distilled spirits plant or to a bonded wine cellar the application shall specify the name, number and location of such premises, and the means or containers by or in which it is proposed to transfer the wine spirits thereto. The application shall also specify whether the proprietor of the designated distilled spirits plant or wine cellar has agreed to receive the wine spirits and file consent of surety on his bond, extending the terms of the bond to cover transfer to his premises and storage thereat. (72 Stat. 1382; 26 U.S.C. 5373.)

§ 240.874 [Amendment]

Section 240.874 is amended:

1. By striking in the third sentence immediately after the words "bonded wine cellar or" the words "internal revenue bonded warehouse" and inserting in lieu thereof the words "bonded premises of a distilled spirits plant"; and

2. By changing the citation to read "(72 Stat. 1382; 26 U.S.C. 5373)".

§ 240.900 [Amendment]

Section 240.900 is amended:

1. By changing the first sentence to read "The proprietor of each bonded wine cellar shall prepare at the close of each month Form 702, in duplicate, verified and executed under penalties of perjury and, on or before the tenth day of the succeeding month, will forward the original of the report to the assistant regional commissioner."; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5367)."

Section 240.901 is amended to read:

§ 240.901 FORM 2050.—The proprietor of every bonded wine cellar removing wine subject to tax will prepare Form 2050, in quadruplicate, showing thereon the number of gallons of wine of each tax class so removed during the period covered by the return, the amount of tax due by tax class, and the total tax due. There shall also be shown any increases or decreases in tax due to errors in previous returns, Form 2050, or credit under the provisions of Subpart 00 for unmerchantable wines returned to bond, or credit under the provisions of Part 252 of this chapter where such a credit is authorized by the assistant regional commissioner on Form 2639, and credit for the prepayment of tax as shown on Form 2052. Form 2050 will be serially numbered by the proprietor, commencing with "1" on January 1 of each year. Form 2050 shall be executed by the proprietor under penalties of perjury. The original and two copies of the Form 2050 shall be filed with the district director as provided in § 240.591, and at the same time, a copy shall be forwarded to the assistant regional commissioner.

Section 240.902 is amended to read:

§ 240.902 FORM 2052.—When the proprietor is required to prepay tax, as provided in §§ 240.594 and 240.595, he shall first prepare Form 2052, in quadruplicate, covering a specific quantity of wine to be removed on that day. The original and two copies of Form 2052 shall be delivered to the district

director of internal revenue or deposited in the United States mail properly addressed to him, together with a remittance as provided in § 240.594, prior to removal of the wine. At the same time a copy shall be forwarded to the assistant regional commissioner. Form 2052 will be serially numbered by the proprietor, commencing with "1" on January 1 of each year. Form 2052 shall be executed by the proprietor under penalties of perjury. Credit for the amount prepaid on Form 2052 will be taken on the tax return, Form 2050, covering all removals for consumption or sale for the period covered by the return.

Section 240.904 is amended to read:

§ 240.904 FORMS 275, 2629, AND 2630.—The proprietor of every bonded wine cellar using wine spirits in the production of wine shall prepare Forms 275 and 2629, (and also Form 2630 if the wine spirits are in packages) at the time wine spirits are gauged and added to wine, as prescribed in §§ 240.376 and 240.379. (72 Stat. 1381; 26 U.S.C. 5367.)

§ 240.906 [Amendment]

Section 240.906 is amended:

1. By inserting in the last sentence immediately after the word "sugar" the words "or ameliorating material"; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5367".

Section 240.912 is amended to read:

§ 240.912 FORM 2621, RECORD OF BOTTLED WINE.—Each proprietor who bottles wine or receives bottled wine, in bond, shall keep Form 2621, record of bottled wine, showing the gallons of wine bottled, the gallons of bottled wine received in bond, and the gallons of bottled wine removed each day. (72 Stat. 1381; 26 U.S.C. 5367.)

§ 240.918 [Amendment]

Section 240.918 is amended:

1. By striking in the first sentence immediately after the words "treatment of wine" the words "as authorized in this part,";

2. By changing the last sentence to read "Record of use of all chemicals except filter aids, inert fining agents, sulphur dioxide compounds, oxygen, and the acids listed in § 240.917, shall be maintained, showing the kind, quantity, and date of use, and kind and quantity of wine in which used."; and

3. By changing the citation to read "72 Stat. 1381; 26 U.S.C. 5367)".

Section 240.919 is amended to read:

§ 240.919 RECORD OF WINE BAKED.—Where wine is baked on bonded wine cellar premises, any claim for allowance of losses due to such baking shall be supported by a complete and up-to-date record maintained by the claimant showing (a) the serial number of each tank, (b) date wine is placed in the tank, (c) quantity and alcohol content of the wine, (d) date baking commenced, (e) date baking completed, (f) date wine removed from tank, and (g) quantity of wine removed and alcohol content thereof. In case wine is baked in barrels or puncheons, the record may be maintained on the basis of groups of such containers filled at one time, rather than for each individual container. (72 Stat. 1381; 26 U.S.C. 5367.)

§ 240.920 [Amendment]

Section 240.902 is amended:

1. By changing the second sentence to read "The record shall show the date of removal, the name and address of the person to whom shipped, the kind (class and type) and quantity of wine, alcohol content (taxable grade), and serial numbers of containers other than cases: *Provided*, That if the wine is not sold for resale or shipped for

sale the name and address of the person to whom sold or shipped may be omitted from the record."; and

2. By changing the citation to read "(72 Stat. 1381; 26 U.S.C. 5367)".

Section 240.921 is amended to read:

§ 240.921 TAXPAID ROOM RECORDS.—Where a taxpaid room has been provided in accordance with § 240.145, or is maintained off the bonded premises, the proprietor shall maintain records at such taxpaid room. Such records shall show, as to all wine received, the date of receipt, the quantities, kind, and alcohol content (taxable grade) of the wine. Also, such records shall show, as to all wine sold for resale or shipped for sale at another location, the date of removal, the quantities, kind, and alcohol content (taxable grade) of the wine, and the names and addresses of the consignees. The required record shall consist of (1) copies of invoices, or other commercial papers if the invoices or other commercial papers contain all of the required information or (2) a book record containing all of the required information. A daily record shall also be kept of the total gallons of wine of each tax class removed, and not required to be recorded in the detailed removal record prescribed in this section. Removals from the taxpaid room of packages of bottles containing two gallons or less need not be serially numbered or marked in accordance with §§ 240.561 and 240.562. (72 Stat. 1381; 26 U.S.C. 5367.)

The following new subparts, Subpart YY and Subpart ZZ, are added immediately following § 240.1029:

Subpart YY.—Withdrawal of Distillates Containing Aldehydes

Section

240.1041 Who may withdraw.
240.1042 Application, Form 257.
240.1043 Receipt and deposit of distillates containing aldehydes.
240.1044 Other provisions applicable.

§ 240.1041 WHO MAY WITHDRAW.—The proprietor of a bonded wine cellar may, as provided in this part, withdraw, without payment of tax, distillates containing aldehydes, for use in the fermentation of wine which is to be used as distilling material. Such withdrawals may be made only from an adjacent distilled spirits plant. Application for withdrawal of distillates containing aldehydes will not be approved unless facilities for the receipt, storage, and use of such distillates have been approved by the assistant regional commissioner. A proprietor of a bonded wine cellar who is operating under bond, Form 700, and who intends to receive and use distillates containing aldehydes, shall furnish a consent of surety, Form 1533, which consent shall contain the following statement of purpose:

> "To extend the terms and conditions of said bond to cover payment of all taxes imposed by law now or hereinafter in force (plus penalties, if any, and interest) for which the principal may become liable on all distillates containing aldehydes removed from the bonded premises of a distilled spirits plant to his bonded wine cellar."

Such facilities may include short detachable hose connections between pipelines and tanks on the bonded wine cellar premises. The proprietor shall notify the assistant regional commissioner, or officer designated by him, sufficiently in advance of withdrawals so that an internal revenue officer may be designated to supervise the receipt of the distillates at the wine cellar. (72 Stat. 1382; 26 U.S.C. 5373.)

§ 240.1042 APPLICATION, FORM 257.—A proprietor who intends to withdraw distillates containing aldehydes will make application on Form 257. The proprietor shall specify in the application the approximate desired date of receipt of the distillates and the method of conveyance, such as pipeline or packages. The same application may not include distillates from more than one distilled spirits plant. (72 Stat. 1382; 26 U.S.C. 5373.)

§ 240.1043 RECEIPT AND DEPOSIT OF DISTILLATES CONTAINING ALDEHYDES.—Distillates containing aldehydes which are received at the bonded wine cellar (if not immediately used) shall be placed under the proprietor's lock in a secure

room or tank on the bonded premises. Distillates containing aldehydes shall not be mingled with wine spirits. If such distillates contain less than one tenth of one percent of aldehydes, they shall be subject to such additional conditions relating to the receipt, storage, and use as the assistant regional commissioner shall require to assure that such distillates will be properly used and accounted for. (72 Stat. 1382; 26 U.S.C. 5373.)

§ 240.1044 OTHER PROVISIONS APPLICABLE.—The provisions of Subpart PP relative to the filing, execution, and disposition of Form 257, bond coverage, withdrawals (including monthly withdrawals), in package, tank cars, tank trucks, and by pipeline, and the transfer, receipt, deposit in wine spirits addition tanks or stored on bonded wine cellar premises, and records and supervision (including waiver of supervision), in respect of wine spirits, shall, subject to the provisions of this subpart, be applicable in respect of distillates to be deposited in fermenters or stored on bonded wine cellar premises, as the case may be, for use under the provisions of this part.

Subpart ZZ.—Materials Authorized for Treatment of Wine

Section

240.1051 Materials authorized for treatment of wine.
240.1052 Notice.

§ 240.1051 MATERIALS AUTHORIZED FOR TREATMENT OF WINE.—The following materials are approved, as being consistent with good commercial practice, for use by proprietors of bonded wine cellars in the production, cellar treatment, or finishing of wine (including distilling material), within the general limitations of § 240.524, or the specific limitations shown in the table, or given in the sections referred to:

Materials	Use	Reference or limitation
Actiferm (Roviferm)	Fermentation adjunct	2 pounds per 1,000 gallons.
Activated carbon	To assist precipitation during fermentation.	§§ 240.361, 240.366, 240.401, 240.405
	To clarify and purify wine.	§ 240.524
	To remove excess color in white wine.	§ 240.527
Aferrin	To reduce trace metals from wine.	No insoluble or soluble residue in excess of one part per million may remain in the finished wine, and the basic character of the wine may not be changed by such treatment. § 240.524
Anion Exchange Resins: Amberlite IR–45 Duolite A–7 (Tartex 180). Duolite A–30 (Tartex 181). SAF.	To reduce the natural acidity of wine.	May be used in a continuous column process for reducing the natural acidity of wine provided the resins are essentially in the hydroxyl (OH) state; the inorganic anion content of the wine is not increased more than 10 mg. per liter (10 parts per million) calculated as chlorine, sulfur, phosphorous, etc.; the treatment does not remove color in excess of that normally contained in the wine; and the basic character of the wine is not altered. Further, the natural or fixed acids may not be reduced below five parts per 1,000.

Materials	Use	Reference or limitation
Duolite A–6	Treatment of white wines.	Restrictions (above) imposed on use of other approved anion exchange resins applicable.
AMA Special Gelatine Solution.	To clarify wine.	
Antifoam "A"	To reduce the foam in fermenters.	
Antifoam AF Emulsion.		
Ascorbic acid	To prevent darkening of color and deterioration in flavor of wines and wine materials, and the over oxidation of vermouth and other wines.	May be added to fruit, grapes, berries, and other materials used in wine production, to the juice of such materials, or to the wine, within limitations which do not alter the class or type of the wine. Its use need not be shown on labels.
Iso-ascorbic acid.		
Bentonite (Wyoming clay).	To clarify wine	§ 240.524
Bentonite slurry	To clarify wine	One pound of Bentonite to not more than two gallons of water. Total quantity of water not to exceed 1% of volume of wine treated.
Calcium carbonate	To reduce the excess natural acids in high acid wine.	§ 240.524 The natural or fixed acids may not be reduced below five parts per 1,000.
Calcium sulphate (gypsum).	Production of Spanish type or Flor Sherry wine.	§ 240.385 Finished wine may contain no more than 2 grams of gypsum per 1000 ml. of wine.
Carbon	To clarify and purify wine.	§ 240.524
Carbon Dioxide, CO_2	To stabilize and preserve.	§§ 240.531 through 240.535
Casein	To clarify wine	§ 240.524

Materials	Use	Reference or limitation
Cation Exchange Resins: Amberlite IR-120-H. Amberlite IR-120 Duolite C-3 Na (Tartex 160) Duolite C-20 Na (Tartex 161). Duolite C-25 Na (Tartex 162). Permutit Q. Permutit Q Spec 157. SAF.	To stabilize wines. To exchange sodium ions for undesirable metallic ions.	May be used in a continuous column process. The resin must be essentially in the sodium state so that certain of the metallic elements in the wine will be replaced with sodium ions. After regeneration and before reuse the resin must again be essentially in the sodium state. The overall change in the pH of the wine before and after treatment shall not be greater than 0.2 pH Units. The wine water eluate from the column during the "sweetening on" process of any wine contained in the wash water during the "sweetened off" process should be discarded or used solely for distilling material.
Citric acid	To increase the acidity of wine.	§§ 240.364, 240.404.
	To stabilize grape wine.	§§ 240.526, 240.539.
Cufex	To remove trace metals from wine.	No insoluble or soluble residue in excess of one part per million may remain in the finished wine, and the basic character of the wine may not be changed by such treatment.
Duolite C-3 (Tartex 160).	To stabilize table wines.	May be used in a batch process employing no more than 4 pounds per 100 gallons of wine.
Eggs (albumen or yolks)	To clarify wine	§ 240.524.
Gelatin	To clarify wine	§ 240.524.
Glycine (amino acetic acid).	Yeast food in fermentation of wines.	Not more than 2 pounds per 1,000 gallons of wine.
Granular cork	To treat wines stored in redwood and concrete tanks.	Not more than 10 pounds per 1,000 gallons of wine.
Gum arabic	To clarify and stabilize wine.	2 pounds per 1,000 gallons of wine. § 240.524.
Gypsum (See calcium sulphate).		
Isinglass	To clarify wine	§ 240.524.
Malic acid	To increase acidity of wine.	§§ 240.364, 240.404
Mineral oil	On surface of wine in storage tanks to prevent the access of air to the wine.	None of the oil may remain in the finished wine when marketed.

Materials	Use	Reference or limitation
Nitrogen gas	To maintain pressure during filtering and bottling of sparkling wine. To prevent oxidation of wine.	May not be contained in sparkling or still wine.
Non-Ionic and Conditioning Resins: Duolite S–30 (Tartex 260) Duolite A–7 Duolite A–30 Amberlite IRA–401 Amberlite IRA–401–S	For removing excessive oxidized color, foreign flavors and odors, and for stabilizing wines by the removal of heavy molecules and proteinaceous material.	May be used in a continuous column process after suitable conditioning and/or regeneration. Conditioning agents and regenerants consisting of fruit acids common to the wine, and inorganic acids and bases may be employed provided the conditioned or regenerated resin is rinsed with ion-free water until the pH of the effluent water is the same as that of the influent water. (Water equal in quality to water obtained by distillation will be considered to be ion-free water.) Tartaric acid may not be used as a conditioning agent when the resin is to be used in treating wines other than grape. The inorganic anions or cations may not be increased more than 10 mg. per liter; color may not be removed in excess of that normally contained in the wine; the overall change in the pH of the wine before and after treatment shall not be greater than 0.2 pH units per; nor the acidity more than 0.5 grams per liter; and the basic character of the wine may not be altered.
Oak chips (uncharred and untreated).	To treat wines	§ 240.524.
Oak chips (charred)	To treat Spanish type blending Sherry.	The finished product, after addition of oak chips must have the flavor and color of Spanish Type Blending Sherry commonly obtained by storage of sherry wine in properly treated used charred oak whisky barrels.

Materials	Use	Reference or limitation
Oxygen	In baking or maturing 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.
Pectolytic Enzymes:		
Pectinol 59L	To clarify wine	0.3 pounds per 1,000 gallons of wine.
Klerzyme	To clarify wine	One half pound per 1,000 gallons of wine.
Pectinol 100D Pectinol 10M Pectinol R10	To clarify wine	1 pound per 1,000 gallons of wine.
Pectinase Concentrate Pectinol A Pectinol M Pectinol O Pectinase Regular Pectinase D Regular Pectolase	To clarify wine	10 pounds per 1,000 gallons of wine.
Phosphates	To start secondary fermentation in manufacturing champagne and sparkling wines.	Small quantity only may be used. (The use of ammonium phosphate, ammonium sulphate or potassium acid phosphate as yeast food in the production of still wine is not permitted.)
Potassium metabisulphite.	Sterilizing and preserving wine.	The sulphur content of the finished wine shall not exceed the limits prescribed in Part 4, Title 27, CFR.
Potassium salt of sorbic acid.	As a sterilizing and preservative agent and to inhibit mold growth and secondary fermentations.	Not more than 0.1% of sorbic acid or salts thereof may be used in wine or in materials for the production of wine.
Protovac PV–7916 Sparkaloid No. 1 Sparkaloid No. 2	To clarify wine	Two pounds to 1,000 gallons of wine.
Sodium bisulfite	As a sterilizing or preserving agent.	§ 240.523
Sodium carbonate	To reduce excess natural acidity in wine.	Natural or fixed acids not to be reduced below five parts per thousand. § 240.523
Sodium caseinate	To clarify wine	§ 240.523
Sodium metabisulphite	Sterilizing and preserving wine.	§ 240.523
Sodium salt of sorbic acid.	As a sterilizing and preservative agent and to inhibit mold growth and secondary fermentations.	Not more than 0.1% of the sorbic acid or salts thereof may be used in wine or in materials for the production of wine.
Sorbic acid	As a sterilizing and preservative agent and to inhibit mold growth and secondary fermentations.	Not more than 0.1% of the sorbic acid or salts thereof may be used in wine or in materials for the production of wine.

Materials	Use	Reference or limitation
Sulphur dioxide	Sterilizing and preserving wine.	§ 240.523
Sulphuric acid	To effect a favorable yeast development in distilling material.	§ 240.486
Tannin	Clarifying grape wine	When fining agents, such as gelatin and isinglass, which require the presence of a certain amount of tannin in grape wine in order to work effectively, are used for clarification of grape wine, and the wine to be clarified does not contain sufficient tannin to permit the fining agents to precipitate completely, a small amount of tannin may be added to the grape wine for the purpose of assisting the fining agents. Tannin may also be added to grape wine after clarification to the extent necessary to raise the tannin content of the wine to that normally contained therein: *Provided*, That white wines in which tannin is used shall not contain more than 0.08 gram of tannin per 100 ml. after clarification, and red grape wine in which tannin is used shall not contain more than 0.3 gram of tannin per 100 ml. after clarification, unless the assistant regional commissioner authorizes a higher tannin content, pursuant to a showing of necessity therefor. Only tannin of a yellowish white or very light brown color, which does not color the wine, may be used in the cellar treatment of wine. The records required by § 240.918 will be kept covering the use of tannin.
Tartaric acid	To increase acidity of grape wine.	§ 240.364
Urea	To facilitate fermentation of wine.	Not more than 2 pounds per 1,000 gallons of wine.
Wine clarifier (containing pure U.S.P. agar agar and standard supercel).	To clarify wine	2 pounds per 1,000 gallons of wine.

(72 Stat. 1383; 26 U.S.C. 5382.)

§ 240.1052 NOTICE.—If the proprietor desires to use materials or methods not specifically authorized in § 240.1051 or elsewhere in this part, he must file notice, in triplicate, with the assistant regional commissioner. The notice will show the name and description of the material or method, the purpose, the manner and the extent to which it is to be used, together with any pertinent information in regard to the material or method. A sample of the material, if requested by the assistant regional commissioner, will be forwarded. There may be forwarded with the notice any data or written statements tending to show that the proposed use of the material or method is a cellar treatment consistent with good commercial practice. If the assistant regional commissioner has been advised by the Director, Alcohol and Tobacco Tax Division, that the use of the method or material is approved, he will so inform the proprietor and state limitations, if any, which must be observed. However, if the assistant regional commissioner has not been so advised, he will forward the notice, with pertinent data, to the Director, Alcohol and Tobacco Tax Division for a decision regarding the use of the method or material. The proprietor should not use the proposed method or material until receipt of advice that the Director, Alcohol and Tobacco Tax Division has found its use not to be contrary to the provisions of this part. (72 Stat. 1383; 26 U.S.C. 5382.)

Because this Treasury Decision is a part of an integrated recodification program under Chapter 51, I.R.C., and in order that the entire program may be effective on July 1, 1960, it is found that it is contrary to the public interest to issue this Treasury decision subject to the effective date limitation of section 4(c) of the Administrative Procedure Act (60 Stat. 238; 5 U.S.C. 1003). Accordingly, this Treasury decision shall become effective on July 1, 1960.

(This Treasury Decision is issued under authority contained in section 7805 of the Internal Revenue Code of 1954. (68A Stat. 917; 26 U.S.C. 7805.))

WILLIAM H. LOEB,
Acting Commissioner of Internal Revenue.

Approved June 24, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 30, 1960, 8:45 a.m., and published in the issue of the Federal Register for July 1, 1960, 25 F.R. 6184)

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26 CFR 240.591: Time for payment of tax.

Provisions for the payment of the tax on wine under the semimonthly return system, effective July 1, 1960. See T.D. 6475, page 526.

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26 CFR 245.117a: Semimonthly return.

Provisions for the payment of the tax on beer under the semimonthly return system. See T.D. 6473, page 517.

PART II.—OCCUPATIONAL TAX

Subpart A.—Rectifier

SECTION 5081.—IMPOSITION AND RATE OF TAX

26 CFR 170.618: Sale of products for beverage use; special tax.

Conditions under which liability for special tax is incurred by the producer or vendor of products containing distilled spirits or wines declared unfit for beverage use. See T.D. 6484, page 512.

Subpart D.—Wholesale Dealers

SECTION 5112.—DEFINITIONS

26 CFR 194.24: Wholesale dealers in liquor.

Circumstances under which ship chandlers must secure basic permits. See Rev. Rul. 60–299, page 619.

Subpart E.—Retail Dealers

SECTION 5121.—IMPOSITION AND RATE OF TAX

26 CFR 194.46: Sale by agencies and instrumentalities of the United States. Rev. Rul. 60–264

Section 5121(a) of the Internal Revenue Code of 1954 provides that every retail dealer in liquors shall pay a special tax. Section 194.34 of the Liquor Dealers Regulations (1960 edition) provides that unless specifically exempted by law, any agency or instrumentality of the United States, including post exchanges, ship's stores, ship's service stores, and commissaries, or any canteen, club, mess, or similar organization operated under regulations of any such agency or instrumentality, which sells or offers for sale, distilled spirits, wines, or beer shall pay a special tax as a dealer in liquors or a dealer in beer, as the case may be, for carrying on such business. *Held*, an organization such as a Noncommissioned Officers' Open Mess is a separate entity from that of an Officers' Open Mess. Therefore, a Noncommissioned Officers' Open Mess which sells liquor at retail, as well as an Officers' Open Mess, must pay a special tax as a liquor dealer. However, each separate entity may sell at as many locations as desired on the reservation without incurring additional special tax.

SECTION 5122.—DEFINITIONS

26 CFR 194.30: Restaurants serving liquor with meals. Rev. Rul. 60–354

Section 194.30 of the Liquor Dealers Regulations provides that proprietors of restaurants and other persons who serve liquors with meals to customers, though no separate or specific charge for the liquors is made, are required to pay the special tax. *Held*, a person who sells coffee, tea or other beverage with distilled spirits added is liable for the special tax as a retail liquor dealer whether or not such coffee, tea or other beverage is served with meals.

Subpart F.—Nonbeverage Domestic Drawback Claimants

SECTION 5131.—ELIGIBILITY AND RATE OF TAX

Rev. Rul. 60–361

Distilled spirits produced in Puerto Rico which are withdrawn taxpaid and shipped to the United States for use in the manufacture of food products are not eligible for drawback of tax under section 5131 of the Internal Revenue Code of 1954.

Advice has been requested whether distilled spirits produced in Puerto Rico which are withdrawn taxpaid and shipped to the United States are eligible for drawback of tax under section 5131 of the Internal Revenue Code of 1954, when used in the manufacture of food products.

Section 5131(a) of the Code provides as follows:

ELIGIBILITY FOR DRAWBACK.—Any person using distilled spirits produced in a domestic registered distillery or industrial alcohol plant and withdrawn from bond, or using distilled spirits withdrawn from the bonded premises of a distilled spirits plant, on which the tax has been determined, in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts, which are unfit for beverage purposes, on payment of a special tax per annum, shall be eligible for drawback at the time when such distilled spirits are used in the manufacture of such products as provided for in this subpart.

Distilled spirits produced in Puerto Rico and brought into the United States are not produced in a domestic registered distillery or industrial alcohol plant or withdrawn from a distilled spirits plant as these terms are used in section 5131(a) of the Code. The tax imposed on such distilled spirits is not the internal revenue tax to which the drawback law applies, but an equivalent tax which under section 7652 of the Code, is covered into the Treasury of Puerto Rico.

Accordingly, distilled spirits produced in Puerto Rico which are withdrawn taxpaid and shipped to the United States are not eligible for drawback of tax under section 5131 of the Code.

SUBCHAPTER B.—QUALIFICATION REQUIREMENTS FOR DISTILLED SPIRITS PLANTS

SECTION 5178.—PREMISES OF DISTILLED SPIRITS PLANTS

26 CFR 201.62: Alternate methods or procedures; and emergency variations from requirements.

The business of a wholesale liquor dealer conducted on general premises of a distilled spirits plant. See Rev. Rul. 60–383, below.

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26 CFR 201.67: Other business. (Also 201.62, 201.73.) Rev. Rul. 60–383

Section 201.67 of the Distilled Spirits Plants Regulations provides, in part, that the Director of the Alcohol and Tobacco Tax Division of the Internal Revenue Service may authorize the carrying on of such other businesses on premises of plants as he finds will not jeopardize the revenue, hinder effective administration of the Distilled Spirits Plants Regulations, or be contrary to law. Such authorization shall designate the premises (i.e., bonded, bottling, or general) on which such other business is authorized to be conducted. *Held*, the proprietor of a distilled spirits plant may conduct the business of a wholesale liquor dealer on the "general" premises of such plants as "other business" under section 201.67 of the regulations. Applications for permission to conduct this type of business on the "general" premises of a distilled spirits plants by the proprietor of such plant may be approved by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, pursuant to section 201.73 of the regulations.

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26 CFR 201.73: Other business.

The business of a wholesale liquor dealer conducted on general premises of a distilled spirits plant. See Rev. Rul. 60–383, above.

SUBCHAPTER C.—OPERATION OF DISTILLED SPIRITS PLANTS

Part I.—GENERAL PROVISIONS

SECTION 5205.—STAMPS

26 CFR 201.531: Obliteration of marks, brands, stamps, and labels. Rev. Rul. 60–340

Section 5205(g) of the Internal Revenue Code of 1954, relating to the effacement of stamps, marks, and brands on emptied containers, provides that every person who empties, or causes to be emptied, any immediate container of distilled spirits bearing any stamp, mark, or brand required by law or regulations prescribed pursuant thereto

(other than containers stamped under subsection (a) or section 5235) shall at the time of emptying such containers, efface and obliterate such stamp, mark, or brand, except that the Secretary of the Treasury or his delegate may, by regulations waive any requirement of this subsection as to effacement or obliteration of marks or brands (or portions thereof) where he determines that no jeopardy to the revenue will be involved. *Held*, in the event that burned or cut marks on barrels would be meaningful, standing alone, such marks must be removed by scraping or sanding at the time the barrels are emptied. At that time any stencilled marks on the barrels should also be effaced and obliterated by painting or other appropriate method. However, where part of the required marks have been applied by stencilling and other such marks have been burned or cut into the barrel head, and the burned or cut marks would be meaningless in the absence of the stencilled marks, the application of a heavy coat of waterproof paint over all required marks which completely obliterates the stencilled markings and completely covers the other markings will comply with section 5205(g) of the Code. Nevertheless, any cut or burned marks remaining on barrels which are to be reused for distilled spirits must be removed before such reuse if there is any possibility that they might be confused with the required marks applicable to the new contents of the barrel.

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26 CFR 250.79: Issuance of distilled spirits stamps. (Also Section 5314; 250.191, 250.291.)

T. D. 6478[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 250.—LIQUORS AND ARTICLES FROM PUERTO RICO AND THE VIRGIN ISLANDS

Miscellaneous amendments

Department of the Treasury,
Office of Commissioner of Internal Revenue,
Office of Commissioner of Customs,
Washington 25, D.C.

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

On May 6, 1960, a notice of proposed rulemaking with respect to the amendments of regulations in 26 CFR Part 250 was published in the Federal Register. The amendments would conform with this regulation in respect of changes made in certain other regulations of this title effective July 1, 1960.

In accordance with the notice interested parties were afforded an opportunity to submit written comments or suggestions or to request a public hearing. No comments or suggestions or requests for a public hearing were received within the 30 days prescribed in the notice. However, it has been administratively determined to make further con-

[1] The publication of this Treasury Decision in 25 F.R. 6196, dated July 1, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 3974, dated May 6, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations. The individual instructions have been omitted.

forming changes in the proposed amendments in respect to (1) use of distilled spirits stamps in lieu of wholesale liquor dealer stamps, (2) preparation and disposition of Form 2260, (3) filing and disposition of Form 27–B Supplemental, and (4) other changes clarifying or technical in nature. Accordingly, the following amendments are hereby adopted.

In order to conform this regulation in respect of changes made in certain other regulations of this title effective July 1, 1960, 26 CFR Part 250 is amended as follows:

§ 250.1 [Amendment]

1. Section 250.1 is amended to read:

§ 250.1 ALCOHOLIC PRODUCTS COMING INTO THE UNITED STATES FROM PUERTO RICO AND THE VIRGIN ISLANDS.—This part, "Liquors and Articles from Puerto Rico and the Virgin Islands," relates to the production, bonded warehousing, and withdrawal of distilled spirits, and denatured spirits, and the manufacture of articles in Puerto Rico and the Virgin Islands to be brought into the United States free of tax and to the collection of internal revenue taxes on taxable alcoholic products coming into the United States from Puerto Rico and the Virgin Islands.

2. The following new section is inserted immediately following § 250.15:

§ 250.15a EXECUTED UNDER PENALTIES OF PERJURY.—Signed with the prescribed declaration under the penalties of perjury as provided on or with respect to the return, claim, form, or other document or, where no form of declaration is prescribed, with the declaration: "I declare under the penalties of perjury that this _____ (insert type of document, such as, statement, report, certificate, application, claim, or other document), including the documents submitted in support thereof, has been examined by me and, to the best of my knowledge and belief, is true, correct, and complete."

§ 250.25 [Amendment]

3. Section 250.25 is amended by striking the number "5008" and inserting in lieu thereof the number "5205".

4. Section 250.28 is amended to read:

§ 250.28 UNITED STATES.—"United States" shall mean the States and the District of Columbia.

5. Section 250.30 is amended to read:

§ 250.30 UNITED STATES INTERNAL REVENUE SERVICE OFFICE.—"United States Internal Revenue Service office," as used in this part, shall mean the United States Internal Revenue Service office in Puerto Rico operating under the direction of the Director of the International Operations Division of the Internal Revenue Service.

§ 250.36b [Amendment]

6. Section 250.36b is amended by striking the phrase "subpart 00 of Part 182 of this chapter in respect of alcohol, denatured alcohol, and products containing denatured alcohol, shall respectively apply to:" from the first sentence and inserting in lieu thereof the phrase "subpart Ia shall apply to:".

7. Section 250.44 is amended to read:

§ 250.44 LIQUOR DEALER'S SPECIAL TAXES.—Every person bringing liquors into the United States from Puerto Rico, who sells, or offers for sale, such liquors must file Form 11 with the district director of internal revenue and pay special (occupational) tax as a wholesale dealer in liquor or as a retail dealer in liquor in accordance with the law and regulations governing the payment of such special taxes (Part 194 of this chapter). (72 Stat. 1340, 1343, 1344; 26 U.S.C. 5111, 5112, 5121, 5122.)

§ 250.53 [Amendment]

8. The second sentence of § 250.53 is amended to read:

The statement of process must also show whether there are to be blended together in the manufacture of the finished product, liquors of less than 190 degrees of proof (a) distilled (1) from different materials, (2) by different distillers, (3) at different distilleries, or (4) from different combinations of the same materials; or (b) of different ages; or (c) which differ in kind according to the standards of identity prescribed in 27 CFR Part 5.

§§ 250.62 and 250.64 [Amendment]

9. Sections 250.62 and 250.64 are amended by changing the number "1520" to the number "2630" wherever it appears in such sections.

§ 250.65 [Amendment]

10. Section 250.65 is amended as follows:

(A) By changing the number "1520" to the number "2630" wherever it appears in the section and

(B) By striking the last sentence.

§§ 250.66 and 250.67 [Amendment]

11. Sections 250.66 and 250.67 are amended by changing the number "1520" to the number "2630" wherever it appears in such sections.

§ 250.70 [Amendment]

12. Section 250.70 is amended by changing the word "denomination" to the word "size" in the first sentence.

§§ 250.74, 250.75, and 250.90 [Amendment]

13. Sections 250.74, 250.75, and 250.90 are amended by changing the number "1520" to the number "2630" wherever it appears in such sections.

§ 250.77 [Amendment]

13a. Section 250.77 is amended:

(A) By striking in the last sentence the words "wholesale liquor dealer's" and inserting in lieu thereof the words "distilled spirits"; and

(B) By changing the statutory citation to read "(72 Stat. 1356, 1358; 26 U.S.C. 5201, 5205)".

§ 250.78 [Amendment]

13b. Section 250.78 is amended:

(A) By striking in the headnote and first sentence the words "wholesale liquor dealer's" and inserting in lieu thereof the words "distilled spirits"; and

(B) By changing the statutory citation to read "(72 Stat. 1358; 26 U.S.C. 5205)".

13c. Section 250.79 is amended to read:

§ 250.79 ISSUANCE OF DISTILLED SPIRITS STAMPS.—Upon receipt of the approved request therefor, and permit Form 487B, the United States Internal Revenue Service office will issue the requested distilled spirits stamps to the proprietor. The issuing officer shall enter on each stamp, the name of the proprietor removing the spirits, and the serial number of the container for which the stamp is issued. When the stamps have been issued, the issuing officer will enter the serial numbers thereof, preceded by the symbols "DS", on each copy of the request; return the Form 487B and one copy of the request, with the stamps, to the applicant; forward one copy of the request to the treasurer; and retain one copy for the files of the office. At the time the proprietor affixes the

stamp to the container, as provided in § 250.80, he shall enter on the stamp the date the stamp is affixed. (72 Stat. 1358; 26 U.S.C. 5205.)

14. Section 250.137 is amended to read:

§ 250.137 SIZE OF RED STRIP STAMPS.—Red strip stamps shall be issued in a standard size, serially numbered, for bottles or containers of ½ pint capacity or more, and in a small size for bottles or containers of less than ½ pint capacity. (72 Stat. 1358; 26 U.S.C. 5205.)

15. Section 250.138 is amended to read:

§ 250.138 AFFIXING STRIP STAMPS.—Strip stamps shall be securely affixed to the containers with a strong adhesive, and shall be affixed in such a manner that on opening the container the stamp will be broken and a portion thereof, sufficient to identify the kind of stamp placed thereon, will remain attached to the container or to a cap or seal which is permanently affixed thereto. Strip stamps affixed to containers shall not be concealed or obscured in any manner except that any such stamp may be covered by a cup, cap, seal, carton, wrapping, or other device which can be readily removed without injury to the stamp or which is sufficiently transparent to permit all data on the stamp to be read. If a cup, cap, or seal is placed over a stamp, a portion of the stamp must remain plainly visible. If containers are enclosed in sealed opaque cartons, such cartons and wrappings on such cartons must bear the words, "This package may be opened for examination by Internal Revenue Officers." Internal revenue and customs officers have the right to open such cartons or wrappings and examine the container. Where there is doubt as to the propriety of the use of any cup, cap, or seal, the closure and container should be submitted to the Director for approval. (72 Stat. 1358; 26 U.S.C. 5205.)

§§ 250.139 and 250.140 [Deletion]

16. Sections 250.139 and 250.140 are deleted.

§ 150.141 [Amendment]

17. Section 250.141 is amended as follows:

(A) By deleting the phrase ", Hawaii, or Alaska," and

(B) By changing the citation at the end of the section to read "(72 Stat. 1358; 26 U.S.C. 5205)".

§ 250.142 [Amendment]

18. Section 250.142 is amended as follows:

(A) By deleting the phrase ", Hawaii, or Alaska," and

(B) By changing the citation at the end of the section to read "(72 Stat. 1358; 26 U.S.C. 5205)".

19. Section 250.145 is amended to read:

§ 250.145 MARKING OF CASES.—The distiller, rectifier, or bottler shall plainly and legibly mark upon each case containing bottles of distilled spirits to which red strip stamps are attached, the following legend:

The red strip stamps required by section 5205, Internal Revenue Code, are affixed to the _____, _____, containers of distilled spirits in this case.
(Number) (Size)

_____
(Name of distiller, rectifier, or bottler)

This legend when stamped on the case may be accepted by customs officers as evidence that the containers bear the stamps as indicated by the certification. (72 Stat. 1358; 26 U.S.C. 5205.)

20. Section 250.146 is amended to read:

§ 250.146 RECORD AND REPORT OF RED STRIP STAMPS.—Insular internal revenue agents having custody of red strip stamps shall maintain for each day a transaction in red strip stamps occurs a daily record of such stamps by size (small or standard), showing the number received, used, lost, mutilated, destroyed or otherwise disposed of, and on hand at the beginning and at the end of the day. The record shall also show the number and size of

bottles to which the stamps were affixed, except that bottles of less than ½ pint capacity shall be recorded as one item. No form is prescribed for the daily records but such records shall be retained to support the monthly report. At the close of the month, or within 10 days thereafter, the insular internal revenue agent will prepare a report, in triplicate, of the strip stamps received and used during the month on Form 2260, properly modified. The agent will retain one copy and forward two copies to the treasurer; the treasurer will retain one copy, forward one copy to the assistant regional commissioner. (72 Stat. 1358; 26 U.S.C. 5205.)

§§ 250.182 and 250.184 [Amendment]

21. Sections 250.182 and 250.184 are amended by changing the number "1520" to the number "2630" whereever it appears in such sections.

22. The following new subpart, Subpart Ia, is inserted immediately following § 250.186:

Subpart Ia.—Tax-Free Shipments to the United States From Puerto Rico

Section

250.191 Samples and analysis.
250.192 Action by assistant regional commissioner.
250.193 Certificate.
250.194 Marking containers.
250.195 Arrival in the United States.

§ 250.191 SAMPLES AND ANALYSIS.—Whenever completely denatured spirits, produced and denatured under the provisions of this subchapter, or proprietary or special industrial solvents, proprietary antifreeze solutions, and toilet preparations (bay rum, hair lotions, skin lotions, and similar products) manufactured under the provisions of this subchapter with denatured spirits produced and denatured under the provisions of this subchapter are shipped in containers larger than 5 wine gallons from Puerto Rico to the United States exempt from tax under the provisions of § 250.36, the shipper shall notify the chemist in charge in Puerto Rico, who will have representative samples taken from each shipment for examination. Such samples must definitely represent the products which are to be shipped. It will not be necessary to sample every container, as samples taken at random from large shipments will be considered as representative of the entire lot. The samples will be examined promptly by the chemist who will forward a copy of his chemical report to the assistant regional commissioner of the region where the port of arrival is located. The report will show whether the product conforms to authorized formulas for completely denatured spirits, or to the formulas on approved Form 1479–A for such products, and must contain sufficient data to definitely identify the particular shipment involved. (72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652.)

§ 250.192 ACTION BY ASSISTANT REGIONAL COMMISSIONER.—If the chemical report discloses to the assistant regional commissioner that the product conforms to an approved formula, he will promptly advise the collector of customs at the port of arrival that the shipment may be released free of tax. If the report discloses that the product does not conform to an approved formula, the assistant regional commissioner will request the collector of customs to detain the product and will forward a copy of the report to the Director, Alcohol and Tobacco Tax Division, for advice as to the disposition of the product. (72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652.)

§ 250.193 CERTIFICATE.—Every person shipping into the United States from Puerto Rico free of tax, pursuant to §§ 250.36 and 250.36a, (a) industrial spirits produced and withdrawn in Puerto Rico in accordance with the provisions of this subchapter relating to the production, bonded warehousing, and the withdrawal from bond of spirits in the United States, (b) distilled spirits produced, warehoused (if applicable), denatured, and withdrawn in Puerto Rico in accordance with the applicable provisions of this subchapter relating to the production, bonded warehousing, denaturation, and the withdrawal from bond of denatured spirits in the United States, and (c) products containing such

denatured spirits and manufactured in accordance with the provisions of this subchapter relating to the use of denatured spirits in the United States, shall certify, in the English language, to such fact on the face of the shipper's waybill. Where the product is made pursuant to approved Form 1479–A, the shipper shall also certify as follows:

Made with _____ denatured spirits, Formula No. _____,
(Completely or specially)
pursuant to Form 1479–A, approved _____, 19____.

(72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652)

§ 250.194 MARKING CONTAINERS.—In addition to such other data as may be required by Part 211 of this chapter to be marked on packages of products containing denatured spirits, the name, address, and permit number of the manufacturer shall appear on each shipping container of such products shipped from Puerto Rico to the United States free of tax. (72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652.)

§ 250.195 ARRIVAL IN THE UNITED STATES.—When industrial spirits, denatured spirits, and products containing denatured spirits, coming into this country from Puerto Rico, are covered by shipper's documents bearing the manufacturer's certificate prescribed in § 250.193, the collector of customs will inspect and verify the consignment. If no discrepancies are found, the products may be released free of tax: *Provided*, That in the case of products required to be examined by the chemist in charge in Puerto Rico in accordance with § 250.191, release shall be withheld until advice is received from the assistant regional commissioner that the shipment may be released free of tax, as provided in § 250.192. (72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652.)

§ 250.201b [Amendment]

23. Section 250.201b is amended by striking the phrase "subpart PP of Part 182 of this chapter in respect of alcohol, denatured alcohol, and products containing denatured alcohol, shall respectively apply to:" from the first sentence and inserting in lieu thereof the phrase "subpart O shall apply to:".

24. Section 250.210 is amended to read:

§ 250.210 LIQUOR DEALER'S SPECIAL TAXES.—Every person bringing liquors into the United States from the Virgin Islands, who sells, or offers for sale, such liquors must file Form 11 with the district director of internal revenue and pay special (occupational) tax as a wholesale dealer in liquor or as a retail dealer in liquor, in accordance with the law and regulations governing the payment of such special taxes (Part 194 of this chapter). (72 Stat. 1340, 1343, 1344; 26 U.S.C. 5111, 5112, 5121, 5122.)

§ 250.223 [Amendment]

25. The second sentence of § 250.223 is amended to read:

The statement of process must also show whether there are to be blended together in the manufacture of the finished product, liquors of less than 190 degrees of proof (a) distilled (1) from different materials, (2) by different distillers, (3) at different distilleries, or (4) from different combinations of the same materials; or (b) of different ages; or (c) which differ in kind according to the standards of identity prescribed in 27 CFR Part 5.

25a. Section 250.225 is amended to read:

§ 250.225 FILING.—Each formula and process shall be filed with the Director, Alcohol and Tobacco Tax Division, on Form 27–B Supplemental, in quintuplicate, properly modified. Two additional copies of each formula and process shall be submitted for each additional port of entry. A separate communication listing the port or ports shall be sumitted with each formula. When, after approval of the formula, the product is to be entered at an additional port or ports, two additional copies of the approved formula (for each additional port) for distribution to the collector of customs and assistant regional commissioner concerned shall be filed with the Director, Alcohol and Tobacco Tax Division, with a separate communication stating the additional port or ports.

25b. Section 250.226 is amended to read:

§ 250.226 DISPOSITION.—When the formula and process have been examined, the rate of tax applicable thereto will be indicated on each copy of Form 27–B Supplemental, one copy each will be forwarded to the collector of customs at each designated port of entry, to the Governor of the Virgin Islands, to the assistant regional commissioner of the region in which such port is located, and to the manufacturer, and one copy will be retained in the files of the Director, Alcohol and Tobacco Tax Division.

26. Subpart L is amended to read:

Subpart L.—Red Strip Stamps for Distilled Spirits From the Virgin Islands

GENERAL

§ 250.230 CONTAINERS OF DISTILLED SPIRITS TO BEAR RED STRIP STAMPS.—No person shall transport, possess, buy, sell, or transfer any distilled spirits brought into the United States from the Virgin Islands unless the immediate container thereof is stamped with a red strip stamp evidencing the determination or payment of all internal revenue taxes thereon. The provisions of this section shall not apply to:

(a) distilled spirits in customs custody;

(b) distilled spirits not intended for sale or for use in the manufacture or production of any article intended for sale;

(c) distilled spirits on which no internal revenue tax is required to be paid;

(d) distilled spirits in immediate containers stamped under other provisions of internal revenue or customs law or regulations issued pursuant thereto; or

(e) any regularly established common carrier, receiving, transporting, delivering, or holding for transportation or delivery distilled spirits in the ordinary course of its business as a common carrier.

(72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.231 PERSONS AUTHORIZED TO AFFIX RED STRIP STAMPS.—Red strip stamps shall be affixed to containers of distilled spirits as follows:

(a) by the bottler or exporter in the Virgin Islands; or

(b) by the importer or owner under customs supervision.

(72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.232 SIZE OF RED STRIP STAMPS.—Red strip stamps shall be issued in a standard size, serially numbered, for bottles or containers of ½ pint capacity or more, and in a small size for bottles or containers of less than ½ pint capacity. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.233 AFFIXING STRIP STAMPS.—Strip stamps shall be securely affixed to the container with a strong adhesive, and shall be affixed in such manner that on opening the container the stamp will be broken and a portion thereof, sufficient to identify the kind of stamp placed thereon, will remain attached to the container or to a cap or seal which is permanently affixed thereto. Strip stamps affixed to containers shall not be concealed or obscured in any manner except that any such stamp may be covered by a cup, cap, seal, carton, wrapping, or other devise which can be readily removed without injury to the stamp or which is sufficiently transparent to permit all data on the stamp to be read. If a cup, cap, or seal is placed over a stamp, a portion of the stamp must remain plainly visible. If containers are enclosed in sealed opaque cartons, such cartons and wrappings on such cartons must bear the words, "This package may be opened for examination by Internal Revenue Officers." Internal revenue and customs officers have the right to open such cartons or wrappings and examine the container. Where there is doubt as to the propriety of the use of any cup, cap, or seal, the closure and container should be submitted to the Director for approval. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.234 POWER OF ATTORNEY.—Where an importer gives power of attorney to another person to sign Form 96, Form 428, Form 1627, or Form 1627A, such power of attorney shall be filed with the collector of customs who approves the issuance of red strip stamps and shall be in such form as is required by Customs

Regulations (19 CFR Chapter I). Where any of the above forms are signed by a duly authorized agent, the name of the importer shall be given, followed by the signature of the agent and the words "Attorney in Fact".

§ 250.235 BREACH OF REGULATIONS, OR FAILURE TO PROPERLY ACCOUNT FOR STRIP STAMPS.—Where an importer fails to render an accounting for strip stamps as prescribed in this subpart, or where the collector of customs is not able to reconcile his records with those of the importer and is not satisfied with the accounting as rendered by the importer, or where there has been any breach of the provisions of this part by the importer, or use of stamps for a purpose other than that for which they were procured, the collector of customs shall refuse to approve any further requisitions, Form 428, submitted by the importer. The collector of customs may also require of the importer an immediate accounting of all strip stamps outstanding in the name of the importer. Such accounting shall be made at a time and place to be specified by the collector of customs, and shall be of such a nature as to satisfy the collector of customs that there has been no unlawful diversion or use of said stamps. If deemed necessary, the collector of customs may require the importer to call in all unused strip stamps, wherever they may be, and deliver them so they may be counted. Where the collector of customs has evidence that any of the provisions of this part have been willfully violated, he shall refer the matter to the Director for appropriate action. (72 Stat. 1358; 26 U.S.C. 5205.)

RED STRIP STAMPS TO BE AFFIXED IN THE VIRGIN ISLANDS

§ 250.236 CONDITIONS.—Red strip stamps may be procured by an importer, or his duly authorized agent, to be affixed to containers of distilled spirits by the bottler or exporter in the Virgin Islands as provided in this subpart. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.237 REQUISITION, FORM 428.—Requisition for red strip stamps shall be made by the importer, or his duly authorized agent, or by the subsequent purchaser of the distilled spirits, on Form 428, in triplicate. The local address of the importer, or his agent, shall be given on Form 428. At the time the importer presents his first Form 428 for approval, he shall present and file (if he has not already done so) with the collector of customs a certified or photostatic copy of his importer's permit issued pursuant to the Federal Alcohol Administration Act and regulations promulgated thereunder. All Forms 428 shall be submitted to the collector of customs of the district in which the place of business of the importer, or his duly authorized agent, or the subsequent purchaser of the distilled spirits, as the case may be, is located. Collectors of customs shall refuse to approve requisitions, Forms 428, submitted by any person or his agent when the collector has knowledge that such person or his agent has, because of failure to account for stamps, been denied approval of a requisition, Form 428, and has not yet accounted for such stamps. All strip stamps issued on Form 428 shall be accounted for, in the manner prescribed in this part, within 18 months from the date of requisition, or within such additional extension of time as may be granted under § 250.239. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.238 STATEMENT, FORM 1627.—The importer, or his duly authorized agent, shall submit, with Form 428 for stamps to be sent to the Virgin Islands, a statement on Form 1627, executed under the penalties of perjury:

(a) that the stamps are requisitioned for sending to the Virgin Islands and are required to supply existing orders and/or represent a reasonable anticipation of current requirements;

(b) that a complete accounting for such stamps will be made within eighteen months from the date of requisition (or within such additional extension of time as may be granted under § 250.239) in accordance with the provisions of this part;

(c) either that no Form 428 from the importer or his duly authorized agent is and has been open beyond eighteen months, or, if any Forms 428 are open, specifying those that are open beyond eighteen months; and

(d) that the requisitionist understands that failure to account for the strip stamps will be grounds for rejection of subsequent requisitions for red strip stamps.

(68A Stat. 749, 852, 72 Stat. 1358; 26 U.S.C. 6065, 7206, 5205.)

§ 250.239 EXTENSION OF TIME FOR FINAL ACCOUNTING OF STRIP STAMPS.—Where an importer is not able, within the eighteen-month period prescribed in § 250.237, or within any extension period which might be granted in this section, to give a complete accounting for all strip stamps issued with respect to any requisition on Form 428 in the manner prescribed in this part, he shall notify the collector of customs, in writing, prior to the expiration of the eighteen-month period or any extension period granted under this section, setting forth all pertinent facts and requesting an extension of time wherein to make his final accounting. If satisfied that the circumstances warrant an extension of time, the collector of customs may grant an extension or extensions, not to exceed a total of twelve months. If any application is made for a further extension of time, the collecter of customs shall submit it, with his recommendation, to the Commissioner of Customs who may, when the circumstances warrant, grant an additional extension of time. Where the collector of customs is not satisfied with the reasons given for requesting an extension of time, he shall proceed as prescribed in § 250.235. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.240 APPROVAL OF REQUISITION.—The collector of customs will approve Form 428 if he—

(a) is satisfied:

(1) that the importer is the holder of an importer's permit issued under the Federal Alcohol Administration Act and the regulations in 27 CFR Part 1;

(2) that the quantity requisitioned is reasonable and necessary for distilled spirits to be brought into the United States from the Virgin Islands to supply existing orders and/or anticipated requirements, or to be removed from customs custody, as provided in this part; and

(3) that his records show that all strip stamps which may have been previously issued to the importer have been properly and timely accounted for as provided in this part; and

(b) has not been informed that the importer or his agent has been denied approval of a requisition and has not accounted for the stamps on account of which such denial was given.

When satisfied that Form 428 may be approved, the collector of customs shall signify his approval on all copies of Form 428, retain Form 1627 (if any) and one copy of Form 428, and return the original and remaining copy of Form 428 to the applicant for submission to the proper district director of internal revenue. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.241 PROCUREMENT OF RED STRIP STAMPS.—Red strip stamps shall be procured by the importer, or his duly authorized agent, or the subsequent purchaser of the distilled spirits, as the case may be, from the district director of internal revenue of the district in which the place of business of such applicant is located. The applicant shall forward to the district director of internal revenue the original and copy of the approved Form 428. The district director of internal revenue may issue the exact number of stamps requisitioned thereon even though it is necessary to use portions of sheets. The district director of internal revenue shall enter the serial numbers of the stamps issued and stamp the date of issue on both copies of Form 428, retain the original copy, and send the remaining copy to the collector of customs who approved it. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.242 OVERPRINTING OF RED STRIP STAMPS.—The importer, or his duly authorized agent, or the subsequent purchaser of the distilled spirits, as the case may be, shall have the red strip stamps overprinted with the importer's real name and/or one of his approved trade names, consistent with the name of the importer as shown on the labels of the imported spirits to which the red strip stamps are to be applied. He shall submit the stamps to the collector of customs, who will verify the overprinting and make an endorsement showing the verification on Form 428 or on the retained original of Form 1627 where such form is submitted: *Provided*, That the collector of customs may so endorse the Form 428 or Form 1627 on presentation of other evidence satisfactory to him that the stamps have been properly overprinted when, in his opinion, physical submission of the stamps is impractical. The collector of customs will then authorize the importer or his duly authorized agent to send the stamps to the bottler or exporter in the Virgin Islands. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.243 MARKING OF CASES.—Where red strip stamps are affixed in the Virgin Islands, the bottler or exporter will plainly and legibly mark the following legend on each case of distilled spirits so stamped:

The red strip stamps required by section 5205, I.R.C., are affixed to the _____, _____ containers of distilled spirits in this case.
(Number) (Size)

_____
(Name of bottler or exporter)

(72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.244 ENDORSEMENT OF ENTRIES.—Upon arrival of the distilled spirits in this country, entries required to be filed under Customs Regulations (19 CFR Chapter I) shall have endorsed thereon by the importer, or his duly authorized agent, the following legend:

The red strip stamps required by section 5205, I.R.C., were affixed aboard. These stamps were procured by _____ on a requisition, Form 428, Importer's No. _____, approved by the collector of customs at _____ on _____
(Name of importer) (Port where Form 428 was approved) (Date of approval of Form 428)
(Date of approval of Form 428)

(72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.245 REQUEST FOR CREDIT OF RED STRIP STAMPS ON DISTILLED SPIRITS DEPOSITED IN A FOREIGN-TRADE ZONE AT SPECIFIED PORT.—When red strip stamps are affixed in the Virgin Islands to containers of distilled spirits and, on arrival in the United States, the spirits are stored in a foreign-trade zone located at the port specified in the requisition, the importer may obtain credit of the red strip stamps against the appropriate requisition. In such cases, the zone application shall have endorsed thereon, by the importer or his duly authorized agent, the legend required by § 250.244. In addition, and as a condition of obtaining approval from the collector of customs for admission of the spirits to the zone, the importer or his duly authorized agent and the zone grantee shall state on the zone application that if such spirits are subsequently exported from the zone the red strip stamps will be effectively destroyed under customs supervision prior to exportation. The collector of customs will not approve such exportation and will not execute a permit of delivery until the red strip stamps have been effectively destroyed as provided in § 250.252. (48A Stat. 999, as amended, 72 Stat. 1358; 19 U.C.S. 81c, 26 U.S.C. 5205.)

§ 250.246 CREDIT OF RED STRIP STAMPS AGAINST REQUISITION ON ARRIVAL OF DISTILLED SPIRITS AT SPECIFIED PORT.—Where entries required to be filed under Customs Regulations (19 CFR Chapter I) are filed at the port where the requisition was approved, the collector of customs who approved the requisition will credit the Form 428 described in the endorsement on the entry referred to in § 250.244 with the number and size of red strip stamps shown by the usual customs examination to have been attached to the containers. When distilled spirits are placed in a foreign-trade zone at the port of requisition and where the zone application complies with the provisions of § 250.245, the collector of customs shall credit the appropriate strip stamp record with the number and size of red strip stamps shown by the usual customs examination to have been affixed to the containers. (48A Stat. 999, as amended, 72 Stat. 1358; 19 U.S.C. 81c, 26 U.S.C. 5205.)

§ 250.247 CREDIT OF RED STRIP STAMPS AGAINST REQUISITION ON DIVERSION OF SPIRITS TO OTHER THAN SPECIFIED PORT.—In the event of diversion of all or part of the spirits to a port or ports, or to a foreign-trade zone at a port, other than the port specified in Form 1627 filed with the Form 428, the importer who requisitioned the stamps, or the importer at the port of diversion, or the duly authorized agent of either, shall prepare Form 1627A, in triplicate, for each such diversion. One copy of Form 1627A shall be promptly sent to the collector of customs at the port of requisition, and the original and remaining copy shall be filed with the collector of customs at the port of diversion at the time the required entry, or zone application, is filed. The corresponding entry or zone application at the port of entry shall be marked with the requisition and diversion numbers, and the name of the port of requisition, as shown on the Form 1627A. The provisions of § 250.245 shall, as applicable, cover stamps on spirits diverted to a foreign-trade zone located at a port other than the port specified in Form 1627.

Such diverted spirits may not be released from customs custody or admitted into a foreign-trade zone until the required Form 1627A has been filed. The collector of customs at the port of diversion shall certify on both copies of Form 1627A as to the disposition of the spirits and of the stamps shown by the usual customs examination to have been affixed to the containers, and forward the original Form 1627A to the collector of customs at the port of requisition. He shall retain the copy of Form 1627A as a record copy in a separate file. On receipt of Form 1627A from the collector of customs at the port of diversion, the collector of customs at the port of requisition shall enter the appropriate credit on his strip stamp record, stamp "Strip stamps used and credited except as noted" on the Copy of Form 1627A originally received by him for such diversion, and send such copy to the importer, or importer's agent, who requisitioned the stamps. Such importer or agent may then take credit for the stamps on his strip stamp record. (48A Stat. 999, as amended, 72 Stat. 1358; 19 U.S.C. 81c, 26 U.S.C. 5205.)

§ 250.248 Follow-up Procedure for Forms 1627A.—When the importer, or importer's agent, who requisitioned the stamps on Form 428 has not, within two months from the date of arrival of the spirits, received from the collector of customs the copy of Form 1627A noted as to credit of strip stamps by the collector, as provided for in § 250.247, he shall inquire of the collector of customs who approved the requisition, Form 428, whether the required report on Form 1627A has been received from the collector of customs at the port of diversion. If the collector of customs reports the nonreceipt of Form 1627A from the collector at the port of diversion, the importer, or the importer's agent, shall make a written inquiry, either directly or through the importer at the port of diversion, of the collector of customs at the port of diversion whether such collector has reported on the diversion. The inquiry shall show the entry number, or identify the zone application, and shall be accompanied by two copies of the original Form 1627A marked "Follow-up: Prepared _____." On receipt of the inquiry, the collector of customs of the port of diversion will compare the "Follow-up" copies with his file of record copies of Form 1627A. If he has a record copy showing that he forwarded the original Form 1627A, he shall insert any stamp data on the "Follow-up" copies, return one copy to the party who presented it, and forward the other copy to the collector of customs at the port of requisition. If the collector of customs at the port of diversion finds no corresponding record copy of Form 1627A, he shall use the "Follow-up" copies as original copies. In such case, he shall strike out the words "Follow-up," enter the stamp date thereon, retain one copy as his record copy, and forward the other copy to the collector of customs at the port of requisition. On receipt of the copy by the collector of customs at the port of requisition, the copy will be compared with the records. If the original Form 1627A has been received and the triplicate copy has already been forwarded to the importer, or to the importer's agent, the "Follow-up" copy shall also be sent to him without further action. If the collector of customs at the port of requisition finds that he has not received the original Form 1627A from the port of diversion, he shall use the "Follow-up" copy as the original of Form 1627A, and process it in accordance with § 250.247. On receipt of the copy of Form 1627A, the importer, or the importer's agent, may, unless he has already received his copy of Form 1627A, take credit for the stamps on his strip stamp record. (72 Stat. 1358; 26 U.S.C. 5205.)

(Date)

§ 250.249 Irregularities or Discrepancies in Shipments.—In case any irregularities or discrepancies are found, the collector of customs at the port of entry will make demand for redelivery of unexamined packages, and will not release examined or redelivered packages until satisfactory explanation and/or proper corrections have been made. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.250 Transfer of Red Strip Stamps in the Virgin Islands.—Where an importer has shipped red strip stamps to a Virgin Islands bottler or exporter, to be affixed to containers of distilled spirits to be brought into the United States, and he desires to transfer all or a part of these stamps to a bottler or exporter in the Virgin Islands other than the one named on the initial Form 1627, he shall first submit a written application, in duplicate, to the collector of customs who approved the requisition, Form 428. The application shall show:

(a) the serial number and date of the requisition, Form 428, covering issuance of the stamps;

(b) the name of the Virgin Islands bottler or exporter holding the stamps;

(c) the number and size of the stamps desired to be transferred; and

(d) the name and address of the bottler or exporter to whom the stamps are to be transferred.

If the collector of customs has no reason to believe that the transfer would constitute a jeopardy to the revenue, he shall indicate his approval on the copy of the application, return the copy to the importer, and retain the original for filing with the requisition, Form 428. On receipt of the approved copy, the importer shall effect the requested transfer of strip stamps. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.251 UNUSED RED STRIP STAMPS.—Unused red strip stamps returned to the importer by the Virgin Islands bottler or exporter shall be submitted to the collector of customs who approved the original requisition, Form 428, for noting of such fact on the requisition and on the Form 1627 covering such stamps on file with the collector. After such notation has been made, the collector of customs shall return the stamps to the importer. If subsequently the importer desires to send all or part of the returned stamps to a bottler or exporter abroad, he shall submit them with Form 1627, properly modified and in duplicate, to the collector of customs who shall note approval on the copy of the modified Form 1627 and return it with the stamps to the importer. The collector of customs shall retain the original Form 1627. The importer shall make appropriate entries on his strip stamp record and in his report, Form 96, of the receipt and disposition of unused stamps covered by this section. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.252 DESTRUCTION OF RED STRIP STAMPS.—When for any reason a Virgin Islands bottler or exporter has on hand a quantity of red strip stamps which are not to be affixed to containers for shipment to the United States, and it is impractical to return such stamps to the importer from whom they were received, the collector of customs who approved the requisition, Form 428, may, on application, in triplicate, by the importer, authorize the destruction of the stamps in the Virgin Islands. The application shall show the size, quantity, and serial numbers of the stamps, the name and address of the Virgin Islands bottler or exporter who has possession of the stamps, and the reasons why destruction in the Virgin Islands is requested. If the collector of customs approves the application for destruction he will return the original and one copy of the application to the importer who will forward both to the Virgin Islands bottler or exporter. On receipt of the approved application, the stamps may be destroyed provided such destruction is under the supervision of an authorized representative of the Governor of the Virgin Islands (including an officer of the Board of Control of Alcoholic Beverages) and such representative certifies to the destruction of the stamps on the approved application. After destruction, the original of the application bearing the required certificate of destruction will be returned, through the Virgin Islands bottler or exporter and the importer, to the collector of customs. The collector of customs will credit the Form 428 accordingly, stamp on the copy of the application "strip stamps credited", and send the copy to the importer who filed the application. Such importer may then take credit for the stamps on his strip stamp record. Red strip stamps affixed to (a) imported distilled spirits prior to arrival in the United States, which spirits are diverted by the importer for exportation purposes, and (b) spirits withdrawn from customs custody free of tax for entry into the United States shall be effectively destroyed under customs supervision, prior to exportation or withdrawal for entry into the United States. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.253 CREDIT FOR RED STRIP STAMPS AFFIXED TO CONTAINERS RETURNED TO A BOTTLER OR EXPORTER IN THE VIRGIN ISLANDS.—When any reason containers of distilled spirits bearing red strip stamps are returned from customs custody to the Virgin Islands bottler or exporter, the importer may be given credit for such stamps, provided he obtains an affidavit from an authorized representative of the Governor of the Virgin Islands (including an officer of the Board of Control of Alcoholic Beverages) to the effect that the stamps were removed from the containers and destroyed under his supervision. The importer shall submit such affidavit to the collector of customs who shall credit the original requisition accordingly. The importer shall make appropriate entries on his strip stamp record. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.254 CREDIT FOR RED STRIP STAMPS AFFIXED TO CONTAINERS DIVERTED BY THE IMPORTER FOR EXPORTATION.—The importer may be given credit for red strip stamps which were affixed to distilled spirits, brought into the United States

from the Virgin Islands, diverted by the importer for exportation purposes and which were effectively destroyed by the exporter under customs supervision, provided he obtains a certificate from the customs officer to the effect that the stamps were removed from the containers and destroyed under his supervision. The importer shall submit such certificate to the collector of customs who shall credit the original requisition accordingly. The importer shall make appropriate entries on his strip stamp record. (72 Stat. 1358; 26 U.S.C. 5205.)

RED STRIP STAMPS TO BE AFFIXED AT PORT OF ENTRY UNDER CUSTOMS SUPERVISION

§ 250.255 CONDITIONS.—Distilled spirits in containers coming into the United States from the Virgin Islands without having red strip stamps attached may not be released from customs custody until a stamp has been affixed to each container, under the supervision of a customs officer. Stamps procured for such containers but not affixed within 48 hours after entry shall be placed in the custody of the collector of customs until such time as they are to be affixed to containers prior to removal from customs custody. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.256 REQUISITION, FORM 428.—Requisition for red strip stamps shall be made by the original importer, or his duly authorized agent: *Provided*, That if the importer has gone out of business the requisition shall be made by the person having title to the distilled spirits. The requisition shall be submitted in accordance with § 250.237. Approval of the requisition shall be subject to the provisions of § 250.240. (72 Stat. 1338; 26 U.S.C. 5205.)

§ 250.257 PROCUREMENT AND OVERPRINTING OF RED STRIP STAMPS.—The importer, or his duly authorized agent, shall procure red strip stamps from the district director of internal revenue as provided by § 250.241, have them overprinted and such overprinting verified under the provisions of § 250.242, and such verification endorsed on Form 428. After verification of the overprinting and the prescribed endorsement on Form 428, the collector of customs will deliver the stamps to their procurer for affixing to containers under customs supervision. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.258 EXPENSE OF AFFIXING RED STRIP STAMPS.—Expenses of cartage, storage, repacking, handling, or other labor connected with the opening of cases and affixing of red strip stamps to the containers shall be borne by the importer, or by the person having title to the distilled spirits, as the case may be. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.259 MARKING OF CASES.—There shall be indelibly stamped upon each case by the customs officer supervising the affixing of red strip stamps to containers the following legend:

Port of _____
_____, 19____
(Month) (Day)

This is to certify that on this date the red strip stamps required by section 5205, I.R.C., were affixed, under my supervision, to the _____, _____, containers of distilled spirits in this case.
(Number) (Size)

_____
(Name)

_____
(Official designation)

(72 Stat. 1358; 26 U.S.C. 5205.)

27. Subpart N is amended to read:

Subpart N.—Records and Reports of Liquors From the Virgin Islands

RECORD AND REPORT OF RED STRIP STAMPS

§ 250.270 DAILY RECORD OF STRIP STAMPS.—Importers shall maintain a daily record of red strip stamps procured, used, lost, mutilated, destroyed, or otherwise disposed of, and of the balances on hand at the beginning and end of the day. Each credit taken on the record shall identify the customs entry number and the port of entry for the stamped bottles received from the Virgin Islands or the authority given by the collector of customs for such credit. A separate record

shall be maintained for each size (small or standard) of stamps. Where an importer has more than one place of business, a separate daily record shall be maintained on the premises of each place of business. When an agent procures stamps for several importers, the agent shall keep a separate record, for each importer, of all strip stamps sent to the Virgin Islands or retained on his premises for the account of the importer. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 250.271 REPORT OF STRIP STAMPS, FORM 96.—Every importer shall prepare on Form 96, in triplicate, an annual report of all strip stamps procured, used, lost, mutilated, destroyed, or otherwise disposed of during each fiscal year (July 1 through June 30, following), a report of the balances on hand at the beginning and end of the fiscal year, and an accounting for any balances outstanding against each requisition at the end of the fiscal year. Where an importer has more than one place of business, a separate report on Form 96 shall be rendered for each place of business. Where an agent procures stamps for several importers, he shall render a separate report on Form 96 in the name of each importer. An original and one copy of Form 96 shall be filed on or before July 10 with the collector of customs who approved the importer's requisitions on Form 428: *Provided*, That where the collector of customs finds it necessary, in order to reconcile his accounts with those of the importer, he may require the importer, in addition to the annual report on Form 96, to file Form 96 at more frequent intervals, but not more often than once a month, completed in whole or in part, as the collector may designate. Such additional reports on Form 96 shall be prepared in duplicate and the original shall be filed with the collector of customs at the time designated by such collector. The importer shall keep one copy of Form 96 for his files. The collector of customs shall, on or before July 20, forward one copy of each annual report on Form 96 to the assistant regional commissioner of the region in which the customs collection district is located. (72 Stat. 1358; 26 U.S.C. 5205.)

RECORD AND REPORT OF LIQUORS BROUGHT INTO THE UNITED STATES

§ 250.272 GENERAL REQUIREMENTS.—Except as provided in § 250.273, every person, other than a tourist, bringing liquors into the United States from the Virgin Islands shall keep such records and render reports of such liquors as are required to be kept by a wholesale or retail dealer, as applicable, under the provisions of Part 194 of this chapter: *Provided*, That regardless of who takes actual physical possession of the liquors at the time of their release from customs custody, the records and reports of the person actually responsible for such release shall reflect the transaction. Records and reports will not be required under this part with respect of liquors while in customs custody. (72 Stat. 1342, 1345; 26 U.S.C. 5114, 5124.)

§ 250.273 PROPRIETORS OF TAXPAID PREMISES.—Transactions involving the bringing of liquors into the United States from the Virgin Islands by proprietors of distilled spirits plants in the United States qualified under the provisions of this chapter shall be recorded and reported in accordance with the regulations governing the operations of such premises in the United States. (72 Stat. 1375; 26 U.S.C. 5314.)

PROCUREMENT OF FORMS

§ 250.274 FORMS TO BE PROVIDED BY USERS AT OWN EXPENSE.—Forms 52A, 52B, and 338 shall be provided by users at their own expense and must be in the form prescribed: *Provided*, That with the approval of the Director, Alcohol and Tobacco Tax Division, they may be modified to adapt their use to tabulating or other mechanical equipment. (72 Stat. 1340, 1342, 1391; 26 U.S.C. 5112, 5114, 5505.)

FILING AND RETENTION OF RECORDS AND REPORTS

§ 250.275 FILING.—If the importer maintains loose-leaf records of receipt or disposition, one legible copy of each such record shall be marked or stamped "Government File Copy", and shall be filed not later than the close of the business day next succeeeding that on which the transaction occurred. All records required by this part, and legible copies of all reports required by this part to be submitted to the assistant regional commissioner or to the collector of customs shall be filed separately, chronologically, and in numerical sequence within each date, at the importer's place of business to which they relate: *Provided*, That on application, the assistant regional commissioner may authorize the files, or any individual file, to be maintained at other premises under control of the importer,

if he finds that such maintenance will not delay the timely filing of any document, or cause undue inconvenience to internal revenue or customs officers desiring to examine such files. Supporting documents, such as consignors' invoices, delivery receipts, bills of lading, etc., or exact copies thereof, may be filed in accordance with the importer's customary practice. Documents supporting records of disposition shall have noted thereon the serial numbers of the records of disposition to which they refer. (72 Stat. 1342, 1391; 26 U.S.C. 5114, 5505.)

§ 250.276 RETENTION.—All records required by this part, documents or copies of documents supporting such records, and file copies of reports required by this part to be submitted to the assistant regional commissioner or to the collector of customs shall be preserved for a period of not less than two years, and during such period shall be available, during business hours, for inspection and the taking of abstracts therefrom by internal revenue or customs officers. Any records, or copies thereof, containing any of the information required by this part to be prepared, wherever kept, shall also be made available for such inspection and the taking of abstracts therefrom. (72 Stat. 1342, 1391; 26 U.S.C. 5114, 5505.)

REPORT OF DISPOSITION OF RED STRIP STAMPS ON DISCONTINUANCE OF BUSINESS

§ 250.277 PROCEDURE.—The importer who discontinues or sells his business shall recall from his agents in the Virgin Islands all unused stamps in their custody. He shall submit his entire stock of unused stamps, accompanied by a report, in duplicate, of inventory, by size, serial numbers, and quantity, to the collector of customs for crediting of the respective Forms 428. The collector of customs shall then destroy the stamps and, after such destruction, note the action taken on both copies of the inventory. He shall retain the original and return the copy of the inventory to the importer. Within five days of the receipt of the returned copy of the inventory, the importer shall note the disposition of the stamps on Form 96, mark the report "Final", and submit it, in duplicate, to the collector of customs. The collector of customs shall forward one copy of the final Form 96 to the assistant regional commissioner. (72 Stat. 1358; 26 U.S.C. 5205.)

28. The following new subpart, subpart O, is added immediately following § 250.277:

Subpart O.—Tax-Free Shipments to the United States From the Virgin Islands

Section
250.291 Certificate
250.292 Marking containers
250.293 Arrival in the United States

§ 250.291 CERTIFICATE.—Every person shipping into the United States from the Virgin Islands free of tax, pursuant to §§ 250.201 and 250.201a, (a) industrial spirits produced and withdrawn in the Virgin Islands in accordance with the provisions of the Virgin Islands regulations relating thereto, (b) distilled spirits produced, warehoused (if applicable), denatured, and withdrawn in the Virgin Islands in accordance with the applicable provisions of the Virgin Islands regulations relating thereto, and (c) products containing such denatured spirits and manufactured in accordance with the provisions of the Virgin Islands regulations relating thereto. shall certify, in the English language, to such fact on the face of the shipper's waybill. Where the product is made pursuant to Form 1479–A, approved as provided in the Virgin Islands regulations, the shipper shall also certify as follows:

Made with _____ denatured spirits, Formula No. _____, pursuant
(Completely or specially)
to Form 1479–A, approved _____, 19 ____.

(72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652.)

§ 250.292 MARKING CONTAINERS.—The name, address, and permit number of the manufacturer shall appear on each shipping container of products containing denatured spirits shipped from the Virgin Islands to the United States free of tax. (72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652.)

§ 250.293 ARRIVAL IN THE UNITED STATES.—When industrial spirits, denatured spirits, and products containing denatured spirits, coming into this country from

the Virgin Islands, are covered by shipper's documents bearing the manufacturer's certificate prescribed in § 250.291, the collector of customs will inspect and verify the consignment. If no discrepancies are found, the products may be released free of tax. (72 Stat. 1375, 1430; 26 U.S.C. 5314, 7652.)

Because this Treasury Decision is a part of an integrated recodification program under Chapter 51, I.R.C., and in order that the entire program may be effective on July 1, 1960, it is found that it is contrary to the public interest to issue this Treasury Decision subject to the effective date limitation of section 4(c) of the Administrative Procedure Act (60 Stat. 238; 5 U.S.C. 1003). Accordingly, this Treasury Decision shall become effective on July 1, 1960.

(This Treasury Decision is issued under authority contained in section 7805 of the Internal Revenue Code of 1954. (68A Stat. 917; 26 U.S.C. 7805.))

WILLIAM H. LOEB,
Acting Commissioner of Internal Revenue.
RALPH KELLY,
Commissioner of Customs.

Approved June 28, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 30, 1960, 8:51 a.m., and published in the issue of the Federal Register for July 1, 1960, 25 F.R. 6196)

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26 CFR 250.242: Overprinting of red strip stamps.

Overprinting red strip stamps and reporting such stamps on Form 96, Strip Stamps Issued to and Used by Importers. See Rev. Proc. 60–26, page 100.

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26 CFR 251.61: Containers of distilled spirits to bear red strip stamps. (Also Sections 5232, 5313; 251.171, 251.181.) T.D. 6477 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 251.—IMPORTATION OF DISTILLED SPIRITS, WINES, AND BEER

Miscellaneous amendments

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

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

On May 6, 1960, a notice of proposed rulemaking with respect to the amendment of 26 CFR Part 251 was published in the Federal Register (26 F.R. 3980). No objection to the proposed amendments were received within the 30-day period prescribed in the notice.

[1] The publication of this Treasury Decision in 25 F.R. 6204, dated July 1, 1960, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 3980, dated May 6, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations. The individual instructions have been omitted.

However, it has been determined administratively to make conforming and clarifying changes in the proposed amendments in respect of the procedures relating to the transfer of distilled spirits from customs custody to internal revenue bond. Accordingly, the following amendments are hereby adopted.

In order to (1) implement changes made in chapter 51, Internal Revenue Code, by the enactment of Public Law 85–859, [C.B. 1958–3, 92], (2) conform to the admission into the Union of the State of Alaska pursuant to Public Law 85–508 and of the State of Hawaii pursuant to Public Law 86–3, (3) revise the procedure for accounting for and affixing red strip stamps issued to importers, (4) include in this part, in conformity with administrative decisions, provisions for the transfer of certain distilled spirits from customs custody to internal revenue bond and the withdrawal of distilled spirits from customs custody for use of the United States, and (5) make certain technical changes, the regulations in 26 CFR Part 251, "Importation of Distilled Spirits, Wines, and Beer," are amended as follows:

§ 251.2 [Amendment]

Section 251.2 is amended by striking ", Alcohol and Tobacco Tax Division,".

Section 251.11 is amended to read:

§ 251.11 DIRECTOR.—"Director" shall mean the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washing, D.C.

Section 251.12 is amended to read:

§ 251.12 DISTILLED SPIRITS OR SPIRITS.—"Distilled spirits or spirits" shall mean the substance known as ethyl alcohol, ethanol, or spirits of wine, and all mixtures or dilutions thereof, from whatever source or by whatever process produced, including alcohol, whisky, brandy, gin, rum, and vodka, but shall not include wine as defined in § 251.23.

§ 251.19 [Amendment]

Section 251.19 is amended by striking "5008(b)" and inserting in lieu thereof "5205(a)(2)".

§ 251.21 [Amendment]

Section 251.21 is amended by striking ", the Territories of Alaska and Hawaii,".

Section 251.30 is amended to read:

§ 251.30 SPECIAL (OCCUPATIONAL) TAX.—Importers engaged in the business of selling, or offering for sale, distilled spirits, wines, or beer, are subject to the provisions of Part 194 of this chapter relating to special (occupational) taxes, which part requires that the special tax return, Form 11, with remittance of the tax, shall be filed with the district director of internal revenue on or before July 1 of each year, or before commencing business. (72 Stat. 1340, 1343, 1346; 26 U.S.C. 5111, 5121, 5142.)

§ 251.48 [Amendment]

Section 251.48 is amended by striking the period at the end of the section and adding—

: *Provided*, That the taxes on distilled spirits withdrawn from customs custody without payment of tax under the provisions of Subpart L and thereafter withdrawn from bonded premises of a distilled spirits plant subject to tax shall be collected and paid under the provisions of Part 201 of this chapter. (72 Stat. 1314, 1366; U.S.C. 5001, 5232.)

Section 251.61 is amended to read:

§ 251.61 CONTAINERS OF DISTILLED SPIRITS TO BEAR RED STRIP STAMPS.—No person shall transport, buy, possess, sell, or transfer any imported distilled spirits, unless the immediate container thereof is stamped with a red strip stamp evidencing the determination or payment of all internal revenue taxes thereon. The provisions of this section shall not apply to—

(a) distilled spirits in bond or in customs custody;

(b) distilled spirits lawfully withdrawn from bond and not intended for sale or for use in the manufacture or production of any article intended for sale;

(c) distilled spirits on which no internal revenue tax is required to be paid;

(d) distilled spirits, lawfully withdrawn from bond, in immediate containers stamped under other provisions of internal revenue or customs law or regulations issued pursuant thereto; or

(e) any regularly established common carrier receiving, transporting, delivering, or holding for transportation or delivery distilled spirits in the ordinary course of its business as a common carrier.

(72 Stat. 1358; 26 U.S.C. 5205.)

Section 251.63 is amended to read:

§ 251.63 SIZE OF RED STRIP STAMPS.—Red strip stamps shall be issued in a standard size, serially numbered, for bottles or containers of ½ pint capacity or more, and in a small size for bottles or containers of less than ½ pint capacity. (72 Stat. 1358; 26 U.S.C. 5205.)

Section 251.64 is amended to read:

§ 251.64 REQUISITION, FORM 428.—Requisition for red strip stamps shall be made by the importer, or his duly authorized agent, or by the subsequent purchaser of the distilled spirits, on Form 428, in triplicate. The local address of the importer, or his agent, shall be given on Form 428. At the time the importer presents his first Form 428 for approval, he shall present and file (if he has not already done so) with the collector of customs a certified or photostatic copy of his importer's permit issued pursuant to the Federal Alcohol Administration Act and regulations promulgated thereunder. All Forms 428 shall be submitted to the collector of customs of the district in which the place of business of the importer or his duly authorized agent, or the subsequent purchaser of the distilled spirits, as the case may be, is located. Collectors of customs shall refuse to approve requisitions, Form 428, submitted by any person or his agent when the collector has knowledge that such person or his agent has, because of failure to account for stamps, been denied approval of a requisition, Form 428, and has not yet accounted for such stamps. All strip stamps issued on Form 428 shall be accounted for, in the manner prescribed in this part, within eighteen months from the date of requisition, or within such additional extension of time as may be granted under § 251.65a. (72 Stat. 1358; U.S.C. 5205.)

A new section, reading as follows, is inserted immediately following § 251.64.

§ 251.64a POWER OF ATTORNEY.—Where an importer gives power of attorney to another person to sign Form 96, Form 428, Form 1627, or Form 1627A, such power of attorney shall be filed with the collector of customs who approves the issuance of the red strip stamps and shall be in such form as is required by Customs Regulations (19 CFR Chapter I). Where any of the above forms are signed by a duly authorized agent, the name of the importer shall be given, followed by the signature of the agent and the words "Attorney in Fact."

Section 251.65 is amended to read:

§ 251.65 STATEMENT, FORM 1627.—The importer, or his duly authorized agent, shall submit, with Form 428 for strip stamps to be sent to a foreign country, a statement on Form 1627, executed under the penalties of perjury:

(a) that the stamps are requisitioned for sending abroad and are required to supply existing orders and/or represent a reasonable anticipation of current requirements;

(b) that a complete accounting for such stamps will be made within eighteen months from the date of requisition (or within such additional extension of time as may be granted under § 251.65a) in accordance with the provisions of this part:

(c) either that no Form 428 from the importer or his duly authorized agent is and has been open beyond eighteen months, or, if any Forms 428 are open, specifying those that are open beyond eighteen months; and

(d) that the requisitionist understands that failure to properly account for the strip stamps will be grounds for rejection of subsequent requisitions for red strip stamps.

(68A Stat. 749, 852, 72 Stat. 1358; 26 U.S.C. 6065, 7206, 5205.)

A new section, reading as follows, is inserted immediately following § 251.65.

§ 251.65a Extension of Time for Final Accounting of Strip Stamps.—Where an importer is not able, within the eighteen-month period prescribed §§ 251.64 and 251.65, or within any extension period which might be granted in this section, to give a complete accounting for all strip stamps issued with respect to any requisition on Form 428 in the manner prescribed in this part, he shall notify the collector of customs, in writing, prior to the expiration of the eighteen-month period or any extension period granted under this section, setting forth all pertinent facts and requesting an extension of time wherein to make his final accounting. If satisfied that the circumstances warrant an extension of time, the collector of customs may grant an extension, or extensions, not to exceed a total of twelve months. If any application is made for a further extension of time, the collector of customs shall submit it, with his recommendation, to the Commissioner of Customs, who may, when the circumstances warrant, grant an additional extension of time. Where the collector of customs is not satisfied with the reasons given for requesting an extension of time, he shall proceed as prescribed in § 251.92. (72 Stat. 1358; 26 U.S.C. 5205.)

Section 251.66 is amended to read:

§ 251.66 Approval of Requisition.—The collector of customs will approve Form 428 if he—

(a) is satisfied:

(1) that the importer is the holder of an importer's permit issued under the Federal Alcohol Administration Act and the regulations in 27 CFR Part 1;

(2) that the quantity requisitioned is reasonable and necessary for distilled spirits to be imported to supply existing orders and/or anticipated requirements, or to be removed from customs custody, as provided in this part; and

(3) that his records show that alll strip stamps which may have been previously issued to the importer have been properly and timely accounted for as provided in this part; and

(b) has not been informed that the importer or his agent has been denied approval of a requisition at any port and has not accounted for the stamps on account of which such denial was given.

When satisfied that Form 428 may be approved, the collector of customs shall signify his approval on all copies of Form 428, retain Form 1627 (if any) and one copy of Form 428, and return the original and remaining copy of Form 428 to the applicant for submission to the proper district director of internal revenue. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 251.67 [Amendment]

Section 251.67 is amended by striking the fourth and fifth sentences, together with the statutory citation at the end of the section, and by inserting in lieu thereof: "The district director of internal revenue shall enter the serial numbers of the stamps issued and stamp the date of issue on both copies of Form 428, retain the original copy and send the remaining copy to the collector of customs who approved it. "(72 Stat. 1358; 26 U.S.C. 5205)".

§ 251.68 [Amendment]

Section 251.68 is amended by striking the second and third sentences, and the statutory citation at the end of the section, and by inserting in lieu thereof: "An importer holding an importer's permit to do business under one or more trade names shall have the red strip stamps overprinted with his real name and/or one of his approved trade names, consistent with the name of the importer as shown on the labels of the imported spirits to which the red strip stamps are to be applied. He shall submit the stamps to the collector of customs who will verify the overprinting and make an endorsement showing the verification on Form 428, or on the retained original of Form 1627 where such form is submitted: *Provided*, That the collector of customs may so endorse the Form 428 or Form 1627 on presentation of other evidence satisfactoury to him that the stamps have been properly overprinted when, in his opinion, physical submission of the stamps is impractical. The collector of customs will then authorize the importer or his duly authorized agent to send the stamps to the bottler or exporter abroad, as provided in subpart F; or authorize the importer or his duly authorized agent, or the subsequent purchaser of the distilled spirits, as the case may be, to affix the stamps to containers under customs supervision, as prescribed in subparts G and H. "(72 Stat. 1358; 26 U.S.C. 5205)".

Section 251.69 is amended to read:

§ 251.69 AFFIXING STRIP STAMPS.—Strip stamps shall be securely affixed to the container with a strong adhesive, and and shall be affixed in such a manner that on opening the container the stamp will be broken and a portion thereof, sufficient to identify the kind of stamp placed thereon, will remain attached to the container or to a cap or seal which is permanently affixed thereto. Strip stamps affixed to containers shall not be concealed or obscured in any manner except that any such stamp may be covered by a cup, cap, seal, carton, wrapping, or other device which can be readily removed without injury to the stamp or which is sufficiently transparent to permit all data on the stamp to be read. If a cup, cap, or seal is placed over a stamp, a portion of the stamp must remain plainly visible. If containers are enclosed in sealed opaque cartons, such cartons or wrappings on such cartons must bear the words, "This package may be opened for examination by Internal Revenue Officers." Internal revenue and customs officers have the right to open such cartons or wrappings and examine the container. Where there is doubt as to the propriety of the use of any cup, cap, or seal, the closure and container should be submitted to the Director for approval. (72 Stat. 1358; 26 U.S.C. 5205.)

Sections 251.70 and 251.71 are revoked.

Section 251.82 is amended to read:

§ 251.82 APPROVAL OF REQUISITION.—The collector of customs shall approve For 428 and dispose of Form 428 and Form 1627 in accordance with and subject to the applicable provisions of § 251.66. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 251.84 [Amendment]

Section 251.84 is amended as follows:

(A) By striking the present legend and inserting in lieu thereof:

The red strip stamps required by section 5205, I.R.C., are affixed to the _____ (Number) _____ (Size) containers of distilled spirits in this case.

_____ (Name of bottler or exporter).

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1358; 26 U.S.C. 5205)".

§ 251.85 [Amendment]

Section 251.85 is amended as follows:

(A) By striking "5008" and inserting in lieu thereof "5205".

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1358; 26 U.S.C. 5205)".

A new section, reading as follows, is inserted immediately following § 251.85:

§ 251.85a. REQUEST FOR CREDIT OF RED STRIP STAMPS ON DISTILLED SPIRITS DEPOSITED IN A FOREIGN-TRADE ZONE AT SPECIFIED PORT.—When red strip stamps are affixed abroad to containers of imported distilled spirits and, on arrival in the United States, the spirits are stored in a foreign-trade zone located at the port specified in the requisition, the importer may obtain credit of the red strip stamps against the appropriate requisition. In such cases, the zone application shall have endorsed thereon, by the importer or his duly authorized agent, the legend required by § 251.85. In addition, and as a condition of obtaining approval from the collector of customs for admission of the spirits to the zone, the importer or his duly authorized agent and the zone grantee shall state on the zone application that if such spirits are subsequently exported from the zone the red strip stamps will be effectively destroyed under customs supervision prior to exportation. The collector of customs will not approve such exportation and will not execute a permit of delivery until the red strip stamps have been effectively destroyed as provided in § 251.72. (48 Stat. 999, as amended, 72 Stat. 1358; 19 U.S.C. 81c, 26 U.S.C. 5205.)

§ 251.86 [Amendment]

Section 251.86 is amended as follows:

(A) By striking, in the present section, the word "denomination", and inserting in lieu thereof the word "size".

(B) By adding, at the end of the section, the following sentence: "When distilled spirits are placed in a foreign-trade zone at the port of requisition and where the zone application conforms with the provisions of § 251.85a, the collector of customs shall credit the appropriate strip stamp record with the number and size of red strip stamps shown by the usual customs examination to have been affixed to the containers."

(C) By striking the statutory citation at the end of the section and inserting in lieu thereof: "(48 Stat. 999, as amended, 72 Stat. 1358; 19 U.S.C. 81c, 26 U.S.C. 5205)".

Section 251.87 is amended to read:

§ 251.87 CREDIT OF RED STRIP STAMPS AGAINST REQUISITION ON DIVERSION OF SPIRITS TO OTHER THAN SPECIFIED PORT.—In the event of diversion of all or part of the spirits to a port or ports, or to a foreign-trade zone at a port, other than the port specified in Form 1627 filed with the Form 428, the importer who requisitioned the stamps, or the importer at the port of diversion, or the duly authorized agent of either, shall prepare Form 1627A, in triplicate, for each such diversion. One copy of Form 1627A shall be promptly sent to the collector of customs at the port of requisition, and the original and remaining copy shall be filed with the collector of customs at the port of diversion at the time the warehouse or consumption entry, or zone application, is filed. The corresponding entry or zone application at the port of entry shall be marked with the requisition and diversion numbers, and the name of the port of requisition, as shown on the Form 1627A. The provisions of § 251.85a shall, as applicable, cover stamps on spirits diverted to a foreign-trade zone located at a port other than the port specified in Form 1627. Such diverted spirits may not be released from customs custody or admitted into a foreign-trade zone until the required Form 1627A has been filed. The collector of customs at the port of diversion shall certify on both copies of Form 1627A as to the disposition of the spirits and of the stamps shown by the usual customs examination to have been affixed to the containers, and forward the original Form 1627A to the collectior of customs

at the port of requisition. He shall retain the copy of Form 1627A as a record copy in a separate file. On receipt of Form 1627A from the collector of customs at the port of diversion, the collector of customs at the port of requisition shall enter the appropriate credit on his strip stamp record, stamp "Strip stamps used and credited except as noted" on the copy of Form 1627A originally received by him for such diversion, and send such copy to the importer, or importer's agent, who requisitioned the stamps. Such importer or agent may then take credit for the stamps on his strip stamp record. (48 Stat. 999, as amended, 72 Stat. 1358; 19 U.S.C. 81c, 26 U.S.C. 5205.)

A new section, reading as follows, is inserted immediately following § 251.87.

§ 251.87a FOLLOW-UP PROCEDURE FOR FORMS 1627A.—When the importer, or importer's agent, who requisitioned the stamps on Form 428 has not, within two months from the date of arrival of the spirits, received from the collector of customs the copy of Form 1627A noted as to credit of strip stamps by the collector, as provided for in § 251.87, he shall inquire of the collector of customs who approved the requisition Form 428 whether the required report on Form 1627A has been received from the collector of customs at the port of diversion. If the collector of customs reports the non-receipt of Form 1627A from the collector at the port of diversion, the importer, or the importer's agent, shall make a written inquiry, either directly or through the importer at the port of diversion, of the collector of customs at the port of diversion whether such collector has reported on the diversion. The inquiry shall show the entry number, or identify the zone application, and shall be accompained by two copies of the original Form 1627A marked "Follow-up: Prepared ——————." On receipt of the inquiry, the collector of customs of
(date)
the port of diversion will compare the "Follow-up" copies with his file of record copies of Form 1627A. If he has a record copy showing that he forwarded the original Form 1627A, he shall insert any stamp data on the "Follow-up" copies, return one copy to the party who presented it, and forward the other copy to the collector of customs at the port of requisition. If the collector of customs at the port of diversion finds no corresponding record copy of Form 1627A, he shall use the "Follow-up" copies as original copies. In such case, he shall strike out the words "Follow-up", enter the stamp data thereon, retain one copy as his record copy, and forward the other copy to the collector of customs at the port of requisition. On receipt of the copy by the collector of customs at the port of requisition, the copy will be compared with the records. If the original Form 1627A has been received and the triplicate copy has already been forwarded to the importer, or to the importer's agent, the "Follow-up" copy shall also be sent to him without further action. If the collector of customs at the port of requisition finds that he has not received the original Form 1627A from the port of diversion, he shall use the "Follow-up" copy as the original of Form 1627A, and process it in accordance with § 251.87. On receipt of the copy of Form 1627A, the importer, or the importer's agent, may, unless he has already received his copy of Form 1627A, take credit for the stamps on his strip stamp record. (72 Stat. 1358; 26 U.S.C. 5205.)

A new section, reading as follows, is inserted immediately following § 251.88.

§ 251.88a TRANSFER OF RED STRIP STAMPS IN FOREIGN COUNTRY.—Where an importer has shipped red strip stamps to a foreign bottler or exporter, to be affixed to containers of distilled spirits to be shipped to the United States, and he desires to transfer all or a part of these stamps to another foreign bottler or exporter, he shall first submit a written application, in duplicate, to the collector of customs who approved the requisition, Form 428. The application shall show: (a) the serial number and date of the requisition, Form 428, covering issuance of the stanps; (b) the name and country of the foreign bottler or exporter holding the stamps; (c) the number and size of the stamps desired to be transferred; and (d) the name and country of the foreign bottler or exporter to whom the stamps are to be transferred. If the collector of customs has no reason to believe that the transfer would constitute a jeopardy to the revenue, he shall indicate his approval on the copy of the application,

return the copy to the importer, and retain the original for filing with the requisition, Form 428. On receipt of the approved copy, the importer shall effect the requested transfer of strip stamps. (72 Stat. 1358; 26 U.S.C. 5205.)

Section 251.89 is amended to read:

§ 251.89 UNUSED RED STRIP STAMPS.—Unused red strip stamps returned to the importer by the bottler or exporter abroad, shall be submitted to the collector of customs who approved the original requisition, Form 428, for noting of such fact on the requisition and on the Form 1627 covering such stamps on file with the collector. After such notation has been made, the collector of customs shall return the stamps to the importer. If subsequently the importer desires to send all or part of the returned stamps to a bottler or exporter abroad, he shall submit them with Form 1627, properly modified and in duplicate, to the collector of customs who shall note approval on the copy of the modified Form 1627 and return it with the stamps to the importer. The collector of customs shall retain the original Form 1627. The importer shall make appropriate entries on his strip stamp record and in his report, Form 96, of the receipt and disposition of unused stamps covered by this section. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 251.89a [Amendment]

Section 251.89a is amended as follows:

(A) By striking, in the second sentence, the word "denomination", and inserting in lieu thereof the word "size".

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1358; 26 U.S.C. 5205)".

§ 251.90 [Amendment]

Section 251.90 is amended as follows:

(A) By amending the second and third sentences to read: "The importer shall submit such affidavit to the collector of customs who shall credit the original requisition accordingly. The importer shall make appropriate entries on his strip stamp record."

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1358; 26 U.S.C. 5205)".

§ 251.91 [Amendment]

Section 251.91 is amended as follows:

(A) By striking from the first sentence the words "or affidavit" and inserting in lieu thereof the words "a certificate".

(B) By amending the second and third sentences to read "The importer shall submit such certificate to the collector of customs who shall credit the original application accordingly. The importer shall make appropriate entries on his strip stamp record."

(C) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1358; 26 U.S.C. 5205)".

Section 251.92 is amended to read:

§ 251.92 BREACH OF REGULATIONS, OR FAILURE TO PROPERLY ACCOUNT FOR STRIP STAMPS.—Where an importer fails to render a proper accounting for strip stamps as prescribed in this part, or where the collector of customs is not able to reconcile his records with those of the importer and is not satisfied with the accounting as rendered by the importer, or where there has been any breach of the provisions of this part by the importer, or use of stamps for a purpose other than that for which they were procured, the collector of customs shall refuse to approve any further requisition, Form 428, submitted by the importer. The collector of customs may also require of the importer an immediate accounting of all strip stamps outstanding in the name of the importer. Such accounting shall be made at a time and place to be specified by the collector of customs, and shall be of such a nature as to satisfy the collector of customs that there has been no unlawful diversion or use of said stamps. If deemed necessary, the collector of customs may require the importer to call in all unused strip stamps,

wherever they may be, and deliver them so that they may be counted. Where the collector of customs has evidence that any of the provisions of this part have been wilfully violated, he shall refer the matter to the Director for appropriate action. (72 Stat. 1358; 26 U.S.C. 5205.)

§ 251.113 [Amendment]

Section 251.113 is amended as follows:

(A) By striking the present legend and inserting in lieu thereof:

Port of _____ _____ 19____. This is to certify that on this
(Month) (Day)
date, the red strip stamps required by section 5205, I.R.C., were affixed, under my supervision, to the_____, _____ containers of distilled spirits in this
(Number) (Size)
case. _____ _____
(Name) (Official designation)

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1358; 26 U.S.C. 5205)".

§ 251.120 [Amendment]

Section 251.120 is amended as follows:

(A) By striking "§ 251.134" from the last sentence and inserting in lieu thereof "§§ 251.133 and 251.134".

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1342, 1361, 1374, 1395; 26 U.S.C. 5114, 5207, 5301, 5555)".

§ 251.122 [Amendment]

Section 251.122 is amended as follows:

(A) By substituting "Part 201" for "Part 230" where it appears twice in this section.

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1358; 26 U.S.C. 5205)".

Section 251.130 is amended to read:

§ 251.130 Daily Record of Strip Stamps.—Importers shall maintain for each day a transaction in red strip stamps occurs a daily record of such stamps by size (small or standard), showing the number received, used, lost, mutilated, destroyed, or otherwise disposed of, and on hand at the beginning and end of the day. The record shall also show the number and size of bottles to which the stamps were affixed, except that bottles of less than ½ pint capacity shall be recorded as one item. Each credit taken on the record shall identify the customs entry number and the port of entry for the stamped bottles received from abroad, or the authority given by the collector of customs for such credit. Where an importer has more than one place of business, a separate daily record shall be maintained on the premises of each place of business. Where an agent procures stamps for several importers, the agent shall keep a separate record, for each importer, of all strip stamps sent abroad or retained on his premises for the account of the importer. (72 Stat. 1358; 26 U.S.C. 5205.)

Section 251.131 is amended to read:

§ 251.131 Report of Strip Stamps, Form 96.—Every importer shall prepare on Form 96, in triplicate, an annual report of all strip stamps procured, used, lost, mutilated, destroyed, or otherwise disposed of during each fiscal year (July 1 through June 30 following), a report of the balances on hand at the beginning and end of the fiscal year, and an accounting for any balances outstanding against each requisition at the end of the fiscal year. Where an importer has more than one place of business, a separate report on Form 96 shall be rendered for each place of business. Where an agent procures stamps for several importers, he shall render a separate report on Form 96 in the name of each importer. An original and one copy of Form 96 shall be filed on or before July 10 with the collector of customs who approved the importer's requisitions on Form 428: *Provided*, That where the collector of customs finds

it necessary, in order to reconcile his accounts with those of the importer, he may require the importer, in addition to the annual report on Form 96, to file Form 96 at more frequent intervals, but not more often than once a month, completed in whole or in part, as the collector may designate. Such additional reports on Form 96 shall be prepared in duplicate and the original shall be filed with the collector of customs at the time designated by such collector. The importer shall keep one copy of Form 96 for his files. The collector of customs shall, on or before July 20, forward one copy of each annual report on Form 96 to the assistant regional commissioner of the region in which the customs collection district is located. (72 Stat. 1358; 26 U.S.C. 5205.)

Section 251.132 is revoked.

§ 251.133 [Amendment]

Section 251.133 is amended as follows:

(A) By striking, in the first sentence, that portion preceding the "Proviso" clause, and inserting in lieu thereof: "Except as provided in § 251.134, every importer who imports distilled spirits, wines, or beer shall keep such records and render such reports of such liquors as are required to be kept by a wholesale or retail dealer, as applicable, under the provisions of Part 194 of this chapter:".

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1342, 1345, 1395; 26 U.S.C. 5114, 5124, 5555)".

§ 251.134 [Amendment]

The headnote of section 251.134 is amended to read:

§ 251.134 PROPRIETORS OF QUALIFIED PREMISES.

§ 251.135 [Amendment]

Section 251.135 is amended as follows:

(A) By striking "Alcohol and Tobacco Tax Division,".

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof: "(72 Stat. 1342, 1395; 26 U.S.C. 5114, 5555)".

§ 251.136 [Amendment]

Section 251.136 is amended as follows:

(A) By changing the second sentence to read: "All records required by this part, and legible copies of all reports required by this part to be submitted to the assistant regional commissioner or to the collector of customs, shall be filed separately, chronologically, and in numerical sequence within each date, at the importer's place of business to which they relate: *Provided*, That on application, the assistant regional commissioner may authorize the files, or any individual file, to be maintained at other premises under control of the importer, if he finds that such maintenance will not delay the timely filing of any document, or cause undue inconvenience to internal revenue or customs officers desiring to examine such files."

(B) By striking the statutory citation at the end of the section and inserting in lieu thereof "(72 Stat. 1342, 1345, 1361, 1395; 26 U.S.C. 5114, 5124, 5207, 5555)".

Section 251.137 is amended to read:

§ 215.137 RETENTION.—All records required by this part, documents or copies of documents supporting such records, and file copies of reports required by this part to be submitted to the assistant regional commissioner or to the collector of customs, shall be preserved for a period of not less than two years, and

during such period shall be available, during business hours, for inspection and the taking of abstracts therefrom by internal revenue or customs officers. Any records, or copies thereof, containing any of the information required by this part to be prepared, wherever kept, shall also be made available for such inspection and the taking of abstracts therefrom. (72 Stat. 1342, 1345, 1361, 1395; 26 U.S.C. 5114, 5124, 5207, 5555.)

Subpart J is revoked.

Section 251.160 is amended to read:

§ 251.160 DISPOSITION OF STRIP STAMPS.—The importer who discontinues or sells his business shall recall from his agents abroad all unused stamps in their custody. He shall submit his entire stock of unused stamps, accompanied by a report, in duplicate, of inventory, by size, serial numbers and quantity, to the collector of customs for crediting of the respective Forms 428. The collector of customs shall then destroy the stamps and, after such destruction, note the action taken on both copies of the inventory. He shall retain the original of the inventory and return the copy to the importer. Within five days of the receipt of the returned copy of the inventory, the importer shall note the disposition of the stamps on Form 96, mark the report "Final", and submit it, in duplicate, to the collector of customs. The collector of customs shall forward one copy of the final Form 96 to the assistant regional commissioner. (72 Stat. 1358; 26 U.S.C. 5205.)

The following new subparts, subpart L and subpart M, are added, immediately following § 251.160:

Subpart L.—Transfer of Distilled Spirits From Customs Custody to Bonded Premises of Distilled Spirits Plant

Section

251.171 General provisions.
251.172 Application, Form 2609.
251.173 Customs gauge and release.
251.174 Tank cars and tank trucks to be sealed.
251.175 Transfer by pipeline at dock.

§ 251.171 GENERAL PROVISIONS.—Imported distilled spirits, other than whisky, brandy, rum, or similar beverage spirits, of 185 degrees or more of proof may, under the provisions of this subpart, be withdrawn by the proprietor of a distilled spirits plant from customs custody and transferred to the bonded premises of his plant for nonbeverage use, without payment of the internal revenue tax imposed on spirits by section 5001, I.R.C. Spirits of any proof, imported for any purpose incident to the requirements of national defense, may also be withdrawn from customs custody and be transferred to the bonded premises of a distilled spirits plant without payment of such tax. Spirits so withdrawn and transferred to a distilled spirits plant may be redistilled or denatured and may, without redistillation or denaturation, be withdrawn from internal revenue bond for any purpose authorized by chapter 51, Internal Revenue Code, in the same manner as domestic distilled spirits. Imported distilled spirits transferred from customs custody to the bonded premises of a distilled spirits plant under the provisions of this subpart shall be received and stored thereat, and withdrawn or transferred therefrom, subject to the applicable provisions of Part 201 of this chapter. (72 Stat. 1366; 26 U.S.C. 5232.)

§ 251.172 APPLICATION, FORM 2609.—The proprietor of a distilled spirits plant desiring to withdraw distilled spirits as authorized in § 251.171, shall, for each withdrawal, submit an application on Form 2609, in triplicate, to the internal revenue officer in charge. The application shall appropriately identify the distilled spirits to be withdrawn, and shall be modified by the applicant to cover the transfer of distilled spirits from customs custody, by naming the port of entry through which the distilled spirits are to be withdrawn, and by inserting in the "Remarks" item the name and address of the assistant regional commissioner for the region in which is located the plant to which the spirits are to be transferred. The internal revenue officer shall, if the proprietor's bond on Form 2601 is sufficient, approve all copies of Form 2609, forward one copy to the assistant regional commissioner, and return the original and remaining copy to the proprietor. The proprietor shall forward the original of Form 2609

to the collector of customs at the port of entry named therein from whose custody it is proposed to withdraw the distilled spirits, and retain the remaining copy for his files. (72 Stat. 1314, 1322, 1366; 26 U.S.C. 5001, 5007, 5232.)

§ 251.173 CUSTOMS GAUGE AND RELEASE.—The collector of customs will not release distilled spirits without payment of internal revenue tax until the approved Form 2609 has been received from the proprietor of the distilled spirits plant. Prior to release from customs custody, the customs officer shall prepare Form 236 (in quadruplicate, when the spirits are in packages; in quintuplicate, when the spirits are in bulk) appropriately modified to show:

(a) Serial number and date of the Form 2609;
(b) Customs port of entry;
(c) The consignee;
(d) Kind of spirits;
(e) Country from which spirits were exported;
(f) Method of transfer;
(g) Elements of bulk gauge (if any);
(h) Quantity to be transferred;
(i) Customs seals used (if any);
(j) Date of release; and
(k) Signature and title of the customs officer in lieu of the proprietor.

When shipments are made in tank cars or tank trucks, the details of the gauge of each tank car or tank truck shall be reported separately. In the case of barrels, drums, or similar portable containers, the details of the gauge shall be shown on Form 2630, in triplicate. In addition, the customs officer shall ascertain and enter on each copy of Form 236 the rate of customs duty paid on the distilled spirits and the rate of customs duty which would have been applicable had such spirits been imported for beverage purposes. On compliance with the reqiurements of customs regulations (including determination of duties due), and on completion of Form 236 (and Form 2630, where required), the customs officer shall release the spirits for transfer, retain one copy of Form 236 (and Form 2630, if any), forward one copy of Form 236 to the assistant regional commissioner (alcohol and tobacco tax) at the address shown on Form 2609, and forward the original and remaining copy (or copies) of Form 236 (and Form 2630, if any) to the internal revenue officer at the distilled spirits plant. (72 Stat. 1314, 1322, 1366; 26 U.S.C. 5001, 5007, 5232.)

§ 251.174 TANK CARS AND TANK TRUCKS TO BE SEALED.—Where a shipment of distilled spirits from customs custody to the distilled spirits plant is made in a tank car or tank truck, all openings affording access to the spirits shall be sealed by the customs officer with customs seals in such manner as will prevent unauthorized removal of spirits through such openings without detection. (72 Stat. 1314, 1322, 1366; 26 U.S.C. 5001, 5007, 5232.)

§ 251.175 TRANSFER BY PIPELINE AT DOCK.—Where the distilled spirits plant is equipped with suitable dock facilities, the distilled spirits may, subject to all requirements of the customs laws and regulations, be transferred by pipeline from the importing vessel or barge through weighing tanks or other suitable measuring tanks into locked empty storage tanks on the bonded premises of the distilled spirits plant, or directly into locked storage tanks on such premises provided such storage tanks are equipped with suitable measuring devices for correctly indicating the actual contents and the outlets thereof are locked. In all such cases of pipeline transfers, the distilled spirits shall be transferred under customs supervision, gauged immediately by a customs officer, and thereupon released for deposit in the distilled spirits plant. The details of the gauge shall be reported on Form 236, and distribution of the form made, as provided in § 251.173. (72 Stat. 1314, 1322, 1366; 26 U.S.C. 5001, 5007, 5232.)

Subpart M.—Withdrawal of Imported Distilled Spirits From Customs Custody Free of Tax for Use of the United States

Section

251.181 General.
251.182 Application and permit, Form 1444.
251.183 Use of permit, Form1444.
251.184 Customs gauge and release.
251.185 Tank cars and tank trucks to be sealed.
251.186 Receipt on Form 1473.

§ 251.181 GENERAL.—On filing of proper customs entry, imported distilled spirits may, under the provisions of this subpart, be withdrawn free of tax from customs custody by the United States or any governmental agency thereof for its own use for nonbeverage purposes. (72 Stat. 1372, 1375; 26 U.S.C. 5272, 5313.)

§ 251.182 APPLICATION AND PERMIT, FORM 1444.—Application on Form 1444, in duplicate, appropriately modified to show the customs port of entry, shall be filed with the Director by the United States or governmental agency thereof for a permit to procure and withdraw imported distilled spirits free of tax for nonbeverage purpose. If it is desired to procure distilled spirits from more than one customs port of entry, a separate application for permit must be filed for each port. Each location to which the distilled spirits are to be shipped shall be shown on the application. The application shall be signed by the head of the department or independent bureau or agency to which such spirits are to be shipped, or by some person duly authorized by such head of a department or independent bureau or agency. Evidence of authority to sign for the head of a department, or independent bureau or agency, shall be furnished the Director. Permits on Form 1444 to procure distilled spirits free of tax from customs custody will not limit the quantity of distilled spirits authorized to be procured, and all such permits shall remain in force until surrendered or canceled. Every appropriate precaution shall be taken by the agency to insure that the tax-free spirits so procured will be used only for governmental purposes. (72 Stat. 1375; 26 U.S.C. 5313.)

§ 251.183 USE OF PERMIT, FORM 1444.—On receipt of the permit, Form 1444, from the Director, the department, bureau, or other agency of the United States, in order to procure distilled spirits from customs custody, shall forward the permit to the collector of customs at the port named therein. The collector of customs may retain such permit to cover future withdrawals pursuant to appropriate customs entry in each case. (72 Stat. 1375; 26 U.S.C. 5313.)

§ 251.184 CUSTOMS GAUGE AND RELEASE.—Where the appropriate permit, Form 1444, is on file, and on receipt of entry for release of distilled spirits, the spirits shall be gauged by a customs officer who shall prepare a report of gauge on Form 2629, in triplicate. The distilled spirits may then be released free of tax for shipment to the United States or governmental agency thereof named in the permit, Form 1444. The customs officer shall make the appropriate withdrawal entry on Form 1444, and shall state on each copy of Form 2629 the permit number of the Form 1444 under which the distilled spirits were withdrawn. The original of Form 2629 shall be retained by the collector of customs, one copy shall be forwarded to the governmental agency to whom the distilled spirits are consigned, and one copy shall be forwarded to the Director. (72 Stat. 1375; 26 U.S.C. 5313.)

§ 251.185 TANK CARS AND TANK TRUCKS TO BE SEALED.—When a shipment of distilled spirits from customs custody is made in a tank car or tank truck, all openings affording access to the spirits shall be sealed by the customs officer with customs seals in such manner as will prevent unauthorized removal of spirits through such openings without detection. (72 Stat. 1375; 26 U.S.C. 5313.)

§ 251.186 RECEIPT ON FORM 1473.—At the time of shipping distilled spirits free of tax to the United States or governmental agency thereof, the collector of customs shall prepare Form 1473, appropriately modified, forward the original and one copy to the Government officer to whom the distilled spirits are to be delivered at destination, and retain one copy for his files. The Government officer, on receiving the shipment, shall execute the certificate of receipt, forward the original to the Director and retain the copy for his files. (72 Stat. 1375; 26 U.S.C. 5313.)

Because this Treasury Decision is a part of an integrated recodification program under Chapter 51, I.R.C., and in order that the entire program may be effective on July 1, 1960, it is found that it is contrary to the public interest to issue this Treasury Decision subject to the effective date limitation of section 4(c) of the Administrative Procedure Act (60 Stat. 238; 5 U.S.C. 1003). Accordingly, this Treasury Decision shall become effective on July 1, 1960.

(This Treasury Decision is issued under authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

WILLIAM H. LOEB,
Acting Commissioner of Internal Revenue.
RALPH KELLY,
Commissioner of Customs.

Approved June 28, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register June 30, 1960, 8:51 a.m., and published in the issue of the Federal Register for July 1, 1960, 25 F.R., 6204)

SECTION 5206.—CONTAINERS

26 CFR 201.516: Marks on packages of spirits filled on bonded premises.

Omission of marks on alcohol for industrial uses. See Rev. Rul. 60–368, below.

26 CFR 201.517: Kind of spirits or wine. (Also 201.516.) (Also Part III–C, Section 5(e); 27 CFR 5.38.) Rev. Rul. 60–368

Section 201.516(a)(3) of the Distilled Spirits Plants Regulations provides that packages of distilled spirits filled on bonded premises must be marked to show the kind of spirits contained therein. Section 201.517(a)(1) of the regulations provides, in part, that where spirits marked with the designation "alcohol" are to be withdrawn on determination of tax, the designation "alcohol" shall be preceded or followed by a word or phrase descriptive of the material from which such spirits were produced. Section 5(e) of the Federal Alcohol Administration Act and section 5.38 of the Distilled Spirits Labeling and Advertising Regulations issued under that Act require that, with certain exceptions, beverage distilled spirits comprised in whole or in part of neutral spirits (alcohol) be labeled to state the name of the commodity from which such neutral spirits have been distilled. *Held*, the purpose of the provisions of sections 201.516 and 201.517 of the Distilled Spirits Plants Regulations requiring packages of taxpaid alcohol to describe the material from which produced is to provide information for the labeling of consumer containers, as required by the Federal Alcohol Administration Act, in instances where alcohol withdrawn on determination of tax is to be used for non-industrial purposes. Therefore, where alcohol withdrawn in drums on determination of tax is to be used for industrial purposes, proprietors of distilled spirits plants may make application under section 201.62(a) of the regulations for permission to omit markings describing the material from which such alcohol was produced and to substitute in lieu thereof markings or securely affixed labels reading "For industrial use," or "This alcohol solely for industrial use."

SECTION 5207.—RECORDS AND REPORTS

26 CFR 201.61: Forms prescribed. Rev. Rul. 60–373
(Also 201.517, 201.270.)
(Also Part III–C, Section 5(e); 27 CFR 5.21.)

Section 201.61 of the Distilled Spirits Plants Regulations authorizes the Director, Alcohol and Tobacco Tax Division, to prescribe all forms required by the regulations and provides that all of the information called for in each form shall be furnished, as indicated by the headings on the form and the instructions thereon or issued in respect thereof, and as required by the regulations. *Held*, in order that distilled spirits transferred in bond may be properly identified for record purposes, column (b) of Form 2630, Package Gauge Report, and item 5 of Form 236, Transfer of Spirits or Denatured Spirits in Bond, must show the kind of spirits by class and type, such as bourbon whiskey, rye whiskey, etc., as defined in section 5.21 of the Distilled Spirits Labeling and Advertising Regulations under the Federal Alcohol Administration Act, and as provided by sections 201.270 and 201.517 of the Distilled Spirits Plants Regulations.

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26 CFR 201.270: Identification of spirits.

Designations of whiskey on Form 2630, Package Gauge Report, and Form 236, Transfer of Spirits or Denatured Spirts in Bond. See Rev. Rul. 60–373, above.

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26 CFR 201.517: Kind of spirits or wine.

Designations of whiskey on Form 2630, Package Gauge Report, and Form 236, Transfer of Spirits or Denatured Spirits in Bond. See Rev. Rul. 60–373, above.

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26 CFR 201.623: Daily bottling, premises records.

Rectified products removed from bottling premises and returned to bottling premises for re-rectification. See Rev. Rul. 60–333, page 511.

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26 CFR 201.631: Submission of reports.

Submission of Form 1473, Notice of Shipment of Specially Denatured, Tax-Free, or Recovered Spirits, and Form 2636, Daily Report of Transactions. See Rev. Proc. 60–21, page 991.

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26 CFR 201.632: Daily Reports.

Preparation of Form 2636. See Rev. Rul. 60–34, page 1013.

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26 CFR 201.633: Monthly Reports.

Preparation of Form 2731. See Rev. Proc. 60–34, page 1013.

PART II.—OPERATIONS ON BONDED PREMISES

Subpart A.—General

SECTION 5213.—WITHDRAWAL OF DISTILLED SPIRITS FROM BONDED PREMISES ON DETERMINATION OF TAX

26 CFR 201.371: Application.

Serial numbers on packages withdrawn from bonded premises. See Rev. Proc. 60–15, page 939.

SECTION 5214.—WITHDRAWALS OF SPIRITS FROM BONDED PREMISES FREE OF TAX OR WITHOUT PAYMENT OF TAX

26 CFR 213.162: Return. Rev. Rul. 60–265

Section 5214(a) of the Internal Revenue Code of 1954 provides, under certain conditions, for the withdrawal of distilled spirits from premises free of tax or without payment of tax. Shipments of tax-free alcohol withdrawn under the provisions of section 5214(a) of the Code are made under the bond of the permittee holding a permit to withdraw and use alcohol and normally he must file a claim for any loss of alcohol while in transit to his premises. On occasion containers of tax-free alcohol which have sustained losses in transit to the consignee are returned by the carrier to the original shipper, the distilled spirits plant, as authorized by section 213.162 of the Distribution and Use of Tax-Free Alcohol Regulations and section 201.575 of the Distilled Spirits Plants Regulations, without having been received by the consignee. *Held*, in such instances the claim for allowance of the loss may be filed by the consignor-shipper who has filed a consent of surety on bond, Form 2601, Distilled Spirits Bond, as required by section 201.575 of the Distilled Spirits Plants Regulations. Such consent of surety must further stipulate that the proprietor will be liable under his bond for all taxes for which he may become liable on the quantity of alcohol as originally shipped from the distilled spirits plant. The claim should set forth all of the facts pertaining to the loss, including the quantity originally shipped, the quantity (determined by gauge) lost and such other pertinent information as will enable the Assistant Regional Commissioner, Alcohol and Tobacco Tax, to take appropriate action thereon. Appropriate notification of the return of the shipment to the consignor must be given to the original consignee by the carrier or the consignor and the consignor must furnish to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax, for the consignor and consignee, a notice of the cancellation of Form 1473, Notice of Shipment of Specially Denatured Alcohol, covering the shipment.

Subpart C.—Storage

SECTION 5232.—IMPORTED DISTILLED SPIRITS

26 CFR 251.171: General provisions.

Provisions for the transfer of imported distilled spirits from customs custody to the bonded premises of a distilled spirits plant. See T.D. 6477, page 575.

SECTION 5233.—BOTTLING OF DISTILLED SPIRITS IN BOND

26 CFR 201.323: Bottling requirements.

Mingling of distilled spirits for bottling in bond. See Rev. Rul. 60-342, page 592.

SECTION 5234.—MINGLING AND BLENDING OF DISTILLED SPIRITS

26 CFR 201.297: Mingling of homogeneous spirits. (Also 201.517, 201.518.) Rev. Rul. 60-353

Section 201.297 of the Distilled Spirits Plants Regulations provides, in part, that spirits which are homogeneous may be mingled on bonded premises for immediate withdrawal or for further storage in bond in tanks or packages. *Held*, section 201.297 does not prohibit the packaging of distilled spirits into a different type of cooperage than that from which the spirits were dumped for mingling. However, since a change in designation as to kind of spirits may result from a change in type of cooperage, prior approval must be obtained from the Assistant Regional Commissioner, Alcohol and Tobacco Tax, under section 201.517(b) of the regulations. The approval of the Assistant Regional Commissioner will be conditioned upon the following:

(1) Form 2630, Package Gauge Report, used for the gauging of new packages, must be marked to show the purpose of gauge as "gauge of spirits mingled to change type of cooperage and kind of spirits."

(2) Both the old and the new designations as to type of cooperage and kind of spirits must be shown on the Form 2630.

(3) Each new package must bear a label similar to that prescribed in section 201.518 of the regulations.

Mingling of homogeneous and heterogeneous spirits. See Rev. Rul. 60-341, page 592.

26 CFR 201.298: Mingling of heterogeneous spirits for immediate removal to bottling premises. (Also 201.297.) Rev. Rul. 60–341

Section 5234 of the Internal Revenue Code of 1954 provides, in part, that, under such regulations as the Secretary of the Treasury or his delegate shall prescribe, distilled spirits may be mingled on bonded premises, if they are homogeneous, or if such spirits are heterogeneous and are being dumped for gauging in bulk gauging tanks for immediate removal to bottling premises for use exclusively in taxable rectification or rectification under section 5025(f) of the Code. Sections 201.297 and 201.298 of the Distilled Spirits Plants Regulations set forth the limitations under which homogeneous or heterogeneous spirits may be mingled. *Held*, distilled spirits of less than 100 degrees of proof which were originally entered for deposit at 100 degrees or more of proof, showing no evidence of tampering or unlawful manipulation, may be mingled with spirits of 100 degrees or more of proof for any of the purposes authorized by sections 201.297 and 201.298 of the regulations. Whether the tax determination of spirits so mingled should be on a proof gallon or on a wine gallon basis will depend upon the proof of the spirits at the time of their removal from bond. In the event that a question arises as to the homogeneity of spirits so mingled under section 201.297 of the regulations, the problem will be resolved by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by analyses of samples of the spirits in question.

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26 CFR 201.301: Mingling to consolidate packages under section 5234(a)(2), I.R.C. (Also Section 5233; 201.323.) Rev. Rul. 60–342

Section 5233(b)(2) of the Internal Revenue Code of 1954, relating to the bottling of distilled spirits in bond, provides, in part, that nothing in this section shall authorize or permit any mingling of different products, or of the same products of different distilling seasons. However, section 5234(a)(2) of the Code authorizes, under certain circumstances and subject to certain conditions, the mingling of spirits produced in different distilling seasons for the purpose of consolidating packages for further storage in bond, and provides that the distilling season of such mingled spirits shall be the distilling season of the youngest spirits contained therein and that notwithstanding any other provisions of law, distilled spirits so mingled may be bottled and labeled the same as if such spirits had not been so mingled. *Held*, spirits of different distilling seasons which have been subjected to bona fide mingling and consolidation in accordance with the provisions of section 5234(a)(2) of the Code and section 201.301 of the Distilled Spirits Plants Regulations, may, if otherwise eligible under section 201.323 of the regulations, be mingled for bottling in bond under section 201.323 of the regulations with spirits which have not been so consolidated, provided the season of production prescribed by statute for the consolidated spirits is the same as the actual distilling season of the spirits which have not been previously consolidated.

26 CFR 201.517: Kind of spirits or wines.

Packing of distilled spirits into a different type of cooperage than that from which the spirits were dumped for mingling. See Rev. Rul. 60–353, page 591.

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26 CFR 201.518: Change of packages.

Packing of distilled spirits into a different type of cooperage than that from which the spirits were dumped for mingling. See Rev. Rul. 60–353, page 591.

Subpart D.—Denaturation

SECTION 5241.—AUTHORITY TO DENATURE

26 CFR 201.407: Notice and gauge for denaturation.

Procedure for filing Form 244, Tank Certificate, and Form 2634, Denaturation of Spirits. See Rev. Proc. 60–20, page 990.

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26 CFR 212.1: Formulas for denatured spirits. T. D. 6474 [1]
(Also Section 5242; 212.10.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 212.—FORMULAS FOR DENATURED ALCOHOL AND RUM

Miscellaneous amendments

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

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

On February 5, 1960, a notice of proposed rulemaking to amend 26 CFR Part 212, with respect to formulas for denatured alcohol and specially denatured rum, was published in the Federal Register (25 F.R. 1037).

In accordance with the notice, interested persons were afforded an opportunity to submit written data, views, or arguments pertaining thereto. No comments or objections having been received, the following amendments are hereby adopted.

In order to conform language of this part to that of the Internal Revenue Code as amended by section 201 of the Excise Tax Technical Changes Act of 1958 (Public Law 85–859, 72 Stat. 1313) [C.B. 1958–3, 92], to provide a formula for the denaturation of rum, to authorize additional denaturants in certain formulas, to authorize additional uses of certain formulas, to delete certain formulations which will be incorporated in 26 CFR Part 211, and to include additional data

[1] The publication of this Treasury Decision in 25 F.R. 5987, dated June 29, 1960, contans (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 1037, dated February 5, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations. The individual instructions have been omitted.

in the table of weights and measures, 26 CFR Part 212 is amended as follows:

1. The title of this part is amended to read "Formulas for Denatured Alcohol and Rum".

2. Section 212.1 is amended to read as follows:

§ 212.1 FORMULAS FOR DENATURED SPIRITS.—The regulations in this part relate to the formulation of completely denatured alcohol, specially denatured alcohol, and specially denatured rum; to the specifications for denaturants; and to the uses of denatured spirits. The procedural and substantive requirements relative to the production of denatured alcohol and specially denatured rum are prescribed in Part 201 of this chapter and those relative to the distribution and use of denatured alcohol and specially denatured rum are prescribed in Part 211 of this chapter.

3. Section 212.2 is amended to read as follows:

§ 212.2 FORMS PRESCRIBED.—The Director is authorized to prescribe all forms required by this part. All of the information called for in each form, as indicated by the headings of the various columns and lines of the form and the instructions printed thereon or issued in respect thereto and as required by this part, shall be given.

§ 212.3 [Amendment]

4. Section 212.3 is amended as follows:

(A) By striking the word "alcohol" the first two times it appears and inserting in lieu thereof the word "spirits";

(B) By inserting immediately preceding the words "formulas of" the words "denaturants or"; and

(C) By striking the words "Alcohol and Tobacco Tax Division" immediately following the word "Director".

5. A new section, section 212.4, is added to read as follows:

§ 212.4 RELATED REGULATIONS.—Regulations related to this part are listed below:

26 CFR 201—Distilled Spirits Plants
26 CFR Part 211—Distribution and Use of Denatured Alcohol and Rum

6. Section 212.5 is amended to read as follows:

§ 212.5 MEANING OF TERMS.—When used in this part and in forms prescribed under this part, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in this section. Words in the plural form shall include the singular, and vice versa, and words importing the masculine gender shall include the feminine. The terms "includes" and "including" do not exclude things not enumerated which are in the same general class.

Alcohol.—Those spirits known as ethyl alcohol, ethanol, or spirits of wine, from whatever source or by whatever process produced; the term does not include such spirits as whisky, brandy, rum, gin, vodka, or products of rectification.

Assistant regional commissioner.—An assistant regional commissioner (alcohol and tobacco tax) who is responsible to, and functions under the direction and supervision of, a regional commissioner.

CFR.—The Code of Federal Regulations.

C.D.A.—Completely denatured alcohol.

Completely denatured alcohol.—Those spirits known as alcohol, as defined in this section, denatured pursuant to completely denatured alcohol formulas prescribed in subpart C.

Denaturant.—A material authorized in accordance with this part, to be added to spirits in order to render such spirits unfit for beverage or internal human medicinal use.

Denatured spirits.—Alcohol or rum to which denaturants have been added as provided in this part.

Director.—The Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington, D.C.

Essential oil.—Any of the volatile odoriferous natural oils found in plants, which impart to such plants odor and often other characteristic properties; also, imitations of such natural oils, and aromatic substances and synthetic oils, which possess the denaturing characteristics of such natural oils.

Gallon.—The liquid measure equivalent to the volume of 231 cubic inches.

I.R.C.—The Internal Revenue Code of 1954, as amended.

Manufacturer or user.—A person who holds an industrial use permit to use specially denatured alcohol or specially denatured rum, or to recover completely or specially denatured alcohol, specially denatured rum, or articles manufactured with denatured spirits.

Proof.—The ethyl alcohol content of a liquid at 60 degrees Fahrenheit, stated as twice the percent of ethyl alcohol by volume.

Regional Commissioner.—A regional commissioner of internal revenue.

Rum.—Any spirits produced from sugar cane products and distilled at less than 190° proof in such manner that the spirits possess the taste, aroma, and characteristics generally attributed to rum.

S.D.A.—Specially denatured alcohol.

Specially denatured alcohol.—Those spirits known as alcohol, as defined in this section, denatured pursuant to the specially denatured alcohol formulas authorized under subpart D.

Specially denatured rum.—Those spirits known as rum, as defined in this section, denatured pursuant to the specially denatured rum formula authorized under subpart D.

Spirits or distilled spirits.—Alcohol or rum as defined in this part.

§ 212.10 [Amendment]

7. Section 212.10 is amended by adding at the end thereof the following:

"Producers of completely denatured alcohol may be authorized to add a small quantity of an odorant, rust inhibitor, or dye to completely denatured alcohol. Any such addition may be made only on approval by the Director. Request for such approval shall be submitted to the Director in triplicate. Odorants or perfume materials may be added to denaturants authorized for completely denatured alcohol in amounts not greater than 1 part to 250, by weight: *Provided*, That such addition shall not decrease the denaturing value nor change the chemical or physical constants beyond the limits of the specifications for these denaturants as prescribed in subpart E, except as to odor. Proprietors of distilled spirits plants using denaturants to which such odorants or perfume materials have been added shall inform the Director of the names and properties of the odorants or perfume materials so used."

8. The heading of subpart D, immediately following section 212.12, is amended to read as follows:

Subpart D.—Specially Denatured Spirits Formulas and Authorized Uses

§ 212.15 [Amendment]

9. Section 212.15 is amended as follows:

(A) By deleting from the first sentence of paragraph (a) the word "will" and inserting in lieu thereof the word "shall";

(B) By adding at the end of paragraph (a) a new sentence to read "Rum for denaturation shall be of not less than 150 degrees of proof and shall be denatured in accordance with formula No. 4.";

(C) By amending the second sentence of paragraph (b) to read "Subject to the provisions of Chapter 51, I.R.C., Part 211 of this chapter, and this part, the Director may authorize, in his discretion, the use of any formula of specially denatured alcohol or specially denatured rum for uses not specifically authorized in this part."; and

(D) by deleting the period at the end of paragraph (b) and adding the words "or specially denatured rum.".

§ 212.16 [Amendment]

10. Section 212.16 is amended as follows:

(A) By deleting, in paragraph (b), the period following "Non-cellulose plastics" in Code No. 022, and adding a comma and the words "including resins.";

(B) By adding, in paragraph (b), two new code numbers to read—

354. Processing rosin.
355. Processing rubber (latex).

immediately following Code No. 353; and

(C) By deleting all of paragraphs (c), (d), and (e).

§ 212.17 [Amendment]

11. Section 212.17 is amended as follows:

(A) By deleting, in paragraph (b), the period following "Non-cellulose plastics" in Code No. 022, and by adding a comma and the words "including resins.";

(B) By adding, in paragraph (b), a new code number to read—

576. Organo-silicone products.

immediately following Code No. 575; and

(C) By deleting, in paragraph (c), the word "must" and inserting in lieu thereof the word "shall".

§ 212.19 [Amendment]

12. Paragraph (b) of section 212.19 is amended as follows:

(A) By changing the period to a comma following the words "Non-cellulose plastics" in Code No. 022 and adding the words "including resins.";

(B) By adding two new code numbers to read—

354. Processing rosin.
355. Processing rubber (latex).

immediately following Code No. 353; and

(C) By adding a new code number to read—

576. Organo-silicone products.

immediately following Code No. 575.

§ 212.21 [Amendment]

13. Paragraph (a) of section 212.21 is amended by striking the word "add", by changing the colon following it to a comma, and by adding to words "or to every 100 gallons of rum of not less than 150 degrees of proof, add :".

§ 212.23 [Amendment]

14. Paragraph (b) of section 212.23 is amended as follows:

(A) By changing the period following the words "Non-cellulose plastics" in Code No. 022 to a comma and by adding the words "including resins.";

(B) By adding a new code number to read—

036. Adhesives and binders.

immediately following Code No. 022; and

(C) By adding a new code number to read—

354. Processing rosin.

immediately following Code No. 352.

§ 212.24 [Amendment]

15. Paragraph (b) of section 212.24 is amended by changing the period following the words "Non-cellulose plastics" in Code No. 022 to a comma and by adding the words "including resins.".

§ 212.26 [Amendment]

15a. Paragraph (a) of section 212.26 is amended to read:

(a) *Formula.*—To every 100 gallons of alcohol add: One hundred gallons of vinegar of not less than 90-grain strength or one hundred and fifty gallons of vinegar of not less than 60-grain strength.

§ 212.29 [Amendment]

16. Paragraph (b) of section 212.29 is amended by changing Code No. 430 to read—

430. Sterilizing and preserving solutions.

§ 212.30 [Amendment]

17. Section 212.30 is amended as follows:

(A) By changing Code No. 042 in paragraph (b) to read—

042. Solvents and thinners (other than proprietary solvents or special industrial solvents).

(B) By striking all of paragraph (c).

§ 212.32 [Amendment]

18. Section 212.32 is amended as follows:

(A) By adding a new code number to read—

113. Lotions and creams (hand, face, and body).

immediately following Code No. 111 in paragraph (b); and

(B) By striking all of paragraph (c).

§ 212.33 [Amendment]

19. Section 212.33 is amended by striking all of paragraphs (c), (d), and (e).

§ 212.34 [Amendment]

20. Section 212.34 is amended by striking all of paragraphs (c), (d), and (e).

§ 212.35 [Amendment]

21. Section 212.35 is amended by striking all of paragraphs (c) and (d).

§ 212.36 [Amendment]

22. Paragraph (b) of section 212.36 is amended by adding at the end thereof a new code number to read—

410. Disinfectants, insecticides, fungicides, and other biocides.

§ 212.37 [Amendment]

23. Section 212.37 is amended as follows:

(A) By adding at the end of paragraph (a) the words "*NOTE:* The requirements of this formula may be met by adding one gallon of lavender oil, U.S.P., and 66.5 pounds of U.S.P. quality soap concentrate containing 25 percent water to 100 gallons of alcohol and, after maxing, by adding thereto 33.5 pounds of water and again mixing."; and

(B) By striking all of paragraphs (c) and (d).

§ 212.39 [Amendment]

24. Section 212.39 is amended as follows:

(A) By striking the phrase ", Alcohol and Tobacco Tax Division," wherever it appears; and

(B) By striking the word "will" from the last sentence of paragraph (a) and inserting in lieu thereof the word "shall".

§ 212.40 [Amendment]

25. Paragraph (b) of section 212.40 is amended by changing the period following the words "Non-cellulose plastics" in Code No. 022 to a comma and by adding the words "including resins."

§ 212.42 [Amendment]

26. Paragraph (b) of section 212.42 is amended as follows:

(A) By adding a new code number to read—

034. Cellulose intermediates and industrial collodions.

immediately following Code No. 031;

(B) By adding a new code number to read—

311. Ethyl cellulose compounds (dehydration).

immediately following Code No. 241; and

(C) By adding a new code number to read—

344. Processing medicinal chemicals, including alkaloids.

immediately following Code No. 343.

§ 212.43 [Amendment]

27. Section 212.43 is amended as follows:

(A) By inserting immediately following the words "Thirty pounds of" in paragraph (a), the words "methyl violet or"; and

(B) By striking the word "must" in the second sentence of paragraph (c) and inserting in lieu thereof the word "shall".

§ 212.45 [Amendment]

28. Paragraph (b) of section 212.45 is amended as follows:

(A) By adding a new code number to read—

512. Acetic acid.

immediately following Code No. 511; and

(B) By adding a new code number to read—

910. Animal feed supplements.

immediately following Code No. 523.

§ 212.46 [Amendment]

29. Section 212.46 Formula No. 36.

(a) *Formula.*—To every 100 gallons of alcohol add: Three gallons of ammonia, aqueous, 27 to 30 percent by weight; three gallons of strong ammonia solution, U.S.P.; 17.5 pounds of caustic soda, liquid grade, containing 50 percent sodium hydroxide by weight; or 12.0 pounds of caustic soda, liquid grade, containing 73 percent sodium hydroxide by weight.

(b) *Authorized uses.*—(1) as a solvent:

141. Shampoos.
142. Soap and bath preparations.
210. External pharmaceuticals (not U.S.P. or N.F.).
450. Cleaning solutions (including household detergents).

(2) as a raw material:
530. Ethylamines (for rubber processing).
540. Dyes and intermediates (ethylamines).
579. Other chemicals.

§ 212.47 [Amendment]

30. Section 212.47 is amended by striking therefrom all of paragraph (c).

§ 212.48 [Amendment]

31. Section 212.48 is amended as follows:

(A) By amending the paragraph following the listing of oils and substances to read as follows:

Where it is shown that none of the above single denaturants or combinations can be used in the manufacture of a particular product, application may be made to use another essential oil or substance having denaturing properties satisfactory to the Director. In such case the applicant shall furnish the Director with specifications and duplicate 8 ounce samples for examination.

(B) By adding, in paragraph (b), a new code number to read—

112. Bay rum.

immediately following Code No. 111;

(C) By adding, in paragraph (b), a new code number to read—

349. Miscellaneous drug processing (including manufacture of pills).

immediately following Code No. 249; and

(D) By striking all of paragraph (c).

§ 212.51 [Amendment]

32. Section 212.51 is amended as follows:

(A) By striking all of the last sentence of paragraph (a)(2), which begins "The denaturants selected"; and

(B) By adding to paragraph (b) a new code number to read—

210. External pharmaceuticals (not U.S.P. or N.F.).

immediately following Code No. 132.

§ 212.52 [Amendment]

33. Section 212.52 is amended as follows:

(A) By adding a new code number in paragraph (b) to read—

113. Lotions and creams (hand, face, and body).

immediately following Code No. 112; and

(B) By striking all of paragraph (c).

§ 212.53 [Amendment]

34. Section 212.53 is amended as follows:

(A) By striking from paragraph (a) all of the last sentence, which begins "The denaturant selected"; and

(B) By striking all of paragraph (c).

§ 212.54 [Amendment]

35. Section 212.54 is amended by striking therefrom all of paragraph (c).

§ 212.55 [Amendment]

36. Section 212.55 is amended by striking therefrom all of paragraph (c).

§ 212.56 [Amendment]

37. Section 212.56 is amended as follows:

(A) By striking from paragraph (a) all of the last sentence, which begins "The denaturant selected"; and

(B) By striking all of paragraph (c).

§ 212.57 [Amendment]

38. Section 212.57 is amended as follows:

(A) By amending paragraph (a) to read:

(a) *Formula.*—To every 100 gallons of alcohol add:

One and one-half avoirdupois ounces of brucine (alkaloid), brucine sulfate (N.F. IX), or quassin, and ⅛ gallon of *tert.*-butyl alcohol.

(B) By amending paragraph (b) by adding a new code number to read—

051. Polishes.

immediately preceding Code No. 111; and

(C) By striking all of paragraph (c).

§ 212.58 [Amendment]

39. Section 212.58 is amended by striking therefrom all of paragraph (c).

40. A new section, section 212.68a, is added, immediately following section 212.68, to read as follows:

§ 212.68a Ammonia Aqueous.—*Alkalinity.*—Strongly alkaline to litmus.

Ammonia (NH_3) *content.*—27 to 30 percent by weight. Accurately weigh a glass-stoppered flask containing 25 ml. of water, add about 2 ml. of the sample, stopper, and weigh again. Add methyl red indicator, and titrate with 1N sulfuric acid. Each ml. of 1N sulfuric acid is equivalent to 17.03 mg. of NH_3.

Color.—Colorless liquid.

Non-volatile residue.—2 mg. maximum. Dilute a portion of the sample with 1½ times its volume of distilled water. Evaporate 10 ml. of this product to dryness in a tared platinum or porcelain dish. Dry residue at 105° C. for one hour, cool and weigh.

Odor.—Characteristic (exceedingly pungent).

Specific gravity at 20°/4° C.—0.9010 to 0.8920.

41. A new section, section 212.73a, is added, immediately following section 212.73, to read as follows:

§ 212.73a. Caustic Soda, Liquid.—The liquid caustic soda may consist of either 50 percent or 73 percent by weight sodium hydroxide in aqueous solution. The amount of caustic soda used shall be such that each 100 gallons of alcohol will contain not less than 8.76 pounds of sodium hydroxide, anhydrous basis.

Color.—A 2 percent solution of the sodium hydroxide in water shall be water-white.

Assay.—The sodium hydroxide content of the caustic soda solution shall be determined by the following procedure:

Accurately weigh two grams of liquid caustic soda into a 100 ml. volumetric flask, dissolve, and dilute to the mark with distilled water at room temperature. Transfer a 25 ml. aliquot of the solution to a titration flask, add 10 ml. of 1 percent barium chloride solution, 0.2 ml. of 1 percent phenolphthalein indicator, and 50 ml. of distilled water. Titrate with 0.25 normal hydrochloric acid to the disappearance of the pink color. Not less than 25 ml. of the hydrochloric acid shall be required to neutralize the sample of diluted 50 percent caustic soda, and not less than 36.5 ml. of the hydrochloric acid shall be required to neutralize the sample of diluted 73 percent caustic soda.

1 ml. of 0.25 N hydrochloric acid equals 0.01 g. of sodium hydroxide (anhydrous).

42. Section 212.77 is amended to read as follows:

§ 212.77 DIETHYL PHTHALATE.—*Refractive index at 25° C.*—1.497–1.502.
Color.—Colorless.
Odor.—Practically odorless.
Solubility.—Soluble in 20 parts of 60 percent alcohol.
Specific gravity at 25°/25° C.—1.115 to 1.118.
Ester content (as diethyl phthalate).—Not less than 99 percent by weight.
NOTE: The sample taken for ester determination should be approximately 0.8 gram. The number of ml. of 0.5N potassium hydroxide used in saponification multiplied by 0.05555 indicates the grams of ester in the sample taken for assay.

43. Section 212.78 is amended to read as follows:

§ 212.78 ETHYL ACETATE.—(a) *85 percent ester.—Acidity (as acetic acid).*—Not more than 0.015 percent by weight.
Color.—Colorless.
Odor.—Characteristic odor.
Ester content.—Not less than 85 percent by weight.
Specific gravity at 20°/20° C.—Not less than 0.882.
Distillation range (applicable A.S.T.M. method).—When 100 ml. of ethyl acetate are distilled by this method, none shall distill below 70° C.; not more than 10 ml. shall distill below 72° C., and none above 80° C.
(b) *100 percent ester.—Acidity (as acetic acid).*—Not more than 0.010 percent by weight.
Color.—Colorless.
Odor.—Characteristic odor.
Ester content.—Not less than 99 percent by weight.
Specific gravity at 20°/20° C.—Not less than 0.899.
Distillation range (applicable A.S.T.M. method).—When 100 ml. of ethyl acetate are distilled by this method, not more than 2 ml. shall distill below 75° C., and none above 80° C. (760 mm.).

44. A new section, section 212.83a, is added immediately following section 212.83, to read as follows:

§ 212.83a METHYL VIOLET.—Methyl violet (Methylrosaniline Chloride) occurs as a dark green powder or crystals having metallic luster.
Arsenic content.—Not more than 15 ppm. (as As_2O_3) as determined by the applicable U.S.P. method.
Identification test.—Sprinkle about 1 mg. of sample on 1 ml. of sulfuric acid; it dissolves in the acid with an orange or brown-red color. When this solution is diluted cautiously with water, the color changes to brown, then to green, and finally to blue.
Insoluble matter.—Not to exceed 0.25 percent when tested by the following method: Transfer 1.0 gram of sample to a 150 ml. beaker containing 50 ml. of alcohol. Stir to complete solution and filter through a weighed Whatman No. 4 filter paper. Wash residue with small amounts of alcohol totaling about 50 ml. Dry paper in oven for 30 minutes at 80° C. and weigh. Calculate insoluble material.

45. A new section, section 212.87a, is added, immediately following section 212.87, to read as follows:

§ 212.87a QUASSIN.—Quassin is the bitter principle of quassia wood (occuring as a mixture of two isomeric forms). It shall be a good commercial grade of purified amorphous quassin, standardized as to bitterness.
Bitterness.—An aqueous solution of quassin shall be distinctly bitter at a 1 to 250,000 dilution. To test: Dissolve 0.1 g. of quassin in 100 ml. of 95 percent alcohol, then dilute 4 ml. of the solution to 1,000 ml. with distilled water, mix well and taste.
Identification test.—Dissolve about 0.5 gram quassin in 10 ml. of 95 percent alcohol and filter. To 5 ml. of the filtrate, add 5 ml. of concentrated hydrochloric acid and 1 mg. phloroglucinol and mix well. A red color develops.

Optical assay.—When 1 gram of quassin (in solution in a small amount of 95 percent alcohol) is dissolved in 10,000 ml. of water, the absorbance of the solution in a 1 cm. cell at a wavelength of 258 millimicrons shall be not less than 0.400.

Solubility.—When 0.5 gram of quassin is added to 25 ml. of 190 proof alcohol, it shall dissolve completely.

3. A new paragraph 45a is inserted immediately following paragraph 45, to amend § 212.90, as follows:

§ 212.90 [Amendment]

45a. Section 212.90 is amended by striking the opening sentence, immediately following the words "*Arsenic content.*", and by inserting in lieu thereof a new sentence to read "Not more than 1.4 parts per million as determined by the Gutzeit Method.".

§ 212.94 [Amendment]

46. Section 212.94 is amended by striking the parenthetical expression "(or SDA No. 30)" in the two places where it appears and by inserting in lieu thereof the parenthetical expression "(or SDA No. 3–A or No. 30)".

46a. Section 212.95 is amended to read:

§ 212.95 VINEGAR.—(a) *Vinegar, 90-grain.—Acidity (as acetic acid).*—9.0 percent by weight, minimum.

(b) *Vinegar, 60-grain.—Acidity (as acetic acid).*—6.0 percent by weight, minimum.

§ 212.96 [Amendment]

47. Section 212.96 is amended by striking the word "acetone" from the second sentence, which begins "It may be a blend of", and from the first sentence under the heading "Pyroligneous bodies", and by inserting in lieu thereof the word "ketone".

48. Subpart F is amended to read as follows:

Subpart F.—Uses of Specially Denatured Alcohol and Specially Denatured Rum

§ 212.105 LISTING OF PRODUCTS AND PROCESSES USING SPECIALLY DENATURED ALCOHOL AND RUM AND FORMULAS AUTHORIZED THEREFOR.—This section gives a listing, alphabetically by product or process, of formulas of specially denatured alcohol authorized for use in such products or processes, and a listing of the code numbers assigned thereto. Specially denatured rum, as well as specially denatured alcohol, may be used in tobacco sprays and flavors, Code No. 460, under Formula No. 4.

Uses of specially denatured alcohol [1]

Product or process	Code No.	Formulas authorized
Acetaldehyde	551	1, 2–B, 29.
Acetic acid	512	1, 2–B, 29, 35–1.
Adhesives and binders	036	1, 3–A, 12–A, 23–A, 30.
Aldehydes, miscellaneous	552	1, 2–B, 29.
Alkaloids (processing)	344	1, 2–B, 2–C, 3–A, 12–A, 13–A, 17, 23–A, 30, 32, 35–A.
Animal feed supplement	910	35–A.
Antibiotics (processing)	343	1, 2–B, 3–A, 12–A, 13–A, 23–A, 30, 32, 35–A.
Antifreeze, proprietary	760	1.
Antiseptic, bathing solution (restricted).	220	46.
Antiseptic solutions, U.S.P. or N.F.	244	37, 38–B, 38–F.
Bath preparations	142	1, 3–A, 3–B, 23–A, 30, 36, 38–B, 39–B, 39–C, 40, 40–A.
Bay rum	112	23–A, 37, 38–B, 39, 39–B, 39–D, 40, 40–A.
Biocides, miscellaneous	410	1, 3–A, 3–B, 23–A, 23–H, 27–A, 27–B, 30, 37, 38–B, 39–B, 40, 40–A.
Blood and blood products (processing).	345	1, 3–A, 12–A, 13–A, 23–A, 30.
Brake fluids	720	1, 3–A.
Candy glazes	015	13–A, 23–A, 35, 35–A, 45.
Cellulose coatings	011	1, 23–A.
Cellulose compounds (dehydration)	311	1, 2–B, 3–A, 32.
Cellulose intermediates	034	1, 3–A, 13–A, 19, 23–A, 32.
Chemicals (miscellaneous)	579	1, 2–B, 2–C, 3–A, 6–B, 12–A, 13–A, 17, 20, 29, 30, 32, 36.
Cleaning solutions	450	1, 3–A, 23–A, 23–H, 30, 36, 39–B, 40.
Coatings, miscellaneous	016	1, 23–A.
Collodions, industrial	034	1, 3–A, 13–A, 19, 23–A, 32.
Collodions, U.S.P. or N.F	241	13–A, 19, 32.
Colognes	122	38–B, 39, 39–A, 39–B, 39–C, 40, 40–A.
Crude drugs (processing)	341	1, 2–B, 3–A, 23–A, 30.
Cutting oils	730	1, 3–A.
Dehydration products, miscellaneous	315	1, 2–B, 3–A.
Dentrifices	131	31–A, 37, 38–B, 38–C, 38–D.
Deodorants (body)	114	23–A, 38–B, 39–B, 39–C, 40, 40–A.
Detergents, household	450	1, 3–A, 23–A, 23–H, 30, 36, 39–B, 40.
Detergents, industrial	440	1, 3–A, 23–A, 30.
Detonators	574	1, 6–B.
Disinfectants	410	1, 3–A, 3–B, 23–A, 23–H, 27–A, 27–B, 30, 37, 38–B, 39–B, 40, 40–A.
Drugs and medicinal chemicals	575	1, 2–B, 2–C, 3–A, 6–B, 12–A, 13–A, 17, 29, 30, 32.
Drugs, miscellaneous (processing)	349	1, 2–B, 3–A, 13–A, 23–A, 30, 35–A, 38–B.
Duplicating fluids	485	1, 3–A, 30.
Dyes and intermediates	540	1, 2–B, 2–C, 3–A, 12–A, 29, 36.
Dyes and intermediates (processing)	351	1, 2–B, 3–A, 12–A.
Dye solutions, miscellaneous	482	1, 3–A, 23–A, 30, 39–C, 40.
Embalming fluids, etc	420	1, 3–A, 22, 23–A.
Esters, ethyl (miscellaneous)	523	1, 2–B, 2–C, 3–A, 6–B, 12–A, 13–A, 17, 29, 32, 35–A.

See footnotes at end of table.

Uses of specially denatured alcohol [1]—Continued

Product or process	Code No.	Formulas authorized
Ether, ethyl	561	1, 2–B, 13–A, 29, 32.
Ethers, miscellaneous	562	1, 2–B, 13–A, 29, 32.
Ethyl acetate	521	1, 2–B, 29, 35–A.
Ethylamines (rubber processing)	530	1, 2–B, 2–C, 3–A, 12–A, 29, 36.
Ethyl chloride	522	1, 2–B, 29, 32.
Ethylene dibromide	571	1, 2–B, 29, 32.
Ethylene gas	572	1, 2–B, 29, 32.
Explosives	033	1, 2–B, 3–A.
External pharmaceuticals (not U.S.P. or N.F.).	210	23–A, 23–F, 23–H, 27–A, 27–B, 36, 37, 38–B, 38–F, 39–B, 40, 40–A.
External pharmaceuticals, miscellaneous (U.S.P. or N.F.).	249	23–A, 25, 25–A, 38–B.
Fluid uses, miscellaneous	750	1, 3–A, 23–A, 30.
Food products, miscellaneous (processing).	332	1, 2–B, 3–A, 13–A, 23–A, 30, 32, 35–A.
Fuel uses, miscellaneous	630	1, 3–A, 28–A.
Fuels, airplane and supplementary	612	1, 3–A, 28–A.
Fuels, automobile and supplementary	611	1, 3–A, 28–A.
Fuels, proprietary heating	620	1, 3–A, 28–A.
Fuels, rocket and jet	613	1, 3–A, 28–A.
Fungicides	410	1, 3–A, 3–B, 23–A, 23–H, 27–A, 27–B, 30, 37, 38–B, 39–B, 40, 40–A.
Glandular products (processing)	342	1, 2–B, 3–A, 12–A, 13–A, 23–A, 30, 32, 35–A.
Hair and scalp preparations	111	3–B, 23–A, 23–F, 23–H, 37, 38–B, 39, 39–A, 39–B, 39–C, 39–D, 40, 40–A.
Hormones (processing)	342	1, 2–B, 3–A, 12–A, 13–A, 23–A, 30, 32, 35–A.
Incense	470	3–A, 22, 37, 38–B, 39–B, 39–C, 40, 40–A.
Inks	052	1, 3–A, 13–A, 23–A, 30, 32, 33.
Insecticides	410	1, 3–A, 3–B, 23–A, 23–H, 27–A, 27–B, 30, 37, 38–B, 39–B, 40, 40–A.
Iodine solutions (including U.S.P. and N.F. tinctures)	230	25, 25–A.
Laboratory reagents (for sale)	810	3–A, 30.
Laboratory uses [2]	810	3–A, 30.
Lacquer thinners	042	1, 23–A.
Liniments (U.S.P. or N.F.)	243	27, 27–B, 38–B.
Lotions and creams (body, face, and hand)	113	23–A, 23–H, 31–A, 37, 38–B, 39, 39–B, 39–C, 40, 40–A.
Medicinal chemicals (processing)	344	1, 2–B, 2–C, 3–A, 12–A, 13–A, 17, 23–A, 30, 32, 35–A.
Miscellaneous chemicals (processing)	358	1, 2–B, 2–C, 3–A, 12–A, 13–A, 17, 23–A, 30, 35–A.
Miscellaneous products (processing)	359	1, 2–B, 2–C, 3–A, 12–A, 13–A, 17, 23–A, 30, 35–A.
Mouth washes	132	37, 38–B, 38–C, 38–D, 38–F.
Organo-silicone products	576	2–B, 3–A.
Pectin (processing)	331	1, 2–B, 3–A, 13–A, 23–A, 30, 35–A.
Perfume materials (processing)	352	1, 2–B, 3–A, 12–A, 13–A, 30.
Perfumes and perfume tinctures	121	38–B, 39, 39–B, 39–C, 40, 40–A.

See footnotes at end of table.

Uses of specially denatured alcohol [1]—Continued

Product or process	Code No.	Formulas authorized
Petroleum products	320	1, 2–B, 3–A.
Photoengraving dyes and solutions	481	1, 3–A, 13–A, 30, 32.
Photographic chemicals (processing)	353	1, 2–B, 3–A, 13–A, 30.
Photographic film and emulsions	031	1, 2–B, 3–A, 13–A, 19, 30, 32.
Pill and tablet manufacture	349	1, 2–B, 3–A, 13–A, 23–A, 30, 35–A, 38–B.
Plastics, cellulose	021	1, 2–B, 3–A, 12–A, 13–A, 30.
Plastics, non-cellulose (including resins)	022	1, 2–B, 3–A, 12–A, 13–A, 30.
Polishes	051	1, 3–A, 30, 40.
Preserving solutions	430	1, 3–A, 12–A, 13–A, 22, 23–A, 30, 32, 37, 38–B, 42, 44.
Proprietary solvents (standard formulas)	041	1.
Refrigerating uses	740	1, 3–A, 23–A, 30.
Resin coatings, natural	014	1, 23–A.
Resin coatings, synthetic	012	1, 23–A.
Room deodorants	470	3–A, 22, 37, 38–B, 39–B, 39–C, 40, 40–A.
Rosin (processing)	354	1, 3–A, 12–A.
Rotogravure dyes and solutions	481	1, 3–A, 13–A, 30, 32.
Rubber (latex) (processing)	355	1, 3–A.
Rubber, synthetic	580	29, 32.
Rubbing alcohol compound	220	23–H.
Scientific instruments	710	1, 3–A.
Shampoos	141	1, 3–A, 3–B, 23–A, 27–B, 31–A, 36, 38–B, 39–A, 39–B, 40, 40–A.
Shellac coatings	013	1, 23–A.
Soaps, industrial	440	1, 3–A, 23–A, 30.
Soaps, toilet	142	1, 3–A, 3–B, 23–A, 30, 36, 38–B, 39–B, 39–C, 40, 40–A.
Sodium ethylate, anhydrous (restricted).	524	2–B, 2–C.
Sodium hydrosulfite (dehydration)	312	1, 2–B, 3–A.
Soldering flux	035	1, 3–A, 23–A, 30.
Solutions, miscellaneous	485	1, 3–A, 23–A, 30, 39–B, 40, 40–A.
Solvents and thinners, miscellaneous	042	1, 23–A.
Solvents, special (restricted sale)	043	1.
Stains (wood)	053	1, 3–A, 23–A, 30.
Sterilizing solutions	430	1, 3–A, 12–A, 13–A, 22, 23–A, 30, 32, 37, 38–B, 42, 44.
Theater sprays	470	3–A, 22, 37, 38–B, 39–B, 39–C, 40, 40–A.
Tobacco sprays and flavors	460	4.
Toilet waters	122	38–B, 39, 39–A, 39–B, 39–C, 40, 40–A.
Transparent sheetings	032	1, 2–B, 3–A, 13–A, 23–A.
Unclassified uses [3]	900	1, 3–A.
Vaccine (processing)	343	1, 2–B, 3–A, 12–A, 13–A, 23–A, 30, 32, 35–A.
Vinegar	511	18, 35–A.
Vitamins (processing)	342	1, 2–B, 3–A, 12–A, 13–A, 23–A, 30, 32, 35–A.
Xanthates	573	1, 2–B, 2–C, 29.
Yeast (processing)	342	1, 2–B, 3–A, 12–A, 13–A, 23–A, 30, 32, 35–A.

[1] Other products or processes may be authorized by the Director under § 212.15(b).
[2] Formula No. 3–A and Formula No. 30 are authorized for general laboratory purposes under Code 810. Other formulas may be authorized for laboratory use in connection with specific product development.
[3] Persons desiring other formulas for this use should indicate the fact in the space provided for this purpose on Form 1479–A.

49. Subpart G is amended to read as follows:

Subpart G.—Denaturants Authorized for Denatured Spirits

§ 212.110 Listing of Denaturants Authorized for Denatured Spirits.—Following is an alphabetical listing of denaturants authorized for use in denatured spirits:

Denaturants Authorized for Completely Denatured Alcohol (C.D.A.) Specially Denatured Alcohol (S.D.A.), and Specially Denatured Rum (S.D.R.)

Acetaldehyde	S.D.A. 29
Acetone N.F	S.D.A. 23–A; 23–H
Acetadol	C.D.A. 18
Almond oil, bitter N.F	S.D.A. 38–B
Ammonia, aqueous	S.D.A. 36
Ammonia, solution, strong U.S.P	S.D.A. 36
Anethole U.S.P	S.D.A. 38–B
Anise oil U.S.P	S.D.A. 38–B
Bay oil (myrcia oil) N.F	S.D.A. 23–F; 38–B; 39–D
Benzaldehyde N.F	S.D.A. 38–B
Benzene	S.D.A. 2–B; 2–C; 12–A
Bergamot oil N.F	S.D.A. 23–F; 38–B
Bone oil (dipple's oil)	S.D.A. 17
Boric acid U.S.P	S.D.A. 38–F
Brucine alkaloid	S.D.A. 40
Brucine sulfate N.F. IX	S.D.A. 40
n-Butyl alcohol	S.D.A. 44
tert.-Butyl alcohol	S.D.A. 39; 39–A; 39–B; 40; 40–A
Camphor U.S.P	S.D.A. 27; 27–A; 38–B
Caustic soda, liquid	S.D.A. 36
Cedar leaf oil U.S.P. XIII	S.D.A. 38–B
Chloroform	S.D.A. 20
Chlorothymol N.F	S.D.A. 38–B; 38–F
Cinchonidine	S.D.A. 39–A
Cinchonidine sulfate N.F. IX	S.D.A. 39–A
Cinnamic aldehyde (cinnamaldehyde) N.F. IX	S.D.A. 38–B
Cinnamon oil (cassia oil) U.S.P	S.D.A. 38–B
Citronella oil, natural	S.D.A. 38–B
Clove oil U.S.P	S.D.A. 27–A; 38–B
Coal tar U.S.P	S.D.A. 38–B
Diethyl phthalate	S.D.A. 39–B; 39–C
Ethyl acetate	S.D.A. 35; 35–A
Ethyl ether	S.D.A. 13–A; 19; 32
Eucalyptol U.S.P	S.D.A. 37; 38–B
Eucalyptus oil N.F	S.D.A. 38–B
Eugenol U.S.P	S.D.A. 38–B
Formaldehyde solution U.S.P	S.D.A. 22; 38–C; 38–D
Gasoline	S.D.A. 28–A
Glycerol U.S.P	S.D.A. 31–A
Guaiacol N.F	S.D.A. 38–B
Iodine U.S.P	S.D.A. 25; 25–A
Kerosene	C.D.A. 18; 19
Lavender oil U.S.P	S.D.A. 27–B; 38–B
Menthol, U.S.P	S.D.A. 37; 38–B; 38–C; 38–D; 38–F
Mercuric iodide, red N.F	S.D.A. 42
Methyl alcohol	S.D.A. 3–A; 30
Methylene blue N.F	S.D.A. 4; S.D.R. 4
Methyl isobutyl ketone	C.D.A. 18; 19; S.D.A. 23–H
Methyl violet (methylrosaniline chloride)	S.D.A. 33
Methyl violet (methylrosaniline chloride) U.S.P	S.D.A. 33

Mustard oil, volatile (allyl isothiocyanate), U.S.P. XII	S.D.A. 38–B
Nicotine solution	S.D.A. 4; S.D.R. 4
Peppermint oil U.S.	S.D.A. 38–B
Phenol U.S.P	S.D.A. 38–B; 46
Phenyl mercuric benzoate	S.D.A. 42
Phenyl mercuric chloride N.F. IX	S.D.A. 42
Phenyl mercuric nitrate N.F	S.D.A. 42
Phenyl salicylate (salon) N.F	S.D.A. 38–B
Pine needle oil, dwarf N.F	S.D.A. 38–B
Pine oil, N.F	S.D.A. 38–B
Pine tar, N.F	S.D.A. 3–B
Potassium iodide, U.S.P	S.D.A. 25; 25–A; 42
Pyridine bases	S.D.A. 6–B
Pyronate	C.D.A. 18
Quassia, fluid extract of, N.F. VII	S.D.A. 39
Quassin	S.D.A. 40
Quinine N.F	S.D.A. 39–A
Quinine bisulfate N.F	S.D.A. 39–A; 39–D
Quinine hydrochloride U.S.P	S.D.A. 39–A
Quinine sulfate U.S.P	S.D.A. 39–D
Resorcin U.S.P	S.D.A. 23–F
Rosemary oil N.F	S.D.A. 27; 38–B
Rubber hydrocarbon solvent	S.D.A. 2–B; 2–C
Safrol	S.D.A. 38–B
Salicylic acid U.S.P	S.D.A. 23–F; 39
Sassafras oil N.F	S.D.A. 38–B
Shellac (refined)	S.D.A. 45
Sodium iodide U.S.P	S.D.A. 25; 25–A
Sodium, metallic	S.D.A. 2–C
Sodium salicylate U.S.P	S.D.A. 39; 39–D
Soap, hard N.F	S.D.A. 31–A
Soap, medicinal soft U.S.P	S.D.A. 27–B
Spearmint oil N.F	S.D.A. 38–B
Spearmint oil, terpeneless	S.D.A. 38–B
Spike lavendar oil, natural	S.D.A. 38–B
Storax U.S.P	S.D.A. 38–B
Sucrose octa-acetate	S.D.A. 40–A
Thimerosal N.F	S.D.A. 42
Thyme oil N.F	S.D.A. 38–B
Thymol N.F	S.D.A. 37; 38–B; 38–F
Tolu balsam U.S.P	S.D.A. 38–B
Turpentine oil N.F	S.D.A. 38–B
Vinegar	S.D.A. 18
Wintergreen oil (methyl salicylate) U.S.P	S.D.A. 38–B; 46
Wood alcohol	S.D.A. 1

§ 212.115 [Amendment]

50. The table of weights and specific gravities contained in § 212.115, and the footnotes thereto, are amended to read as follows:

Weights and specific gravities of specially denatured alcohol [1]

[Slight deviations from this table may occur due to variations in specific gravities of authorized denaturants. Values for 190° proof determined experimentally by National Bureau of Standards. Other values calculated from these gravities]

SDA Formula No.	Finished formula (gal.)	190° proof		192° proof		200° proof	
		Wt./gal. in air (pounds)	Sp. gr. in vac.	Wt./gal. in air (pounds)	Sp. gr. in vac.	Wt./gal. in air (pounds)	Sp. gr. in vac.
1	105. 0	6. 788	0. 8153	6. 757	0. 8115	6. 612	0. 7942
2–B	100. 5	6. 795	. 8161	6. 762	. 8121	6. 612	. 7941
2–C	99. 5					6. 959	. 8358
3–A	105. 0	6. 785	. 8149	6. 753	. 8111	6. 609	. 7938
3–B	101. 0	6. 810	. 8179	6. 777	. 8140	6. 627	. 7960
4	100. 8	6. 823	. 8195	6. 791	. 8156	6. 640	. 7975
6–B	100. 5	6. 801	. 8169	6. 768	. 8129	6. 618	. 7949
12–A	105. 0	6. 820	. 8192	6. 789	. 8154	6. 645	. 7981
13–A	109. 7	6. 740	. 8095	6. 710	. 8059	6. 572	. 7893
17	100. 05	6. 795	. 8161	6. 762	. 8121	6. 611	. 7940
18	195. 4	7. 802	. 9369	7. 785	. 9349	7. 708	. 9256
19	197. 9	6. 468	. 7769	6. 452	. 7749	6. 375	. 7657
20	104. 9	7. 062	. 8481	7. 030	. 8443	6. 886	. 8270
22	109. 5	7. 037	. 8451	7. 007	. 8415	6. 868	. 8249
23–A	109. 9	6. 788	. 8153	6. 758	. 8117	6. 621	. 7952
23–F	101. 5	6. 808	. 8177	6. 776	. 8138	6. 627	. 7959
23–H	109. 45	6. 785	. 8149	6. 755	. 8113	6. 617	. 7947
25	100. 9	7. 080	. 8502	7. 047	. 8463	6. 897	. 8283
25 [2]	100. 9	7. 083	. 8506	7. 050	. 8467	6. 900	. 8287
25–A	102. 5	7. 119	. 8550	7. 087	. 8511	6. 939	. 8334
25–A [2]	102. 5	7. 117	. 8548	7. 085	. 8509	6. 938	. 8332
27	104. 7	6. 846	. 8222	6. 814	. 8184	6. 670	. 8011
27–A	105. 2	6. 867	. 8247	6. 835	. 8209	6. 692	. 8037
27–B	112. 0	7. 027	. 8439	6. 998	. 8404	6. 862	. 8241
28–A	101. 0	6. 786	. 8150	6. 753	. 8111	6. 603	. 7931
29	101. 0	6. 822	. 8194	6. 790	. 8155	6. 640	. 7975
30	110. 0	6. 785	. 8149	6. 755	. 8113	6. 617	. 7948
31–A	111. 5	7. 167	. 8608	7. 138	. 8572	7. 002	. 8409
32	104. 8	6. 769	. 8130	6. 737	. 8092	6. 593	. 7919
33	102. 9	6. 893	. 8279	6. 861	. 8240	6. 714	. 8064
35 [3]	135. 0	6. 956	. 8355	6. 933	. 8326	6. 820	. 8191
35 [4]	129. 75	6. 963	. 8362	6. 937	. 8331	6. 820	. 8191
35–A [3]	105. 0	6. 817	. 8187	6. 785	. 8149	6. 641	. 7976
35–A [4]	104. 25	6. 826	. 8197	6. 794	. 8159	6. 649	. 7985
36	102. 7	6. 837	. 8211	6. 804	. 8172	6. 657	. 7995
37	100. 9	6. 794	. 8160	6. 762	. 8121	6. 612	. 7941
38–B	101. 3	6. 804	. 8172	6. 772	. 8133	6. 622	. 7953
38–C	102. 6	6. 832	. 8206	6. 800	. 8167	6. 652	. 7990
38–D	102. 7	6. 863	. 8242	6. 830	. 8203	6. 682	. 8026
38–F	100. 9	6. 828	. 8201	6. 796	. 8162	6. 646	. 7982
39	102. 0	6. 867	. 8247	6. 834	. 8208	6. 686	. 8030
39–A	100. 5	6. 810	. 8179	6. 777	. 8139	6. 627	. 7959
39–B	102. 7	6. 857	. 8236	6. 825	. 8197	6. 677	. 8020
39–C	101. 0	6. 819	. 8189	6. 792	. 8157	6. 642	. 7977
39–D	101. 3	6. 819	. 8190	6. 787	. 8151	6. 637	. 7971
40	100. 1	6. 795	. 8161	6. 762	. 8121	6. 611	. 7940
40–A	100. 5	6. 815	. 8185	6. 782	. 8145	6. 632	. 7965
42	100. 0	6. 797	. 8164	6. 764	. 8124	6. 613	. 7943
44	110. 0	6. 790	. 8155	6. 760	. 8119	6. 622	. 7954
45	129. 8	7. 545	. 9060	7. 520	. 9030	7. 403	. 8890
46	100. 1	6. 805	. 8173	6. 772	. 8133	6. 621	. 7952

[1] Where alternate denaturants are permitted, the above weights are based on the first denaturant or combination listed in the formula.
[2] With sodium iodide.
[3] Calculated on the basis of 85 percent ethyl acetate.
[4] Calculated on the basis of 100 percent ethyl acetate.

Because this Treasury Decision is a part of an integrated recodification program under chapter 51, I.R.C., and in order that the entire program may be effective on July 1, 1960, it is found that it is contrary to the public interest to issue this Treasury decision subject to the effective date limitation of section 4(c) of the Administrative Procedure Act (60 Stat. 238; 5 U.S.C. 1003). Accordingly, this Treasury Decision shall become effective on July 1, 1960.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved June 23, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 28, 1960, 8:45 a.m., and published in the issue of the Federal Register for June 29, 1960, 25 F.R. 5987)

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26 CFR 212.15: General. Rev. Rul. 60–374
(Also Section 5242; 212.19, 212.39, 212.40, 212.45.)

The Formulas For Denatured Alcohol and Rum Regulations, at section 212.15, provide that, subject to certain conditions the Director, Alcohol and Tobacco Tax Division, may authorize, in his discretion, the use of any formula of specially denatured alcohol or specially denatured rum for uses not specifically authorized in Part 212 of the regulations. *Held*, specially denatured alcohol formulas numbered 3–A, 29, 30, and 35–A are authorized for use in the manufacture of synthetic resins under formulas on Form 1479–A, Formula for Preparation Made With Specially Denatured Alcohol, which have been approved by the Director. Code number 590 should be used in reporting the use of specially denatured alcohol.

SECTION 5242.—DENATURING MATERIALS

26 CFR 212.10: General.

Amendment of the regulations to provide for the addition of certain materials to formulas for completely denatured alcohol. See T.D. 6474, page 593.

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26 CFR 212.19: Formula No. 3–A.

Use of specially denatured alcohol for manufacture of synthetic resins. See Rev. Rul. 60–374, above.

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26 CFR 212.39: Formula No. 29.

Use of specially denatured alcohol for manufacture of synthetic resins. See Rev. Rul. 60–374, above.

26 CFR 212.40: Formula No. 30.

Use of specially denatured alcohol for manufacture of synthetic resins. See Rev. Rul. 60–374, page 609.

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26 CFR 212.45: Formula No. 35–A.

Use of specially denatured alcohol for manufacture of synthetic resins. See Rev. Rul. 60–374, page 609.

SUBCHAPTER D.—INDUSTRIAL USE OF DISTILLED SPIRITS

SECTION 5273.—SALE, USE, AND RECOVERY OF DENATURED DISTILLED SPIRITS

26 CFR 211.169: General. (Also 212.55.) Rev. Rul. 60–363

> Where a specially denatured alcohol permittee manufactures hair spray and packages the product in pressurized containers, the quantity of perfume oil used in the product may be decreased upon the approval of the Director, Alcohol and Tobacco Tax Division. However, hair spray which is shipped in bulk to a non-permittee for packaging in pressurized containers must contain not less than one-half ounce of an acceptable perfume oil in each gallon of the finished product.

Advice has been requested whether there may be a reduction in the quantity of perfume oil used in the manufacture of hair sprays made with specially denatured alcohol and packaged or repackaged in pressurized containers.

Section 5273(a) of the Internal Revenue Code of 1954 provides that any person using specially denatured distilled spirits in the manufacture of articles shall file such formulas and statements of process, submit such samples, and comply with such other requirements, as the Secretary of the Treasury or his delegate shall by regulations prescribe, and no person shall use specially denatured distilled spirits in the manufacture or production of any article until approval of the article, formula, and process has been obtained from the Secretary or his delegate.

Section 211.169 of the Industrial Alcohol and Denatured Rum Regulations provides, in part, that liquid products containing specially denatured alcohol shall be unfit for beverage or internal human use and that the essential oils and chemicals used in their manufacture shall make the finished products conform to the samples and formulas for such products submitted by the applicant with Form 1479–A, Formula for Preparation Made with Specially Denatured Spirits, and approved by the Director, Alcohol and Tobacco Tax Division, or, in the case of rubbing alcohol compounds, by the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

Accordingly, it is held that the quantity of perfume oil used in the manufacture of hair sprays made with specially denatured alcohol and packaged in pressurized containers by the manufacturer (per-

mittee) may be decreased upon the submission of a revised formula on Form 1479–A and approval by the Director, Alcohol and Tobacco Tax Division.

However, hair spray which is shipped in bulk to a non-permittee for packaging in pressurized containers must contain not less than one-half ounce of an acceptable perfume oil in each gallon of the finished product.

This Revenue Ruling is not applicable to hair sprays manufactured with specially denatured alcohol, Formula No. 39–C, which must contain not less than 2 fluid ounces of perfume material in each gallon of finished product as required by section 211.192 of the regulations.

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26 CFR 211.174: Receipt. Rev. Rul. 60–343
(Also 211.176.)

Proprietary solvent received by a user thereof in bulk conveyances and drawn into packages may be transferred to other plants operated by the same consignee provided (1) that notice of this operation is given to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, (2) that the packages which are to be transshipped have been filled, numbered, and marked or labeled as required by the Denatured Alcohol and Rum Regulations, (3) that serial numbers and a description of contents is marked upon each package, and (4) that complete records of receipt, use, and shipment are maintained at the plant receiving the proprietary solvent in bulk conveyances.

Advice has been requested whether proprietary solvent, received by a user thereof in bulk conveyances and drawn into packages, may be transferred to other plants operated by the same consignee.

A user of proprietary solvents operates more than one manufacturing plant. He receives proprietary solvents in bulk at his principal place of business and there packages a portion for shipment to his other plants.

Section 211.174 of the Denatured Alcohol and Rum Regulations provides that unless proprietary solvents received in bulk conveyances are to be used immediately, they shall be deposited in storage tanks or drawn into packages which shall be marked as required by subpart J of the regulations.

Section 211.176 of the regulations further provides that distributors and persons using proprietary solvents may package such solvents in containers of any size not exceeding 55 gallons and that the container (except those filled for convenience by persons using such products at their own plant premises) shall be marked or labeled as required by sections 211.177 and 211.179 of the regulations.

It is held, in view of the above cited regulations, that the transfer of packages of proprietary solvent, filled by the consignee from bulk conveyances, from one plant to other plants operated by him, is permissible under the following conditions:

1. The consignee receiving proprietary solvent in bulk conveyances for transhipment in packages will be considered both a distributor and user. In his capacity as a distributor, he must give notice of the proposed operation to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, of the region in which the plant is located.

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2. The packages which are not to be used at the plant where originally received must be filled, numbered, and marked or labeled as required by sections 211.176, 211.177, and 211.179 of the regulations. The marks and brands on such packages must not be effaced or obliterated until they are emptied, as provided by section 211.33 of the regulations.

3. The packages which are to be used at the plant receiving the proprietary solvent in bulk must have placed thereon a serial number, as required by section 211.178 of the regulations. In addition, the nature of the contents must be marked on each such package.

4. The plant receiving proprietary solvent in bulk conveyances must maintain complete records of the receipt and use of the solvent at such plant and of the shipment of packages of solvent to the other plant.

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26 CFR 211.176: Filling of packages.

Transfer of proprietary solvent by a consignee to another of its plants. See Rev. Rul. 60–343, page 611.

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26 CFR 212.55: Formula No. 39–C.

Reduction in the quantity of perfume oil used in the manufacture of hair sprays. See Rev. Rul. 60–363, page 610.

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26 CFR 212.57: Formula No. 40. Rev. Rul. 60–286
(Also 212.65.)

Bitrex (THS–839), the benzoate form of a synthetic quaternary ammonium compound, may be used in the amount of ¼ ounce to each 100 gallons of ethyl alcohol, as a substitute denaturant in the manufacture of specially denatured alcohol Formula No. 40.

Section 212.57 of the Regulations relating to Formulas for Denatured Alcohol and Rum prescribes the denaturants to be used in specially denatured alcohol Formula No. 40. Laboratory tests have shown that another product, designated "Bitrex (THS–839)," is also suitable as a denaturant for this formula. Accordingly, this denaturant is authorized under authority of section 212.65 of the regulations, as an alternate denaturant for Formula No. 40, as follows:

To every 100 gallons of alcohol add ¼ av. ounce of denaturing grade Bitrex (THS–839) and ⅛ gallon of *tert*-butyl alcohol.

The specifications for denaturing grade Bitrex (THS–839) are as follows:

Bitrex (THS–839) is a synthetic quaternary ammonium compound; Benzyldiethyl (2:6-xylylcarbamoyl) ammonium benzoate, having an intensely bitter taste.

Color—White (crystalline powder)

Melting Point—158–161° C.

Solubility at 20° C.—One gram is soluble in 1.5 ml. water and in 1.5 ml. ethyl alcohol. Solutions are clear and colorless and reasonably free of extraneous matter.

Assay—Not less than 99 percent $C_{28}H_{34}O_3N_2$. Dissolve about 0.5 gm. Bitrex (THS–839) accurately weighed in 60ml. glacial acetic acid, cool; add 15 ml. of a 5 percent w/v solution of mecuric acetate in glacial acetic acid, and titrate with N/10 perchloric acid in glacial acetic acid using 0.2 ml. of a 0.5 percent w/v solution of crystal violet in glacial acetic acid as indicator (or methylrosaniline chloride T.S.). Repeat the titration omitting the samples. The difference between the two readings will represent the volume of perchloric acid required by the sample. Each ml. of N/10 perchloric acid is equivalent to 0.04465 gm. $C_{28}H_{34}O_3N_2$.

Identification Tests—(a) Dissolve about 0.15 gm. sample in 10 ml. water, and add 15 ml. of 0.66 percent w/v trinitrophenol in water; the melting point of the precipitate after washing with water and drying is about 175° C.

(b) Dissolve about 0.1 gm. sample in 10 ml. water and add 20 ml. dilute sulfuric acid and 30 ml. 1 percent w/v ammonium reineckate in water; the melting point of the precipitate after washing with water and drying, is about 170° C.

Bitterness—An alcoholic or aqueous solution of Bitrex (THS–839) shall be distinctly bitter at 1 to 250,000 dilution.

Optical Assay—When 25 ml. of an aqueous solution containing 1 part in 10,000 of Bitrex (0.1 gm/L) is made acid with 1 ml. of HC[1], and extracted 3 times with a total of 100 ml. of diethyl ether, the resulting ether extract shall have an absorbance in a 1 cm. cell of not less than 0.400 at a wavelength of 228 millimicrons.

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26 CFR 212.65: General.

Use of Bitrex (THS–839) as a substitute denaturant in manufacture of specially denatured alcohol Formula No. 40. See Rev. Rul. 60–286, page 612.

SUBCHAPTER E.—GENERAL PROVISIONS RELATING TO DISTILLED SPIRITS

PART II.—REGULATION OF TRAFFIC IN CONTAINERS OF DISTILLED SPIRITS

SECTION 5301.—GENERAL

26 CFR 175.9: Bottler. T.D. 6471 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 175.—TRAFFIC IN CONTAINERS OF DISTILLED SPIRITS

Miscellaneous amendments

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

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

On March 19, 1960, a notice of proposed rulemaking to amend 26 CFR Part 175, with respect to traffic in containers of distilled spirits, was published in the Federal Register (25 F.R. 2367).

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[1] 25 F.R. 5334.

After consideration of all relevant matter as was presented by interested parties regarding the rules proposed, the regulations as so published are hereby adopted.

In order to implement provisions of the Internal Revenue Code of 1954, as amended by Public Law 85–859 [C.B. 1958–3, 92], relating to the refilling and reuse of liquor bottles, 26 CFR Part 175 is amended as follows:

1. Section 175.9 is amended to read as follows:

§ 175.9 BOTTLER.—

A proprietor of a distilled spirts plant authorized to bottle spirts, a proprietor of a class 8 bonded warehouse qualified under the customs laws, or an agency of the United States or any State or political subdivision thereof.

2. Section 175.13 is amended to read as follows:

§ 175.13 DISTILLED SPIRITS OR SPIRITS.—That substance known as ethyl alcohol, ethanol, or spirits of wine, including all dilutions and mixtures thereof, from whatever source or by whatever process produced, and shall include whisky, brandy, rum, gin, and vodka, and products of rectification not classified as wine.

3. Section 175.21 is amended to read as follows:

§ 175.21 UNITED STATES.—The several States and the District of Columbia.

4. Subpart I is amended to read as follows:

SUBPART I—PURCHASE, SALE, REUSE, AND POSSESSION OF USED LIQUOR BOTTLES

§ 175.120 PURCHASE OR SALE OF USED LIQUOR BOTTLES.—Except as provided in this part, no person shall purchase or sell used liquor bottles.

§ 175.121 REUSE OR REFILLING OF LIQUOR BOTTLES.—Except as authorized by the provisions of Chapter 51, I.R.C., and regulations thereunder, including the regulations in this part, and in accordance with the conditions, limitations, and requirements set forth therein, including those in respect to the stamping of containers, no person who sells, or offers for sale, distilled spirits, or any agent or employee of such person, shall (a) place in any liquor bottle any distilled spirits whatsoever other than the distilled spirits contained in such bottle at the time such bottle was filled and stamped under the provisions of Chapter 51, I.R.C., or (b) by the addition of any substance whatsoever to any liquor bottle, in any manner alter or increase the original contents or any portion of the original contents contained in such bottle at the time such bottle was filled and stamped under the provisions of Chapter 51, I.R.C.

§ 175.122 POSSESSION OF REFILLED LIQUOR BOTTLES.—No person who sells, or offers for sale, distilled spirits, or agent or employee of such person, shall (a) possess any liquor bottle in which any distilled spirits have been placed in violation of section 5301(c) of the Internal Revenue Code or § 175.121 or (b) possess any liquor bottle, any portion of the contents of which has been altered or increased in violation of section 5301(c) of the Internal Revenue Code or § 175.121.

§ 175.123 *Possession of used liquor bottles.*—The possession of used liquor bottles by any person other than the person who empties the original contents thereof, or the bottler or the importer as authorized by this part, is prohibited, except that this shall not prevent the owner or occupant of any premises on which such bottles have been lawfully emptied from assembling the same on such premises (a) for the purpose of destruction or (b) for delivery to a bottler or importer who maintains a storage place for used liquor bottles as authorized by this part.

This Treasury Decision shall become effective on July 1, 1960.

(This Treasury Decision is issued under authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805)

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved June 9, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 14, 1960, 8:49 a.m., and published in the issue of the Federal Register for June 15, 1960, 25 F.R. 5334)

PART III.—MISCELLANEOUS PROVISIONS

SECTION 5313.—WITHDRAWAL OF DISTILLED SPIRITS FROM CUSTOMS CUSTODY FREE OF TAX FOR USE OF THE UNITED STATES

26 CFR 251.181: General.

Procedure covering the withdrawal of imported distilled spirits from customs custody for use of the United States. See T.D. 6477, page 575.

SECTION 5314.—SPECIAL APPLICABILITY OF CERTAIN PROVISIONS

26 CFR 250.191: Samples and analysis.

Tax-free shipments from Puerto Rico to the United States of denatured spirits and products containing such spirits. See T.D. 6478, page 560.

26 CFR 250.291: Certificate.

Tax-free shipments from the Virgin Islands to the United States of denatured spirits and products containing such spirits. See T.D. 6478, page 560.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATIONS

SECTION 5362.—REMOVALS OF WINE FROM BONDED WINE CELLARS

26 CFR 252.122: Application or notice, Form 206.

Disposition of Form 206, Withdrawal of Spirits, Specially Denatured Spirits, or Wines for Exportation, where the exporter is the proprietor of the bonded wine cellar from which the wine is to be withdrawn. See Rev. Proc. 60–25, page 1000.

26 CFR 252.125: Disposition of forms.

Disposition of Form 206, Withdrawal of Spirits, Specially Denatured Spirits, or Wines for Exportation, where an exporter is the proprietor of a bonded wine cellar. See Rev. Proc. 60–25, page 1000.

SECTION 5373.—WINE SPIRITS

26 CFR 240.490: General.

Authorized use of distillates containing aldehydes for use in the fermentation of wine to be used as distilling material. See T.D. 6475, page 526.

26 CFR 240.1041: Who may withdraw.

Withdrawal of distillates containing aldehydes for use in the fermentation of wine to be used as distilling material. See T.D. 6475, page 526.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.524: Finishing of wine. (Also 240.530.) Rev. Rul. 60–266

The use of gum arabic in amounts not exceeding two pounds per 1,000 gallons of wine to stabilize and clarify wine, and the use of a product identified as "Wine Clarifier" containing pure U.S.P. agar-agar and Standard Supercel, to clarify wines, in amounts not exceeding two pounds per 1,000 gallons of wine are also considered as being consistent with good commercial practice within the provisions of section 240.524 of the Federal Wine Regulations. Winemakers desiring to use these products in the treatment of wine may receive approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by filing of appropriate notice pursuant to section 240.530 of the regulations.

This ruling amplifies Revenue Ruling 58–461, C.B. 1958–2, 999, which contains a list of materials authorized for use in the production, cellar treatment, and finishing of wine. Revenue Ruling 58–461, has previously been amplified by the following:

Revenue Ruling 58–595, C.B. 1958–2, 1003;
Revenue Ruling 58–596, C.B. 1958–2, 1003;
Revenue Ruling 59–105, C.B. 1959–1, 729;
Revenue Ruling 59–150, C.B. 1959–1, 728;
Revenue Ruling 59–189, C.B. 1959–1, 728;
Revenue Ruling 59–207, C.B. 1959–1, 729;
Revenue Ruling 59–217, C.B. 1959–1, 729;
Revenue Ruling 59–338, C.B. 1959–2, 607;
Revenue Ruling 59–370, C.B. 1959–2, 607; and
Revenue Ruling 60–46, C.B. 1960–1, 733.

(Also 240.1051, 240.1052.) Rev. Rul. 60–298

The use of Pectinase LM to clarify wine, in amounts not to exceed ten pounds per 1000 gallons of wine, is considered as being consistent with good commercial practice within the limitations of section 240.524 of the Federal Wine Regulations. Winemakers desiring to use Pectinase LM in the clarification of wine may receive the approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by the filing of appropriate notice pursuant to section 240.1052 of the regulations.

(Also 240.1051, 240.1052.) Rev. Rul. 60–334

The use of Promine-D, a soya bean protein material, to clarify and stabilize wine, in amounts not to exceed one and one-half pounds per 1,000 gallons of wine, is considered as being consistent with good commercial practice within the limitations of section 240.524 of the Federal Wine Regulations, provided the amount of water used in the process does not exceed 0.5 percent of the volume of the wine to be treated. Winemakers desiring to use Promine-D in the clarification and stabilization of wine may receive the approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by the filing of appropriate notice pursuant to section 240.1052 of the regulations.

(Also 240.1051, 240.1052.) Rev. Rul. 60–335

The use of a product known as "Fulgur" (composed of aluminum silicate and albumin) to clarify wine, in amounts not exceeding 6.6 pounds per 1000 gallons of wine, is considered as being consistent with good commercial practice within the limitations of section 240.524 of the Federal Wine Regulations. Winemakers desiring to use "Fulgur" in the clarification of wine may receive the approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by the filing of appropriate notice pursuant to section 240.1052 of the regulations.

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26 CFR 240.527: Removal of excessive color in white wine.

Extension through June 30, 1961, of the experimental study for removing excess color from white wines, other than vermouth. See Rev. Proc. 60–19, page 990.

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26 CFR 240.530: Notice.

Use of gum arabic, and "Wine Clarifier" in the treatment of wine. See Rev. Rul. 60–266, page 616.

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26 CFR 240.536: General.

Procedure to be used in the reduction of the acid content of standard wine. See T.D. 6475, page 526.

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26 CFR 240.1051: Materials authorized for treatment of wine.

Use of Pectinase LM to clarify wine. See Rev. Rul. 60–298, page 617.

Use of Promine–D to clarify and stabilize wine. See Rev. Rul. 60–334, page 617.

Use of "Fulgur" in the clarification of wines. See Rev. Rul. 60–335, page 617.

26 CFR 240.1052: Notice.

Use of Pectinase LM to clarify wine. See Rev. Rul. 60–298, page 617.

Use of Promine–D to clarify and stabilize wine. See Rev. Rul. 60–334, page 617.

Use of "Fulgur" in the clarification of wines. See Rev. Rul. 60–335, page 617.

SUBCHAPTER G.—BREWERIES

PART II.—OPERATIONS

SECTION 5411.—USE OF BREWERY

26 CFR 245.12: Use of brewery. Rev. Rul. 60–267

Section 5411 of the Internal Revenue Code of 1954 provides that a brewery shall be used under regulations prescribed by the Secretary of the Treasury or his delegate only for the purpose of producing beer and for certain additionally specified purposes or for other such purposes as the Secretary or his delegate by regulations finds will not jeopardize the revenue. Section 245.12 of the Beer Regulations provides that the brewery shall be used only for the specifically enumerated operations, or by the *brewer* for other purposes pursuant to application to, and approval of, the Director of the Alcohol and Tobacco Tax Division. *Held*, only the brewer who has given notice and bond may conduct operations on brewery premises involving the use of brewery equipment, including operations enumerated in section 245.12 of the Beer Regulations, as well as operations which can be conducted pursuant to such section only on approval of the Director of the Alcohol and Tobacco Tax Division.

SUBCHAPTER I.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 5552.—INSTALLATION OF METERS, TANKS, AND OTHER APPARATUS

26 CFR 245.30: Meters required.

Use of the Rotocycle Beer Meter. See Rev. Proc. 60–30, page 1008.

SUBPART B.—RULINGS AND DECISIONS UNDER THE FEDERAL ALCOHOL ADMINISTRATION ACT

Rulings and decisions published in Part III, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Alcohol Administration Act.

SECTION 3.—UNLAWFUL BUSINESSES WITHOUT PERMIT

27 CFR 1.20: Importers. Rev. Rul. 60–299
(Also 1.22.)
(Also Part III–A, Section 5112; 26 CFR 194.24.)

> Ship chandlers importing distilled spirits, wines or beer and holding them in customs custody until laden aboard vessels engaged in foreign trade must obtain basic permits as importers and must pay the special tax as a retail liquor dealer. However, ship chandlers domestically purchasing distilled spirits, wines or beer must obtain basic permits as wholesalers, even though they sell exclusively to vessels engaged in foreign trade.

The Internal Revenue Service has been requested to state its position with respect to the basic permits required by ship chandlers.

Marine suppliers, otherwise known as ship chandlers, operate such businesses at ports of the United States and frequently service both American and foreign ships with supplies.

Section 3(a) of the Federal Alcohol Administration Act makes it unlawful, except pursuant to a basic permit, to engage in the business of importing into the United States distilled spirits, wines, or malt beverages, or for any person so engaged to sell, offer, or deliver for sale, contract to sell, or ship, in interstate or foreign commerce, directly or indirectly, or through an affiliate, distilled spirits, wine, or malt beverages so imported.

The questions with respect to which advice has been requested and the answer thereto are set forth as follows:

(1) Under what circumstances must a ship chandler obtain a basic permit as an importer?

It is held that a ship chandler who imports distilled spirits, wines, or beer into the custody of the Bureau of Customs for sale (even though he sells them exclusively to vessels engaged in foreign trade) for use as ships supplies must obtain a basic permit as an importer.

(2) Under what circumstances must a ship chandler obtain a basic permit as a wholesaler?

A ship chandler who engages in the domestic purchase of distilled spirits, wine or beer for sale (even though he sells them exclusively to vessels engaged in foreign trade) for use as ships supplies must obtain a basic permit as a wholesaler. See also Revenue Ruling 54–451, C.B. 1954–2, 515, which provides in part that a company purchasing beer for resale as ships supplies must possess a wholesaler's basic permit and must pay the special tax as a retail or wholesale beer dealer as may be required.

(3) Under what circumstances must a ship chandler obtain both importer's and wholesaler's basic permits?

A ship chandler who both imports and purchases domestically distilled spirits, wines or beer must obtain both importer's and wholesaler's basic permits.

(4) Under what circumstances is a ship chandler not subject to special taxes as a wholesale dealer?

A ship chandler who withdraws alcoholic beverages for sale to a ship which is engaged in foreign trade and which uses them as ships supplies solely outside the jurisdictional limits of the United States, is not subject to special tax as a wholesale dealer since such vessel is not considered a dealer within the meaning of section 5112(a) of the Code, and the sale of spirits to such vessel is not a sale to another dealer as provided in section 5112 (b) and (c) of the Code. Such a ship chandler is, however, subject to the special tax as a retail dealer.

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27 CFR 1.22: Wholesalers.

Circumstances under which ship chandlers must secure basic permits. See Rev. Rul. 60–299, page 619.

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

27 CFR 4.34: Class and type. Rev. Rul. 60–300

Section 4.34(b) of the Federal Labeling and Advertising of Wine Regulations under the Federal Alcohol Administration Act requires that an appellation of origin such as "American," "California," "New York State," or "Spanish," disclosing the true place of origin of wine, shall appear in conjunction with the class and type designation of the wine: (1) if the wine's designation includes a grape varietal name of geographic significance; or (2) if the wine's designation is a semi-generic type designation of geographic significance; or (3) if the label bears any statement, design, device, or representation which indicates or infers origin other than the true place of origin. *Held*, as used in this section, the term "appellation of origin" means the official, legal or geographical name of the area in question. The statement of a popular secondary name, nickname, sobriquet or pseudonym, such as "The Pine Tree State" or "The Garden State" is not sufficient.

Rev. Rul. 60–369

Section 205(e) of the Federal Alcohol Administration Act requires that alcoholic beverages be so labeled as to prohibit deception of the consumer and so as to provide the consumer, among other things, with adequate information as to the identity and quality of distilled spirits and wines. Section 4.34(a) of the Wine Labeling and Advertising Regulations under the Federal Alcohol Administration Act provides, in part, that if the class of wine is not defined in sections 4.20 through 4.25 of the regulations, a truthful and adequate statement of its composition must appear upon the brand label of the product in lieu of

the class designation. Since a standard of identity for "aperitif wine" is prescribed in section 4.21(g) of the Regulations, and as that definition recognizes the use of caramel for coloring purposes, no declaration of the presence of caramel color is required on the label of any such product. *Held*, the color of special natural wines produced on bonded wine cellar premises, which do not have enough of the taste, aroma, and characteristics of "aperitif wines" to be so classified, but are otherwise similar, and are, therefore, designated "Grape Wine and Natural Flavors" or "Grape Wine with Natural Flavors Added," may be adjusted to attain uniformity by the addition of caramel color without disclosure of that fact on labels. However, this rule does not apply to the labeling of wine specialty products where caramel color is employed for the purpose of simulating or enhancing the color of a particular natural flavoring material, such as "Cocoa," "Peach," "Blackberry," etc.

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27 CFR 5.21: The standards of identity. Rev. Rul. 60–362

Revenue Ruling 56–495, C.B. 1956–2, 1060, holds that corn whiskey may be stored in paraffin-lined wooden barrels or metal containers, but does not age during the period of storage in such vessels. *Held*, for storage purposes, no distinction is drawn between metal containers of drum size and large metal tanks. Accordingly, corn whiskey stored for the full period of storage in metal tanks must be labeled with the statement that "This whiskey is less than one month old" or a similar statement, such as "Less than one month old" or "Less than 30 days old."

Revenue Ruling 56–495, C.B. 1956–2, 1060, is hereby amplified.

Designations of whisky on Form 2630, Package Gauge Report, and Form 236, Transfer of Spirits or Denatured Spirits in Bond. See Rev. Rul. 60–373, page 589.

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27 CFR 5.38: Presence of neutral spirits and coloring, flavoring, and blending materials.

Omission of marks on alcohol for industrial uses. See Rev. Rul. 60–368, page 588.

PART IV

LEGISLATION AND TREATIES

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PART IV

LEGISLATION AND TREATIES

SUBPART A.—TAX CONVENTIONS

UNITED STATES-BELGIUM SUPPLEMENTARY INCOME TAX CONVENTION

Pursuant to Article XXII of the Income Tax Convention between the United States and Belgium signed in Washington, D.C., October 28, 1948, as modified by the supplementary convention of September 9, 1952, C.B. 1954–2, 626, Belgium notified the United States, in a note of April 2, 1954, of its desire to extend that convention to the Belgian Congo and Ruanda-Urundi. Both parties found it desirable to further modify the existing convention to facilitate the extension. Accordingly, a supplementary convention between the United States and Belgium was signed at Washington, D.C., on August 22, 1957. It was approved for ratification by the United States Senate [1] on July 9, 1958, and was ratified by the President on July 23, 1958. It was ratified by Belgium on July 8, 1959. The instruments of ratification were exchanged at Brussels on July 10, 1959, and the President proclaimed the supplementary convention on July 28, 1959. The supplementary convention is effective with respect to taxable years beginning on or after January 1, 1959. In a note of July 28, 1959, the United States informed Belgium of its acceptance of Belgium's notification of April 2, 1954. The supplementary convention and notes read as follows:

The Government of the United States of America and the Government of Belgium, desiring to modify and supplement in certain respects the convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on October 28, 1948, as modified by the supplementary convention of September 9, 1952, and desiring to facilitate the extension thereof to, and facilitate investment in, the Belgian Congo and the Trust Territory of Ruanda-Urundi, in accordance with the provisions of Article XXII of the convention, have decided to conclude a supplementary convention and have appointed as their respective plenipotentiaries:

The Government of the United States of America:

John Foster Dulles, Secretary of State of the United States of America, and

The Government of Belgium:

Baron Silvercruys, Ambassador Extraordinary and Plenipotentiary of Belgium at Washington,

who, having communicated to each other their full powers, found in good and due form, have agreed upon the following articles:

[1] Senate Executive Report No. 1 is reproduced, in part, beginning on page 906, this Bulletin.

ARTICLE I

Article II(1)(d) of the convention of October 28, 1948 is amended by adding the following sentence at the end thereof:

For the purposes of this convention, any corporation organized or created under the laws of Belgium or of the Belgian Congo and subject to tax under the Belgian fiscal law of June 21, 1927 shall be deemed to be a "Belgian enterprise."

ARTICLE II

In the application to the Belgian Congo and the Trust Territory of Ruanda-Urundi of the convention of October 28, 1948, as amended by the supplementary convention of September 9, 1952, the Belgian Congo and the Trust Territory of Ruanda-Urundi may impose taxe mobilière at a rate not in excess of 15 percent on dividends from sources within the Belgian Congo and Ruanda-Urundi paid to a resident or corporation or other entity of the United States not having a permanent establishment in the Belgian Congo or Ruanda-Urundi.

ARTICLE III

In its application to the Belgian Congo and the Trust Territory of Ruanda-Urundi, paragraph (2) of Article XXII of the convention of October 28, 1948 is amended by striking out the word "following" and inserting in lieu thereof the words "immediately preceding."

ARTICLE IV

For the purposes of Article XXII of the convention of October 28, 1948, the expression "overseas territories" is construed as applying to any overseas territory for the foreign relations of which either contracting State is responsible.

ARTICLE V

(1) The present supplementary convention shall be ratified and the instruments of ratification shall be exchanged at Brussels as soon as possible.

(2) The present supplementary convention shall be regarded as an integral part of the convention of October 28, 1948, as amended, but shall become effective with respect to taxable years beginning on or after the first day of January of the calendar year in which the exchange of instruments of ratification takes place. It shall continue in effect in accordance with Article XXIII of the convention of October 28, 1948, as amended by Article I(g) of the supplementary convention of September 9, 1952, and in the event of termination of such convention shall terminate simultaneously with such convention.

DONE in duplicate, in the English and French languages, the two texts having equal authenticity, at Washington this 22d day of August, 1957.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

JOHN FOSTER DULLES

[SEAL]

FOR THE GOVERNMENT OF BELGIUM:

SILVERCRUYS

[SEAL]

The Belgian Ambassador to the Secretary of State

EMBASSY OF BELGIUM

WASHINGTON, *April 2, 1954.*

MR. SECRETARY OF STATE,

On instruction of my Government, I have the honor to inform you that, in accordance with the provisions of Article XXII of the Convention between Belgium and the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington October 28, 1948, the Belgian Government desires that the application of all the provisions of the said Convention and of the supplementary Convention, signed at Washington September 9, 1952, be extended to the Territory of the Belgian Congo and to the Trust Territories of Ruanda-Urundi.

I shall be happy to be advised of the acceptance by the Government of the United States of such extension.

I take this occasion, Mr. Secretary of State, to renew to you the assurance of my highest consideration.

SILVERCRUYS.

The Honorable John Foster Dulles,
Secretary of State,
Washington, D.C.

The Acting Secretary of State to the Belgian Chargé d'Affaires ad interim

DEPARTMENT OF STATE,
WASHINGTON,
July 28, 1959.

SIR:

I refer to the note dated April 2, 1954 (D.6698 No. 1460) from the Ambassador of Belgium notifying the Government of the United States of America, in accordance with the provisions of Article XXII of the convention between the United States of America and Belgium for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on October 28, 1948, that the Belgian Government desires that the application of all the provisions of the said convention and of the supplementary convention signed at Washington on September 9, 1952, be extended to the Territory of the Belgian Congo and to the Trust Territory of Ruanda-Urundi.

After the above-mentioned notification had been given, the competent authorities of the United States of America and Belgium reached the conclusion that it was necessary to make certain modifications in the 1948 convention, as modified by the 1952 supplementary convention, before completing action under Article XXII to make the proposed extension effective. There was signed at Washington on August 22, 1957, a supplementary convention modifying the 1948 convention, as modified, in order to facilitate the extension thereof to, and facilitate investment in, the Belgian Congo and the Trust Territory of Ruanda-Urundi.

The supplementary convention of August 22, 1957, was brought into force by the exchange of instruments of ratification at Brussels on July 10, 1959. Pursuant to the terms of Article V thereof, the supplementary protocol became effective with respect to taxable years beginning on or after January 1, 1959.

Consequently, the Government of the United States of America hereby informs the Government of Belgium that the above-mentioned notification by the Government of Belgium in respect of the Belgian Congo and the Trust Territory of Ruanda-Urundi is accepted by the Government of the United States of America. It is understood that, in accordance with Article XXII (2) of the 1948 convention as modified by Article III of the 1957 supplementary convention, the operation of the 1948 convention as modified by the supplementary conventions of 1952 and 1957 is extended and applies to the Belgian Congo and the Trust Territory of Ruanda-Urundi with respect to taxable years beginning on or after January 1, 1959.

Accept, Sir, the renewed assurances of my high consideration.

For the Acting Secretary of State:
RAYMOND T. YINGLING.

MR. JEAN DE BASSOMPIERRE,
Chargé d'Affaires ad interim
of Belgium.

UNITED STATES-FRANCE INCOME TAX CONVENTION

T.D. 5499, C.B. 1946–1, 134; Section 7.420: Compensation for labor or personal services. Rev. Rul. 60–313

(Also Part I, Section 894; 26 CFR 1.894–1.)

Residents of France (nonresident aliens with respect to the United States) who render personal services as public entertainers while temporarily in the United States are considered as being

engaged in the exercise of a liberal profession within the meaning of Article 10 of the income tax convention between the United States and France. Where such public entertainers have no fixed center in the United States, the income derived from the exercise of the liberal profession is exempt from United States income tax.

Advice has been requested whether residents of France (nonresident aliens with respect to the United States) who render personal services as public entertainers while temporarily in the United States are considered as being engaged in the exercise of a liberal profession within the meaning of Article 10 of the income tax convention between the United States and France, C.B. 1946–1, 134.

Certain nonresident alien individuals such as actors, actresses, cabaret dancers, singers, ice skaters, ballet dancers, and comedian acrobats, who are residents of France earn income by rendering personal services as professional public entertainers while temporarily in the United States. In addition to the above entertainers, there also are musicians who may perform with a group, or may be solo artists, instructors, or conductors.

Article 10 of the income tax convention between the United States and France reads as follows:

Income from the exercise of a liberal profession shall be taxable only in the State in which the professional activity is exercised.

There is the exercise of a liberal profession in one of the two contracting States only when the professional activity has a fixed center in that country.

Section 7.420(b) of Treasury Decision 5499, C.B. 1946–1, 134 at 146, states, in part, that Article 10 provides a special rule of taxation with respect to professional fees constituting income derived from sources within the United States by a resident of France who is a nonresident alien. Under this rule, such a nonresident alien rendering professional services, for example, medical, legal, engineering or scientific services, is not subject to United States income tax with respect to such compensation unless he has an office or other fixed place situated in the United States during the taxable year.

Article I, paragraph (4) of the supplementary Protocol between the United States and France, signed May 17, 1948, C.B. 1956–1, 845, provides that the "provisions of Article 10 of the Convention signed July 25, 1939 between the United States and France shall be applied on a reciprocal basis." The report of the Department of State accompanying the supplementary Protocol, Senate Executive G, 80th Cong., 2d Sess., reads, in part, as follows: "Paragraph (4) is designed, in view of the fact that in France the expression 'liberal profession' is construed liberally in extending benefits to United States citizens, to clarify the intent of Article 10 of the convention of 1939 that its provisions should be applied resiprocally. This is consistent with the corresponding provisions in the income-tax convention and protocol with the United Kingdom."

Paragraph (3) of Article XI (which contains such corresponding provisions) of the Tax Convention between the United States and the United Kingdom, C.B. 1947–2, 100, made the provisions of such article inapplicable to "compensation, profits, emoluments or other remuneration of public entertainers such as stage, motion picture or

radio artists, musicians and athletes." However, paragraph (3) was deleted by Article I of the supplementary Protocol, signed June 6, 1946, between the United States and the United Kingdom, C.B. 1947–2, 100 at 108. The report of the Secretary of State which accompanied the supplementary Protocol, Senate Executive F, 79th Cong., 2d Sess., stated that, "The subcommittee of the Committee on Foreign Relations reached the conclusion that a substantial basis existed for the view that paragraph (3) of Article XI is open to the objection that it is discriminatory. * * *."

The deletion of paragraph (3) of Article XI of the convention between the United States and the United Kingdom indicates an intention to include "public entertainers such as stage, motion picture or radio artists, musicians and athletes" among those entitled to the benefits of that article. Paragraph (4) of Article I of the supplementary Protocol between the United States and France was designed to assure the liberal construction of the term "liberal profession," consistent with the corresponding provisions of the income-tax convention and protocol with the United Kingdom.

In view of the above, it is held that public entertainers are considered as being engaged in the "exercise of a liberal profession" within the meaning of Article 10 of the income tax convention between the United States and France. If the public entertainers herein considered have no fixed center in the United States and are nonresident aliens, the income with respect to the United States derived from the exercise of the liberal profession is exempt from United States income tax.

However, the current performance of an individual is the basis for determining the application of Article 10. For example, an individual by reason of being a ballet dancer would not necessarily qualify for the exemption under Article 10 unless he is engaged as a ballet dancer or is engaged in some other liberal profession and all other stated conditions are satisfied.

UNITED STATES-FRANCE INCOME TAX CONVENTION

T.D. 5499, C.B. 1946–1, 134; Section 7.414: Scope of convention with respect to determination of "industrial and commercial profits" of a nonresident alien individual resident of France, or of a French corporation or other entity carrying on a French enterprise in the United States.

Taxability of winnings received by a nonresident alien from the entry of a horse in a race in the United States. See Rev. Rul. 60–249, page 264.

UNITED STATES-NORWAY INCOME TAX CONVENTION

(Also Part I, Sections 1441, 1442; 26 CFR 1.1441–1, 1.1442–1.)

T. D. 6489[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER G, PART 510.—NORWAY

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding of United States tax at source in the case of residents of Norway and of Norwegian corporations or other entities, as affected by the income tax convention between the United States and Norway of June 13, 1949, as amended.

DEPARTMENT OF THE TREASURY,
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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§ 510.1 TEXT OF CONVENTION.—(a) *Pertinent articles.*—The income tax convention between the United States and Norway of June 13, 1949, as modified and supplemented by the convention of July 10, 1958, referred to in this Treasury Decision as the convention, provides 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.

[1] 25 F.R. 7785.

(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 III

(1) An enterprise of one of the contracting States shall not be subject to taxation in the other contracting State in respect of its industrial and commercial profits unless it is engaged in trade or business in such other State through a permanent establishment situated therein. If it is so engaged such other State may impose its tax upon such profits of the enterprise from sources within such other State.

(2) In determining the industrial or commercial profits from sources within the territory of one of the contracting States of an enterprise of the other contracting State, no profits shall be deemed to arise from the mere purchase of goods or merchandise within the territory of the former contracting State by such enterprise.

(3) Where an enterprise of one of the contracting States is engaged in trade or business in the territory of the other contracting State through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment and the profits so attributed shall, subject to the law of such other contracting State, be deemed to be income from sources within the territory of such other contracting State.

(4) The competent authorities of the two contracting States may lay down rules by agreement for the apportionment of industrial and commercial profits.

ARTICLE IV

Where an enterprise of one of the contracting States, by reason of its participation in the management or the financial structure of an enterprise of the other contracting State, makes with or imposes on the latter, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would normally have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

ARTICLE V

(1) Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft shall be exempt from taxation in the other contracting State.

(2) The provisions of this Article shall be deemed to suspend the arrangement between the United States and Norway providing for relief from double income taxation on shipping profits, effected by exchanges of notes dated November 26, 1924, January 23, 1925, and March 24, 1925.[1]

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 VI–A

(1) The rate of United States tax on dividends received from a United States corporation by a resident or corporation or other entity of Norway, not engaged in trade or business in the United States through a permanent establishment therein at any time during the taxable year, shall not exceed 15 percent. The rate shall, however, not exceed 5 percent in the case of such dividends received by a Norwegian corporation if (a) during the part of the United States corporation's taxable year preceding the payment of the dividend and during the whole of the prior taxable year, such Norwegian corporation either alone or in association with not more than three other Norwegian corporations owned more than 50 percent of the voting stock of the United States corporation, provided each Norwegian corporation owned at least 10 percent of the voting stock of the United States corporation, and (b) not more than 25 percent of the gross income of the United States corporation for the taxable year immediately preceding the payment of the dividend is derived from interest and dividends other than interest and dividends received from its subsidiary corporations.

(2) The provisions of the preceding paragraph shall apply, *mutatis mutandis*, in the case of dividends received from a Norwegian corporation by a resident or corporation or other entity of the United States.

(3) Dividends paid by a Norwegian corporation shall be exempt from United States tax except where the recipient is a citizen, resident or corporation of the United States.

(4) Dividends paid by a United States corporation shall be exempt from Norwegian tax except where the recipient is a resident or corporation of Norway.

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.

[1] Executive Agreement Series 15; 47 Stat. 2617.

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, quaries, 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 IX

Gains derived from the sale or exchange of real property shall be taxable only in the contracting State in which such property is situated.

ARTICLE X

(1) A resident of Norway shall be exempt from United States tax upon compensation for labor or personal services (including the practice of the liberal and artistic professions) if he is temporarily present in the United States for a period or periods not exceeding a total of 183 days during the taxable year and either of the following conditions is met:

(a) his compensation is received for labor or personal services performed as an employee, or under contract with, a resident, or corporation or other entity of Norway, or does not exceed $10,000.

(b) his compensation received for labor or personal services.

(2) The provisions of paragraph (1) of this Article shall apply *mutatis mutandis*, to a resident of the United States with respect to compensation for such labor or personal services performed in Norway.

(3) The provisions of paragraphs (1) and (2) of this Article shall have application to directors' fees representing reasonable compensation for services rendered whether or not the recipient of such fees has been present at any time during the taxable year in the contracting State from which payment of such fees has been made.

(4) The provisions of this Article shall have no application to the income to which Article X(1) relates.

ARTICLE XI

(1)(a) Wages, salaries and similar compensation, and pensions paid by the United States or by the political subdivisions or territories thereof to an individual (other than a Norwegian citizen who is not also a citizen of the United States) shall be exempt from Norwegian tax.

(b) Wages, salaries and similar compensation, and pensions paid either directly by, or from funds or institutions created by, Norway or Norwegian communities or counties (fylker) to an individual (other than a United States citizen who is not also a citizen of Norway) shall be exempt from United States tax.

(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 XII

A professor or teacher, a resident of one of the contracting States, who temporarily visits the other contracting State for the purpose of teaching for a period not exceeding two years at a university, college, school or other educational institution in the other contracting State, shall be exempted in such other contracting State from tax on his remuneration for such teaching for such period.

ARTICLE XIII

A student or apprentice, a resident of one of the contracting States, who temporarily visits the other contracting State exclusively for the purposes of study or for acquiring business or technical experience shall not be taxable in the latter State in respect of remittances received by him from abroad for the purposes of his maintenance or studies.

ARTICLE XIV

(1) It is agreed that double taxation shall be avoided in the following manner:

(a) The United States in determining its taxes specified in Article I of this Convention in the case of its citizens, residents or corporations may, regardless of any other provision of this Convention, include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of the United States as if this Convention had not come into effect. The United States shall, however, subject to the provisions of section 131, Internal Revenue Code, as in effect on the date of the entry into force of this Convention, deduct from its taxes the amount of Norwegian taxes specified in Article I of this Convention.

(b) Norway in determining its taxes specified in Article I of this Convention in the case of its residents or corporations may, regardless of any other provision of this Convention, include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of Norway as if the Convention had not come into effect. Norway shall, however, deduct from the taxes so calculated that portion of such tax liability which the taxpayer's income from sources in the United States (not exempt from United States tax under this Convention) bears to his entire income. The competent authority of Norway may, however, decide that the deduction shall not exceed the United States tax on income taxable in the United States.

(2) The provisions of this Article shall not be construed to deny the exemptions from United States tax or Norwegian tax, as the case may be, granted by Article XI (1) of this Convention.

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 XVII

(1) The contracting States undertake to lend assistance and support to each other in the collection of the taxes which are the subject of the present Convention, together with interest, costs, and additions to the taxes.

(2) In the case of applications for enforcement of taxes, revenue claims of each of the contracting States which have been finally determined may be

accepted for enforcement by the other contracting State and may be collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes.

(3) Any application shall include a certification that under the laws of the State making the application the taxes have been finally determined.

(4) The assistance provided for in this Article shall not be accorded with respect to the citizens, corporations, or other entities of the State to which application is made.

["It is understood that the application of Article XVII of the convention shall be confined and limited as granting authority to each Contracting State to collect only such taxes imposed by the other Contracting State as will insure that the exemption or reduced rate of tax granted under the present convention by such other State, shall not be enjoyed by persons not entitled to such benefits." Protocol of Exchange signed December 11, 1951, 2 UST 2351].

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 XIX

Where a taxpayer shows proof that the action of the revenue authorities of the contracting States has resulted, or will result, in double taxation contrary to the provisions of the present Convention, he shall be entitled to lodge a claim with the State of which he is a citizen or, if he is not a citizen of either of the contracting States, with the State of which he is a resident, or, if the taxpayer is a corporation or other entity, with the State in which it is created or organized. Should the claim be upheld, the competent authority of such State shall undertake to come to an agreement with the competent authority of the other State with a view to equitable avoidance of the double taxation in question.

ARTICLE XX

(1) The provisions of this Convention shall not be construed to deny or effect 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 first day of January of the year in which such exchange takes place.

(2) The present Convention shall continue effective for a period of five years and indefinitely after that period, but may be terminated by either of the con-

tracting States at the end of the five-year period or at any time thereafter, provided that at least six 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 first day of January next following the expiration of the six-month period.

(b) *Meaning of terms.*—As used in this Treasury Decision, any term defined in the convention shall have the meaning so assigned to it; any term not so defined shall, unless the context otherwise requires, have the meaning which such term has under the internal revenue laws of the United States.

§ 510.2 INTEREST.—(a) *Exemption from United States tax.*—(1) *Requirements for obtaining exemption.*—Interest on bonds, securities, notes, debentures, or on any other form of indebtedness, including interest on obligations of the United States and its instrumentalities and on mortgages and bonds secured by real property, which is derived from sources within the United States in a taxable year beginning on or after January 1, 1960, by a nonresident alien individual who is a resident of Norway, or by a Norwegian corporation or other entity, shall be exempt from United States tax under the provisions of Article VI of the convention if such alien, corporation, or other entity does not have a permanent establishment in the United States at any time during the taxable year in which the interest is derived.

(2) *Personal services.*—If a nonresident alien individual who is a resident of Norway were to perform personal services within the United States during the taxable year but not to have a permanent establishment in the United States at any time during the year, he would be entitled to the exemption from United States tax with respect to interest granted by Article VI of the convention even though under the provisions of section 871(c) of the Internal Revenue Code of 1954 he had engaged in trade or business within the United States during that year by reason of his having performed personal services therein.

(b) *Exemption from withholding of United States tax.*—(1) *Coupon bond interest.*—(i) *Form to use.*—To avoid withholding of United States tax at source on or after January 1, 1960, in the case of coupon bond interest to which paragraph (a) of this section applies, the nonresident alien individual who is a resident of Norway, or the Norwegian corporation or other entity, shall, for each issue of bonds, file Form 1001–NO in duplicate when presenting the interest coupons for payment. This form shall be signed by the owner of the interest, or by his trustee or agent, and shall show the information required by § 1.1461–1(d) of the Income Tax Regulations (26 CFR 1.1461–1(d)). Form 1001–NO shall contain a statement that the owner (*a*) is a resident of Norway, or is a Norwegian corporation or other entity, and (*b*) has no permanent establishment in the United States.

(ii) *Exemption applicable only to owner.*—The exemption from United States tax granted by Article VI of the convention is applicable only to the owner of the interest. The person presenting the interest coupon, or on whose behalf it is presented, shall, for the purpose of the exemption from withholding of United States tax, be deemed to be the owner of the interest only if he is, at the time the coupon is presented for payment, the owner of the bond from

which the coupon has been detached. If the person presenting the coupon, or on whose behalf it is presented, is not the owner of the bond, Form 1001, and not Form 1001–NO, shall be executed.

(iii) *Disposition of Form 1001–NO.*—The original and duplicate of Form 1001–NO shall be forwarded by the withholding agent to the Director, International Operations Division, Internal Revenue Service, Washington 25, D.C., in accordance with § 1.1461–2(b)(2) of the Income Tax Regulations (26 CFR 1.1461–2(b)(2)).

(2) *Interest on noncoupon bonds.*—(i) *Use of letter of notification.*—To avoid withholding of United States tax at source on or after January 1, 1960, in the case of interest (other than coupon bond interest) to which paragraph (a) of this section applies, the nonresident alien individual who is a resident of Norway, or the Norwegian corporation or other entity, shall notify the withholding agent by letter in duplicate that the interest 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, or by his trustee or agent, and shall show the name and address of the obligor and the name and address of the owner of the interest. The letter shall contain a statement (*a*) that the owner is neither a citizen nor a resident of the United States but is a resident of Norway, or, in the case of a corporation or other entity, the owner is a Norwegian corporation or other entity, and (*b*) that the owner has not had a permanent establishment in the United States at any time during the current taxable year. The letter shall also indicate the dates on which the current taxable year of the taxpayer begins and ends.

(ii) *Use of letter for release of excess tax withheld.*—If the letter of notification is also to be used as authorization for the release, pursuant to § 510.9(a)(3), of excess tax withheld from the interest, it shall also contain a statement (*a*) that, at the time when the interest was derived from which the excess tax was withheld, the owner was neither a citizen nor a resident of the United States but was a resident of Norway, or, in the case of a corporation or other entity, the owner was a Norwegian corporation or other entity, and (*b*) that the owner did not have a permanent establishment in the United States at any time during the taxable year in which the interest was derived. The dates of the beginning and ending of the taxable year of the taxpayer in which the interest was derived shall also be indicated.

(iii) *Manner of filing letter of notification.*—The letter of notification, which shall constitute authorization for the payment of the interest without withholding of United States tax at source, shall be filed with the withholding agent for each successive 3-calendar-year period during which the interest is paid. Each 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. Once a letter has been filed in respect of any 3-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 granted by Article VI of the convention, 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 withholding of United States tax shall no longer apply unless the new owner of record is entitled to and does properly file a letter of notification with the withholding agent.

(iv) *Disposition of the letter of notification.*—Each letter of notification filed pursuant to this subparagraph, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the Director, International Operations Division, Internal Revenue Service, Washington 25, D.C.

§ 510.3 DIVIDENDS PAID BY A NORWEGIAN CORPORATION.—Dividends which are paid by a Norwegian corporation and are received from sources within the United States in a taxable year beginning on or after January 1, 1960, by a recipient who is not a citizen or resident or corporation of the United States shall be exempt from United States tax under the provisions of Article VI–A of the convention. No withholding of United States tax is required in the case of dividends paid by a Norwegian corporation if, in accordance with the preceding sentence, the dividends are exempt from United States tax.

§ 510.4 DIVIDENDS PAID BY A UNITED STATES CORPORATION.—(a) *Reduction in rate of United States tax.*—(1) *Rate of 15 percent.*—(i) *Requirements for obtaining reduced rate.*—The rate of United States tax imposed upon dividends received from a domestic corporation in a taxable year beginning on or after January 1, 1960, by a nonresident alien individual who is a resident of Norway, or by a Norwegian corporation or other entity, shall not exceed 15 percent under the provisions of Article VI–A of the convention if such alien, corporation, or other entity has not, at any time during the taxable year in which the dividend is received, engaged in trade or business within the United States through a permanent establishment situated therein. This subparagraph does not apply to dividends falling within the scope of subparagraph (2) of this paragraph.

(ii) *Personal services.*—If a nonresident alien individual who is a resident of Norway were to perform personal services within the United States during the taxable year in which a dividend is received from a domestic corporation, but not to have a permanent establishment in the United States at any time during the year, he would be entitled to the 15-percent rate of United States tax granted by Article VI–A of the convention even though under the provisions of section 871(c) of the Internal Revenue Code of 1954 he had engaged in trade or business within the United States during that year by reason of his having performed personal services therein.

(2) *Rate of 5 percent.*—(i) *Conditions for obtaining reduced rate.*—The rate of United States tax imposed upon dividends received from a domestic corporation in a taxable year beginning on or after January 1, 1960, by a Norwegian corporation shall not exceed 5 percent under the provisions of Article VI–A of the convention if—

(*a*) During the part of the domestic corporation's taxable year preceding the payment of the dividend and during the whole of its prior taxable year, the Norwegian corporation, either alone or in association with not more than three other Norwegian corporations,

owned more than 50 percent of the voting stock of the domestic corporation; and

(*b*) During such period preceding the payment of the dividend each such Norwegian corporation owned 10 percent or more of the voting stock of the domestic corporation; and

(*c*) Not more than 25 percent of the gross income of the domestic corporation for its taxable year immediately preceding the taxable year in which the dividend is paid was derived from interest and dividends (other than interest and dividends received from its subsidiary corporations, if any); and

(*d*) The Norwegian corporation receiving the dividend has not, at any time during its taxable year in which the dividend is received, engaged in trade or business within the United States through a permanent establishment situated therein.

(ii) *Information to be filed with Commissioner when claiming the reduced rate.*—Any domestic corporation which claims or contemplates claiming that dividends paid or to be paid by it on or after January 1, 1960, are subject to United States tax at the rate of 5 percent shall file the following information with the Commissioner of Internal Revenue, Washington 25, D.C., as soon as practicable:

(*a*) The date and place of its organization;

(*b*) The number of outstanding shares of stock of the domestic corporation having voting power and the voting power thereof;

(*c*) The person or persons beneficially owning such stock of the domestic corporation and their relationship to the Norwegian corporation;

(*d*) The amount of the gross income of the domestic corporation for its taxable year immediately preceding the taxable year in which the dividends are paid, of the interest and dividends included in such gross income, and of such interest and dividends received by the domestic corporation from its own subsidiary corporations, if any; and

(*e*) The relationship between the domestic corporation and the Norwegian corporation receiving the dividends.

(iii) *Notification by Commissioner.*—As soon as practicable after such information is filed, the Commissioner will determine whether the dividends concerned qualify under Article VI–A of the convention for the reduced rate of 5 percent and will notify the domestic corporation of his determination. If the dividends do qualify for such reduced rate, this notification may also authorize the release, pursuant to § 510.9(a)(1)(ii), of excess tax withheld from the dividends concerned.

(b) *Withholding of tax from dividends.*—(1) *Reduced rate of 15 percent.*—(i) *Reduction based on address in Norway.*—Withholding of United States tax at source on or after January 1, 1960, from dividends received from a domestic corporation by a nonresident alien (including a nonresident alien individual, fiduciary, or partnership) or by a foreign corporation or other entity, whose address is in Norway, shall, to the extent withholding of United States tax is required, be at the reduced rate of 15 percent in every case except that in which, prior to the date of payment of such dividends, the Commissioner of Internal Revenue has notified the withholding agent that the reduced rate of withholding shall not apply. This subparagraph does not apply to dividends falling within the scope of subparagraph (2) of this paragraph.

(ii) *Effect of address in Norway.*—For the purposes of withholding of United States tax pursuant to this subparagraph, every nonresident alien (including a nonresident alien individual, fiduciary, and partnership) whose address is in Norway shall be deemed by United States withholding agents to be a nonresident alien individual who is a resident of Norway not engaged in trade or business in the United States through a permanent establishment situated therein; and every foreign corporation or other entity whose address is in Norway shall be deemed by such withholding agents to be a Norwegian corporation or other entity not engaged in trade or business in the United States through a permanent establishment situated therein.

(iii) *Reduced rate of 15 percent applicable only to owner of capital stock.*—This subparagraph is based upon the assumption that the payee of the dividend is the actual owner of the capital stock from which the dividend is derived. As to action by a Norwegian addressee who is not the owner of the capital stock, see § 510.5.

(2) *Reduced rate of 5 percent.*—If, in accordance with paragraph (a)(2)(iii) of this section, the Commissioner of Internal Revenue has notified the domestic corporation that the dividends qualify under Article VI–A of the convention for the reduced rate of 5 percent, the reduced withholding rate of 5 percent, to the extent withholding of United States tax is required, shall apply on or after January 1, 1960, to any dividends subsequently paid by such corporation and received by the Norwegian corporation, unless the stock ownership of the domestic corporation, or the character of its income, materially changes. If such a change occurs, the domestic corporation shall promptly notify the Commissioner of Internal Revenue of the then existing facts with respect thereto. The continued application of the reduced withholding rate of 5 percent is also dependent upon the continued fulfillment of the condition contained in paragraph (a)(2)(i)(*d*) of this section.

(3) *Evidence of rate of tax withheld.*—The rate at which United States tax has been withheld from any dividend paid at any time after the expiration of the thirtieth day after the date on which this Treasury Decision is published in the Federal Register to any person whose address is in Norway 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.

§ 510.5 Dividends Received by Norwegian Addressee Who Is Not the Owner of the Capital Stock.—(a) *Additional United States tax to be withheld in Norway.*—(1) *By a nominee or representative.*—The recipient in Norway of any dividend from which United States tax has been withheld at the reduced rate of 15 percent pursuant to § 510.4(b)(1), who is a nominee or representative through whom the dividend is received by a person other than one described in § 510.4(a)(1) as being entitled to the reduced rate, 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 as of the date of approval of this Treasury Decision) minus the 15 percent which has been withheld at the source.

(2) *By a fiduciary or partnership.*—A fiduciary or a partnership with an address in Norway which receives, otherwise than as a nominee or representative, a dividend from which United States tax has

been withheld at the reduced rate of 15 percent pursuant to § 510.4(b)(1) shall withhold an additional amount of United States tax from the portion of the dividend included in the gross income from sources within the United States of any beneficiary or partner, as the case may be, who is not entitled to the reduced rate of tax in accordance with § 510.4(a)(1). The amount of the additional tax is to be calculated in the same manner as under subparagraph (1) of this paragraph.

(3) *Withholding additional United States tax from amounts released.*—If any amount of United States tax is released pursuant to § 510.9(a)(1)(i) by the withholding agent in the United States with respect to a dividend received by such a person (nominee, representative, fiduciary, or partnership) with an address in Norway, the recipient shall withhold from such released amount any additional amount of United States tax, otherwise required to be withheld from the dividend by the provisions of subparagraphs (1) and (2) of this paragraph, in the same manner as if at the time of payment of the dividend United States tax at the rate of only 15 percent had been withheld at source therefrom.

(b) *Return of United States tax by Norwegian withholding agents.*—The amounts of United States tax withheld pursuant to paragraph (a) of this section by any withholding agent in Norway should be deposited, without converting the amounts into United States dollars, with the Norwegian Ministry of Finance and Customs on or before the 15th day after the close of the quarter of the calendar year in which the withholding in Norway occurs. The withholding agent making the deposit should render therewith such appropriate Norwegian form as may be prescribed by the Ministry of Finance and Customs. The amounts so deposited should be remitted by the Ministry of Finance and Customs by draft in United States dollars, on or before the end of the calendar month in which the deposit is made, to the Director, International Operations Division, Internal Revenue Service, Washington 25, D.C., U.S.A. The remittance should be accompanied by copies of such Norwegian forms as may be required to be rendered by the withholding agent in Norway in connection with the deposit.

§ 510.6 Patent and Copyright Royalties and Film Rentals.—(a) *Exemption from United States tax.*—Royalties and other amounts derived from sources within the United States in a taxable year beginning on or after January 1, 1960, by a nonresident alien individual 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 (including rentals and like payments in respect of motion picture films) shall be exempt from United States tax under the provisions of Article VII of the convention if such alien, corporation, or other entity does not have a permanent establishment in the United States at any time during the taxable year in which such royalties are derived.

(b) *Exemption from withholding of tax.*—(1) *Use of letter of notification.*—To avoid withholding of United States tax on or after January 1, 1960, from a royalty or other amount which is exempt from United States tax in accordance with paragraph (a) of this section,

the nonresident alien individual who is a resident of Norway, or the Norwegian corporation or other entity, shall notify the withholding agent by letter in duplicate that the royalty or other amount is exempt from United States tax under the provisions of Article VII of the convention.

(2) *Manner of filing letter of notification.*—The provisions of § 510.2(b)(2) relating to the execution, filing, effective period, and disposition of the letter of notification prescribed therein, including its use for the release of excess tax withheld, shall also apply to the letter of notification prescribed in this paragraph.

§ 510.7 PRIVATE PENSIONS AND LIFE ANNUITIES.—(a) *Exemption from United States tax.*—(1) *Requirements for obtaining exemption.*—Any private pension or life annuity derived from sources within the United States and paid in a taxable year beginning on or after January 1, 1960, to a nonresident alien individual who is a resident of Norway shall be exempt from United States tax under the provisions of Article XI(2) of the convention.

(2) *Definitions of terms.*—As used in this section, the term "pension" means a periodic payment made in consideration for services rendered or by way of compensation for injuries received, and the term "life annuity" 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.

(b) *Exemption from withholding of tax.*—(1) *Use of letter of notification.*—To avoid withholding of United States tax on or after January 1, 1960, from pensions or life annuities which are exempt from United States tax in accordance with paragraph (a) of this section, the nonresident alien individual who is a resident of Norway shall notify the withholding agent by letter in duplicate that the pensions or annuities are exempt from United States tax under the provisions of Article XI(2) of the convention. The letter of notification shall be signed by the owner of the income, shall show the name and address of both the payer and 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. The letter shall also indicate the dates on which the current taxable year of the taxpayer begins and ends.

(2) *Use of letter for release of excess tax withheld.*—If the letter of notification is also to be used as authorization for the release, pursuant to § 510.9(a)(3), of excess tax withheld from the pensions or life annuities, 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 a resident of Norway. The dates of the beginning and ending of the taxable year of the taxpayer in which the pensions or annuities were paid shall also be indicated.

(3) *Manner of filing letter of notification.*—The letter of notification shall constitute authorization for the payment of the pensions or life annuities without withholding of United States tax at the source unless the Commissioner of Internal Revenue notifies the withholding agent thereafter to withhold the tax from such items of income. If, after filing a letter of notification, the owner of the income ceases to

be eligible under the convention for the exemption from the United States tax on such items of income, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of the income as recorded on the books of the payer, the exemption from withholding of United States tax shall no longer apply unless the new owner of record is entitled to and does properly file a letter of notification with the withholding agent.

(4) *Disposition of the letter of notification.*—Each letter of notification filed pursuant to this paragraph, or the duplicate thereof, shall be forwarded immediately by the withholding agent to the Director, International Operations Division, Internal Revenue Service, Washington 25, D.C.

§ 510.8 Beneficiaries of a Domestic Estate or Trust.—A nonresident alien individual who is a resident of Norway and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption from, or reduction in the rate of, United States tax granted by Articles VI, VI–A, and VII of the convention with respect to interest, dividends, and patent and copyright royalties, to the extent that (1) any amount paid, credited, or required to be distributed by the estate or trust to the beneficiary is deemed to consist of those items and (2) the items so deemed to be included in such amount would, without regard to the convention, be includible in his gross income; provided, however, that the beneficiary otherwise satisfies the requirements for exemption or reduction specified in the respective articles concerned. To obtain the exemption from, or reduction in the rate of, withholding of United States tax in such a case, the beneficiary must, where applicable, execute and submit to the fiduciary of the estate or trust in the United States the appropriate letter of notification prescribed in § 510.2(b)(2) or § 510.6(b)(1).

§ 510.9 Release of Excess Tax Withheld at Source.—(a) *Amounts to be released.*—(1) *Tax withheld from dividends.*—(i) *Dividends subject to 15 percent rate.*—If United States tax has been withheld at the statutory rate on or after January 1, 1960, from dividends described in § 510.4(a)(1) received from a domestic corporation by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) or by a foreign corporation or other entity, whose address at the time of payment was in Norway, the withholding agent shall release and pay over to the person from whom the tax was withheld an amount which is equal to the difference between the tax so withheld and the tax required to be withheld pursuant to § 510.4(b)(1).

(ii) *Dividends subject to 5 percent rate.*—If United States tax has been withheld at the statutory rate on or after January 1, 1960, from dividends which qualify for the reduced rate of 5 percent under § 510.4(a)(2)(i), the withholding agent shall, if so authorized in accordance with § 510.4(a)(2)(iii), release and pay over to the corporation from which the tax was withheld an amount which is equal to the difference between the tax so withheld and the tax required to be withheld pursuant to § 510.4(b)(2).

(iii) *Dividends exempt from tax.*—If United States tax at the statutory rate has been withheld on or after January 1, 1960, from dividends paid by a Norwegian corporation to a recipient other than a

citizen or resident or corporation of the United States, the withholding agent shall release and pay over to the person from whom the tax was withheld an amount which is equal to the tax so withheld.

(2) *Tax withheld from coupon bond interest.*—(i) *Substitute ownership certificate.*—In the case of every taxpayer who furnishes to the withholding agent Form 1001–NO clearly marked "Substitute" and executed in accordance with § 510.2(b)(1)(i), where United States tax has been withheld at the statutory rate on or after January 1, 1960, from coupon bond interest, the withholding agent shall release and pay over to the person from whom the tax was withheld an amount which is equal to the tax so withheld from such interest derived by the taxpayer in a taxable year beginning on or after January 1, 1960, if the taxpayer also attaches to the form a letter in duplicate, signed by the owner, or by his trustee or agent, and containing the following:

(*a*) The name and address of the obligor;

(*b*) The name and address of the owner of the interest from which the excess tax was withheld;

(*c*) A statement that, at the time when the interest was derived from which the excess tax was withheld, the owner was neither a citizen nor a resident of the United States but was a resident of Norway, or, in the case of a corporation or other entity, the owner was a Norweigian corporation or other entity;

(*d*) A statement that the owner did not have a permanent establishment in the United States at any time during the taxable year in which the interest was derived; and

(*e*) The dates of the beginning and ending of the taxable year of the taxpayer in which the interest was derived.

(ii) *Manner of filing substitute ownership certificate.*—One substitute Form 1001–NO shall be filed in duplicate with respect to each issue of bonds and will serve with respect to that issue to replace all Forms 1001 previously filed by the taxpayer in the calendar year in which the excess tax was withheld and with respect to which the excess is released.

(iii) *Disposition of substitute ownership certificate.*—The original and duplicate of substitute Form 1001–NO (and letter) shall be forwarded by the withholding agent to the Director, International Operations Division, Internal Revenue Service, Washington 25, D.C., in accordance with § 1.1461–2(b) of the Income Tax Regulations (26 CFR 1.1461–2(b)).

(3) *Tax withheld from interest on noncoupon bonds, patent and copyright royalties, and private pensions and life annuities.*—If a taxpayer furnishes to the withholding agent the authorization for release prescribed in § 510.2(b)(2)(ii), § 510.6(b)(2), or § 510.7(b)(2) and United States tax has been withheld at the statutory rate on or after January 1, 1960, from the interest, patent royalties, copyright royalties, film rentals, and private pensions and life annuities in respect to which such authorization is prescribed, the withholding agent shall release and pay over to the person from whom the tax was withheld an amount which is equal to the tax so withheld from such private pensions and life annuities paid to, and from such interest, royalties, and rentals derived by, the taxpayer in a taxable year beginning on or after January 1, 1960.

(b) *Amounts not to be released.*—The provisions of this section do not apply to any excess tax withheld at the source which has been paid by the withholding agent to the Director, International Operations Division.

(c) *Statutory rate.*—As used in this section, the term "statutory rate" means the rate prescribed by chapter 3 (relating to the withholding of tax on nonresident aliens and foreign corporations and tax-free covenant bonds) of the Internal Revenue Code of 1954 as though the convention has not come into effect.

§ 510.10 Information To Be Furnished to Norway in Ordinary Course.—For provisions relating to the exchange of information under Articles XV and XVI of the convention, see § 1.1461–2(d) of the Income Tax Regulations (26 CFR 1.1461–2(d)).

§ 510.11 Applicability of Regulations.—(a) *Effective date; applicability of prior regulations.*—The provisions of this Treasury Decision shall be effective with respect to taxable years beginning after December 31, 1959, and for such taxable years this Treasury Decision supersedes the provisions of Treasury Decision 5956 [C.B. 1953–1, 228] approved December 9, 1952 [26 CFR (1939) 7.100 through 7.109], except that this Treasury Decision shall not be construed to require the renewal of any document, filed by a taxpayer pursuant to Treasury Decision 5956 in respect of any taxable year beginning after December 31, 1959.

(b) *Fiscal years beginning in 1960.*—Since the provisions of Article VI–A of the convention, relating to the exemption from or reduction in the rate of United States tax on dividends, are effective for taxable years beginning on or after January 1, 1960, the fact that the exemption from or reduction in the rate of withholding of United States tax on dividends authorized by this Treasury Decision is made effective beginning January 1, 1960, is not a determination in itself that the dividends concerned are entitled to the benefit of the exemption from or reduced rate of United States tax granted by the convention.

Because it is necessary to bring into effect at the earliest practicable date the rules of this Treasury Decision respecting release of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax, it is hereby found that it is impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805) and in Article XXI of the convention.)

Dana Latham,
Commissioner of Internal Revenue.

Approved August 10, 1960.

Fred C. Scribner, Jr.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 15, 1960, 8:50 a.m., and published in the issue of the Federal Register for August 16, 1960, 25 F.R. 7785)

UNITED STATES-PAKISTAN INCOME TAX CONVENTION[1]

A convention between the United States and Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was signed at Washington, D.C., on July 1, 1957. It was approved for ratification, with a reservation, by the United States Senate on July 9, 1958, and was ratified by the President, subject to the said reservation, on November 6, 1958. It was ratified by Pakistan on May 2, 1959. The instruments of ratification were exchanged at Karachi on May 21, 1959, and the President proclaimed the convention on May 28, 1959. The convention is effective for taxable years beginning on or after January 1, 1959. The convention reads as follows:

The Government of the United States of America and the Government of Pakistan, desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, have appointed for that purpose as their respective Plenipotentiaries:

The Government of the United States of America:

John Foster Dulles, Secretary of State of the United States of America, and

The Government of Pakistan:

Mohammed Ali, Ambassador Extraordinary and Plenipotentiary of Pakistan to the United States of America, and

Syed Amjad Ali, Minister of Finance of Pakistan,

who, having communicated to one another their full powers, found in good and due form, have agreed as follows:

ARTICLE I

(1) The taxes which are the subject of the present Convention are:

(a) In the United States of America:

The Federal income taxes, including surtaxes (hereinafter referred to as United States tax).

(b) In Pakistan:

The income tax, super-tax and the business profits tax (hereinafter referred to as Pakistan tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character (including excess profits tax) imposed by either contracting State after the date of signature of the present Convention, or by the Government of any territory to which the present Convention is extended under Article XVIII.

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 thereof, the Territories of Alaska and Hawaii and the District of Columbia;

(b) The term "Pakistan" means the Provinces of Pakistan and the Capital of the Federation;

(c) The terms "one of the contracting States" and "the other contracting State" mean the United States or Pakistan, as the context requires;

(d) The term "tax" means United States tax, or Pakistan tax, as the context requires:

(e) The term "person" includes any body of persons, corporate or not corporate:

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[1] Senate Executive Report No. 1 is reproduced, in part, beginning at page 906, this Bulletin.

(f) The term "company" means any body corporate or not corporate, assessed as a company under Pakistan law relating to Pakistan tax;

(g) The term "United States corporation" means a corporation, association or other like 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;

(h) The term "resident of the United States" means any individual or fiduciary who is resident in the United States for the purposes of the United States tax, and not resident in Pakistan for the purposes of the Pakistan tax, and any United States corporation or any partnership created or organized in the United States or under the laws of the United States, being a corporation or partnership which is not resident in Pakistan for the purposes of Pakistan tax;

(i) The term "resident of Pakistan" means any person (other than a citizen of the United States or a United States corporation) who is resident in Pakistan for the purposes of Pakistan tax and not resident in the United States for the purposes of the United States tax. A company is to be regarded as a resident of Pakistan if its business is managed and controlled in Pakistan;

(j) The terms "resident of one of the contracting States" and "resident of the other contracting State" mean a person who is a resident of the United States or a person who is a resident of Pakistan, as the context requires;

(k) The terms "United States enterprise" and "Pakistan enterprise" mean, respectively, an industrial or commercial enterprise or undertaking carried on in the United States by a resident of the United States and an industrial or commercial enterprise or undertaking carried on in Pakistan by a resident of Pakistan; and the terms "enterprise of one of the contracting States" and "enterprise of the other contracting State" mean a United States enterprise or a Pakistan enterprise, as the context requires;

(l) The term "industrial or commercial profits" does not include rents or royalties in respect of motion picture films or of oil wells, mines and quarries, or income in the form of dividends, interest, rents, or royalties, or fees or other remuneration derived by an enterprise from the management, control or supervision of the trade, business, or other activity of another enterprise or concern, or remuneration for labor or personal sevices, or income from the operation of ships;

(m) The term "permanent establishment", when used with respect to an enterprise of one of the contracting States, means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. In this connection—

(i) An enterprise of one of the contracting States shall not be deemed to have a permanent establishment in the other contracting State merely because it carries on business dealings in that other contracting State through a *bona fide* broker or general commission agent acting in the ordinary course of his business as such; and

(ii) The fact that a corporation or company which is a resident of one of the contracting States has a subsidiary corporation or company which is a resident of the other contracting State or which is engaged in trade or business in such other contracting State (whether through a permanent establishment or otherwies) shall not of itself constitute that subsidiary corporation or company a permanent establishment of its parent corporation or company;

(n) The term "taxation authorities" means, in the case of the United States, the Commissioner of Internal Revenue as authorized by the Secretary of the Treasury and, in the case of Pakistan, the Central Board of Revenue or their authorized representatives; and, in the case of any territory to which the present Convention is extended under Article XVIII, the competent authority for the administration in such territory of the taxes to which the present Convention applies.

(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 it has under the laws of that contracting State relating to the taxes which are the subject of the present Convention.

ARTICLE III

(1) A United States enterprise shall not be subject to Pakistan tax in respect of its industrial or commercial profits unless it is engaged in trade or business in Pakistan through a permanent establishment situated therein. If it is so engaged, Pakistan tax may be imposed upon the entire income of such enterprise from sources within Pakistan.

(2) A Pakistan enterprise shall not be subject to United States tax in respect of its industrial or commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged, United States tax may be imposed upon the entire income of such enterprise from sources within the United States.

(3) Where an enterprise of one of the contracting States is engaged in trade or business in the other contracting State through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive in such other contracting State if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment, and the profits so attributed shall be deemed to be income of that permanent establishment and shall be taxed accordingly.

ARTICLE IV

Where—

(a) an enterprise of one of the contracting States participates directly or indirectly in the management, control or capital of an enterprise of the other contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the contracting States and an enterprise of the other contracting State, and

(c) in either case, conditions are made or imposed between the two enterprises, in their commercial or financial relations, which differ from those which would be made between independent enterprises,

any profits, which would but for those conditions have accrued to one of the enterprises but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

ARTICLE V

Profits derived by an enterprise of one of the contracting States from the operation of aircraft registered in such State shall be exempted from tax by the other contracting State, unless the aircraft is operated wholly or mainly between places within such other contracting State.

ARTICLE VI

(1) The rate of United States tax on dividends paid by a United States corporation to a Pakistan company

(i) not having a permanent establishment in the United States and

(ii) owning shares carrying more than 50 percent of the voting power in the corporation paying such dividends

shall not exceed fifteen percent.

(2) Where a United States corporation

(i) has no permanent establishment in Pakistan, and

(ii) is a public company as defined in paragraph (4) of this Article, and

(iii) owns shares carrying more than 50 percent of the voting power of a company which is a resident of Pakistan and is engaged in an industrial undertaking of the classes specified in section 15B of the Income Tax Act, 1922 (XI of 1922),

the rate of Pakistan super-tax otherwise payable with respect to dividends paid by such company to such corporation shall be reduced by 1 anna in the rupee.

(3) The provisions of section 23A of the Income Tax Act, 1922 (XI of 1922) (relating to the distribution of company profits) shall not apply to the income of a company in which shares carrying more than 50 percent of the voting power are owned by a United States corporation constituting a public company, as defined in paragraph (4) of this Article, if the company is engaged in an industrial undertaking of the classes specified in section 15B of the Income Tax Act, 1922 (XI of 1922) and its profits are retained for the purpose of its industrial development and expansion in Pakistan.

(4) In paragraphs (2) and (3) of this Article, the term "public company" means, in relation to any year of assessment—

(a) A corporation which does not restrict the right to transfer its shares, which does not prohibit the issue of its shares or debentures to the public or the sale of its shares on a stock exchange and of which shares carrying more than 50 percent of the voting power were not at any time during the previous year held by less than six persons; or

(b) A corporation all of whose shares were held at the end of the previous year by one or more public companies as defined in clause (a) of this paragraph.

ARTICLE VII

(1) Dividends paid by a company which is a resident of Pakistan shall be exempt from United States tax except where the recipient thereof is a citizen or resident or corporation of the United States.

(2) Dividends paid by a United States corporation shall be exempt from Pakistan tax except where the recipient thereof is resident in Pakistan.

ARTICLE VIII

(1) Any royalty (other than royalties or rentals from motion picture films) paid as consideration for the use of, or for the privilege of using any copyright, patent, design, secret process or formula, trademark, or other like property, and derived from sources in one of the contracting States by a resident of the other contracting State not having a permanent establishment in the former State shall be exempt from tax by such former State.

(2) Where any royalty exceeds a fair and reasonable consideration in respect of the rights for which it is paid, the exemption provided by the present Article shall apply only to so much of the royalty as represents such fair and reasonable consideration.

ARTICLE IX

(1) Remuneration, including pensions and annuities, paid by or on behalf of the Government of the United States or its political subdivisions to an individual who is a citizen of the United States, not ordinarily resident in Pakistan, for services rendered to that Government in the discharge of governmental functions shall be exempt from Pakistan tax.

(2) Remuneration, including pensions and annuities, paid by or on behalf of the Government of Pakistan or the Government of a Province in Pakistan or any local authority thereof to any individual who is a citizen of Pakistan not having immigrant status in the United States, for services rendered in the discharge of functions of that Government or of local authority, as the case may be, shall be exempt from United States tax.

(3) The provisions of this Article shall not apply to payments in respect of services rendered in connection with any trade or business carried on for purposes of profit.

ARTICLE X

(1) A pension or annuity (other than a pension or annuity of the kind referred to in paragraphs (1) and (2) of Article IX) derived from sources within one of the contracting States by a resident of the other contracting State shall be exempted from tax by the former State.

(2) The term "annuity," for the purposes of this Article, means a stated sum payable periodically at stated times during life or during a specified as ascertainable period of time, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

(3) This Article shall not apply to a pension or annuity payable from a superannuation fund approved or recognized under the tax law of Pakistan nor to a pension or annuity from a fund, under an employees' pension or annuity plan, contributions to which under the tax law of the United States are deductible in determining the taxable income of the employer.

ARTICLE XI

(1) An individual, who is a resident of the United States, shall be exempt from Pakistan tax on profits or remuneration in respect of personal (including professional) services performed within Pakistan in any financial year if—

(a) he is present within Pakistan on a temporary visit for a period or periods not exceeding in the aggregate 183 days during that year, and

(b) the services are performed for or on behalf of a resident of the United States, and

(c) the profits or remuneration are subject to United States tax.

(2) An individual, who is a resident of Pakistan, shall be exempt from United States tax on profits or remuneration in respect of personal (including professional) services performed within the United States in any taxable year if—

(a) he is present within the United States on a temporary visit for a period or periods not exceeding in the aggregate 183 days during that year, and

(b) the services are performed for or on behalf of a resident of Pakistan, and

(c) the profits or remuneration are subject to Pakistan tax.

ARTICLE XII

A professor or teacher, resident in one of the contracting States, who temporarily visits the other contracting State for the purpose of teaching for a period not exceeding two years at a university, college, school or other educational institution in the other contracting State, shall be exempted from tax by such other contracting State in respect of remuneration for such teaching.

ARTICLE XIII

(1) A resident of one of the contracting States who is temporarily present in the other contracting State solely

(a) as a student at a recognized university, college or school in such other State, or

(b) as the recipient of a grant, allowance or award for the primary purpose of study or research from a religious, charitable, scientific or educational organization of the former State

shall be exempted from tax by such other State (i) on all remittances from abroad for the purposes of his maintenance, education or training, and (ii) with respect to an amount not in excess of 5,000 United States dollars for any taxable year, representing compensation for personal services.

(2) A resident of one of the contracting States who is temporarily present in the other contracting State for a period not exceeding one year, as an employee of, or under contract with, an enterprise of the former State or an organization referred to in paragraph (1), solely to acquire technical, professional or business experience from a person other than such enterprise or organization, shall be exempted from tax by such other State on compensation for such period in an amount not in excess of 6,000 United States dollars (including remuneration from such person in the other contracting State).

(3) A resident of one of the contracting States temporarily present in the other contracting State under arrangements with such other State or any agency or instrumentality thereof solely for the purpose of training, study or orientation shall be exempted from tax by such other State with respect to compensation not exceeding 10,000 United States dollars for the rendition of services directly related to such training, study or orientation (including emoluments and remuneration, if any, from the employer abroad of such resident).

ARTICLE XIV

(1) Effective January 1, 1956 the State Bank of Pakistan shall be exempted from United States tax with respect to interest from sources within the United States.

(2) Effective January 1, 1956 the Federal Reserve Banks of the United States shall be exempted from Pakistan tax with respect to interest from sources within Pakistan.

ARTICLE XV

(1) Subject to the provisions of the Internal Revenue Code (as in effect on the date of signature of the present Convention) regarding the allowance of a credit against United States tax for tax payable in a territory outside the United States, Pakistan tax payable, whether directly or by deduction, in respect of income from sources within Pakistan shall be allowed as a credit against United States tax payable in respect of that income. [For the purposes of this credit there shall be deemed to have been paid by a United States domestic corporation the amount by which such Pakistan taxes (other than the business profits tax) have been reduced under the provisions of section 15B of the Income Tax Act, 1922 (XI of 1922) as in effect on the date of the signature of the present Convention: Provided, That any extension made by law of the period within which an industrial undertaking may be set up or commenced in order to obtain the reduction provided in section 15B shall be deemed to be in effect on the date of the signature of the present Convention.][1]

(2) Subject to the provisions of Pakistan income tax law (as in effect on the date of signature of the present Convention), United States tax payable, whether directly or by deduction, by a person resident in Pakistan, in respect of income from sources within the United States (including income accruing or arising in the United States but deemed, under the provisions of the law of Pakistan, to accrue or arise in Pakistan) shall be allowed as a credit against any Pakistan tax payable in respect of that income.

(3) For the purposes of this Article, profits or remuneration for personal (including professional) services performed in one of the contracting States shall be treated as income from sources within that State.

ARTICLE XVI

(1) The taxation authorities of the contracting States shall exchange such information (being information which is available under their respective taxation laws in the normal course of administration) 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 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 persons other than those concerned with the assessment and collection of the taxes which are the subject of the present Convention. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or trade process.

(2) The taxation authorities of the contracting States may consult together, as may be necessary, for the purpose of carrying out the provisions of the present Convention and in particular the provisions of Articles III and IV. Where a taxpayer claims that he has been or may be subjected to double taxation contrary to the provisions of the present Convention, he may present the facts to the taxation authorities of either contracting State. Should the taxpayer's claim be deemed worthy of consideration, the taxation authorities shall endeavor to come to an agreement with a view to avoidance of the double taxation in question.

(3) The taxation authorities of both contracting States may prescribe regulations necessary to interpret and carry out the provisions of the present Convention and may communicate with each other directly for the purpose of giving effect to the provisions of the present Convention.

(4) 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 either contracting State in determining the tax of such State.

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[1] Senate reservation. See Senate Executive Report No. 1 reproduced at page 906, this Bulletin.

ARTICLE XVII

(1) The citizens or nationals of one of the contracting States shall not, while resident in the other contracting State, be subjected in such other State to taxes or any requirement connected therewith which is other, higher or more burdensome than the taxes and connected requirements to which the citizens or nationals of such other State resident therein are or may be subjected.

(2) The term "citizens" or "nationals", as used in this Article, includes all legal persons, partnerships and associations deriving their status from, or created or organized under, the laws in force in the respective contracting States.

(3) Nothing contained in this Article shall be construed—

(a) as obliging either of the contracting States to grant to persons not resident in its territory those personal allowances, reliefs and reductions for tax purposes which are by law available only to persons who are so resident; or

(b) as affecting any provisions of the law of Pakistan regarding the imposition of tax on a non-resident or the grant of rebate of tax to companies fulfilling specified requirements regarding the declaration and payment of dividends, unless those requirements are fulfilled.

ARTICLE XVIII

(1) The present Convention may be extended, either in its entirety or with modifications, to any territory for whose international relations either of the contracting States is responsible and which imposes taxes substantially similiar in character to those which are the subject of the present Convention and any such extension shall take effect from such date and subject to such modifications and conditions (including conditions as to termination) as may be specified and agreed between the contracting States in notes to be exchanged for this purpose.

(2) The termination in respect of Pakistan or the United States of the present Convention under Article XX shall, unless otherwise expressly agreed by both contracting States, terminate the application of the present Convention to any territory to which the Convention has been extended under this Article.

ARTICLE XIX

The present Convention shall come into force on the date when the last of all such things shall have been done in the United States and Pakistan as are necessary to give the Convention the force of law in the United States and Pakistan, respectively, and shall thereupon have effect—

(a) In the United States, for the taxable years beginning on or after the first day of January of the year in which the instruments of ratification are exchanged;

(b) In Pakistan, in respect of the "previous years" or the "chargeable accounting periods" (as defined by the tax laws of Pakistan) beginning on or after the first day of January of the year in which the instruments of ratification are exchanged.

ARTICLE XX

The present Convention shall continue in effect indefinitely but either of the contracting States may, on or before the 30th day of June in any calendar year not earlier than three years from the date of signature of the present Convention, give to the other contracting State written notice of terminaion and, in such event the present Convention shall cease to be effective—

(a) in the United States, for the taxable years beginning on or after the first day of January next following such written notice of termination; and

(b) in Pakistan, in respect of the "previous years" or the "chargeable accounting periods" (as defined by the tax laws of Pakistan) beginning on or after the first day of January next following such written notice of termination.

IN WITNESS WHEREOF, the respective Plenipotentiaries have signed this Convention and have affixed thereto their seals.

DONE in duplicate at Washington this first day of July, 1957.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

JOHN FOSTER DULLES [SEAL]

FOR THE GOVERNMENT OF PAKISTAN:

MOHAMMED ALI [SEAL]

S. AMJAD ALI [SEAL]

UNITED STATES-UNITED KINGDOM AGREEMENT TO EXTEND APPLICATION OF CONVENTION OF APRIL 16, 1945, AS MODIFIED [1]

An agreement has been entered into between the United States and the United Kingdom of Great Britain and Northern Ireland to extend the income tax convention signed April 16, 1945, as modified, to certain territories of the United Kingdom. The agreement was effected by the exchange of notes signed in Washington, D.C., August 19, 1957, and December 3, 1958. The notes read as follows:

The British Ambassador to the Secretary of State

BRITISH EMBASSY,
WASHINGTON, D.C.
August 19, 1957.

SIR,

I have the honour, upon instructions of Her Majesty's Principal Secretary of State for Foreign Affairs, to refer to the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed at Washington on the 16th of April, 1945, as modified by the Supplementary Protocols signed at Washington on the 6th of June, 1946 [C.B. 1947–1, 209], the 25th of May, 1954 [C.B. 1957–1, 665], and the 19th of August, 1957 [C.B. 1958–2, 1078].

In accordance with the provisions of Article XXII of the above-mentioned Convention as amended by the Supplementary Protocol of the 25th of May 1954, Her Majesty's Government in the United Kingdom desire that the application of the Convention should be extended to the territories named in the Annex to this note, subject to the modifications and with effect from the dates specified therein.

If the present notification is acceptable to the Government of the United States of America, I have the honour to request that you will be so good as to inform me accordingly and confirm that the desired application of the Convention to the territories in question shall take effect from the dates specified in the Annex to this Note.

I avail myself of this opportunity to renew to you the assurance of my highest consideration.

HAROLD CACCIA.

The Honorable
JOHN FOSTER DULLES,
Secretary of State of the United States,
Washington, D.C.

ANNEX

I. TABLE OF TERRITORIES TO WHICH THE CONVENTION OF THE 16TH APRIL, 1945, FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME IS TO BE EXTENDED IN ACCORDANCE WITH ARTICLE XXII OF THE SAID CONVENTION AS AMENDED, SUBJECT TO THE CONDITIONS SET OUT IN PARAGRAPHS II AND III OF THIS ANNEX

Column (1)	*Column (2)*	*Column (3)*
Aden	Income Tax	1st April
Antigua	Income Tax	1st January
Barbados	Income Tax	1st January
British Honduras	Income Tax (including Surtax)	1st January
Cyprus	Income Tax	1st January
Dominica	Income Tax	1st January

[1] Senate Executive Report No. 1 is reproduced, in part, beginning at page 906, this Bulletin.

Column (1)	*Column (2)*	*Column (3)*
Falkland Islands	Income Tax	1st January
Gambia	Income Tax	1st January
Grenada	Income Tax (including Surtax)	1st January
Jamaica	Income Tax (including Surtax)	1st January
Montserrat	Income Tax	1st January
Nigeria, Federation of	Income Tax	1st April
Rhodesia and Nyasaland, Federation of	Income Tax, Super Tax and Undistributed Profits Tax	1st April
St. Christopher, Nevis and Anguilla	Income Tax	1st January
St. Lucia	Income Tax	1st January
St. Vincent	Income Tax	1st January
Seychelles	Income Tax	1st January
Sierra Leone	The Income Tax, the duty on profits charged under the Concessions Ordinance, 1931, the diamond industry Profits Tax and the Iron Ore Concessions Tax	1st April
Trinidad and Tobago	Income Tax	1st January
Virgin Islands	Income Tax	1st January

II. APPLICATION

(a) The said Convention as modified shall apply in the case of each territory mentioned in Column (1) of the above Table,

(1) as if the Contracting Parties were the Government of the United States of America and the Government of that territory;

(2) as if the taxes concerned in the case of each territory were those mentioned opposite the name of that territory in Column (2) of the above Table; provided that for the purposes only of the application of Article XIII(1) of the Convention to the Federation of Rhodesia and Nyasaland the taxes concerned shall include the Territorial Surcharges charged in Northern Rhodesia, Nyasaland and Southern Rhodesia;

(3) as if references to "the date of signature of the present Convention" were references to the date of the reply from the United States Government to the note from the United Kingdom Government of the 19th of August, 1957, relating hereto;

(4) as if reference to the 6th day of April were references to the date opposite the name of each territory in Column (3) of the above Table.

(b) When the last of those measures shall have been taken in the United States of America and in any territory named in the above Table necessary to give the present extension the force of law in the United States of America and in such territory, respectively, the present extension shall have effect,

(1) in the United States of America as respects United States tax on and after the first day of January next following the date on which the last of those measures have been taken; and

(2) in such territory as respects tax for the year of assessment beginning on the date specified opposite its name in Column (3) of the above Table, next following the date on which the last of those measures have been taken, and for subsequent years of assessment.

(c) The Government of the United States of America shall inform the Government of the United Kingdom, in writing through the diplomatic channel, when the last of the measures necessary, as indicated in paragraph (b), have been taken in the United States of America. The Government of the United Kingdom shall inform the Government of the United States of America, in writing through the diplomatic channel, when the last of the measures necessary, as indicated in paragraph (b), have been taken in all or any of the territories named in the above Table.

III. MODIFICATIONS

(a) The said Convention as modified shall apply with the exception that for the purposes of the extension to the Federation of Rhodesia and Nyasaland Articles XIV and XVI shall be deemed to be deleted, and for the purposes of the extension to the other territories in the above Table Articles VII, XIV and XVI shall be deemed to be deleted.

(b) The words "shall be exempt from United Kingdom surtax" in Article VI(2) of the Convention shall be understood, for the purposes of this extension, as though they read "shall not be liable to any tax in the territory other than tax imposed with respect to the profits or earnings of the corporation out of which such dividends are paid".

(c) The words "shall be exempt from United Kingdom surtax" in Article IX(2) of the Convention shall be understood, for the purposes of this extension, as though they read "shall not be liable to tax in the territory at a rate in excess of the rate applicable to a company".

(d) For the purposes of the extension to the Federation of Rhodesia and Nyasaland the term "the laws of the United Kingdom" shall be understood as though it read "the laws of the Federation of Rhodesia and Nyasaland and the laws of its constituent Territories".

The Acting Secretary of State to the British Ambassador

DEPARTMENT OF STATE,
WASHINGTON, *December 3, 1958.*

EXCELLENCY:

I have the honor to refer to Your Excellency's note No. 554 dated August 19, 1957, in which reference is made to the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed at Washington on the 16th of April 1945, as modified by the Supplementary Protocols signed at Washington on the 6th of June 1946, the 25th of May 1954, and the 19th of August 1957.

In the above-mentioned note the Government of the United States of America is notified, in accordance with the provisions of Article XXII of the 1945 Convention, as amended by the Supplementary Protocol of 1954, of the desire of Her Majesty's Government in the United Kingdom that the application of the Convention should be extended to the territories named in the Annex to the note, subject to the modifications and with effect from the dates specified therein.

On July 9, 1958 the Senate of the United States of America approved the proposal for extending to the territories named in the above-mentioned note, on the terms and conditions set forth therein, the 1945 Convention as modified by the Supplementary Protocols of 1946, 1954, and 1957. The Supplementary Protocol of 1957 having been brought into force by the exchange of instruments of ratification on October 15, 1958, it is now possible for the Government of the United States of America to take the action prescribed in Article XXII of the 1945 Convention, as amended, to give effect to the proposed extension.

The Government of the United States of America hereby accepts the notification embodied in the above-mentioned note. Accordingly, pursuant to the aforesaid Article XXII as amended, the Convention, as modified by the Supplementary Protocols of 1946, 1954, and 1957, shall apply to the territories named in the Annex to the above-mentioned note, subject to the modifications and with effect from the dates specified therein and subject to the completion of such legislative or other internal measures in the respective territories as will give effect to the extension in such territories.

This acceptance by the Government of the United States of America is the last of the measures necessary on its part to give the extension the force of law in the United States of America. It is understood that the Government of the United Kingdom will inform the Government of the United States of America when the last of the measures necessary have been taken in all or any of the territories named in the aforesaid Annex to give the extension the force of law in the respective territories. [Footnote omitted]

Accept, Excellency, the renewed assurances of my highest consideration.

CHRISTIAN A. HERTER,
Acting Secretary of State.

HIS EXCELLENCY
SIR HAROLD CACCIA, K.C.M.G., K.C.V.O.,
British Ambassador.

SUBPART B.—LEGISLATION

DIGEST OF PUBLIC LAWS ENACTED DURING THE SECOND SESSION OF THE 86TH CONGRESS WHICH PERTAIN TO INTERNAL REVENUE MATTERS

Public laws pertaining to internal revenue matters which were enacted during the second session of the Eighty-sixth Congress are as follows:

Public law number	Date approved	Digested on page—	Public law number	Date approved	Digested on page—
86–413 (H.R. 4586)	4/ 8/60	658	86–564 (H.R. 12381)	6/30/60	662
86–416 (H.R. 6132)	4/ 8/60	658	86–592 (H.R. 12311)	7/ 6/60	663
86–418 (H.R. 8318)	4/ 8/60	658	86–594 (H.R. 4251)	7/ 6/60	663
86–422 (H.R. 2164)	4/ 8/60	659	86–624 (H.R. 11602)	7/12/60	663
86–428 (H.R. 6155)	4/22/60	659	86–631 (H.R. 7726)	7/12/60	680
86–429 (H.R. 529)	4/22/60	659	86–667 (H.R. 8229)	7/14/60	663
86–432 (H.R. 8649)	4/22/60	679	86–707 (H.R. 7758)	9/ 6/60	664
86–435 (H.R. 7588)	4/22/60	660	86–723 (S. 2633)	9/ 8/60	665
86–437 (H.R. 135)	4/22/60	660	86–733 (H.R. 11813)	9/ 8/60	680
86–440 (H.R. 6785)	4/22/60	660	86–778 (H.R. 12580)	9/13/60	665
86–459 (H.R. 8684)	5/13/60	679	86–779 (H.R. 10960)	9/14/60	669
86–470 (H.R. 9660)	5/14/60	661	86–780 (H.R. 10087)	9/14/60	674
86–496 (H.R. 11405)	6/ 8/60	661	86–781 (H.R. 12536)	9/14/60	678

The following sections of the Internal Revenue Code of 1954, and the following Public Laws, have been amended by the Public Laws indicated.

INDEX OF INTERNAL REVENUE CODE OF 1954 SECTIONS AMENDED

Code section	Public law number	Public law section	Code section	Public law number	Public law section
11(b)	86–564	201	503(a)	86–667	2(a)
11(d)(3)	86–779	10(d)	503(b)	86–667	2(b)
34(c)	86–779	10(e)	503(d)	86–667	2(c)
104(a)(4)	86–723	51	503(h)	86–667	2(d)
108(b)	86–496	1(a)	511(a)(2)	86–667	3(a)
116(b)	86–779	10(f)	511(b)(2)	86–667	3(b)
162(b)	86–779	7(b)	513(b)(2)	86–667	4
162(d)	86–779	8(a)	514(c)(8)	86–667	5
162(e)	86–779	8(a)	543(a)(1)	86–435	1(b)
170(c)	86–779	7(a)	543(a)(6)	86–435	1(b)
179(d)	86–779	7(a)	543(a)(9)	86–435	1(a)
180	86–779	6(a)	544(a)	86–435	1(c)
213(a)	86–470	3(a)	544(a)(4)(B)	86–435	1(c)
243(c)	86–779	10(g)	544(b)(2)	86–435	1(d)
243(d)	86–779	3(a)	544(b)(3)	86–435	1(d)
263(a)(1)	86–779	6(c)	544(b)(4)	86–435	1(d)
318(b)	86–779	10(h)	553	86–435	1(e)
402(a)(1)	86–437	2(a)	613(b)	86–564	302(a)
402(a)(4)	86–437	1	613(c)	86–564	302(b)
443(d)	86–779	10(i)	615(c)	86–594	1
461(d)	86–781	6(a)	821(a)(1)(A)	86–564	201
501(c)(14)	86–428	1	821(b)(1)	86–564	201
501(c)(17)	86–667	1	852(a)	86–779	10(b)

NDEX OF INTERNAL REVENUE CODE OF 1954 SECTIONS AMENDED—
Continued

Code section	Public law number	Public law section	Code section	Public law number	Public law section
52(b)(3)(C)	86-779	10(b)	3306(c)(10)	86-778	534
55(c)	86-779	10(b)	3306(j)	86-624	18(d)
56	86-779	10(a)	3306(j)	86-778	543(a)
57	86-779	10(a)	3306(m)	86-778	532(c)
58	86-779	10(a)	3308	86-778	531(d)
61(a)(2)	86-779	3(b)	4021	86-413	1
71	86-437	2(b)	4061	86-564	202(a)
01(a)	86-780	3(a)	4071(a)	86-440	1(a)
01(a)	86-780	3(b)	4201	86-779	9(a)
01(b)	86-780	3(a)	4216(f)	86-781	1
02(e)	86-780	6(b)	4218	86-418	2(a)
04(a)(1)	86-780	1(a)	4221(d)(4)	86-624	18(e)
04(a)(2)	86-780	1(a)	4221(e)	86-418	1
04(b)	86-780	1(b)	4223(b)(1)	86-418	2(b)
04(c)	86-780	1(c)	4231(6)	86-422	1
04(d)	86-780	1(c)	4233(b)	86-624	18(d)
04(e)	86-780	1(d)	4251(b)(2)	86-564	202(a)
12	86-707	523(a)	4261	86-564	202(a)
34	86-779	4(a)	4262(c)(1)	86-624	18(a)
1054	86-779	8(b)	4301	86-416	1
1055	86-779	8(b)	4501(c)	86-592	2
1402(a)	86-778	103(k)	4502(5)	86-624	18(f)
1402(b)	86-778	103(l)	4702(a)	86-429	4(c)
1402(c)(2)	86-778	106(b)	4731(a)	86-429	4(a)
1402(e)(2)	86-778	101(a)	4731(g)	86-429	4(b)
1402(e)(3)	86-778	101(b)	4774	86-624	18(f)
1402(e)(5)	86-778	101(c)	5001(a)(1)	86-564	202(a)
1402(g)	86-778	105(c)	5001(a)(3)	86-564	202(a)
1403(b)(2)	86-778	103(m)	5022	86-564	202(a)
1503(d)(1)	86-780	2	5041(b)	86-564	202(a)
1503(d)(2)	86-780	2	5051(a)	86-564	202(a)
1503(d)(3)	86-780	2	5063	86-564	202(b)
1504(b)(6)	86-779	10(j)	5701(c)(1)	86-564	202(a)
2106(a)(3)	86-779	4(c)	5707(a)	86-564	202(b)
2202	86-624	18(b)	5707(b)	86-564	202(b)
2209	86-779	4(b)	6015(a)	86-779	5(a)
2501(a)	86-779	4(d)	6038	86-780	6(a)
2501(c)	86-779	4(d)	6039	86-780	6(a)
3121(b)	86-778	103(o)	6046	86-780	7(a)
3121(b)(7)	86-778	103(n)	6205(a)	86-778	103(r)
3121(b)(18)	86-778	103(o)	6412(a)(1)	86-564	202(b)
3121(e)	86-778	103(p)	6412(d)	86-592	2
3121(e)(1)	86-624	18(c)	6413(a)(3)	86-778	103(r)
3121(k)(1)(A)	86-778	105(a)	6413(c)(2)	86-778	103(r)
3121(k)(1)(E)	86-778	105(a)	6416(b)(1)	86-781	2
3125	86-778	103(q)	6416(b)(2)(E)	86-418	3(a)
3301	86-778	523(a)	6416(b)(3)	86-418	3(b)
3302(c)	86-778	523(b)	6501(i)	86-780	3(c)
3302(d)	86-778	523(b)	6501(j)	86-780	3(c)
3305(b)	86-778	531(a)	6659(b)	86-470	1
3305(g)	86-778	531(b)	7213(d)	86-778	103(s)
3306(e)	86-778	532(a)	7653(d)	86-624	18(f)
3306(c)(4)	86-778	532(b)	7701(a)(9)	86-624	18(i)
3306(c)(6)	86-778	531(c)	7701(a)(10)	86-624	18(j)
3306(c)(8)	86-778	533	7701(a)(12)	86-778	103(t)

P.L. 85-235	86-432	1	R.A. 1951	86-564	202
P.L. 86-37	86-432	1	R.A. 1951	86-778	603
T.A.A. 1958	86-496	2	P.L. 86-564	86-781	4

Following is a brief explanation of the provisions of the above public laws and the respective Code sections amended thereby. The statements explaining Code sections before amendment and the amendments thereto are not intended as interpretations but are intended merely to indicate the general nature or effect of the provisions involved. Alcohol, tobacco and firearm provisions are omitted.

AMENDMENTS TO THE 1954 CODE

PUBLIC LAW 86-413 (C.B. 1960-1, 786).

4021

Exemption of aromatic cachous from tax on toilet preparations.—Section 1 of this Act deletes "aromatic cachous" from the list of toilet articles taxable under section 4021. The amendment is effective with respect to articles sold at retail on or after May 1, 1960.

PUBLIC LAW 86-416 (C.B. 1960-1, 786).

4301

Reduction of rate of tax on the issuance of shares of certificates of stock by regulated investment companies.—Section 1 of this Act amends section 4301 to provide that the rate of documentary stamp tax on original issues of stock shall be 4 cents per $100 (or major fraction thereof) of actual value instead of 10 cents in the case of stock issued by a corporation which qualifies as a regulated investment company within the meaning of subchapter M of chapter 1 of the Code. The amendment is effective with respect to shares and certificates issued after April 8, 1960.

PUBLIC LAW 86-418 (C.B. 1960-1, 786).

4218, 4221(e), 4223(b)(1), 6416(b)(2)(E), 6416(b)(3)

Exemption of bicycle tires and tubes therefor used in the manufacture or production of new bicycles.—Section 4071(a) imposes a tax on the sale by the manufacturer, producer, or importer of tires and tubes. Section 1 of this Act amends section 4221(e) by adding thereto a new paragraph (4) which permits the sale of bicycle tires and tubes without the payment of the tax imposed under section 4071(a) for use by the purchaser in the manufacture or production of a bicycle (other than a rebuilt or reconditioned bicycle). A "bicycle tire" is defined as a tire, composed of rubber in combination with fabric or other reinforcing element, which is not more than 28 inches in outer diameter and not more than 2¼ inches in cross section and is primarily designed or adapted for use on bicycles. The seller must receive proof within 6 months from the exemption sale that the tire or tube has been used for the exempt purpose.

Section 2 of this Act amends section 4218 to exempt from tax tires and tubes used by the manufacturer or importer thereof to produce a

bicycle (other than a rebuilt or reconditioned bicycle) produced by such manufacturer or importer.

Section 3 of this Act makes the necessary amendments to sections 6416(b)(2)(E) and 6416(b)(3) to provide for credit or refund in the event tax has been paid on bicycle tires or tubes which have been used in the manufacture of new bicycles.

Section 4 of this Act provides that the amendment shall be effective with respect to bicycle tires and tubes sold by the manufacturer on or after May 1, 1960.

PUBLIC LAW 86–422 (C.B. 1960–1, 788).
4231(6)

Reduction of cabaret tax.—Section 4231(6) imposes a tax on all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit. Section 1 of this Act reduces the tax from 20 percent to 10 percent. The reduction in rate of tax is effective with respect to amounts paid after 10 a.m., May 1, 1960 for admisison, etc., furnished after such time.

PUBLIC LAW 86–428 (C.B. 1960–1, 788).
501(c)(14)

Tax exemption of certain nonprofit organizations organized after August 31, 1951, and before September 1, 1957.—Certain nonprofit corporations or associations described in section 501(c)(14) are exempt from tax only if they were organized before September 1, 1951. These organizations are organized and operated for the purpose of providing reserve funds for, and insurance of, shares or deposits in domestic building and loan associations and certain cooperative or mutual savings banks. This Act amends section 501(c)(14) to permit exemption for similar organizations organized after August 31, 1951, and before September 1, 1957. The amendment applies only with respect to taxable years beginning after December 31, 1959.

PUBLIC LAW 86–429 (C.B. 1960–1, 789).
4702(a), 4731(a), 4731(g)

Licensing and control of the manufacture of all narcotics.—This Act is cited as "Narcotics Manufacturing Act of 1960". Its purpose is to (1) discharge more effectively the obligations of the United States under certain conventions and protocols relating to the institution of controls over the manufacture of narcotic drugs, (2) to promote the public health, safety, and welfare, (3) to regulate interstate and foreign commerce in narcotic drugs, and (4) to safeguard the revenue derived from taxation of narcotic drugs. Section 4 of this Act made several amendments to the Code. Section 4731(a) was amended to exclude from the definition of the term "narcotic drugs" certain derivatives of coca leaves which do not contain cocaine or ecgonine. Sections 4731(g) and 4702(a) were amended in order to conform these sections of the Code to some of the provisions of the Narcotic Manufacturing Act of 1960, relating to the authority granted to the Secretary of the Treasury to decide and proclaim which drugs are "opiates". The amendments made by section 4 of this Act take effect on January 1, 1961.

PUBLIC LAW 86–435 (C.B. 1960–1, 792).
543(a)(1), 5434(a)(6), 543(a)(9), 544(a), 544(a)(4)(B), 544(b)(2), 544(b)(3), 544(b)(4), 553

Exclusion of copyright royalties from personal holding company income.—Public Law 86–435 provides a new formula for the treatment of copyright royalties in computing undistributed personal holding company taxable income. It amends section 543(a) by adding at the end thereof a new paragraph (9) which provides that copyright royalties shall not be included as personal holding company income if (A) such royalties constitute 50 percent or more of the gross income, (B) other personal holding company income is 10 percent or less of the gross income, and (C) the deductions under section 162 constitute 50 percent or more of the gross income. For purposes of the new paragraph, the term "copyright royalties" is restricted to copyrights in works protected by copyright issued under title 17 of the United States Code (except sections 2 or 6 thereof) and to which protection is also extended by the laws of any other country by virtue of any international treaty, convention or agreement. The new paragraph (9) is not applicable to compensation which is rent within the meaning of paragraph (7) of section 543(a), determined without regard to the requirement that rents constitute 50 percent or more of gross income. The new provision applies with respect to taxable years beginning after December 31, 1959.

PUBLIC LAW 86–437 (C.B. 1960–1, 794).
402(a)(1), 402(a)(4), 871

Taxation of civil service annuities received by nonresident alien individuals.—This Act amends section 402(a) by adding paragraph (4). The new paragraph allows nonresident alien individuals to exclude from gross income the portion of amounts paid to them by the United States as civil service annuities and other retirement benefits for services performed abroad as employees of the United States. Before this enactment, that part of the civil service annuity that was in excess of the allowance for the investment in the retirement fund was generally includable in gross income and subject to withholding usually at a 30 percent rate. This is the tax rate imposed on income received by a nonresident alien from sources within the United States absent a treaty provision to the contrary. The new provision applies only to taxable years beginning after December 31, 1959.

PUBLIC LAW 86–440 (C.B. 1960–1, 795).
4071(a)

Tax of 1 cent per pound applicable to laminated tires.—Public Law 86–440 amends section 4071(a) to decrease the manufacturers excise tax on certain laminated tires from 5 cents a pound to 1 cent a pound. This lower rate applies to sales of laminated tires not of the type used on highway vehicles, if the tires consist wholly of scrap rubber from used tire casings with an internal metal fastening agent. This lower tax rate is effective with respect to laminated tires sold by the manufacturer or importer on or after June 1, 1960.

This Act amends section 209(c)(1)(E) of the Highway Revenue Act of 1956, P.L. 627, C.B. 1956–2, 1150, so as to provide that the taxes collected on the sale of laminated tires shall be included in the Highway Trust Fund.

PUBLIC LAW 86–470 (C.B. 1960–1, 800).

6659(b)

Procedure for assessing certain additions to tax.—Section 1 of this Act amends section 6659(b) to make it clear that, in general, additions to tax for failure to file income, estate, and gift tax returns on time, and for underpayment of estimated income tax, shall not be subject to the deficiency procedures in subchapter B of chapter 63. Section 1 of the Act further provides that (1) if there is a deficiency in tax as defined in section 6211, that portion of any addition to tax for failure to file a return on time which is attributable to such deficiency shall be subject to the deficiency procedures, and (2) if no return is filed for the taxable year and a deficiency in tax as defined in section 6211 is determined, the entire amount of any addition to tax for underpayment of estimated income tax shall be subject to the deficiency procedures.

Section 2 of the Act provides that the amendment made by the first section of the Act shall apply with respect to assessments made after May 14, 1960, and that any addition to tax for failure to file a return on time or for underpayment of estimated income tax which was assessed and collected on or before May 14, 1960, shall not be considered and overpayment solely on the ground that the assessment was made before such date.

213(a)

Deduction of medical and dental expenses for dependent mother or father of taxpayer or his spouse.—Section 3 of Public Law 86–470 amends section 213(a) relating to deductions of medical, dental, etc., expenses. The amendment allows the taxpayer to deduct, subject to certain maximum limitations, all the allowable medical and dental expenses that he incurs for the care of his dependent mother or father and the dependent mother or father of his spouse if they have reached the age of 65 before the end of the taxable year. Before the amendment these expenses were deductible by the taxpayer only to the extent they exceeded 3 percent of his adjusted gross income. This amendment applies to taxable years beginning after December 31, 1959.

PUBLIC LAW 86–496 (page 680, this Bulletin).

108(b)

Income from discharge of indebtedness of railroads.—Under the provisions of section 108(b) of existing law the income from discharge of indebtedness is excluded only where the discharge occurred in a taxable year beginning before January 1, 1958. Under section 1 of the Act, section 108(b) is made applicable to taxable years ending after December 31, 1959, but only with respect to discharges occurring after that date pursuant to a court proceeding commenced before January 1, 1960.

Accrual of vacation pay.—Section 2 of this Act amends section 97 of the Technical Amendments Act of 1958, P.L. 85–866, C.B. 1958–3, 254, by substituting "January 1, 1963" for "January 1, 1961". The effect of this amendment is to extend for two more years the period within which employers who have consistently accrued vacation pay for income tax purposes pursuant to I.T. 3956, C.B. 1949–1, 78, may

continue to use that method. As a result, such taxpayers will not be required to follow the strict accrual rules set forth in Revenue Ruling 54–608, C.B. 1954–2, 8, for taxable years ending before January 1, 1963.

PUBLIC LAW 86–564 (page 681, this Bulletin).

11(b), 821(a)(1)(A), 821(b)(1), 4061, 4251(b)(2), 4261, 5001(a)(1), (3), 5022, 5041(b), 5051(a), 5063, 5701(c)(1), 5707(a)(b), 6412(a)(1)

Extension for one year of the existing corporate normal-tax rate and certain excise-tax rates.—Section 201 of this Act extends the corporate normal-tax rate of 30 percent for an additional year to July 1, 1961. Section 202 of this Act postpones until July 1, 1961, the excise tax rate reductions on the following taxable articles which were to become effective on July 1, 1960: Passenger automobiles, automobile parts and accessories, distilled spirits generally, imported perfumes containing distilled spirits, wines, cordials and liqueurs containing wine, beer, and cigarettes. The floor stocks credit or refunds applicable to floor stocks of all the articles listed above on hand as of July 1, 1960, except automobile parts and accessories for which no floor stock refund is provided, were likewise postponed for one year.

Section 202(a)(2) of this Act amends section 4251(b)(2) to postpone the termination of the tax on general telephone service from July 1, 1960, to July 1, 1961.

Section 202(a)(3) of this Act amends section 4261 to postpone from July 1, 1960, to July 1, 1961, the reduction of the rate of tax on the transportation of persons from 10 percent to 5 percent.

613(b), 613(c)

Percentage depletion for minerals and ores.—Section 302 of this Act amends subsections (b) and (c) of section 613. Before this amendment section 613(c) defined "mining" as including "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". This Act eliminates the "commercially marketable" concept and lists specific treatment processes that are to be considered as mining where applied by the mine owner or operator. Treatment processes that are not to be considered as mining in certain instances are also specified in the Act. The Act provides for a percentage depletion rate of 15 percent for ball clay, bentonite, china clay, sagger clay, and clay used or sold for uses dependent on the clay's refractory properties. A 5 percent depletion rate is to apply for any clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products. These amendments apply to taxable years beginning after December 31, 1960.

Investigation and reports in respect of entertainment expenses.—Section 301 of the Act directs the Joint Committee on Internal Revenue Taxation to investigate the operation and effects of present law, regulations, and practices relating to the deduction, as ordinary and necessary business expenses, of expenses for entertainment, gifts, dues or initiation fees in social, athletic, or sporting clubs or organizations, and similar or related items. The results of the investigation are to be reported to the 87th Congress.

Also, the Secretary of the Treasury is directed to report to the 87th Congress the results of the Service's enforcement program announced in Technical Information Release 221 dated April 4, 1960, relating to the deductions, as ordinary and necessary business expenses, of expenses for entertainment, travel, yachts, hunting lodges, club dues, and similar or related items, together with any appropriate recommendations to avoid misuse of the business expense deductions.

PUBLIC LAW 86–592 (page 685, this Bulletin).
4501(c), 6412(d)

Amendment of the Sugar Act of 1948.—Section 2 of this Act amends section 4501(c) to postpone the termination of the tax on manufactured sugar from June 30, 1961 to September 30, 1961, and also amends section 6412(d) to provide that floor stocks refund shall apply to manufactured sugar held by importers for sale on September 30, 1961 rather than June 30, 1961.

PUBLIC LAW 86–594 (page 685, this Bulletin).
615(c)

Exploration expenditures.—This Act amends section 615(c) by removing the limitation of four years for deducting exploration expenditures up to $400,000 for minerals other than oil and gas. The annual maximum of $100,000 for exploration expenditures deductible under this section is not changed but there is now no limit on the number of years over which qualifying exploration expenditures may be deducted. This amendment applies to any taxable year beginning after July 6, 1960.

PUBLIC LAW 86–624 (page 686, this Bulletin).
2202, 3121(e)(1), 3306(j), 4221(d)(4), 4233(b), 4262(c)(1), 4502(5), 4774, 7653(d), 7701(a)(9), 7701(a)(10)

Removal of reference to Hawaii.—Section 18 of this Act makes perfecting amendments to the 1954 Code which are necessitated by the admission of Hawaii into the Union. All, except the amendment to section 4262(c)(1), relating to the definition of the phrase "continental United States" for purposes of the tax on transportation of persons, merely remove references to Hawaii which are now superfluous. Prior to the admission of Hawaii into the Union, transportation between the continental United States or the 225 mile zone and the Territory of Hawaii was partially exempt from tax. The amendment of section 4262(c)(1) accords to Hawaii, as a State, the same treatment for transportation tax purposes it received as a Territory. The amendments are effective as of August 21, 1959.

PUBLIC LAW 86–667 (page 687, this Bulletin).
501(c)(17), 503(a), 503(b), 503(d), 503(h), 511(a)(2), 511(b)(2), 513(b)(2), 514(c)(8)

Exemption from income tax for supplemental unemployment trusts.—A new paragraph (17) is added to section 501(c) which provides a new tax exempt category for income tax purposes in the case of trusts providing for the payment of supplemental unemployment compensation benefits. Such a trust may also pay sickness and accident benefits if they are a subordinate part of the plan providing for the payment of unemployment benefits. The new exempt category differs from the category under section 501(c)(9) of existing

law in that it does not require such trusts to obtain at least 85 percent of their income from employers or employees. However, it is not an exclusive category and an organization providing for payment of supplemental unemployment compensation benefits can obtain exemption under section 501(a) if it meets the conditions of section 501(c)(9). Exemption from income tax under the new category is limited to trusts which are a part of plans which meet certain conditions as to nondiscrimination. In addition, the "prohibited transaction" provisions, and "unrelated business income" provisions (including the business lease provisions) of present law are made applicable to the new exempt category. Certain conforming technical changes were made to sections 503, 511, 513 and 514. Except as otherwise provided in the Act, the new exempt category and other related provisions generally are made applicable to taxable years beginning after December 31, 1959.

PUBLIC LAW 86–707 (page 690, this Bulletin).

912

Exemptions for certain allowances.—Under the provisions of section 912 of the 1954 Code, prior to its amendment by section 523 of the Overseas Differentials and Allowances Act, amounts received by an officer or employee of the Foreign Service of the United States as allowances or otherwise under the terms of title IX of the Foreign Service Act of 1946 were not includible in gross income. Certain allowances for living quarters, cost-of-living, post differentials, etc., which were available to Foreign Service personnel under the Foreign Service Act, are now available under title II of the Overseas Differentials and Allowances Act, both to Foreign Service personnel and to any other civilian employee of the Government officially stationed in a foreign area who is a citizen of the United States.

Under the latter Act, appropriate amendments to certain other Acts were made in order that the allowances made to civilian employees of the Government stationed in foreign areas might be uniform. Thus, the new section 912(1) extends the exclusion from gross income, in the case of civilian officers and employees of the Government, to amounts received by them as allowances or otherwise (including amounts received as cost-of-living allowances, but not including amounts received as post differentials) under title IX of the Foreign Service Act of 1946, as amended, section 4 of the Central Intelligence Agency Act of 1949, as amended, title II of the Overseas Differentials and Allowances Act, or subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, as amended, or section 22 of such Act.

The new section 912(2) continues to provide for the exclusion from gross income of amounts received as cost-of-living allowances (which are not excluded under section 912(1)) in accordance with regulations approved by the President in the case of civilian officers and employees of the Government who are stationed outside the continental United States. As used in section 912(2), the term "continental United States" does not include Alaska.

The provisions of section 912, as amended by section 523(a) of the Overseas Differentials and Allowances Act, shall apply only with respect to amounts received on or after September 6, 1960, the date of enactment of the Act.

PUBLIC LAW 86–723 (page 691, this Bulletin).

104(a)(4)

Exclusion from gross income of compensation for injuries or sickness.—Section 104(a)(4) of the Code, prior to amendment by Public Law 86–723, provides that gross income does not include amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service. Section 51 of Public Law 86–723 amends section 104(a)(4) to also exclude from gross income amounts received as a disability annuity payable under the provisions of section 831 of the Foreign Service Act of 1946, as amended. This amendment is effective with respect to taxable years ending after September 8, 1960, the date of enactment of this Act.

PUBLIC LAW 86–778 (page 693, this Bulletin).

1402(a), 1402(b)

SOCIAL SECURITY AMENDMENTS OF 1960

Extension of self-employment tax to Guam and American Samoa.—Section 1402(a), relating to net earnings from self-employment, and section 1402(b), relating to self-employment income, are amended so that self-employment tax will be applicable with respect to Guam and American Samoa. This extension of coverage is effective for taxable years beginning after 1960. Section 1402(a) is amended by adding a new paragraph (9) pursuant to which Guam and American Samoa are not considered as possessions of the United States as that term is used in sections 931 and 932, for purposes of determining liability for the self-employment tax. In general, Guamanians and American Samoans will be accorded the same treatment for self-employment tax purposes as citizens born in any State of the Union. Section 1402(b) is amended so that nonresident aliens who are residents of Guam or American Samoa will be accorded the same treatment, for self-employment tax purposes, as aliens who are residents of the United States.

3121(b)(7), 3121(b)(18), 3121(e), 3125

Extension of Federal Insurance Contributions Act to Guam and American Samoa.—Section 3121(e), relating to the definition of "State", "United States", and "citizen", is amended so that the taxes imposed by the Federal Insurance Contributions Act will be applicable with respect to Guam and American Samoa. This extension of coverage is effective with respect to service performed after 1960. Section 3121(b)(7) is amended so that these taxes will apply with respect to the service of employees of the government of Guam or American Samoa (other than service covered by a U. S. retirement system) performed after 1960 and after the quarter in which the Governor certifies that such coverage is desired. Section 3121(b)(18) is added to except from "employment" service performed after 1960 by certain residents of the Philippines temporarily in Guam as contract workers.

6205(a), 6413, 7213, 7701(a)(12)

Administrative provisions relating to extension of coverage to Guam and American Samoa.—Special provisions are added with re-

spect to returns, adjustments, and special refunds in the case of governmental employees in Guam and American Samoa. Authority is provided for the delegation of functions in Guam and American Samoa in relation to taxes imposed by chapters 2 and 21 of the Code, and for the appropriation of funds for the performance of the delegated functions. Section 30 of the Organic Act of Guam is amended to preclude any necessity under the law for covering into the Guam treasury any tax imposed by chapter 2 or 21 of the Code.

1402(c)(2)

American citizen employees of foreign governments and international organizations.—Section 1402(c)(2), relating to the definition of trade or business for purposes of self-employment tax, is amended so as to impose self-employment tax with respect to certain services performed in the United States (including Guam and American Samoa after 1960) by a citizen of the United States, in the employ of a foreign government, an instrumentality wholly owned by a foreign government, or an international organization. The services affected are those described in section 3121(b)(11), (12), or (15). This amendment is effective for taxable years ending on or after December 31, 1960.

1402(e)(2), 1402(e)(3), 1402(e)(5)

Election of social security coverage by ministers, members of religious orders, and Christian Science practitioners.—Under section 1402(e)(2), as it existed before amendment by Public Law 86-778, a minister, member of a religious order, or Christian Science practitioner could elect to pay self-employment tax (and obtain social security coverage) only if he filed a waiver certificate on or before the due date of the return for his second taxable year ending after 1954 for which he had net earnings from self-employment of $400 or more, any part of which was derived from his ministry, etc. For some ministers, this period had expired. The amendment of section 1402(e)(2) supplements previously existing provisions by permitting the filing of a waiver certificate at any time after September 13, 1960, and on or before April 16, 1962 (that is, on or before the due date of the return for the second taxable year ending after 1959). Section 1402(e)(3) is amended by adding a new subparagraph (B) providing that a waiver certificate which was effective for the first taxable year ending after 1956 may (by the filing of a supplemental certificate) be made effective for the preceding taxable year. Section 1402(e)(5) is added to enable ministers, members of religious orders, and Christian Science practitioners to obtain retroactive coverage beginning with the first taxable year which ended after 1954 and before 1960 for which such person filed a timely return reporting self-employment income as a minister, etc., but for which no waiver certificate was in effect. Such retroactive coverage may be obtained by filing a waiver certificate, or a supplemental certificate in any case in which a certificate previously filed is not effective for such first year, and by paying the tax, on or before April 15, 1962. Section 101(d) of P.L. 86-778 gives relief from interest and penalties with respect to additional tax due by reason of section 1402(e)(3)(B) or (5), and extends the period of limitation for assessing such tax.

1402(g), 3121(b)

Treatment of certain remuneration erroneously reported as net earnings from self-employment.—Self-employment tax returns have been erroneously filed by certain lay missionaries and other individuals who erroneously believed that they were qualified as ministers to elect social security coverage as self-employed individuals. Section 1402(g) is added to enable such an individual or his representative to request that any such return for a year ending after 1954 and before 1962 be validated under stated conditions, if the earnings reported are for services described in section 3121(b)(8) (other than service as a minister or a member of a religious order) and if the organization for which such service is performed has in effect a certificate under section 3121(k) of the Federal Insurance Contributions Act on or before the date the validation is requested. For purposes of section 3121(b)(8)(B) (ii) or (iii), if such certificate is not effective with respect to services performed by such individual on or before the first day of the calendar quarter in which the request for validation is filed, the certificate shall be effective with respect to any service performed by the individual for such organization on or after the first day of the next calendar quarter.

3121(b)

Service of parent for son or daughter.—Service performed after 1960, by a parent in the employ of his or her child, will not be excepted from employment by reason of the family relationship, unless the service is domestic service in the child's private home, or is otherwise not in the course of the child's trade or business.

Employees of nonprofit organizations.—Section 105(b) of P.L. 86–778 sets forth conditions under which certain remuneration paid by a religious, charitable, etc., organization to an employee before July 1, 1960, for service performed after 1950, may be "validated" as remuneration for employment for purposes of title II of the Social Security Act. Requests for such validation should not be directed to the Internal Revenue Service, and should be made in accordance with regulations of the Secretary of Health, Education, and Welfare. One of the prerequisites to validation is a requirement that, if the validation is requested at a time when the organization has any individual in its employ, the organization must have filed a certificate under section 3121(k). If an individual performs service for an organization on or after the date on which the validation of his remuneration is requested, and the organization's certificate was not effective with respect to such individual's service, the certificate becomes effective, for purposes of the taxes imposed by the Federal Insurance Contributions Act, with respect to service performed by him after the quarter in which the validation is requested. Section 105(b) is effective on the date of enactment, September 13, 1960. Section 403(a) of the Social Security Amendments of 1954 will not apply to requests made after the date of enactment.

3121(k)(1)

Waiver of exemption by nonprofit organization.—Section 3121(k)(1) is amended to eliminate the requirement that at least two-thirds of an organization's employees must concur in the filing of a

waiver certificate (Form SS–15). After September 13, 1960, waiver certificates may be filed without regard to the number of employees, if any, who concur. As in the past, however, coverage will be effective only for those employees whose signatures are included on a Form SS–15a or Form SS–15a Supplement, or who are hired or rehired after the calendar quarter in which the Form SS–15 is filed.

3301

Increase in tax rate under Federal Unemployment Tax Act.—Section 3301 is amended to increase the rate of tax from 3 percent to 3.1 percent for the calendar year 1961 and each calendar year thereafter.

3302(c)

Computation of credits against tax.—Existing law makes provision for the reduction of credit otherwise allowable to an employer if he pays wages attributable to a State with respect to which there is outstanding, after a specified period of time, a balance of amounts previously advanced to the State pursuant to title XII of the Social Security Act or previously paid out pursuant to the Temporary Unemployment Compensation Act of 1958. As a practical matter, no credit reduction is expected to occur for any calendar year prior to 1961. With minor changes, existing law will continue to apply in the case of advances made to States before September 13, 1960. Credit reductions will be increased in amount and will be accelerated in the case of advances made on or after September 13, 1960. The reduction of credit will be computed as if the tax rate were 3 percent (rather than 3.1 percent).

3305(b), 3305(g), 3306(c)(6), 3308

Federal instumentalities.—Subsections (b) and (g) of section 3305 are amended so that, under specified conditions, States may require unemployment contributions from certain instrumentalities of the United States which are neither wholly nor partially owned by the United States. Such instrumentalities, which also will become subject to the Federal unemployment tax, include the Federal Reserve banks, Federal credit unions, Federal land banks, Federal land bank associations, and Federal home loan banks. Section 3306(c)(6) is amended so that the Federal unemployment tax will not apply to partially-owned instrumentalities of the United States. (The tax will continue to be inapplicable to wholly-owned instrumentalities of the United States). The tax will thus be made inapplicable to partially-owned instrumentalities such as banks for cooperatives, Federal intermediate credit banks, and some production credit associations. These amendments will apply to remuneration paid after 1961 for services performed after 1961.

3306(c), 3306(m)

American aircraft.—Subsections (c) and (m) of section 3306 are amended so that the Federal unemployment tax will apply with respect to American aircraft outside the United States in the same manner as such tax applies to American vessels outside the United States. Section 3306(c)(4) is amended to apply the same exclusion with respect to non-American aircraft as is provided with respect to non-American vessels. These amendments are effective with respect to remuneration paid after 1961 for services performed after 1961.

3306(c)(8)

Feeder organizations, etc.—Section 3306(c)(8) is amended to exclude from coverage under the Federal Unemployment Tax Act any service performed in the employ of an organization described in section 501(c)(3) which is exempt from income tax under section 501(a). This differs from the existing provision which excludes the described organizations whether or not they are exempt from income tax. The amendment will have the effect of extending coverage to "feeder" organizations which are operated for the primary purpose of carrying on a trade or business for profit, and turning such profits over to organizations described in section 501(c)(3). The amendment is effective with respect to remuneration paid after 1961 for services performed after 1961.

3306(c)(10)

Fraternal beneficiary societies, agricultural organizations, voluntary employees' beneficiary association, etc.—Section 3306(c)(10) is amended to cover services performed in the employ of the various non-profit organizations previously described therein, except that the services of an employee will continue to be excluded for any quarter in which the employee earns less than $50, and the services of a student will continue to be excluded if performed in the employ of the school he attends. This amendment is effective with respect to remuneration paid after 1961 for services performed after 1961.

3306(j)

Extension of Federal Unemployment Tax Act to Puerto Rico.—Section 3306(j), relating to the definition of "State", is amended with the effect of extending the Federal unemployment tax to Puerto Rico in the same manner as if Puerto Rico were a State. This amendment is effective with respect to remuneration paid after 1960 for services performed after 1960.

PUBLIC LAW 86-779 (page 709, this Bulletin).

243(d), 861(a)(2)

Certain dividends from foreign corporations.—Section 243 is amended to make available the 85 percent intercorporate dividends received deduction when a foreign corporation pays a dividend out of its earnings and profits if they were accumulated by a predecessor domestic corporation which was subject to the regular U.S. corporate income tax when these earnings were accumulated. Section 861(a)(2) is amended so that such dividends shall constitute income from sources within the United States. The amendments apply to dividends received after December 31, 1959, in taxable years ending after such date. (Section 3 of the Act)

934

Limitation Imposed on Reduction of Tax Liability to the Virgin Islands.—Under present law, the entire income taxes of Virgin Island inhabitants, including those on income derived from the United States, are paid to the Virgin Islands. To induce new business to come to the Islands, and for other purposes, the tax liabilities of certain taxpayers have, in effect, been reduced by the government of the Virgin Islands in recent years by the payment of subsidies. The subsidies served to reduce the tax liability of the recipient not only

in respect of income derived in the Islands, but in respect of that derived in the U.S. In order that the tax liability may not be reduced in respect of U.S. income, section 4(a) of Public Law 86–779 adds a new section 934 to the Code which denies the right to pay any subsidy which has the effect of reducing tax liability, except in the following cases: (1) U.S. and Virgin Island corporations which have derived during the three-year period preceding the close of the taxable year, or the applicable part thereof, 80 percent of their income from sources within the Virgin Islands and 50 percent of their income for such period or part thereof from the active conduct of a trade or business within the Virgin Islands; and (2) U.S. citizens who are bona fide residents of the Virgin Islands for the entire taxable year, to the extent that their incomes are derived from within the Virgin Islands. The income of employees of the U.S. in the Virgin Islands will not be considered to be derived in the Virgin Islands, nor will gains on sales of securities. Both exceptions (1) and (2) will apply only in the case of persons who supply such information as may be prescribed by regulations. These amendments apply to tax liability incurred for tax years beginning on or after January 1, 1960.

2106(a)(3)(B), 2209, 2501(a), 2501(c)

Certain residents of possessions considered nonresidents not citizens of the United States.—Prior to the enactment of section 4(b) of Public Law 86–779 the estate of a U.S. citizen who was a resident of a U.S. possession was subject to estate tax only if his citizenship was acquired wholly independently of his connection with the possession. Those other U.S. citizens who were residents of a possession were exempt from estate tax. The new provision of law imposes estate tax liability on this group, but only as nonresidents not citizens (that is, only with respect to property situated within the U.S.).

Section 4(c) provides that the $60,000 estate tax exemption will be available to this class only in the same proportion in which the gross estate situated within the U.S. bears to the total gross estate, but in no case to be less than $2,000.

Similarly, in the case of the gift tax, section 4(d) provides that a donor who is a member of this group, and who had been exempt from gift tax prior to this Act, shall also be taxed as a nonresident not a citizen (that is, generally with respect to the transfer of property situated within the United States).

Sections 4(b) and 4(c) shall be effective with respect to the estates of those decedents dying after September 14, 1960 and section 4(d) shall be effective with respect to those donors who make a gift after such date.

6015(a)

Declaration of estimated income tax by individuals.—Section 5 of this Act amends section 6015(a) by eliminating the wage and $100 non-wage income tests in section 6015(a)(1) and the test of $400 plus $600 times the number of exemptions in section 6015(a)(2). The amendment also increases the $100 non-wage income test in section 6015(a)(2) to $200 and adds a new provision under which no declaration is required if the estimated income tax can reasonably be expected to be less than $40. The amendment is effective for all taxable years beginning after December 31, 1960.

180, 263(a)(1)

Expenditures by farmers for fertilizer.—Section 6 of this Act adds section 180 to the Code. The new section allows taxpayers engaged in the business of farming to elect to deduct expenditures for soil treatment (otherwise chargeable to capital account) in the year in which they are paid or incurred. Included within the election are expenses for purchasing and applying fertilizer, lime, ground limestone, marl, or other material to enrich, neutralize, or condition land used in farming. For this purpose, "land used in farming" means land used (before or simultaneously with such expenditures) by the taxpayer or his tenant for the production of crops, fruit, or other agricultural products or for the sustenance of livestock. Section 263(a)(1), relating to nondeductibility of capital expenditures is amended by adding a new subparagraph (D) thereto to provide that such section shall be inapplicable to expenditures deductible under new section 180. Section 180 applies to taxable years beginning after December 31, 1959.

162(b), 170(c), 170(d)

Amounts paid to maintain certain students as members of the taxpayer's household treated as charitable contributions.—Amounts paid directly to or on behalf of any individual are not considered as charitable contributions under present section 170 of the Internal Revenue Code of 1954. However, the amendments made by section 7 of the Act permit such amounts, under the conditions provided, to be treated as charitable contributions and to be deducted to a limited extent under section 170. Section 7 accomplishes this by adding a provision at the end of section 170(c) which includes in the definition of the term "charitable contribution" an amount treated under the new subsection (d) (also added by section 7) as paid for the use of an organization described in section 170(c)(2), (3), or (4). Amounts so treated under the new subsection (d) include only those amounts paid by the taxpayer in maintaining an individual (other than a dependent or relative) in the taxpayer's home, as a member of his household, during the period that such individual is a full-time student in the 12th or any lower grade at an educational institution (as defined in section 151(e)(4)) located in the United States. Such student must have been placed in the taxpayer's home in accordance with a written agreement between the taxpayer and an organization described in section 170(c)(2), (3), or (4) and for the purpose of implementing a program of such organization to provide educational opportunities for students in private homes.

The deduction for any taxable year for amounts paid in accordance with the new subsection (d) of section 170 is limited to $50 times the number of calendar months during such year which fall within the period in which the student is a member of the taxpayer's household. Moreover, no deduction shall be allowed if the taxpayer receives any money or other property as compensation or reimbursement for maintenance of such student.

Subsection (b) of section 7 amends section 162(b) of the Code to prohibit a deduction under section 162(a) for any amount which would be allowable under the foregoing amendments were it not for the dollar limitations referred to therein.

The amendments made by section 7 of the Act are effective for taxable years beginning after December 31, 1959.

162(d), 162(e), 1054, 1055

Purchase of certain stock of Federal National Mortgage Association.—Section 8(a) of this Act inserts in section 162 a new subsection (d) and redesignates subsection (d) as subsection (e). Section 8(b) of this Act redesignates section 1054 as section 1055, and inserts a new section 1054. The new section 162(d) requires the initial purchaser of stock issued under section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718), to treat as ordinary and necessary business expense paid or incurred during the taxable year, the amount by which the capital contribution evidenced by the stock exceeds the fair market value of the stock as of its issue date. The new section 1054 provides for the basis of this stock to be the amount of such capital contribution reduced by the amount required by section 162(d) to be treated as ordinary and necessary business expense. The position of the Service in regard to purchases of this stock was set out in Revenue Ruling 58–41, C.B. 1958–1, 86. That ruling required that the entire amount paid for the stock must be capitalized. Therefore any tax effect occurred only when the stock was sold by the taxpayer. These amendments apply to taxable years beginning after December 31, 1959.

4201

Change in rate of tax on sales of mechanical lighters for cigarettes, cigars, and pipes.—Section 4201 imposes a tax on mechanical lighters for cigarettes, cigars, and pipes at the rate of 10 percent of the price for which sold by the manufacturer, producer, or importer. Section 9 of this Act changes the rate of tax to a flat 10-cents-per-lighter except that in no case shall the tax exceed 10 percent of the price for which the lighter is sold. This amendment is effective with respect to sales made by the manufacturer, producer, or importer on and after October 1, 1960.

11(d)(3), 34(c), 116(b), 243(c), 318(b), 443(d), 852(a), 852(b)(3)(C), 855(c), 856, 857, 858, 1504(b)(6)

Tax treatment of real estate investment trusts and associations.—A new part II composed of sections 856, 857, and 858 is added to subchapter M, chapter 1. Under section 856, an unincorporated trust or an unincorporated association, as defined in subsection (a), may, subject to the limitations and conditions prescribed in subsection (c), be considered a "real estate investment trust".

As a "real estate investment trust", a trust or association is entitled to pass through its earnings (including capital gains) to its beneficial owners without imposition of tax at the trust level. However, this treatment is not allowed to a real estate investment trust unless its distributions equal or exceed the 90 percent requirement prescribed in section 857(a). A real estate investment trust is taxable under section 11 on "real estate-investment trust taxable income" which is its taxable income, adjusted as prescribed in section 857(b)(2); one adjustment being the allowance of a deduction for distributions to beneficial owners. It is also taxable at capital gain rates on the amount of the excess of any net long-term capital gain over any

net short-term capital loss which is not distributed to beneficial owners.

Distributions meeting the requirements of section 857(a) are taxable to the beneficial owners as ordinary income, while capital gain distributions are taxable to them as gains from the sale or exchange of capital assets held for more than 6 months. A special provision is included to treat as losses from the sale or exchange of a capital asset held for more than 6 months, certain losses on the sale or exchange of beneficial interests or shares in a real estate investment trust which are held for less than 31 days.

Under section 857(c), amounts received from a real estate investment trust are not considered dividends for purposes of sections 34 (a), 116, and 243, relating to credit for dividends received by individuals, exclusion for dividends received by individuals, and deduction for dividends received by corporations, respectively. Section 857(d) provides a special rule for the purpose of computing the earnings and profits of a real estate investment trust. Another special rule is provided, in section 858, under which distributions by a real estate investment trust during a specified period following the close of a taxable year are considered to have been paid during such taxable year.

Conforming amendments are made in sections 11(d)(3), 34(c), 116(b), 243(c), 852(a) and (b)(3)(C), 855(c), and 1504(b)(6). Cross references are added to sections 318(b) and 443(d).

The amendments apply with respect to taxable years of real estate investment trusts beginning after December 31, 1960. (Section 10 of the Act)

Retroactive tax exemption for Plumbers' Local 775 pension fund.— Where a pension plan for employees has been negotiated under and pursuant to a collective bargaining agreement between a union and one or more employers, the employer contributions toward the cost of such plan usually begin immediately. Usually the only detail of the plan agreed upon at the time of the collective bargaining agreement is the rate of contributions to be made thereto by the bargaining employer or employers. All other necessary details of a plan meeting the requirements of section 401(a) of the Code are to be worked out, agreed upon, and adopted after employer contributions have begun. Prior to the adoption of a plan sufficient in all of its details to meet the requirements of section 401(a), often from one or two or more years, the employer contributions are made to a trust (or escrow fund) not exempt under section 501(a) of the Code and such contributions are usually not deductible under section 404(a) of the Code. Public Law 86–779 provides retroactive tax relief for the trust, and therefore also for the employers who made contributions thereto prior to 5/12/59, in the case of The Pension Fund, Plumbers Local Union Numbered 775, which found itself in this situation. Such Fund came into existence on 5/1/57 but a plan meeting the requirements of section 401(a) was not adopted until the later date. However, the retroactive relief is granted only on the condition that it be shown to the satisfaction of the Service that the trust did not operate during the period May 1, 1957 to May 11, 1959, in a manner which would jeopardize the interests of its beneficiaries.

PUBLIC LAW 86-780 (page 720, this Bulletin).

904(a)(1), 904(a)(2), 904(b), 904(c), 904(d), 904(e)

Overall limitation of foreign tax credit.—Prior to the new law, income taxes paid to a foreign country (or U.S. possession) were allowable as a credit against income taxes otherwise due the United States subject to the per-country limitation of section 904(a). The per-country limitation is continued under the new law as section 904(a)(1); in addition, taxpayers may now elect the overall limitation provided by new section 904(a)(2). This overall limitation allows as a credit against the United States income tax the same proportion of the United States tax (before the credit) which the taxable income from sources without the United States is of the total taxable income. Such election may be made for any taxable year beginning after December 31, 1960. Subsections (b) and (c) of section 904 are redesignated (c) and (d), respectively. New subsection (b) of such section provides that taxpayers may at their own volition elect to make an initial shift from the per-country to the overall limitation at any time, but thereafter they can change from the overall limitation to the per-country, or vice versa, only with the consent of the Secretary or his delegate. An election or revocation of an election with respect to any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax for such taxable year. Section 904 is also amended by adding a new subsection (e) which provides that the excess of foreign taxes over the amount which could be credited for the current year cannot be carried back or over either from a per-country limitation year to an overall limitation year or from an overall limitation year to a per-country limitation year. However, in applying the statutory rule which prescribes the number of years for which a carryback or carryover may be taken the provisions of new subsection (e) are to be disregarded. Such excess foreign taxes may be carried from one per-country limitation year to another per-country limitation year, or from one overall limitation year to another overall limitation year. The amendments to section 904 apply only to taxable years beginning after December 31, 1960. (The first section of the Act.)

1503(d)(1), 1503(d)(2), 1503(d)(3)

Application of foreign tax credit when overall limitation applies in case of corporations filing consolidated returns.—Section 1503 is amended by adding subsection (d)(1) which provides that in the case of a consolidated return by an affiliated group of corporations which includes Western Hemisphere trade corporations in a year in which the overall limitation is in effect, the foreign taxes paid or accrued to foreign countries and U.S. possessions by such Western Hemisphere trade corporations which are taken into account in computing the foreign tax credit are to be reduced by the amount by which the amount of such foreign taxes (or the amount of the United States taxes which would have been imposed on such corporations if they had not been Western Hemisphere trade corporations, if the latter amount is less than the amount of the foreign taxes) exceeds the amount of the United States tax computed under the reduced rate applicable to such corporations on their share of the consolidated taxable income. The

effect of this provision is to deny, where the overall limitation is used, the right to credit foreign taxes paid or accrued by Western Hemisphere trade corporations between the tax rates of 38 percent and 52 percent against the United States taxes on income attributable to corporations in the same affiliated group which are not Western Hemisphere trade corporations.

Section 1503 is further amended by adding subsection (d)(2) which provides that the reduction under new section 1503(d)(1) in foreign taxes paid by corporations which are both Western Hemisphere trade corporations and regulated public utilities is to be reduced by the excess of the amount of United States tax computed on the income derived by the corporations in the affiliated group which are not Western Hemisphere trade corporations, from sources within the foreign countries in which the affiliated Western Hemisphere trade corporation regulated public utility derives the principal part of its income, over the amount of taxes paid or accrued to such foreign countries by the corporations which are not Western Hemisphere trade corporations. This adjustment is available only when the corporations involved, which are not Western Hemisphere trade corporations, receive at least 80 percent of the gross income from sources within such foreign countries from regulated public utilities and from their own operations (where they are regulated public utilities). Capital gains and losses are not taken into account for purposes of the 80 percent computation.

Section 1503 is amended by adding subsection (d)(3) which provides special rules with respect to subsection (d)(1) and (2). The amendments to section 1503 apply to taxable years beginning after December 31, 1960. (Section 2 of the Act)

901(a), 901(b)

Technical amendments.—Section 901 (a) and (b) is amended by striking out "the limitation of section 904" and inserting in lieu thereof "the applicable limitation of section 904". This is to make it clear that the reference is either to the per-country limitation of section 904(a)(1) or to the overall limitation of section 904(a)(2). This amendment applies to taxable years beginning after December 31, 1960. Section 901(a) is also amended to make it clear that the choice as whether to take a foreign tax credit for any taxable year, or to take the foreign taxes as a deduction for such year, must be made or changed before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed for such taxable year by chapter 1 of the 1954 Code. Such period is not extended by section 6511(d)(3) which provides, in effect, a 10-year period of limitation. However, for this 10-year period to be applicable, the choice to take the foreign tax credit must have been timely made under section 901(a). The amendment of this provision is effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

6501(i), 6501(j)

Section 6501 is amended by redesignating subsection (i) as subsection (j) and inserting a new subsection (i). This new subsection provides in effect that in the case of a deficiency attributable to the ap-

plication to the taxpayer of a carryback of taxes paid or accrued to foreign countries or United States possessions in excess of the applicable limitation under section 904(a), such deficiency may be assessed at any time before the expiration of one year after the expiration of the period within which a deficiency may be assessed for the taxable year from which such excess may be carried. The amendment of this provision is effective for taxable years beginning after December 31, 1957. (Section 3 of the Act)

Section 4 of the Act provides the above effective dates for the amendments made by the first three sections of the bill.

Moving expenses.—Amounts received after December 31, 1949, and before October 1, 1955, from a corporation formed exclusively for the purpose of, and engaged exclusively in, operating without profit a scientific laboratory for the Atomic Energy Commission, and operated solely on funds appropriated to the Atomic Energy Commission, by an individual as reimbursement for moving expenses to a new place of residence in order to accept employment with such corporation are excluded from the individual's gross income, to the extent that such amounts did not exceed the actual moving expenses. This exclusion applies if the individual was advised, at the time of his employment, by an authorized officer, employee, or agent of such corporation that the amount of such reimbursement would not be includible in his gross income. In any case in which a refund or credit of an overpayment resulting from applying this provision is prevented on the date of enactment of this Act, or within six months after such date, by the operation of any law or rule of law (other than chapter 74 of the 1954 Code, relating to closing agreements and compromises, and the corresponding provisions of prior law), such refund or credit may be made or allowed if claim is filed within six months from the enactment of this Act, but no interest is allowable with respect to such overpayment. (Section 5 of the Act)

6038, 6039, 902

Information with respect to certain foreign corporations.—Subpart A of part III of subchapter A of chapter 61 is amended by renumbering section 6038 as 6039, and by inserting a new section 6038 which provides that if a domestic corporation controls any foreign corporation it must furnish such information with respect to such foreign corporation and any foreign subsidiaries of such foreign corporation as the Secretary or his delegate prescribes by regulations relating to certain specified items. In general, these include a corporation's name; country or incorporation; nature and place of business; profits, deductions, foreign taxes, and any other items taken into account to determine accumulated profits; a balance sheet showing assets, liabilities, and capital; transactions with certain related persons and certain shareholders who are citizens or residents of the United States, or shareholders which are domestic corporations; and a description of the various classes of stock outstanding and a list showing the name and address and the number of shares held by shareholders owning at the same time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation or foreign subsidiary. Information must be furnished at such time

and in such manner as the Secretary or his delegate prescribes by regulations, but only such information shall be required for any annual accounting period as is required to be furnished under regulations in effect on the first day of the period. If the domestic corporation fails to furnish such required information, then in applying section 902 to such domestic corporation (or to any person who requires from any person any portion of the interest of such domestic corporation in any such foreign corporation or foreign subsidiary for any taxable year), the amount of taxes paid or deemed paid by each foreign corporation and foreign subsidiary during the accounting period or periods for which the domestic corporation was required to furnish information for the taxable year of the failure shall be reduced by 10 percent. If the failure continues 90 days or more after notice by the Secretary or his delegate, the reduction is 10 percent plus 5 percent for each 3-month period or part thereof during which the failure continues after the 90-day period. No taxes are to be reduced more than once for the same failure. The time to furnish information and the beginning of the 90-day period is treated as delayed until the last day, as shown to the satisfaction of the Secretary or his delegate, that reasonable cause exists for the failure. For purposes of this section a domestic corporation is deemed to control a foreign corporation 50 percent of whose voting stock it owns, and a foreign corporation is deemed to have as a subsidiary another corporation 50 percent of whose voting stock it owns. "Annual accounting period" of a foreign corporation or its foreign subsidiary is defined as the annual period on the basis of which such corporation keeps its books. Section 902 is amended by adding a new subsection (e) which is a cross reference to section 6038. The new section 6038 applies to taxable years of a domestic corporation beginning after December 31, 1960, with respect to information as to a foreign corporation or a foreign subsidiary for annual accounting periods beginning after December 31, 1960. (Section 6 of the Act.)

Returns as to creation or organization, or reorganization, of foreign corporations.—Present section 6046 is completely modified by the new section 6046. The new section requires returns relating to the creation, organization, or reorganization of foreign corporations to be made by every citizen or resident of the United States who was an officer or director of the corporation at any time within 60 days after its creation, organization, or reorganization, and by every United States shareholder of the corporation owning at least 5 percent of its outstanding stock at any time within such 60 days. The returns required by this section are to be filed on or before the 90th day after the creation or organization, or reorganization, of the foreign corporation, are to be in such form and are to set forth, in respect of the foreign corporation, such information as the Secretary or his delegate prescribes by forms or regulations as necessary for carrying out the provisions of the income tax laws. A United States shareholder includes a citizen or resident of the United States, a domestic corporation, a domestic partnership or an estate or trust. This amendment is to apply only with respect to foreign corporations created or organized, or reorganized, after the date of the enactment of the Act. (Section 7 of the Act)

PUBLIC LAW 86–781 (page 726, this Bulletin).
4216(f), 6416(b)(1)

Exclusion of local advertising charges from price for purposes of the manufacturers excise tax.—Section 4216 relates to the determination of sale price, which is the tax base for most of the manufacturers excise taxes. Section 1 of this Act amends section 4216 by adding thereto a new subsection (f) providing an exclusion from the sale price of any article for certain charges made by the manufacturer for "local advertising" as defined in subsection (f). If the advertising qualifies as "local advertising" within this definition, any charge by the manufacturer for such advertising is excludible from sale price to the extent that (1) it is separately stated when the article is sold, (2) it does not exceed 5 percent of the price of the article (determined for this purpose by excluding the advertising charge), and (3) it is to be refunded by the manufacturer in reimbursement of costs incurred by his vendee, or any subsequent vendee, for local advertising. If not so refunded before May 1 of the year following the year in which the article was sold, the exclusion ceases to apply as of such date.

Section 2 of this Act amends section 6416(b)(1) so as to permit credit or refund by reason of a price readjustment when amounts on which tax has been paid are refunded by the manufacturer to his vendee in reimbursement of costs for local advertising. In general, these credits and refunds, together with local advertising charges, previously excluded from price in the calendar year, are subject to an over-all limitation to be computed at the end of each calendar quarter by applying 5 percent to total taxable sales in such year of articles taxable under a particular section of the Code.

Pursuant to section 3 of this Act, the amendments made by sections 1 and 2 apply with respect to articles sold on or after January 1, 1961.

Election regarding depletion allowance on calcium carbonates, etc.—Section 4 of this Act amends subsection (c) of section 302 of the Public Debt and Tax Rate Extension Act of 1960 (P.L. 86–564, 74 Stat. 293, page 681, this Bulletin) that modified section 613(c) of the 1954 Code. The Public Debt and Tax Rate Extension Act of 1960, applicable to taxable years beginning after December 31, 1960, specifically established the cutoff points for the determination of depletion allowances for calcium carbonates and other minerals when used in making cement. To be included are only those processes (other than preheating the kiln feed) applied prior to the introduction of the kiln feed into the kiln. Section 4 of P.L. 86–781 permits taxpayers mining minerals when used in making cement to elect to apply the cutoff provisions in the Public Debt and Tax Rate Extension Act of 1960 for the years prior to 1961. An election will apply to all of a taxpayer's properties producing minerals that are used in making cement and, in general, to all of a taxpayer's taxable years beginning before 1961 that are open on the date the amendment was enacted. A taxpayer not making the election would use the cutoff point determined under the existing law.

Retroactive tax exemption for certain union-negotiated pension funds.—The situation here is similar to that described above in the case of The Pension Fund, Plumbers Local Union Numbered 775

(P.L. 86–779). Public Law 86–781 provides similar retroactive tax relief to the following named union negotiated pension funds which found themselves in such a situation, and to the employers who made contributions thereto, for the periods indicated:

The Iron Workers, Mid-America Pension Fund	1/30/57–12/16/58
The Pattern Makers' Pension Trust Fund of Chicago	4/28/58– 2/24/59
The Pipe and Refrigeration Fitters Local 537 Pension Fund of Boston, Mass	3/ 1/56–11/ 9/59
The Annuity Plan of Electrical Switchboard and Panelboard Manufacturing Industry of N.Y	5/16/56– 5/22/57
The Painters District Council No. 19 Welfare and Pension Fund	1/ 1/54– 8/ 6/56
The Local Union Numbered 377 Pension Fund	10/13/52– 4/ 1/58

As in the case of Plumbers Local Numbered 775, the retroactive relief is granted in each of the above cases only on the condition that it be shown to the satisfaction of the Service that the trust did not operate during the period involved in a manner which would jeopardize the interests of its beneficiaries.

461(d)

Limitation on acceleration of accrual of taxes.—Section 6 of this Act amends section 461 by adding subsection (d). Under the new subsection, a taxpayer using an accrual method of accounting is prevented for Federal income tax purposes from accruing taxes earlier than the taxes would have accrued had it not been for the action of a State or other taxing jurisdiction taken after December 31, 1960. However, the rule is not to be applied in a case where its application would prevent all persons (including successors in interest) from ever taking an item into account. This amendment applies to taxable years ending after December 31, 1960.

MISCELLANEOUS PUBLIC LAWS

PUBLIC LAW 86–432 (C.B. 1960–1, 792).

Section 3 of Public Law 85–235, C.B. 1957–2, 1061, approved August 30, 1957, suspended the tax imposed under section 4511(a) with respect to the first domestic processing of coconut oil, fatty acids derived therefrom, or salts thereof, or any combination or mixture containing a substantial quantity of such oil, fatty acids or salts, during the period beginning October 1, 1957 and ending with the close of June 30, 1960. Public Law 86–37, C.B. 1959–2, 654, approved May 29, 1959, suspended the tax imposed under section 4511(a) with respect to the first domestic processing of palm oil, palm kernel oil, fatty acids derived therefrom, or salts thereof, or any combination or mixture containing a substantial quantity of one or more of such oils, fatty acids, or salts during the period July 1, 1959 and ending with the close of June 30, 1960. This Act amends Public Law 85–235 and Public Law 86–37 so as to extend the suspension period provided therein to the close of June 30, 1963.

PUBLIC LAW 86–459 (C.B. 1960–1, 795).

Dealer Reserve Income Adjustment Act of 1960.—The purpose of the Act is to relieve certain dealers in real and intangible personal property from a heavy transitional tax burden that resulted from the

Supreme Court's decisions in *Commissioner* v. *Hansen*, *Commissioner* v. *Glover*, and *Baird* v. *Commissioner* (360 U.S. 446, June 22, 1959), Ct. D. 1838, C.B. 1959–2, 40 requiring dealers to reflect the proper accrual accounting method of reporting dealer reserve income. Under Public Law 86–459, taxpayers may before September 1, 1960, elect one of two alternate forms of treatment that the law provides to ease the hardship created by requiring dealers to make a transition to a proper accrual accounting basis of reporting their income. In general terms, one alternative that the taxpayer may elect permits him to treat the correction of the method of reporting his dealer reserve income as a *required* change in his method of accounting, usually for the year 1959. The second alternative permits him to redetermine his taxes, properly reporting this dealer reserve income, on a year-by-year basis with respect to all open years as of June 21, 1959. Under the second alternative, if the sum of the increases exceeds the sum of the decreases in tax liability by $2,500 or more, the resulting net increase in tax may be paid in 10 equal annual installments, generally beginning in 1961.

PUBLIC LAW 86–631 (page 687, this Bulletin).

This Act eliminates the requirement now contained in the Bankruptcy Act that the court or the referee, as the case may be, shall transmit to the Secretary of the Treasury copies of all petitions, notices, and orders in cases under Chapter XIII, relating to Wage Earners' Plans. The Act provides instead that the court or the referee shall transmit a notice of the first meeting of creditors to the district director of internal revenue for the district in which the court is located.

PUBLIC LAW 86–733 (page 691, this Bulletin).

Exemption under Menominee Termination Act.—Section 3 of this Act amends section 9 of the Menominee Termination Act of June 17, 1954 to provide for an exemption from the documentary stamp tax with respect to the initial conveyance of realty and the initial transfer of stocks and bonds pursuant to the approved plan for termination of the Menominee Tribe from Federal jurisdiction. The exemption does not extend to subsequent conveyances of realty or subsequent issuance, or transfer of stocks and bonds.

PUBLIC LAW 86–496
EIGHTY-SIXTH CONGRESS, JUNE 8, 1960
H.R. 11405 [1]

An Act to provide for the treatment of income from discharge of indebtedness of a railroad corporation in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act commenced before January 1, 1960, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 108(b) of the Internal Revenue Code of 1954 (relating to income of a

[1] Senate Report No. 1416, page 731, this Bulletin; since House Report No. 1563 is substantially the same as the Senate Report, it is not published in the Bulletin.

ailroad corporation from discharge of indebtedness) is hereby mended to read as follows:

(b) RAILROAD CORPORATIONS.—No amount shall be included in gross income by eason of the discharge, cancellation, or modification, in whole or in part, within he taxable year, of any indebtedness of a railroad corporation, as defined in ection 77(m) of the Bankruptcy Act (11 U.S.C. 205(m)), if such discharge, ancellation, or modification is effected pursuant to an order of a court—

(A) in a receivership proceeding, or

(B) in a proceeding under section 77 of the Bankruptcy Act, commenced before January 1, 1960. In such cases, the amount of any income of the axpayer attributable to any unamortized premium (computed as of the first lay of the taxable year in which such discharge occurred) with respect to such ndebtedness shall not be included in gross income, and the amount of the deduction attributable to any unamortized discount (computed as of the first day of he taxable year in which such discharge occurred) with respect to such indebtdness shall not be allowed as a deduction. Subsection (a) of this section shall ot apply with respect to any discharge of indebtedness to which this subsection pplies.

(b) The amendment made by subsection (a) shall apply to taxable ears ending after December 31, 1959, but only with respect to disharges occurring after such date.

SEC. 2. Section 97 of the Technical Amendments Act of 1958 (26 U.S.C., sec. 162 note; 72 Stat. 1672), relating to deductibility of accrued vacation pay, is amended by striking out "January 1, 1961," nd inserting in lieu thereof "January 1, 1963,".

Approved June 8, 1960.

PUBLIC LAW 86-564
EIGHTY-SIXTH CONGRESS, JUNE 30, 1960
H.R. 12381 [2]

An Act to increase for a one-year period the public debt limit set forth in section 21 of the Second Liberty Bond Act and to extend for one year the existing corporate normal-tax rate and certain excise-tax rates, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may e cited as the "Public Debt and Tax Rate Extension Act of 1960".

* * * * * * *

TITLE II—EXTENSION OF EXISTING TAX RATES

EC. 201. ONE-YEAR EXTENSION OF CORPORATE NORMAL-TAX RATE.

Section 11(b) (relating to corporate normal tax), section 21(a)(1)(A) (relating to mutual insurance companies other than nterinsurers), and section 821(b)(1) (relating to interinsurers) of he Internal Revenue Code of 1954 are amended as follows:

(1) By striking out "JULY 1, 1960" each place it appears and inserting in lieu thereof "JULY 1, 1961";

(2) By striking out "July 1, 1960" each place it appears and inserting in lieu thereof "July 1, 1961";

(3) By striking out "JUNE 30, 1960" each place it appears and inserting in lieu thereof "JUNE 30, 1961";

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[2] House Report No. 1699, page 733, this Bulletin; Senate Report No. 1602, page 736, this ulletin; Conference Report No. 2005, page 741, this Bulletin.

(4) By striking out "June 30, 1960" each place it appears and inserting in lieu thereof "June 30, 1961".

SEC. 202. ONE-YEAR EXTENSION OF CERTAIN EXCISE-TAX RATES.

(a) EXTENSION OF RATES.—The following provisions of the Internal Revenue Code of 1954 are amended by striking out "July 1, 1960" each place it appears and inserting in lieu thereof "July 1, 1961"—

(1) section 4061 (relating to motor vehicles);

(2) section 4251(b)(2) (relating to termination of tax on general telephone service);

(3) section 4261 (relating to tax on transportation of persons);

(4) section 5001(a)(1) (relating to distilled spirits);

(5) section 5001(a)(3) (relating to imported perfumes containing distilled spirits);

(6) section 5022 (relating to cordials and liquers containing wine);

(7) section 5041(b) (relating to wines);

(8) section 5051(a) (relating to beer); and

(9) section 5701(c)(1) (relating to cigarettes).

(b) TECHNICAL AMENDMENTS.—The following provisions of the Internal Revenue Code of 1954 are amended as follows:

(1) Section 5063 (relating to floor stocks refunds on distilled spirits, wines, cordials, and beer) is amended by striking out "July 1, 1960" each place it appears and inserting in lieu thereof "July 1, 1961", and by striking out "October 1, 1960" and inserting in lieu thereof "October 1, 1961".

(2) Subsections (a) and (b) of section 5707 (relating to floor stocks refunds on cigarettes) are amended by striking out "July 1, 1960" each place it appears and inserting in lieu thereof "July 1, 1961", and by striking out "October 1, 1960" and inserting in lieu thereof "October 1, 1961".

(3) Section 6412(a)(1) (relating to floor stocks refunds on automobiles) is amended by striking out "July 1, 1960" each place it appears and inserting in lieu thereof "July 1, 1961", by striking out "October 1, 1960" and inserting in lieu thereof "October 1, 1961", and by striking out "November 10, 1960" each place it appears and inserting in lieu thereof "November 10, 1961".

Section 497 of the Revenue Act of 1951 (relating to refunds on articles from foreign trade zones), as amended, is amended by striking out "July 1, 1960" each place it appears and inserting in lieu thereof "July 1, 1961".

TITLE III—MISCELLANEOUS PROVISIONS

SEC. 301. INVESTIGATION OF, AND REPORTS ON, TREATMENT OF ENTERTAINMENT AND CERTAIN OTHER EXPENSES

(a) INVESTIGATION AND REPORT BY JOINT COMMITTEE ON INTERNAL REVENUE TAXATION.—The Joint Committee on Internal Revenue Taxation is hereby authorized and directed to make a full and complete investigation and study of the operation and effects of present law, regulations, and practices relating to the deduction, as ordinary and necessary business expenses, of expenses for entertainment, gifts,

dues or initiation fees in social, athletic, or sporting clubs or organizations, and similar or related items. The Joint Committee shall report to the House of Representatives and to the Senate the results of its investigation and study as soon as practicable during the 87th Congress, together with its recommendations for any changes in the law and administrative practices which in its judgment are necessary or appropriate.

(b) REPORT BY SECRETARY OF THE TREASURY.—The Secretary of the Treasury is hereby authorized and directed to report as soon as practicable during the 87th Congress to the House of Representatives and to the Senate the results of the enforcement program of the Internal Revenue Service (announced in Technical Information Release 221, dated April 4, 1960) relating to the deductions, as ordinary and necessary business expenses, of expenses for entertainment, travel, yachts, hunting lodges, club dues, and similar or related items, together with such recommendations with respect thereto as he considers necessary or appropriate to avoid misuse of the business expense deduction.

(c) CONSULTATION OF STATES.—The staff of the Joint Committee on Internal Revenue Taxation, and the staff of the Secretary of the Treasury, shall consult and cooperate with each other in performing any duties assigned to carry out the purposes of this section.

SEC. 302. DEPLETION RATE FOR CERTAIN CLAYS; TREATMENT PROCESSES CONSIDERED AS MINING FOR COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS AND ORES.

(a) DEPLETION RATE FOR CERTAIN CLAYS.—Subsection (b) of section 613 of the Internal Revenue Code of 1954 (relating to percentage depletion rates) is amended to read as follows:

(1) Paragraph (3) is amended to read as follows:

> (3) 15 percent—
>
> (A) metal mines (if paragraph (2) (B) does not apply), rock asphalt, and vermiculite; and
>
> (B) if paragraph (5) (B) does not apply, ball clay, bentonite, china clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties.

(2) Paragraph (5) is amended to read as follows:

> (5) 5 percent—
>
> (A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);
>
> (B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products; and
>
> (C) if from brine wells—bromine, calcium chloride, and magnesium chloride.

(3) Paragraph (6) is amended by striking "refractory and fire clay,".

(b) TREATMENT PROCESSES CONSIDERED AS MINING.—Subsection (c) of section 613 of the Internal Revenue Code of 1954 (relating to the definition of gross income from property) is amended as follows:

(1) By amending paragraph (2) to read as follows:

> (2) MINING.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment proc-

esses necessary or incidental thereto), 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 such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate 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.

(2) By striking out paragraph (4) and inserting in lieu thereof the following new paragraphs:

(4) TREATMENT PROCESSES CONSIDERED AS MINING.—The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—cleaning, pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and ores or minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, sintering, and substantially equivalent processes to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, uranium, or fluorspar ores, potash, and ores or minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore or the mineral or minerals from other material from the mine or other natural deposit;

(E) the pulverization of talc, the burning of magnesite, the sintering and nodulizing of phosphate rock, and the furnacing of quicksilver ores;

(F) in the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process;

(G) in the case of clay to which paragraph (5)(B) of subsection (b) applies—crushing, grinding, and separating the mineral from waste, but not including any subsequent process; and

(H) any other treatment process provided for by regulations prescribed by the Secretary or his delegate which, with respect to the particular ore or mineral, is not inconsistent with the preceding provisions of this paragraph.

(5) TREATMENT PROCESSES NOT CONSIDERED AS MINING.—Unless such processes are otherwise provided for in paragraph (4) (or are necessary or incidental to processes so provided for), the following treatment processes shall not be considered as 'mining': electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping.

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall be applicable only with respect to taxable years beginning after December 31, 1960.

Approved June 30, 1960.

PUBLIC LAW 86-592
EIGHTY-SIXTH CONGRESS, JULY 6, 1960
H.R. 12311 [3]

An Act to amend the Sugar Act of 1948, as amended

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * * * *

SEC. 2. Sections 4501(c) and 6412(d) (relating to the termination and refund of taxes on sugar) of the Internal Revenue Code of 1954 are amended by striking out "June 30, 1961" in each place it appears therein and inserting in lieu thereof "September 30, 1961".

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PUBLIC LAW 86-594
EIGHTY-SIXTH CONGRESS, JULY 6, 1960
H.R. 4251 [4]

An Act to amend the Internal Revenue Code of 1954 with respect to the limitation on the deduction of exploration expeditures.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (c) of section 615 of the Internal Revenue Code of 1954 (relating to the deduction of exploration expenditures) is amended to read as follows:

(c) LIMITATION.—

(1) IN GENERAL.—This section shall not apply to any amount paid or incurred to the extent that it would, when added to the amounts which have been deducted under subsection (a) and the amounts which have been treated as deferred expenses under subsection (b), or the corresponding provisions of prior law, exceed $400,000.

(2) AMOUNTS TAKEN INTO ACCOUNT.—For purposes of paragraph (1), there shall be taken into account amounts deducted and amounts treated as deferred expenses by—

(A) the taxpayer, and

(B) any individual or corporation who has transferred to the taxpayer any mineral property.

(3) APPLICATION OF PARAGRAPH (2)(B).—Paragraph (2)(B) shall apply with respect to all amounts deducted and all amounts treated as deferred expenses which were paid or incurred before the latest such transfer from the individual or corporation to the taxpayer. Paragraph (2)(B) shall apply only if—

(A) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make paragraph (7), (8), (11), (15), (17, (20), or (22) of section 113(a) of the Internal Revenue Code of 1939 apply to such transfer;

(B) the taxpayer would be entitled under section 381(c)(10) to deduct expenses deferred under this section had the distributor or transferor corporation elected to defer such expenses; or

(C) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make section 334(b), 362 (a) and (b), 372(a), 373(b)(1), 1051, or 1082 apply to such transfer.

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[3] This publication of the law is restricted to excerpts involving internal revenue matters; Senate Report No. 1833, House Report No. 1746, and Conference Report No. 2090, not published.

[4] Senate Report No. 1137, page 748, this Bulletin; since House Report No. 1054 is substantially the same as the Senate Report, it is not published in the Bulletin.

SEC. 2. The amendment made by the first section of this Act shall apply only with respect to taxable years beginning after the date of the enactment of this Act.

Approved July 6, 1960.

PUBLIC LAW 86-624
EIGHTY-SIXTH CONGRESS, JULY 12, 1960
H.R. 11602 [5]

An act to amend certain laws of the United States in light of the admission of the State of Hawaii into the Union, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Hawaii Omnibus Act".

* * * * * * *

INTERNAL REVENUE

SEC. 18. (a) Section 4262(c)(1) of the Internal Revenue Code of 1954 (relating to the definition of "continental United States" for purposes of the tax on transportation of persons) is amended to read as follows:

> (1) CONTINENTAL UNITED STATES.—The term "continental United States" means the District of Columbia and the States other than Alaska and Hawaii.

(b) Section 2202 of the Internal Revenue Code of 1954 (relating to missionaries in foreign service) is amended by striking out "the State, the District of Columbia, or Hawaii" and inserting in lieu thereof "the State or the District of Columbia".

(c) Section 3121(e)(1) of the Internal Revenue Code of 1954 (relating to a special definition of "State") is amended by striking out "Hawaii,".

(d) Sections 3306(j) and 4233(b) of the Internal Revenue Code of 1954 (each relating to a special definition of "State") are amended by striking out "Hawaii, and".

(e) Section 4221(d)(4) of the Internal Revenue Code of 1954 (relating to a special definition of "State or local government") is amended to read as follows:

> (4) STATE OR LOCAL GOVERNMENT.—The term "State or local government" means any State, any political subdivision thereof or the District of Columbia.

(f) Section 4502(5) of the Internal Revenue Code of 1954 (relating to definition of "United States") is amended by striking out "the Territory of Hawaii,".

(g) Section 4774 of the Internal Revenue Code of 1954 (relating to territorial extent of law) is amended by striking out "the Territory of Hawaii,".

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[5] This publication of the law is restricted to excerpts involving internal revenue matters; Senate Report No. 1681, page 751, this Bulletin. House Report No. 1564 not published.

(h) Section 7653(d) of the Internal Revenue Code of 1954 (relating to shipments from the United States) is amended by striking out ", its possessions or the Territory of Hawaii" and inserting in lieu thereof "or its possessions".

(i) Section 7701(a)(9) of the Internal Revenue Code of 1954 (relating to definition of "United States") is amended by striking out ", the Territory of Hawaii,".

(j) Section 7701(a)(10) of the Internal Revenue Code of 1954 (relating to definition of "State") is amended by striking out "the Territory of Hawaii and".

(k) The amendments contained in subsections (a) through (j) of this section shall be effective as of August 21, 1959.

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Approved July 12, 1960.

PUBLIC LAW 86-631
EIGHTY-SIXTH CONGRESS, JULY 12, 1960
H.R. 7726 [6]

An Act to amend section 678 of the Bankruptcy Act (11 U.S.C. 1078) relating to the transmission of petitions, notices, orders, and other papers to the Secretary of the Treasury in chapter XIII proceedings.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 678 of the Bankruptcy Act (11 U.S.C. 1078) is amended to read:

SEC. 678. The court shall, in every case instituted under any provisions of this chapter, mail or cause to be mailed a copy of the notice of the first meeting of creditors to the district director of internal revenue for the district in which the court is located. Whenever the schedules of the debtor, or the list of creditors of the debtor, or any other papers filed in the case disclose a debt to the United States acting through any department, agency, or instrumentality thereof (except for any internal revenue obligation payable to the Secretary of the Treasury or his delegate), a notice of the first meeting shall be mailed as well to the head of such department, agency, or instrumentality.

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Approved July 12, 1960.

PUBLIC LAW 86-667
EIGHTY-SIXTH CONGRESS, JULY 14, 1960
H.R. 8229 [7]

An Act to amend the Internal Revenue Code of 1954 to provide an exemption from income tax for supplemental unemployment benefit trusts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 501(c) of the Internal Revenue Code of 1954 (relating to exemption from tax

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[6] This publication of the law is restricted to excerpts involving internal revenue matters; Senate Report No. 1709, page 752, this Bulletin; since House Report No. 1731 is substantially the same as the Senate Report, it is not published in the Bulletin.

[7] Senate Report No. 1518, page 753, this Bulletin; House Conference Report No. 2073, page 759, this Bulletin; since House Report No. 1145 is substantially identical to the Senate Report, it is not published in the Bulletin.

on corporations, certain organizations, etc.) is amended by adding after paragraph (16) the following new paragraph:

(17) (A) A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits, if—

(i) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits,

(ii) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees, and

(iii) such benefits do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. A plan shall not be considered discriminatory within the meaning of this clause merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

(B) In determining whether a plan meets the requirements of subparagraph (A), any benefits provided under any other plan shall not be taken into consideration, except that a plan shall not be considered discriminatory—

(i) merely because the benefits under the plan which are first determined in a nondiscriminatory manner within the meaning of subparagraph (A) are then reduced by any sick, accident, or unemployment compensation benefits received under State or Federal law (or reduced by a portion of such benefits if determined in a nondiscriminatory manner), or

(ii) merely because the plan provides only for employees who are not eligible to receive sick, accident, or unemployment compensation benefits under State or Federal law the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such laws if such employees were eligible for such benefits, or

(iii) merely because the plan provides only for employees who are not eligible under another plan (which meets the requirements of subparagraph (A)) of supplemental unemployment compensation benefits provided wholly by the employer the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such other plan if such employees were eligible under such other plan, but only if the employees eligible under both plans would make a classification which would be nondiscriminatory within the meaning of subparagraph (A).

(C) A plan shall be considered to meet the requirements of subparagraph (A) during the whole of any year of the plan if on one day in each quarter it satisfies such requirements.

(D) The term "supplemental unemployment compensation benefits" means only—

(i) benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and

(ii) sick and accident benefits subordinate to the benefits described in clause (i).

(E) Exemption shall not be denied under subsection (a) to any organization entitled to such exemption as an association described in paragraph (9)

of this subsection merely because such organization provides for the payment of supplemental unemployment benefits (as defined in subparagraph (D) (i)).

SEC. 2. (a) Subsection (a) of section 503 of the Internal Revenue Code of 1954 (relating to denial of exemption to organizations engaged in prohibited transactions) is amended—

(1) by revising paragraph (1) to read as follows:

(1) GENERAL RULE.—

(A) An organization described in section 501(c)(3) which is subject to the provisions of this section shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after July 1, 1950.

(B) An organization described in section 501(c)(17) which is subject to the provisions of this section shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after December 31, 1959.

(C) An organization described in section 401(a) which is subject to the provisions of this section shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954.", and

(2) by striking out "section 501(c)(3)" in paragraph (2) and inserting in lieu thereof "section 501(c)(3) or (17)".

(b) Subsection (b) of such section 503 is amended by striking out "section 501(c)(3)" and inserting in lieu thereof "section 501(c)(3) or (17)".

(c) Subsection (d) of such section 503 is amended by striking out "section 501(c)(3)" and inserting in lieu thereof "section 501(c)(3) or (17)".

(d) Subsection (h) of such section 503 is amended—

(1) by striking out "section 401(a)" in the heading and inserting in lieu thereof "section 401(a) and section 501(c)(17)", and

(2) by striking out "section 401(a)" in such subsection and inserting in lieu thereof "section 401(a) or section 501(c)(17)".

SEC. 3. (a) Subsection (a)(2) of section 511 of the Internal Revenue Code of 1954 (relating to imposition of tax on unrelated business income of charitable, etc., organizations) is amended—

(1) by striking out "and (6)" in the heading of subparagraph (A) and inserting in lieu thereof "(6), and (17)", and

(2) by striking out "or (6)" in the first sentence of subparagraph (A) and inserting in lieu thereof "(6), or (17)".

(b) Subsection (b) of such section 511 is amended by striking out "section 501(c)(3)" in paragraph (2) and inserting in lieu thereof "section 501(c)(3) or (17)".

SEC. 4. Section 513(b)(2) of the Internal Revenue Code of 1954 (relating to the definition of unrelated trade or business) is amended by striking out "section 401(a)" and inserting in lieu thereof "section 401(a), or section 501(c)(17),".

SEC. 5. Section 514(c) of the Internal Revenue Code of 1954 (relating to business leases) is amended by adding at the end thereof the following new paragraph:

(8) TRUSTS DESCRIBED IN SECTION 501(c)(17).—

(A) In the case of a trust described in section 501(c)(17), or in the case of a corporation described in section 501(c)(2), all of the stock of which was acquired before January 1, 1960, by a trust described in section 501(c)(17), any indebtedness incurred by such trust or such corporation before January 1, 1960, in connection with real property

which is leased before January 1, 1960, and any indebtedness incurred by such trust or such corporation on or after such date necessary to carry out the terms of such lease, shall not be considered as an indebtedness with respect to such trust or such corporation for purposes of this subsection.

(B) In the application of paragraph (1), if a trust described in section 501(c)(17) forming part of a supplemental unemployment compensation benefit plan lends any money to another trust described in section 501(c)(17) forming part of the same plan, such loan shall not be treated as an indebtedness of the borrowing trust, except to the extent that the loaning trust—

(i) incurs any indebtedness in order to make such loan,

(ii) incurred indebtedness before the making of such loan which would not have been incurred but for the making of such loan, or

(iii) incurred indebtedness after the making of such loan which would not have been incurred but for the making of such loan and which was reasonably foreseeable at the time of making such loan.

SEC. 6. (a) Except as provided in subsection (b), the amendments made by this Act shall apply to taxable years beginning after December 31, 1959.

(b) In the case of loans, the amendments made by section 2 of this Act shall apply only to loans made, renewed, or continued after December 31, 1959.

Approved July 14, 1960.

PUBLIC LAW 86-707
EIGHTY-SIXTH CONGRESS, SEPTEMBER 6, 1960
H.R. 7758 [8]

An act to improve the administration of overseas activities of the Government of the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That titles I to V, inclusive, of this Act may be cited as the "Overseas Differentials and Allowances Act".

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TITLE V—APPROPRIATION, REPEAL, AMENDATORY, AND MISCELLANEOUS PROVISIONS

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PART C—MISCELLANEOUS PROVISIONS

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SEC. 523. (a) Section 912 of the Internal Revenue Code of 1954 (relating to exemption for certain allowances) is amended to read as follows:

SEC. 912. EXEMPTIONS FOR CERTAIN ALLOWANCES.

The following items shall not be included in gross income, and shall be exempt from taxation under this subtitle:

(1) FOREIGN AREAS ALLOWANCES.—In the case of civilian officers and employees of the Government of the United States, amounts received as allowances or otherwise (but not amounts received as post differentials) under—

(A) title IX of the Foreign Service Act of 1946, as amended (22 U.S.C., sec. 1131 and following),

(B) section 4 of the Central Intelligence Agency Act of 1949, as amended (50 U.S.C., sec. 403e),

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[8] This publication of the law is restricted to excerpts involving internal revenue matters; Senate Report No. 1647, page 762, this Bulletin: House Report No. 902, page 760, this Bulletin.

(C) title II of the Overseas Differentials and Allowances Act, or

(D) subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, as amended, or section 22 of such Act.

(2) COST-OF-LIVING ALLOWANCES.—In the case of civilian officers or employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differentials and Allowances Act) received as cost-of-living allowances in accordance with regulations approved by the President.

(b) Paragraphs (1) and (2) of section 912 of the Internal Revenue Code of 1954, as amended by subsection (a) of this section, shall apply only with respect to amounts received on or after the date of the enactment of this Act in taxable years ending on or after such date.

Approved September 6, 1960.

* * * * * * *

PUBLIC LAW 86-723
EIGHTY-SIXTH CONGRESS, SEPTEMBER 8, 1960
S. 2633 [9]

An Act to amend the Foreign Service Act of 1946, as amended, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Foreign Service Act Amendments of 1960".

* * * * * * *

SEC. 51. Paragraph (4) of section 104(a) of the Internal Revenue Code of 1954 (26 U.S.C. 104(a)(4)) (relating to the exclusion from gross income of compensation for injuries and sickness) is hereby amended to read as follows:

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 831 of the Foreign Service Act of 1946, as amended (22 U.S.C. 1081; 60 Stat. 1021).

* * * * * * *

Approved September 8, 1960.

PUBLIC LAW 86-733
EIGHTY-SIXTH CONGRESS, SEPTEMBER 8, 1960
H.R. 11813 [10]

An act to amend the Menominee Termination Act

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 7 of the Act of June 17, 1954 (68 Stat. 250), as amended (25 U.S.C. 891),

[9] This publication of the law is restricted to excerpts involving internal revenue matters; Senate Report No. 880, House Report No. 2104, and Conference Report No. 2173 are not published herein.

[10] House Report No. 1824 and Senate Report No. 1907 are not published herein.

is further amended by changing the sixth and seventh sentences to read as follows:

If the Menominee Tribe and the Secretary cannot agree upon a plan within the aforementioned six-month period, or if they agree upon a plan within such period and the tribal corporation and voting trust contemplated by the plan are not established prior to March 1, 1961, the Secretary shall transfer the tribal property to a trustee of his choice for the management or disposition for the benefit of the Menominee Tribe. The responsibility of the United States to furnish all such supervision and services to the tribe and to the members thereof, because of their status as Indians, shall cease on April 30, 1961, or on such earlier date as may be agreed upon by the tribe and the Secretary.

SEC. 2. The first sentence and proviso of section 8 of said Act of June 17, 1954, as amended, are hereby amended to read as follows:

On or before April 30, 1961, the Secretary is authorized to transfer to the tribal corporation or to a trustee of the Secretary's choice, as provided in Section 7 of this Act, the title to all property, real and personal, held in trust by the United States for the tribe. The Secretary is hereby directed to begin immediate negotiations with a private trustee of his choice to perfect a trust agreement so that if by March 1, 1961, the tribal corporation is not functioning, the Secretary will be prepared to transfer title to such property to said trustee as soon after March 1, 1961, as possible, but in no event later than April 30, 1961.

SEC. 3. Section 9 of said Act of June 17, 1954, as amended, is further amended as follows:

SEC. 9. No distribution, conveyance, or transfer of title to assets and no issuance or distribution of securities pursuant to the plan approved by the Secretary under the provisions of this Act shall be subject to any Federal or State transfer, issuance, or income tax: *Provided*, That nothing contained in this Act shall exempt the recipient of any cash distribution made hereunder from payment of income tax for the year in which the distribution is made on that portion of his share thereof which consists of interest on funds deposited in the Treasury of the United States pursuant to the Supplemental Appropriation Act, 1952 (65 Stat. 736, 754). Following any distribution, conveyance, transfer, or issuance as aforesaid, the assets and securities which are held by, and any income derived therefrom which is received by or payable to, any person, or any corporation or organization as provided in section 8 of this Act, shall be subject to the same taxes, State and Federal, as in the case of non-Indians, except that the basis of any valuation for purposes of Federal income tax on gains or losses shall be the value of the property on the date title is transferred by the United States pursuant to section 8 of this Act.

SEC. 4. The Act of June 17, 1954, as amended, is further amended by adding at the end thereof a new section 14 as follows:

SEC. 14. Nothwithstanding any other provision of this Act, the Secretary of the Interior is authorized to contract with the Wisconsin Department of Public Instruction, prior to the date for terminating Federal responsibilities, for the completion of a vocational or undergraduate college program of any member of the Menominee tribe who has been accepted for such program prior to the termination date.

Approved September 8, 1960.

PUBLIC LAW 86-761
EIGHTY-SIXTH CONGRESS, SEPTEMBER 13, 1960
H.R. 7990 [11]

An Act to provide for the conveyance of certain land of the United States to the Citizen Band of Potawatomi Indians of Oklahoma

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary

[11] House Report No. 1661 and Senate Report No. 1605 are not published herein.

of the Interior is authorized and directed to convey to the Citizen Band of Potawatomi Indians of Oklahoma, all right, title, and interest of the United States in and to approximately 57.99 acres of land more particularly described in section 2 of this Act, subject to the right of the Absentee Shawnee of Oklahoma, Sac and Fox of Oklahoma, Kickapoo of Oklahoma, and Iowa Tribe of Oklahoma to use the Potawatomi community house that may be constructed and maintained thereon. The title of the tribe thereto shall be subject to no exemption from taxation or restriction on use, management or disposition because of Indian ownership.

SEC. 2. The property referred to in the first section of this Act is more particularly described as follows: Lot 1 (northwest quarter of northwest quarter) and north half of lot 2 (north half of southwest quarter of northwest quarter) and the part of the north half of the southeast quarter of the northwest quarter laying west of the east right-of-way line of Oklahoma State Highway Numbered 18, all in section 31, township 10 north, range 4 east of the Indian meridian, in Pottawatomie County, Oklahoma, and containing 57.99 acres more or less.

SEC. 3. The Indian Claims Commission is directed to determine in accordance with the provisions of section 2 of the Act of August 13, 1946 (60 Stat. 1050), the extent to which the value of the title conveyed by this Act should or should not be set off against any claim against the United States determined by the Commission.

Approved September 13, 1960.

PUBLIC LAW 86–778
EIGHTY-SIXTH CONGRESS, SEPTEMBER 13, 1960
H.R. 12580 [12]

An act to extend and improve coverage under the Federal Old-Age, Survivors, and Disability Insurance System and to remove hardships and inequities, improve the financing of the trust funds, and provide disability benefits to additional individuals under such system; to provide grants to States for medical care for aged individuals of low income; to amend the public assistance and maternal and child welfare provisions of the Social Security Act; to improve the unemployment compensation provisions of such Act; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act, divided into titles and sections according to the following table of contents, may be cited as the "Social Security Amendments of 1960".

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* * * * * * *

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[12] This publication of the law is restricted to excerpts involving internal revenue matters; House Report No. 1799, page 763, this Bulletin; Senate Report No. 1856, page 792, this Bulletin; Conference Report No. 2165, page 807, this Bulletin.

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* * * * * * *

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TITLE I—COVERAGE

EXTENSION OF TIME FOR MINISTERS TO ELECT COVERAGE

SEC. 101. (a) Clause (B) of section 1402(e)(2) of the Internal Revenue Code of 1954 (relating to time for filing waiver certificate) is amended by striking out "1956" and inserting in lieu thereof "1959".

(b) Section 1402(e)(3) of such Code (relating to effective date of certificate) is amended to read as follows:

> (3) (A) EFFECTIVE DATE OF CERTIFICATE.—A certificate filed pursuant to this subsection shall be effective for the taxable year immediately preceding the earliest taxable year for which, at the time the certificate is filed, the period for filing a return (including any extension thereof) has not expired, and for all succeeding taxable years. An election made pursuant to this subsection shall be irrevocable.
>
> (B) Notwithstanding the first sentence of subparagraph (A), if an individual field a certificate on or before the date of enactment of this subparagraph which (but for this subparagraph) is effective only for the first taxable year ending after 1956 and all succeeding taxable years, such certificate shall be effective for his first taxable year ending after 1955 and all succeeding taxable years if—
>
> (i) such individual files a supplemental certificate after the date of enactment of this subparagraph and on or before April 15, 1962,
>
> (ii) the tax under section 1401 in respect of all such individual's self-employment income (except for underpayments of tax attributable to errors made in good faith) for his first taxable year ending after 1955 is paid on or before April 15, 1962, and
>
> (iii) in any case where refund has been made of any such tax which (but for this subparagraph) is an overpayment, the amount refunded (including any interest paid under section 6611) is repaid on or before April 15, 1962.
>
> The provisions of section 6401 shall not apply to any payment or repayment described in this subparagraph.

(c) Section 1402(e) of such Code is further amended by adding at the end thereof the following new paragraph:

(5) OPTIONAL PROVISION FOR CERTAIN CERTIFICATES FILED ON OR BEFORE APRIL 15, 1962.—In any case where an individual has derived earnings, in any taxable year ending after 1954 and before 1960, from the performance of service described in subsection (c)(4), or in subsection (c)(5) (as in effect prior to the enactment of this paragraph) insofar as it related to the performance of service by an individual in the exercise of his profession as a Christian Science practitioner, and has reported such earnings as self-employment income on a return filed on or before the date of the enactment of this paragraph and on or before the due date prescribed for filing such return (including any extension thereof)—

(A) a certificate filed by such individual (or a fiduciary acting for such individual or his estate, or his survivor within the meaning of section 205(c)(1)(C) of the Social Security Act) after the date of the enactment of this paragraph and on or before April 15, 1962, may be effective, at the election of the person filing such certificate, for the first taxable year ending after 1954 and before 1960 for which such a return was filed, and for all succeeding taxable years, rather than for the period prescribed in paragraph (3), and

(B) a certificate filed by such individual on or before the date of the enactment of this paragraph which (but for this subparagraph) is ineffective for the first taxable year ending after 1954 and before 1959 for which such a return was filed shall be effective for such first taxable year, and for all succeeding taxable years, provided a supplemental certificate is filed by such individual (or a fiduciary acting for such individual or his estate, or his survivor within the meaning of section 205(c)(1)(C) of the Social Security Act) after the date of the enactment of this paragraph and on or before April 15, 1962,

but only if—

(i) the tax under section 1401 in respect of all such individual's self-employment income (except for underpayments of tax attributable to errors made in good faith), for each such year ending before 1960 in the case of a certificate described in subparagraph (A) or for each such year ending before 1959 in the case of a certificate described in subparagraph (B), is paid on or before April 15, 1962, and

(ii) in any case where refund has been made of any such tax which (but for this paragraph) is an overpayment, the amount refunded (including any interest paid under section 6611) is repaid on or before April 15, 1962.

The provisions of section 6401 shall not apply to any payment or repayment described in this paragraph.

(d) In the case of a certificate or supplemental certificate filed pursuant to section 1402(e)(3)(B) or (5) of the Internal Revenue Code of 1954—

(1) for purposes of computing interest, the due date for the payment of the tax under section 1401 which is due for any taxable year ending before 1959 solely by reason of the filing of a certificate which is effective under such section 1402(e)(3)(B) or (5) shall be April 15, 1962;

(2) the statutory period for the assessment of any tax for any such year which is attributable to the filing of such certificate shall not expire before the expiration of 3 years from such due date; and

(3) for purposes of section 6651 of such Code (relating to addition to tax for failure to file tax return), the amount of tax required to be shown on the return shall not include such tax under section 1401.

* * * * * * *

(f) The amendments made by this section shall be applicable (except as othewise specifically indicated therein) only with respect to certificates (and supplemental certificates) filed pursuant to section 1402(e) of the Internal Revenue Code of 1954 after the date of the enactment of this Act;

* * * * * * *

EXTENSION OF THE PROGRAM TO GUAM AND AMERICAN SAMOA

SEC. 103.

* * * * * * *

(k)(1) Section 1402(a) of the Internal Revenue Code of 1954 (relating to definition of net earnings from self-employment) is amended by striking out the period at the end of paragraph (8) and inserting in lieu thereof "; and", and by inserting after paragraph (8) the following new paragraph:

> (9) the term "possession of the United States" as used in sections 931 (relating to income from sources within possessions of the United States) and 932 (relating to citizens of possessions of the United States) shall be deemed not to include the Virgin Islands, Guam, or American Samoa.

(2) Clauses (v) and (vi) in the last sentence of such section 1402(a) are each amended by striking out "paragraphs (1) through (7)" and inserting in lieu thereof "paragraphs (1) through (7) and paragraph (9)".

(l) The last sentence of section 1402(b) of such Code (relating to definition of self-employment income) is amended by striking out "the Virgin Islands or a resident of Puerto Rico" and inserting in lieu thereof "the Commonwealth of Puerto Rico, the Virgin Islands, Guam, or American Samoa".

(m) Section 1403(b)(2) of such Code (relating to cross references) is amended by inserting ", Guam, American Samoa," after "Virgin Islands".

(n) Section 3121(b)(7) of such Code (relating to definition of employment) is amended to read as follows:

> (7) service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, except that this paragraph shall not apply in the case of—
>
> (A) service which, under subsection (j), constitutes covered transportation service, or
>
> (B) service in the employ of the Government of Guam or the Government of American Samoa or any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, performed by an officer or employee thereof (including a member of the legislature of any such Government or political subdivision), and, for purposes of this title with respect to the taxes imposed by this chapter—
>
> (i) any person whose service as such an officer or employee is not covered by a retirement system established by a law of the United States shall not, with respect to such service, be regarded as an employee of the United States or any agency or instrumentality thereof, and
>
> (ii) the remuneration for service described in clause (i) (including fees paid to a public official) shall be deemed to have been paid by the Goverment of Guam or the Government of American Samoa or by a political subdivision thereof or an instrumentality of any one or more of the foregoing which is wholly owned thereby, whichever is appropriate;.

(o) Section 3121(b) of such Code is further amended—

(1) by striking out "or" at the end of paragraph 16),

(2) by striking out the period at the end of paragraph (17) and inserting in lieu thereof "; or", and

(3) by adding at the end thereof the following new paragraph:

(18) services performed in Guam by a resident of the Republic of the Philippines while in Guam on a temporary basis as a nonimmigrant alien admitted to Guam pursuant to section 101(a)(15)(H)(ii) of the Immigration and Nationality Act (8 U.S.C. 1101(a)(15)(H)(ii)).

(p) Section 3121(e) of such Code (relating to definition of State, United States, and citizen) is amended to read as follows:

(e) STATE, UNITED STATES, AND CITIZENS.—For purposes of this chapter—

(1) STATE.—The term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

(2) UNITED STATES.—The term "United States" when used in a geographical sense includes the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

An individual who is a citizen of the Commonwealth of Puerto Rico (but not otherwise a citizen of the United States) shall be considered, for purposes of this section, as a citizen of the United States.

(q)(1) Subchapter C. of chapter 21 of such Code (general provisions relating to tax under Federal Insurance Contributions Act) is amended by redesignating section 3125 as section 3126, and by inserting after section 3124 the following new section:

SEC. 3125. RETURNS IN THE CASE OF GOVERNMENTAL EMPLOYEES IN GUAM AND AMERICAN SAMOA.

(a) GUAM.—The return and payment of the taxes imposed by this chapter on the income of individuals who are officers or employees of the Government of Guam or any political subdivision thereof or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, and those imposed on such Government or political subdivision or instrumentality with respect to having such individuals in its employ, may be made by the Governor of Guam or by such agents as he may designate. The person making such return may, for convenience of administration, make payments of the tax imposed under section 3111 with respect to the service of such individuals without regard to the $4,800 limitation in section 3121(a)(1).

(b) AMERICAN SAMOA.—The return and payment of the taxes imposed by this chapter on the income of individuals who are officers or employees of the Government of American Samoa or any political subdivision thereof or of any instrumentality of any one of more of the foregoing which is wholly owned thereby, and those imposed on such Government or political subdivision or instrumentality with respect to having such individuals in its employ, may be made by the Governor of American Samoa or by such agents as he may designate. The person making such return may, for convenience of administration, make payments of the tax imposed under section 3111 with respect to the service of such individuals without regard to the $4,800 limitation in section 3121(a)(1).

(2) The table of sections for such subchapter C is amended by striking out

Sec. 3125. Short title.

and inserting in lieu thereof:

Sec. 3125. Returns in the case of governmental employees in Guam and American Samoa.

Sec. 3126. Short title.

(r)(1) Section 6205(a) of such Code (relating to adjustment of tax) is amended by adding at the end thereof the following new paragraph:

(3) GUAM OR AMERICAN SAMOA AS EMPLOYER.—For purposes of this subsection, in the case of remuneration received during any calendar year from the Government of Guam, the Government of American Samoa, a political subdivision of either, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, the Governor of Guam, the Governor of American Samoa, and each agent designated by either who makes a return pursuant to section 3125 shall be deemed a separate employer.

(2) Section 6413(a) of such Code (relating to adjustment of tax) is amended by adding at the end thereof the following new paragraph:

(3) GUAM OR AMERICAN SAMOA AS EMPLOYER.—For purposes of this subsection, in the case of remuneration received during any calendar year from the Government of Guam, the Government of American Samoa, a political subdivision of either, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, the Governor of Guam, the Governor of American Samoa, and each agent designated by either who makes a return pursuant to section 3125 shall be deemed a separate employer.

(3) Section 6413(c)(2) of such Code (relating to applicability of special rules to certain employment taxes) is amended by adding at the end thereof the following new subparagraphs:

(D) GOVERNMENTAL EMPLOYEES IN GUAM.—In the case of remuneration received from the Government of Guam or any political subdivision thereof or from any instrumentality of any one or more of the foregoing which is wholly owned thereby, during any calendar year, the Governor of Guam and each agent designated by him who makes a return pursuant to section 3125(a) shall, for purposes of this subsection, be deemed a separate employer.

(E) GOVERNMENTAL EMPLOYEES IN AMERICAN SAMOA.—In the case of remuneration received from the Government of American Samoa or any political subdivision thereof or from any instrumentality of any one or more of the foregoing which is wholly owned thereby, during any calendar year, the Governor of American Samoa and each agent designated by him who makes a return pursuant to section 3125(b) shall, for purposes of this subsection, be deemed a separate employer.

(4) The heading of such section 6413(c)(2) is amended by striking out "AND EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS" and inserting in lieu thereof ", EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS, AND GOVERNMENTAL EMPLOYEES IN GUAM AND AMERICAN SAMOA".

(s) Section 7213 of such Code (relating to unauthorized disclosure of information) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

(d) DISCLOSURES BY CERTAIN DELEGATES OF SECRETARY.—All provisions of law relating to the disclosure of information, and all provisions of law relating to penalties for unauthorized disclosure of information, which are applicable in respect of any function under this title when performed by an officer or employee of the Treasury Department are likewise applicable in respect of such function when performed by any person who is a "delegate" within the meaning of section 7701(a)(12)(B).

(t) Section 7701(a)(12) of such Code (relating to definition of delegate) is amended to read as follows:

(12) DELEGATE.—

(A) IN GENERAL.—The term "Secretary or his delegate" means the Secretary of the Treasury, or any officer, employee, or agency of the Treasury Department duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform the function mentioned or described in the context, and the term "or his

delegate" when used in connection with any other official of the United States shall be similarly construed.

(B) PERFORMANCE OF CERTAIN FUNCTIONS IN GUAM OR AMERICAN SAMOA.—The term "delegate", in relation to the performance of functions in Guam or American Samoa with respect to the taxes imposed by chapters 2 and 21, also includes any officer or employee of any other department or agency of the United States, or of any possession thereof, duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform such functions.

(u) Section 30 of the Organic Act of Guam (48 U.S.C., sec. 1421h) is amended by inserting before the period at the end thereof the following: "; except that nothing in this Act shall be construed to apply to any tax imposed by chapter 2 or 21 of the Internal Revenue Code of 1954".

(v)(1) The amendments made by subsection (a) shall apply only with respect to reinterments after the date of the enactment of this Act. The amendments made by subsections (b), (e), and (f) shall apply only with respect to service performed after 1960; except that insofar as the carrying on of a trade or business (other than performance of service as an employee) is concerned, such amendments shall apply only in the case of taxable years beginning after 1960. The amendments made by subsection (d), (i), (o), and (p) shall apply only with respect to service performed after 1960. The amendments made by subsections (h) and (l) shall apply only in the case of taxable years beginning after 1960. The amendments made by subsections (c), (n), (q), and (r) shall apply only with respect to (1) service in the employ of the Government of Guam or any political subdivision thereof, or any instrumentality of any one or more of the foregoing wholly owned thereby, which is performed after 1960 and after the calendar quarter in which the Secretary of the Treasury receives a certification by the Governor of Guam that legislation has been enacted by the Government of Guam expressing its desire to have the insurance system established by title II of the Social Security Act extended to the officers and employees of such Government and such political subdivisions and instrumentalities, and (2) service in the employ of the Government of American Samoa or any political subdivision thereof or any instrumentality of any one or more of the foregoing wholly owned thereby, which is performed after 1960 and after the calendar quarter in which the Secretary of the Treasury receives a certification by the Governor of American Samoa that the Government of American Samoa desires to have the insurance system established by such title II extended to the officers and employees of such Government and such political subdivisions and instrumentalities. The amendments made by subsections (g) and (k) shall apply only in the case of taxable years beginning after 1960, except that, insofar as they involve the nonapplication of section 932 of the Internal Revenue Code of 1954 to the Virgin Islands for purposes of chapter 2 of such Code and section 211 of the Social Security Act, such amendments shall be effective in the case of all taxable years with respect to which such chapter 2 (and corresponding provisions of prior law) and such section 211 are applicable. The amendments made by subsections (j), (s), and (t) shall take effect on the date of the enactment of this Act; and there are authorized to be appropriated such sums as may be necessary for the performance

by any officer or employee of functions delegated to him by the Secretary of the Treasury in accordance with the amendment made by such subsection (t).

(2) The amendments made by subsections (c) and (n) shall have application only as expressly provided therein, and determinations as to whether an officer or employee of the Government of Guam or the Government of American Samoa or any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, is an employee of the United States or any agency or instrumentality thereof within the meaning of any provision of law not affected by such amendments, shall be made without any inferences drawn from such amendments.

(3) The repeal (by subsection (j)(1)) of section 219 of the Social Security Act, and the elimination (by subsections (e), (f), (h), (j)(2), and (j)(3)) of other provisions of such Act making reference to such section 219, shall not be construed as changing or otherwise affecting the effective date specified in such section for the extension to the Commonwealth of Puerto Rico of the insurance system under title II of such Act, the manner or consequences of such extension, or the status of any individual with respect to whom the provisions so eliminated are applicable.

SERVICE OF PARENT FOR SON OR DAUGHTER

SEC. 104.

* * * * * * *

(b) Section 3121(b)(3) of the Internal Revenue Code of 1954 (related to definition of employment) is amended to read as follows:

> (3) (A) service performed by an individual in the employ of his spouse, and service performed by a child under the age of 21 in the employ of his father or mother;
>
> (B) service not in the course of the employer's trade or business, or domestic service in a private home of the employer, performed by an individual in the employ of his son or daughter;.

(c) The amendments made by subsections (a) and (b) shall apply only with respect to services performed after 1960.

EMPLOYEES OF NONPROFIT ORGANIZATIONS

SEC. 105. (a)(1) The first sentence of section 3121(k)(1)(A) of the Internal Revenue Code of 1954 (relating to waiver of exemption by religious, charitable, and certain other organizations) is amended by striking out "and that at least two-thirds of its employees concur in the filing of the certificate".

(2) The second sentence of such section 3121(k)(1)(A) is amended by inserting "(if any)" after "each employee".

(3) Section 3121(k)(1)(E) of such Code is amended by striking out the last two sentences and inserting in lieu thereof: "An organization which has so divided its employees into two groups may file a certificate pursuant to subparagraph (A) with respect to the employees in either group, or may file a separate certificate pursuant to such subparagraph with respect to the employees in each group."

(b)(1) If—

(A) an individual performed service in the employ of an organization after 1950 with respect to which remuneration was paid before July 1, 1960, and such service is excepted from em-

ployment under section 210(a)(8)(B) of the Social Security Act,

(B) such service would have constituted employment as defined in section 210 of such Act if the requirements of section 3121(k)(1) of the Internal Revenue Code of 1954 (or corresponding provisions of prior law) were satisfied,

(C) such organization paid before August 11, 1960, any amount, as taxes imposed by sections 3101 and 3111 of the Internal Revenue Code of 1954 (or corresponding provisions of prior law), with respect to such remuneration paid by the organization to the individual for such service,

(D) such individual (or a fiduciary acting for such individual or his estate, or his survivor (within the meaning of section 205(c)(1)(C) of the Social Security Act)) requests that such remuneration be deemed to constitute remuneration for employment for purposes of title II of the Social Security Act, and

(E) the request is made in such form and manner, and with such official, as may be prescribed by regulations made by the Secretary of Health, Education, and Welfare,

then, subject to the conditions stated in paragraphs (2), (3), and (4), the remuneration with respect to which the amount has been paid as taxes shall be deemed to constitute remuneration for employment for purposes of title II of the Social Security Act.

(2) Paragraph (1) shall not apply with respect to an individual unless the organization referred to in paragraph (1)(A)—

(A) on or before the date on which the request described in paragraph (1) is made, has filed a certificate pursuant to section 3121(k)(1) of the Internal Revenue Code of 1954 (or corresponding provisions of prior law), or

(B) no longer has any individual in its employ for remuneration at the time such request is made.

(3) Paragraph (1) shall not apply with respect to an individual who was in the employ of the organization referred to in paragraph (2)(A) at any time during the 24-month period following the calendar quarter in which the certificate was filed, unless the organization paid an amount as taxes under sections 3101 and 3111 of the Internal Revenue Code of 1954 (or corresponding provisions of prior law) with respect to remuneration paid by the organization to the employee during some portion of such 24-month period.

(4) If credit or refund of any portion of the amount referred to in paragraph (1)(C) (other than a credit or refund which would be allowed if the service constituted employment for purposes of chapter 21 of the Internal Revenue Code of 1954) has been obtained, paragraph (1) shall not apply with respect to the individual unless the amount credited or refunded (including any interest under section 6611) is repaid before January 1, 1963.

(5) If—

(A) any remuneration for service performed by an individual is deemed pursuant to paragraph (1) to constitute remuneration for employment for purposes of title II of the Social Security Act,

(B) such individual performs service, on or after the date on which the request is made, in the employ of the organization referred to in paragraph (1)(A), and

(C) the certificate filed by such organization pursuant to section 3121(k)(1) of the Internal Revenue Code of 1954 (or corresponding provisions of prior law) is not effective with respect to service performed by such individual before the first day of the calendar quarter following the quarter in which the request is made,

then, for purposes of clauses (ii) and (iii) of section 210(a)(8)(B) of the Social Securial Act and of clauses (ii) and (iii) of section 3121(b)(8)(B) of the Internal Revnue Code of 1954, such individual shall be deemed to have become an employee of such organization (or to have become a member of a group described in section 3121(k)(1)(E) of such Code) on the first day of the calendar quarter following the quarter in which the request is made.

(6) Section 403(a) of the Social Security Amendments of 1954 is amended by striking out "filed in such form and manner" and inserting in lieu thereof "filed on or before the date of the enactment of the Social Security Amendments of 1960 and in such form and manner".

(c)(1) Section 1402 of such Code is further amended by adding at the end thereof the following new subsection:

(g) TREATMENT OF CERTAIN REMUNERATION ERRONEOUSLY REPORTED AS NET EARNINGS FROM SELF-EMPLOYMENT.—If—

(1) an amount is erroneously paid as tax under section 1401, for any taxable year ending after 1954 and before 1962, with respect to remuneration for service described in section 3121(b)(8) (other than service described in section 3121(b)(8)(A)), and such remuneration is reported as self-employment income on a return filed on or before the due date prescribed for filing such return (including any extension thereof),

(2) the individual who paid such amount (or a fiduciary acting for such individual or his estate, or his survivor (within the meaning of section 205(c)(1)(C) of the Social Security Act)) requests that such remuneration be deemed to constitute net earnings from self-employment.

(3) such request is filed after the date of the enactment of this paragraph and on or before April 15, 1962,

(4) such remuneration was paid to such individual for services performed in the employ of an organization which, on or before the date on which such request is filed, has filed a certificate pursuant to section 3121(k), and

(5) no credit or refund of any portion of the amount erroneously paid for such taxable year as tax under section 1401 (other than a credit or refund which would be allowable if such tax were applicable with respect to such remuneration) has been obtained before the date on which such request is filed or, if obtained, the amount credited or refunded (including any interest under section 6611) is repaid on or before such date,

then, for purposes of this chapter and chapter 21, any amount of such remuneration which is paid to such individual before the calendar quarter in which such request is filed (or before the succeeding quarter if such certificate first becomes effective with respect to services performed by such individual in such succeeding quarter), and with respect to which no tax (other than an amount erroneously paid as tax) has been paid under chapter 21, shall be deemed to constitute net earnings from self-employment and not remuneration for employment. For purposes of section 3121(b)(8)(B)(ii) and (iii), if the certificate filed by such organization pursuant to section 3121(k) is not effective with respect to services performed by such individual on or before the first day of the calendar quarter in which the request is filed, such individual shall be deemed to have become an employee of such organization (or to have become a member of a group described in section 3121(k)(1)(E))on the first day of the succeeding quarter.

(2) Remuneration which is deemed under section 1402(g) of the Internal Revenue Code of 1954 to constitute net earnings from self-employment and not remuneration for employment shall also be

deemed, for purposes of title II of the Social Security Act, to constitute net earnings from self-employment and not remuneration for employment. If, pursuant to the last sentence of section 1402(g) of the Internal Revenue Code of 1954, an individual is deemed to have become an employee of an organization (or to have become a member of a group) on the first day of a calendar quarter, such individual shall likewise be deemed, for purposes of clause (ii) or (iii) of section 210(a)(8)(B) of the Social Security Act, to have become an employee of such organization (or to have become a member of such group) on such day.

(d)(1) The amendments made by subsection (a) shall apply only with respect to certificates filed under section 3121(k)(1) of the Internal Revenue Code of 1954 after the date of the enactment of this Act.

* * * * * * *

AMERICAN CITIZEN EMPLOYEES OF FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS

SEC. 106.

* * * * * * *

(b) Section 1402(c)(2) of the Internal Revenue Code of 1954 (relating to definition of trade or business) is amended to read as follows:

> (2) the performance of service by an individual as an employee, other than—
>
> (A) service described in section 3121(b)(14)(B) performed by an individual who has attained the age of 18,
>
> (B) service described in section 3121(b)(16),
>
> (C) service described in section 3121(b) (11), (12), or (15) performed in the United States (as defined in section 3121(e)(2)) by a citizen of the United States, and
>
> (D) service described in paragraph (4) of this subsection;

(c) The amendments made by this section shall apply only with respect to taxable years ending on or after December 31, 1960;

* * * * * * *

TITLE V—EMPLOYMENT SECURITY

Part 1—Short Title

SEC. 501. This title may be cited as the "Employment Security Act of 1960".

SEC. 522. * * *

(b) * * *

(2) For purposes of section 3302(c) of the Federal Unemployment Tax Act and titles IX and XII of the Social Security Act, if any amount is transferred pursuant to paragraph (1) to the unemployment account of any State, such amount shall be treated as an advance made before the date of the enactment of this Act.

AMENDMENTS TO THE FEDERAL UNEMPLOYMENT TAX ACT

Increase in Tax Rate

SEC. 523. (a) Section 3301 of the Internal Revenue Code of 1954 (relating to rate of tax under Federal Unemployment Tax Act) is amended—

(1) by striking out "1955" and inserting in lieu thereof "1961", and

(2) by striking out "3 percent" and inserting in lieu thereof "3.1 percent".

Computation of Credits Against Tax

(b) Section 3302 of such Code (relating to credits against tax) is amended by striking out subsection (c) and inserting in lieu thereof the following new subsections:

(c) LIMIT ON TOTAL CREDITS.—

(1) The total credits allowed to a taxpayer under this section shall not exceed 90 percent of the tax against which such credits are allowable.

(2) If an advance or advances have been made to the unemployment account of a State under title XII of the Social Security Act before the date of the enactment of the Employment Security Act of 1960, then the total credits (after applying subsections (a) and (b) and paragraph (1) of this subsection) otherwise allowable under this section for the taxable year in the case of a taxpayer subject to the unemployment compensation law of such State shall be reduced—

(A) in the case of a taxable year beginning with the fourth consecutive January 1 as of the beginning of which there is a balance of such advances, by 5 percent of the tax imposed by section 3301 with respect to the wages paid by such taxpayer during such taxable year which are attributable to such State; and

(B) in the case of any succeeding taxable year beginning with a consecutive January 1 as of the beginning of which there is a balance of such advances, by an additional 5 percent, for each such succeeding taxable year, of the tax imposed by section 3301 with respect to the wages paid by such taxpayer during such taxable year which are attributable to such State.

(3) If an advance or advances have been made to the unemployment account of a State under title XII of the Social Security Act on or after the date of the enactment of the Employment Security Act of 1960, then the total credits (after applying subsections (a) and (b) and paragraphs (1) and (2) of this subsection) otherwise allowable under this section for the taxable year in the case of a taxpayer subject to the unemployment compensation law of such State shall be reduced—

(A) (i) in the case of a taxable year beginning with the second consecutive January 1 as of the beginning of which there is a balance of such advances, by 10 percent of the tax imposed by section 3301 with respect to the wages paid by such taxpayer during such taxable year which are attributable to such State; and

(ii) in the case of any succeeding taxable year beginning with a consecutive January 1 as of the beginning of which there is a balance of such advances, by an additional 10 percent, for each such succeeding taxable year, of the tax imposed by section 3301 with respect to the wages paid by such taxpayer during such taxable year which are attributable to such State;

(B) in the case of a taxable year beginning with the third or fourth consecutive January 1 as of the beginning of which there is a balance of such advances, by the amount determined by multiplying the wages paid by such taxpayer during such taxable year which are attributable to such State by the percentage (if any) by which—

(i) 2.7 percent, exceeds

(ii) the average employer contribution rate for such State for the calendar year preceding such taxable year; and

(C) in the case of a taxable year beginning with the fifth or any succeeding consecutive January 1 as of the beginning of which there is a balance of such advances, by the amount determined by multiplying the wages paid by such taxpayer during such taxable year which are attributable to such State by the percentage (if any) by which—

(i) the 5-year benefit cost rate applicable to such State for such taxable year or (if higher) 2.7 percent, exceeds

(ii) the average employer contribution rate for such State for the calendar year preceding such taxable year.

(d) DEFINITIONS AND SPECIAL RULES RELATING TO SUBSECTION (c).—

(1) RATE OF TAX DEEMED TO BE 3 PERCENT.—In applying subsection (c), the tax imposed by section 3301 shall be computed at the rate of 3 percent in lieu of 3.1 percent.

(2) WAGES ATTRIBUTABLE TO A PARTICULER STATE.—For purposes of subsection (c), wages shall be attributable to a particular State if they are subject to the unemployment compensation law of the State, or (if not subject to the unemployment compensation law of any State) if they are determined (under rules or regulations prescribed by the Secretary or his delegate) to be attributable to such State.

(3) ADDITIONAL TAXES INAPPLICABLE WHERE ADVANCES ARE REPAID BEFORE NOVEMBER 10 OF TAXABLE YEAR.—Paragraph (2) or (3) of subsection (c) shall not apply with respect to any State for the taxable year if (as of the beginning of November 10 of such year) there is no balance of advances referred to in such paragraph.

(4) AVERAGE EMPLOYER CONTRIBUTION RATE.—For purposes of subparagraphs (B) and (C) of subsection (c)(3), the average employer contribution rate for any State for any calendar year is that percentage obtained by dividing—

(A) the total of the contributions paid into the State unemployment fund with respect to such calendar year, by

(B) the total of the remuneration subject to contributions under the State unemployment compensation law with respect to such calendar year.

For purposes of subparagraph (C) of subsection (c)(3), if the average employer contribution rate for any State for any calendar year (determined without regard to this sentence) equals or exceeds 2.7 percent, such rate shall be determined by increasing the amount taken into account under subparagraph (A) of the preceding sentence by the aggregate amount of employee payments (if any) into the unemployment fund of such State with respect to such calendar year which are to be used solely in the payment of unemployment compensation.

(5) 5-YEAR BENEFIT COST RATE.—For purposes of subparagraph (C) of subsection (c)(3), the 5-year benefit cost rate applicable to any State for any taxable year is that percentage obtained by dividing—

(A) one-fifth of the total of the compensation paid under the State unemployment compensation law during the 5-year period ending at the close of the second calendar year preceding such taxable year, by

(B) the total of the remuneration subject to contributions under the State unemployment compensation law with respect to the first calendar year preceding such taxable year.

(6) ROUNDING.—If any percentage referred to in either subparagraph (B) or (C) of subsection (c)(3) is not a multiple of .1 percent, it shall be rounded to the nearest multiple of .1 percent.

(7) DETERMINATION AND CERTIFICATION OF PERCENTAGES.—The percentage referred to in subsection (c)(3) (B) or (C) for any taxable year for any State having a balance referred to therein shall be determined by the Secretary of Labor, and shall be certified by him to the Secretary of the Treasury before June 1 of such year, on the basis of a report furnished by such State to the Secretary of Labor before May 1 of such year. Any such State report shall be made as of the close of March 31 of the taxable year, and shall be made on such forms, and shall contain such information, as the Secretary of Labor deems necessary to the performance of his duties under this section.

(8) CROSS REFERENCE.—For reduction of total credits allowable under subsection (c), see section 104 of the Temporary Unemployment Compensation Act of 1958.

Effective Date

(c) The amendments made by subsection (a) shall apply only with respect to the calendar year 1961 and calendar years thereafter.

CONFORMING AMENDMENTS

SEC. 524.

* * * * * * *

(b) Section 104 of the Temporary Unemployment Compensation Act of 1958, as amended, is amended—

(1) by striking out subsection (b); and

(2) by amending subsection (a) by striking out the heading and "(a)", and by striking out "by December 1" and inserting in lieu thereof "before November 10".

Part 3—Extension of Coverage Under Unemployment Compensation Program

FEDERAL INSTRUMENTALITIES

SEC. 531. (a) Section 3305(b) of the Internal Revenue Code of 1954 is amended to read as follows:

(b) FEDERAL INSTRUMENTALITIES IN GENERAL.—The legislature of any State may require any instrumentality of the United States (other than an instrumentality to which section 3306(c)(6) applies), and the individuals in its employ, to make contributions to an unemployment fund under a State unemployment compensation law approved by the Secretary of Labor under section 3304 and (except as provided in section 5240 of the Revised Statutes, as amended (12 U.S.C., sec. 484), and as modified by subsection (c)), to comply otherwise with such law. The permission granted in this subsection shall apply (A) only to the extent that no discrimination is made against such instrumentality, so that if the rate of contribution is uniform upon all other persons subject to such law on account of having individuals in their employ, and upon all employees of such persons, respectively, the contributions required of such instrumentality or the individuals in its employ shall not be at a greater rate than is required of such other persons and such employees, and if the rates are determined separately for different persons or classes of persons having individuals in their employ or for different classes of employees, the determination shall be based solely upon unemployment experience and other factors bearing a direct relation to unemployment risk; (B) only if such State law makes provision for the refund of any contributions required under such law from an instrumentality of the United States or its employees for any year in the event such State is not certified by the Secretary of Labor under section 3304 with respect to such year; and (C) only if such State law makes provision for the payment of unemployment compensation to any employee of any such instrumentality of the United States in the same amount, on the same terms, and subject to the same conditions as unemployment compensation is payable to employees of other employers under the State unemployment compensation law.

(b) The third sentence of section 3305(g) of such Code is amended by striking out "not wholly" and inserting in lieu thereof "neither wholly nor partially".

(c) Section 3306(c)(6) of such Code is amended to read as follows:

(6) service performed in the employ of the United States Government or of an instrumentality of the United States which is—

(A) wholly or partially owned by the United States, or

(B) exempt from the tax imposed by section 3301 by virtue of any provision of law which specifically refers to such section (or the corresponding section of prior law) in granting such exemption.

(d)(1) Chapter 23 of such Code is amended by renumbering section 3308 as section 3309 and by inserting after section 3307 the following new section:

SEC. 3308. INSTRUMENTALITIES OF THE UNITED STATES.

Notwithstanding any other provision of law (whether enacted before or after the enactment of this section) which grants to any instrumentality of the United States an exemption from taxation, such instrumentality shall not be exempt

from the tax imposed by section 3301 unless such other provision of law grants a specific exemption, by reference to section 3301 (or the corresponding section of prior law), from the tax imposed by such section.

(2) The table of sections for such chapter is amended by striking out the last line and inserting in lieu thereof the following:

Sec. 3308. Instrumentalities of the United States.
Sec. 3309. Short title.

* * * * * * *

(g) Notwithstanding section 203(b) of the Farm Credit Act of 1959, sections 3305(b), 3306(c)(6), and 3308 of the Internal Revenue Code of 1954 and sections 1501(a) and 1507(a) of the Social Security Act shall be applicable, according to their terms, to the Federal land banks, Federal intermediate credit banks, and banks for cooperatives.

AMERICAN AIRCRAFT

SEC. 532. (a) So much of section 3306(c) of the Internal Revenue Code of 1954 as precedes paragraph (1) thereof is amended by striking out "or (B) on or in connection with an American vessel" and all that follows down through the phrase "outside the United States," and by inserting in lieu thereof the following: "or (B) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States,".

(b) Section 3306(c)(4) of such Code is amended to read as follows:

(4) service performed on or in connection with a vessel or aircraft not an American vessel or American aircraft, if the employee is employed on and in connection with such vessel or aircraft when outside the United States;.

(c) Section 3306(m) of such Code is amended—

(1) by striking out the heading and inserting in lieu thereof the following:

(m) AMERICAN VESSEL AND AIRCRAFT.—; and

(2) by striking out the period at the end thereof and inserting in lieu thereof a semicolon and the following: "and the term 'American aircraft' means an aircraft registered under the laws of the United States."

FEEDER ORGANIZATIONS, ETC.

SEC. 533. Section 3306(c)(8) of the Internal Revenue Code of 1954 is amended to read as follows:

(8) service performed in the employ of a religious, charitable, educational, or other organization described in section 501(c)(3) which is exempt from income tax under section 501(a);.

FRATERNAL BENEFICIARY SOCIETIES, AGRICULTURAL ORGANIZATIONS, VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATIONS, ETC.

SEC. 534. Section 3306(c)(10) of the Internal Revenue Code of 1954 is amended to read as follows:

(10)(A) service performed in any calendar quarter in the employ of any organization exempt from income tax under section 501(a) (other than an

organization described in section 401(a)) or under section 521, if the remuneration for such service is less than $50, or

(B) service performed in the employ of a school, college, or university, if such service is performed by a student who is enrolled and is regularly attending classes at such school, college, or university;.

EFFECTIVE DATE

SEC. 535. The amendments made by this part * * * shall apply with respect to remuneration paid after 1961 for services performed after 1961. * * *

Part 4—Extension of Federal-State Unemployment Compensation Program to Puerto Rico

* * * * * * *

EXTENSION OF FEDERAL UNEMPLOYMENT TAX ACT

SEC. 543. (a) Effective with respect to remuneration paid after December 31, 1960, for services performed after such date, section 3306(j) of the Internal Revenue Code of 1954 is amended to read as follows:

(j) STATE, UNITED STATES, AND CITIZEN.—For purposes of this chapter—

(1) STATE.—The term "State" includes the District of Columbia and the Commonwealth of Puerto Rico.

(2) UNITED STATES.—The term "United States" when used in a geographical sense includes the States, the District of Columbia, and the Commonwealth of Puerto Rico.

An individual who is a citizen of the Commonwealth of Puerto Rico (but not otherwise a citizen of the United States) shall be considered for purposes of this section, as a citizen of the United States.

(b) The unemployment compensation law of the Commonwealth of Puerto Rico shall be considered as meeting the requirements of—

(1) Section 3304(a)(2) of the Federal Unemployment Tax Act, if such law provides that no compensation is payable with respect to any day of unemployment occurring before January 1, 1959.

(2) Section 3304(a)(3) of the Federal Unemployment Tax Act and section 303(a)(4) of the Social Security Act, if such law contains the provisions required by those sections and if it requires that, on or before February 1, 1961, there be paid over to the Secretary of the Treasury, for credit to the Puerto Rico account in the Unemployment Trust Fund, an amount equal to the excess of—

(A) the aggregate of the moneys received in the Puerto Rico unemployment fund before January 1, 1961, over

(B) the aggregate of the moneys paid from such fund before January 1, 1961, as unemployment compensation or as refunds of contributions erroneously paid.

* * * * * * *

Approved September 13, 1960.

PUBLIC LAW 86-779
EIGHTY-SIXTH CONGRESS, SEPTEMBER 14, 1960
H.R. 10960 [13]

An Act to amend section 5701 of the Internal Revenue Code of 1954 with respect to the excise tax upon cigars, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the next to the last sentence of section 5701(b) of the Internal Revenue Code of 1954 (relating to tax on cigars) is amended by striking out "exclusive of any State or local taxes imposed on the retail sale of cigars" and inserting in lieu thereof "exclusive of any State or local taxes imposed on cigars as a commodity".

SEC. 2. The amendment made by the first section of this Act shall apply with respect to cigars removed on or after the ninth day of the first month which begins after the date of the enactment of this Act.

SEC. 3. (a) Section 243 of the Internal Revenue Code of 1954 (relating to deduction for dividends received by corporations) is amended by adding at the end thereof the following new subsection: [14]

(d) CERTAIN DIVIDENDS FROM FOREIGN CORPORATIONS.—For purposes of subsections (a) and (b) of this section and for purposes of section 245, any dividend from a foreign corporation from earnings and profits accumulated by a domestic corporation during a period with respect to which such domestic corporation was subject to taxation under this chapter (or corresponding provisions of prior law) shall be treated as a dividend from a domestic corporation which is subject to taxation under this chapter.

(b) Section 861(a)(2) of the Internal Revenue Code of 1954 (relating to treatment of dividends as income from sources within the United States) is amended by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or", and by adding after subparagraph (B) the following new subparagraph:

(C) from a foreign corporation to the extent that such amount is required by section 243(d) (relating to certain dividends from foreign corporations) to be treated as dividends from a domestic corporation which is subject to taxation under this chapter, and to such extent subparagraph (B) shall not apply to such amount.

(c) The amendments made by subsections (a) and (b) shall apply to dividends received after December 31, 1959, in taxable years ending after such date.

SEC. 4. (a)(1) Subpart D of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1954 (relating to possessions of the United States) is amended by adding at the end thereof the following new section: [15]

SEC. 934. LIMITATION ON REDUCTION IN INCOME TAX LIABILITY INCURRED TO THE VIRGIN ISLANDS.

(a) GENERAL RULE.—Tax liability incurred to the Virgin Islands pursuant to this subtitle, as made applicable in the Virgin Islands by the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June

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[13] Senate Report No. 1915, page 858, this Bulletin; House Conference Report No. 2214, page 859, this Bulletin; since House Report No. 2098 is substantially the same as the Senate Report, it is not published herein.

[14] Sec. 3 introduced as H.R. 12036; related House Report No. 2101, page 827, this Bulletin; House Conference Report No. 2214, Amendment No. 1, page 859, this Bulletin.

[15] Sec. 4 introduced as H.R. 5547; related House Report No. 1131; Senate Report No. 1767; and House Conference Report No. 2214, Amendment No. 3, pages 811, 829, and 859, this Bulletin.

30, 1922, and for other purposes", approved July 12, 1921 (48 U.S.C. 1397), or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), shall not be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands, except to the extent provided in subsection (b) or (c).

(b) EXCEPTION FOR CERTAIN DOMESTIC AND VIRGIN ISLANDS CORPORATIONS.—In the case of a domestic corporation or a Virgin Island corporation, subsection (a) shall not apply (if the information required by subsection (d) is supplied) to the extent such corporation derived its income from sources without the United States if the conditions of both paragraph (1) and paragraph (2) are satisfied:

(1) THREE-YEAR PERIOD.—If 80 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Virgin Islands; and

(2) TRADE OR BUSINESS.—If 50 percent or more of the gross income of such corporation for such period or such part thereof was derived from the active conduct of a trade or business within the Virgin Islands.

For purposes of the preceding sentence, the gross income of a Virgin Islands corporation, and the sources from which the income of such corporation is derived, shall be determined as if such corporation were a domestic corporation. For the purposes of this subsection, all amounts received by such corporation within the United States, whether derived from sources within or without the United States, shall be considered as being derived from sources within the United States.

(c) EXCEPTION FOR CERTAIN RESIDENTS OF THE VIRGIN ISLANDS.—Subsection (a) shall not apply in the case of an individual citizen of the United States who is a bona fide resident of the Virgin Islands during the entire taxable year (if the information required by subsection (d) is supplied), to the extent his income is derived from sources within the Virgin Islands (except that subsection (a) shall apply in the case of amounts received for services performed as an employee of the United States or any agency thereof). For purposes of the preceding sentence, gain or loss from the sale or exchange of any security (as defined in section 165(g)(2)) shall not be treated as derived from sources within the Virgin Islands.

(d) REQUIREMENT TO SUPPLY INFORMATION.—Subsections (b) and (c) shall apply only in the case of persons who supply (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) such information as the Secretary or his delegate may by regulations prescribe for purposes of determining the applicability of such subsections.

(2) The table of sections for such subpart D is amended by adding at the end thereof the following:

Sec. 934. Limitation on reduction in income tax liability incurred to the Virgin Islands.

(b)(1) Subchapter C of chapter 11 of the Internal Revenue Code of 1954 (relating to miscellaneous estate tax provisions) is amended by adding at the end thereof the following new section:

SEC. 2209. CERTAIN RESIDENTS OF POSSESSIONS CONSIDERED NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.

A decedent who was a citizen of the United States and a resident of a possession thereof at the time of his death shall, for purposes of the tax imposed by this chapter, be considered a "nonresident not a citizen of the United States" within the meaning of that term wherever used in this title, but only if such person acquired his United States citizenship solely by reason of (1) his being a citizen of such possession of the United States, or (2) his birth or residence within such possession of the United States.

(2) The table of sections for subchapter C of chapter 11 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

Sec. 2209. Certain residents of possessions considered nonresidents not citizens of the United States

(c) Section 2106(a)(3) of the Internal Revenue Code of 1954 (relating to exemption in determining taxable estate of nonresidents not citizens) is amended to read as follows:

(3) EXEMPTION.—

(A) GENERAL RULE.—An exemption of $2,000.

(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a "nonresident not a citizen of the United States" under the provisions of section 2209, the exemption shall be the greater of (i) $2,000, or (ii) that proportion of the exemption authorized by section 2052 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

(d)(1) Section 2501 of the Internal Revenue Code of 1954 (relating to imposition of gift tax) is amended by redesignating subsection (c) to be subsection (d) and by adding after subsection (b) the following new subsection:

(c) CERTAIN RESIDENTS OF POSSESSIONS CONSIDERED NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.—A donor who is a citizen of the United States and a resident of a possession thereof shall, for purposes of the tax imposed by this chapter, be considered a "nonresident not a citizen of the United States" within the meaning of that term wherever used in this title, but only if such donor acquired his United States citizenship solely by reason of (1) his being a citizen of such possession of the United States, or (2) his birth or residence within such possession of the United States.

(2) Section 2501(a) of such Code is amended by striking out "nonresident who is not a citizen of the United States and" and inserting in lieu thereof "nonresident not a citizen of the United States."

(e)(1) The amendments made by subsection (a) shall apply to tax liability incurred with respect to taxable years beginning on or after January 1, 1960.

(2) The amendments made by subsections (b) and (c) shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

(3) The amendments made by subsection (d) shall apply with respect to gifts made after the date of the enactment of this Act.

SEC. 5. (a) Section 6015(a) of the Internal Revenue Code of 1954 (relating to requirement of declaration of estimated income tax by individuals) is amended to read as follows:[16]

(a) REQUIREMENT OF DECLARATION.—Every individual (other than a nonresident alien with respect to whose wages, as defined in section 3401(a), withholding under chapter 24 is not made applicable, but including every alien individual who is a resident of Puerto Rico during the entire taxable year) shall make a declaration of his estimated tax for the taxable year if—

(1) the gross income for the taxable year can reasonably be expected to exceed—

(A) $5,000, in the case of—

(i) a single individual other than a head of a household (as defined in section 1(b)(2)) or a surviving spouse (as defined in section 2(b));

(ii) a married individual not entitled under subsection (b) to file a joint declaration with his spouse; or

(iii) a married individual entitled under subsection (b) to file a joint declaration with his spouse, but only if the aggregate gross income of such individual and his spouse for the taxable year can reasonably be expected to exceed $10,000; or

(B) $10,000, in the case of—

(i) a head of a household (as defined in section 1(b)(2)); or

(ii) a surviving spouse (as defined in section 2(b)); or

[16] Sec. 5 was added as a floor amendment in the Senate and is discussed in House Conference Report No. 2214, Amendment No. 4, page 859, this Bulletin.

(2) the gross income can reasonably be expected to include more than $200 from sources other than wages (as defined in section 3401(a)).

Notwithstanding the provisions of this subsection, no declaration is required if the estimated tax (as defined in subsection (c)) can reasonably be expected to be less than $40.

(b) The amendment made by subsection (a) shall apply with respect to taxable years beginning after December 31, 1960.

SEC. 6. (a) Part VI of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to itemized deductions for individuals and corporations) is amended by adding at the end thereof the following new section:[17]

SEC. 180. EXPENDITURES BY FARMERS FOR FERTILIZER, ETC.

(a) IN GENERAL.—A taxpayer engaged in the business of farming may elect to treat as expenses which are not chargeable to capital account expenditures (otherwise chargeable to capital account) which are paid or incurred by him during the taxable year for the purchase or acquisition of fertilizer, lime, ground limestone, marl, or other materials to enrich, neutralize, or condition land used in farming, or for the application of such materials to such land. The expenditures so treated shall be allowed as a deduction.

(b) LAND USED IN FARMING.—For purposes of subsection (a), the term "land used in farming" means land used (before or simultaneously with the expenditures described in subsection (a)) by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.

(c) ELECTION.—The election under subsection (a) for any taxable year shall be made within the time prescribed by law (including extensions thereof) for filing the return for such taxable year. Such election shall be made in such manner as the Secretary or his delegate may by regulations prescribe. Such election may not be revoked except with the consent of the Secretary or his delegate.

(b) The table of sections for such part VI is amended by adding at the end thereof the following:

Sec. 180. Expenditures by farmers for fertilizer, etc.

(c) Section 263(a)(1) of such Code (relating to capital expenditures) is amended—

(1) by striking out "or" at the end of subparagraph (B);

(2) by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", or"; and

(3) by adding after subparagraph (C) the following new subparagraph:

(D) expenditures by farmers for fertilizer, etc., deductible under section 180.

(d) The amendments made by subsections (a), (b), and (c) shall apply to taxable years beginning after December 31, 1959.

SEC. 7. (a) Section 170 of the Internal Revenue Code of 1954 (relating to charitable, etc., contributions and gifts) is amended—

(1) by adding at the end of subsection (c) the following new sentence:[18]

"For purposes of this section, the term 'charitable contribution' also means an amount treated under subsection (d) as paid for the use of an organization described in paragraph (2), (3), or (4),"; and

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[17] Sec. 6 introduced as H.R. 5547; related Senate Report No. 1767, page 829, this Bulletin; House Conference Report No. 2214, Amendment No. 5, page 859, this Bulletin.

[18] Sec. 7 introduced as H.R. 5547; related Senate Report No. 1767, page 829, this Bulletin; House Conference Report No. 2214, Amendment 6, page 859, this Bulletin.

(2) by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

(d) AMOUNTS PAID TO MAINTAIN CERTAIN STUDENTS AS MEMBERS OF TAXPAYER'S HOUSEHOLD.—

(1) IN GENERAL.—Subject to the limitations provided by paragraph (2), amounts paid by the taxpayer to maintain an individual (other than a dependent, as defined in section 152, or a relative of the taxpayer) as a member of his household during the period that such individual is—

(A) a member of the taxpayer's household under a written agreement between the taxpayer and an organization described in paragraph (2), (3), or (4) of subsection (c) to implement a program of the organization to provide educational opportunities for pupils or students in private homes, and

(B) a full-time pupil or student in the twelfth or any lower grade at an educational institution (as defined in section 151(e)(4)) located in the United States,

shall be treated as amounts paid for the use of the organization.

(2) LIMITATIONS.—

(A) AMOUNT.—Paragraph (1) shall apply to amounts paid within the taxable year only to the extent that such amounts do not exceed $50 multiplied by the number of full calendar months during the taxable year which fall within the period described in paragraph (1). For purposes of the preceding sentence, if 15 or more days of a calendar month fall within such period such month shall be considered as a full calendar month.

(B) COMPENSATION OR REIMBURSEMENT.—Paragraph (1) shall not apply to any amount paid by the taxpayer within the taxable year if the taxpayer receives any money or other property as compensation or reimbursement for maintaining the individual in his household during the period described in paragraph (1).

(3) RELATIVE DEFINED.—For purposes of paragraph (1), the term "relative of the taxpayer" means an individual who, with respect to the taxpayer, bears any of the relationships described in paragraphs (1) through (8) of section 152(a).

(4) NO OTHER AMOUNT ALLOWED AS DEDUCTION.—No deduction shall be allowed under subsection (a) for any amount paid by a taxpayer to maintain an individual as a member of his household under a program described in paragraph (1)(A) except as provided in this subsection.

(b) Section 162(b) of the Internal Revenue Code of 1954 (relating to charitable contributions and gifts excepted from trade or business expenses) is amended by inserting after "the percentage limitations," the following: "the dollar limitations,".

(c) The amendments made by subsections (a) and (b) shall apply with respect to taxable years beginning after December 31, 1959.

SEC. 8. (a) Section 162 of the Internal Revenue Code of 1954 (relating to trade or business expenses) is amended by redesignating subsection (d) as subsection (e), and by inserting after subsection (c) the following new subsection: [19]

(d) CAPITAL CONTRIBUTIONS TO FEDERAL NATIONAL MORTGAGE ASSOCIATION.—For purposes of this subtitle, whenever the amount of capital contributions evidenced by a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718) exceeds the fair market value of the stock as of the issue date of such stock, the initial holder of the stock shall treat the excess as ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business.

(b) Part IV of subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to special rules as to basis of property) is

[19] Sec. 8 introduced as H.R. 7885; related House Report No. 1662; Senate Report No. 1767, H.R. 5547; and House Conference Report No. 2214, Amendment No. 7, pages 816, 829, and 859, this Bulletin.

amended by redesignating section 1054 as 1055, and by inserting after section 1053 the following new section:

SEC. 1054. CERTAIN STOCK OF FEDERAL NATIONAL MORTGAGE ASSOCIATION.

In the case of a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718), the basis of such share in the hands of the initial holder shall be an amount equal to the capital contributions evidenced by such share reduced by the amount (if any) required by section 162(d) to be treated (with respect to such share) as ordinary and necessary expenses paid or incurred in carrying on a trade or business.

(c) The table of sections for such part IV is amended by striking out the last line and inserting in lieu thereof the following:

Sec. 1054. Certain stock of Federal National Mortgage Association.
Sec. 1055. Cross references.

(d) The amendments made by subsections (a), (b), and (c) shall apply with respect to taxable years beginning after December 31, 1959.

SEC. 9. (a) Section 4201 of the Internal Revenue Code of 1954 (relating to tax on pens and mechanical pencils and lighters) is amended—[20]

(1) by inserting "(a)" before "There",

(2) by striking out "Mechanical lighters for cigarettes, cigars, and pipes.", and

(3) by adding at the end thereof the following new subsection:

(b) There is hereby imposed upon the sale by the manufacturer, producer, or importer of mechanical lighters for cigarettes, cigars, and pipes a tax of 10 cents for each lighter but not more than 10 percent of the price for which so sold.

(b) The amendments made by subsection (a) shall apply only with respect to articles sold by the manufacturer, producer, or importer thereof 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.

SEC. 10. (a) Subchapter M of chapter 1 of the Internal Revenue Code of 1954 (relating to regulated investment companies) is amended by adding at the end thereof the following:[21]

Part II—Real Estate Investment Trusts

Sec. 856. Definition of real estate investment trust.
Sec. 857. Taxation of real estate investment trusts and their beneficiaries.
Sec. 858. Dividends paid by real estate investment trust after close of taxable year.

SEC. 856. DEFINITION OF REAL ESTATE INVESTMENT TRUST.

(a) IN GENERAL.—For purposes of this subtitle, the term "real estate investment trust" means an unincorporated trust or an unincorporated association—

(1) which is managed by one or more trustees;

(2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;

(3) which (but for the provisions of this part) would be taxable as a domestic corporation;

(4) which does not hold any property primarily for sale to customers in the ordinary course of its trade or business;

(5) the beneficial ownership of which is held by 100 or more persons;

[20] Sec. 9 was added as a floor amendment in the Senate and is discussed in House Conference Report No. 2214, Amendment No. 8, page 859, this Bulletin.

[21] Sec. 10 introduced as H.R. 12559; related House Report No. 2020, page 819, this Bulletin; House Conference Report No. 2214, Amendment No. 9, page 859, this Bulletin.

(6) which would not be a personal holding company (as defined in section 542) if all of its gross income constituted personal holding company income (as defined in section 543) ; and

(7) which meets the requirements of subsection (c).

(b) DETERMINATION OF STATUS.—The conditions described in paragraphs (1) to (4), inclusive, of subsection (a) must be met during the entire taxable year, and the condition described in paragraph (5) must exist during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months.

(c) LIMITATIONS.—A trust or association shall not be considered a real estate investment trust for any taxable year unless—

(1) it files with its return for the taxable year an election to be a real estate investment trust or has made such election for a previous taxable year which began after December 31, 1960;

(2) at least 90 percent of its gross income is derived from—

(A) dividends;

(B) interest;

(C) rents from real property;

(D) gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property) ; and

(E) abatements and refunds of taxes on real property;

(3) at least 75 percent of its gross income is derived from—

(A) rents from real property;

(B) interest on obligations secured by mortgages on real property or on interests in real property;

(C) gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) ;

(D) dividends or other distributions on, and gain from the sale or other disposition of, transferable shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part ; and

(E) abatements and refunds of taxes on real property;

(4) less than 30 percent of its gross income is derived from the sale or other disposition of—

(A) stock or securities held for less than 6 months ; and

(B) real property (including interests in real property) not compulsorily or involuntarily converted within the meaning of section 1033, held for less than 4 years ; and

(5) at the close of each quarter of the taxable year—

(A) at least 75 percent of the value of its total assets is represented by real estate assets, cash and cash items (including receivables), and Government securities ; and

(B) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)) for purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the trust and to not more than 10 percent of the outstanding voting securities of such issuer.

A real estate investment trust which meets the requirements of this paragraph at the close of any quarter shall not lose its status as a real estate investment trust because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A real estate investment trust which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a real estate investment trust if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

(6) For purposes of this part—

(A) The term "value" means, with respect to securities for which market quotations are readily available, the market value of such se-

curities; and with respect to other securities and assets, fair value as determined in good faith by the trustees, except that in the case of securities of real estate investment trusts such fair value shall not exceed market value or asset value, whichever is higher.

(B) The term "real estate assets" means real property (including interests in real property and interests in mortgages on real property) and shares (or transferrable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part.

(C) The term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon and leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

(D) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended.

(d) RENTS FROM REAL PROPERTY DEFINED.—For purposes of paragraphs (2) and (3) of subsection (c), the term "rents from real property" includes rents from interests in real property but does not include—

(1) any amount received or accrued, directly or indirectly, with respect to any real property, if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property (except that any amount so received or accrued shall not be excluded from the term "rents from real property" solely by reason of being based on a fixed percentage or percentages of receipts or sales);

(2) any amount received or accrued directly or indirectly from any person if the real estate investment trust owns, directly or indirectly—

(A) in the case of any person which is a corporation, stock of such person possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total number of shares of all classes of stock of such person; or

(B) in the case of any person which is not a corporation, an interest of 10 percent or more in the assets or net profits of such person; and

(3) any amount received or accrued, directly or indirectly, with respect to any real property, if the real estate investment trust furnishes or renders services to the tenants of such property, or manages or operates such property, other than through an independent contractor from whom the trust itself does not derive or receive any income. For purposes of this paragraph, the term "independent contractor" means—

(A) a person who does not own, directly or indirectly, more than 35 percent of the shares, or certificates of beneficial interest, in the real estate investment trust, or

(B) a person, if a corporation, not more than 35 percent of the total combined voting power of whose stock (or 35 percent of the total shares of all classes of whose stock), or, if not a corporation, not more than 35 percent of the interest in whose assets or net profits is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the trust.

For purposes of paragraphs (2) and (3), the rules prescribed by section 318(a) for determining the ownership of stock shall apply in determining the ownership of stock, assets, or net profits of any person; except that "10 percent" shall be substituted for "50 percent" in subparagraph (C) of section 318(a)(2).

SEC. 857. TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

(a) REQUIREMENTS APPLICABLE TO REAL ESTATE INVESTMENT TRUSTS.—The provisions of this part (other than subsection (d) of this section) shall not apply to a real estate investment trust for a taxable year unless—

(1) the deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gains dividends) equals or exceeds 90 percent of its real estate investment trust taxable income for the taxable year (determined without regard to subsection (b)(2)(C), and

(2) the real estate investment trust complies for such year with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining the actual ownership of the outstanding shares, or certificates of beneficial interest, of such trust.

(b) METHOD OF TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND HOLDERS OF SHARES OR CERTIFICATES OF BENEFICIAL INTEREST.—

(1) IMPOSITION OF NORMAL TAX AND SURTAX ON REAL ESTATE INVESTMENT TRUSTS.—There is hereby imposed for each taxable year on the real estate investment trust taxable income of every real estate investment trust a normal tax and surtax computed as provided in section 11, as though the real estate investment trust taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid deduction of such real estate investment trust for the taxable year (computed without regard to capital gains dividends) shall be reduced by the deduction provided by section 242 (relating to partially tax-exempt interest).

(2) REAL ESTATE INVESTMENT TRUST TAXABLE INCOME.—For purposes of this part, the term "real estate investment trust taxable income" means the taxable income of the real estate investment trust, adjusted as follows:

(A) There shall be excluded the excess, if any, of the net long-term capital gain over the net short-term capital loss.

(B) The deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(C) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends.

(D) The taxable income shall be computed without regard to section 443(b) (relating to computation of tax on change of annual accounting period).

(E) The net operating loss deduction provided in section 172 shall not be allowed.

(3) CAPITAL GAINS.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year in the case of every real estate investment trust a tax of 25 percent of the excess, if any, of the net long-term capital gain over the sum of—

(i) the net short-term capital loss; and

(ii) the deduction for dividends paid (as defined in section 561) determined with reference to capital gains dividends only.

(B) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by the shareholders or holders of beneficial interests as a gain from the sale or exchange of a capital asset held for more than 6 months.

(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders or holders of beneficial interests at any time before the expiration of 30 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the trust (including capital gain dividends paid after the close of the taxable year described in section 858) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated.

(4) LOSS ON SALE OR EXCHANGE OF STOCK HELD LESS THAN 31 DAYS.—If—

(A) under subparagraph (B) of paragraph (3) a shareholder of, or a holder of a beneficial interest in, a real estate investment trust is required, with respect to any share or beneficial interest, to treat any amount as a long-term capital gain, and

(B) such share or interest is held by the taxpayer for less than 31 days,

then any loss on the sale or exchange of such share or interest shall, to the extent of the amount described in subparagraph (A) of this paragraph, be treated as loss from the sale or exchange of a capital asset held for more than 6 months. For purposes of this paragraph, the rules of section 246

(c)(3) shall apply in determining whether any share of stock or beneficial interest has been held for less than 31 days; except that "30 days" shall be substituted for the number of days specified in subparagraph (B) of section 246(c)(3).

(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—For purposes of section 34(a) (relating to credit for dividends received by individuals), section 116 (relating to an exclusion for dividends received by individuals), and section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

(d) EARNINGS AND PROFITS.—The earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year. For purposes of this subsection, the term "real estate investment trust" includes a domestic unincorporated trust or association which is a real estate investment trust determined without regard to the requirements of subsection (a).

SEC. 858. DIVIDENDS PAID BY REAL ESTATE INVESTMENT TRUST AFTER CLOSE OF TAXABLE YEAR.

(a) GENERAL RULE.—For purposes of this part, if a real estate investment trust—

(1) declares a dividend before the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return), and

(2) distributes the amount of such dividend to shareholders or holders of beneficial interests in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration,

the amount so declared and distributed shall, to the extent the trust elects in such return in accordance with regulations prescribed by the Secretary or his delegate, be considered as having been paid during such taxable year, except as provided in subsections (b) and (c).

(b) RECEIPT BY SHAREHOLDER.—Amounts to which subsection (a) applies shall be treated as received by the shareholder or holder of a beneficial interest in the taxable year in which the distribution is made.

(c) NOTICE TO SHAREHOLDERS.—In the case of amounts to which subsection (a) applies, any notice to shareholders or holders of beneficial interests required under this part with respect to such amounts shall be made not later than 30 days after the close of the taxable year in which the distribution is made.

(b) Subchapter M of chapter 1 of the Internal Revenue Code of 1954 is amended—

(1) by striking out the heading thereof and inserting in lieu thereof the following:

SUBCHAPTER M—REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS

Part I. Regulated investment companies.
Part II. Real estate investment trusts.

Part I—Regulated Investment Companies;

(2) by striking out "this subchapter" in sections 852(a) and 855(c) and inserting in lieu thereof "this part"; and

(3) by striking out "A capital gain dividend means" in section 852(b)(3)(C) and inserting in lieu thereof "For purposes of this part, a capital gain dividend is".

(c) The table of subchapters for chapter 1 of such Code is amended by inserting "and real estate investment trusts" after "Regulated investment companies".

(d) Section 11(d)(3) of such Code (relating to tax on corporations) is amended by inserting "and real estate investment trusts" after "regulated investment companies."

(e) Section 34(c) of such Code (relating to credit for dividends received by individuals) is amended by striking out the word "or" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

(3) a real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (sec. 856 and following).

(f) Section 116(b) of such Code (relating to an exclusion for dividends received by individuals) is amended by striking out the word "or" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

(3) a real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (sec. 856 and following).

(g) Section 243(c) of such Code (relating to deduction for dividends received by corporations) is amended by adding at the end thereof the following new paragraph:

(3) Any dividend received from a real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (sec. 856 and following) shall not be treated as a dividend.

(h) Section 318(b) of such Code (relating to constructive ownership of stock) is amended by striking out the word "and" at the end of paragraph (4), by striking out the period at the end of paragraph (5) and inserting in lieu thereof "; and", and by adding at the end thereof the following new paragraph:

(6) section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts).

(i) Section 443(d) of such Code (relating to computation of tax on change of annual accounting period) is amended by adding at the end thereof the following new paragraph:

(5) The taxable income of a real estate investment trust, see section 857 (b)(2)(D).

(j) Section 1504(b)(6) of such Code (relating to consolidated returns) is amended by inserting "and real estate investment trusts" after "Regulated investment companies".

(k) The amendments made by this section shall apply with respect to taxable years of real estate investment trusts beginning after December 31, 1960.

SEC. 11. The Pension Fund, Plumbers' Local Union Numbered 775, which was created May 1, 1957, as a result of an agreement between Plumbers' Local Union Numbered 775, of Suffolk County, New York, affiliated with the United Association of Journeymen and Apprentices of the Plumbing and Pipe Fitting Industry of the United States and Canada, and the Suffolk County Plumbing and Heating Contractors Association, Inc., and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the

Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning May 1, 1957, and ending May 11, 1959, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.[22]

Approved September 14, 1960.

PUBLIC LAW 86-780
EIGHTY-SIXTH CONGRESS, SEPTEMBER 14, 1960
H.R. 10087 [23]

An Act to amend the Internal Revenue Code of 1954 to permit taxpayers to elect an overall limitation on the foreign tax credit.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 904 of the Internal Revenue Code of 1954 (relating to limitation on foreign tax credit) is amended by striking out subsection (a) and inserting in lieu thereof the following new subsections:

(a) ALTERNATIVE LIMITATIONS.—

(1) PER-COUNTRY LIMITATION.—In the case of any taxpayer who does not elect the limitation provided by paragraph (2), the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(2) OVERALL LIMITATION.—In the case of any taxpayer who elects the limitation provided by this paragraph, the total amount of the credit in respect of taxes paid or accrued to all foreign countries and possessions of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(b) ELECTION OF OVERALL LIMITATION.—

(1) IN GENERAL.—A taxpayer may elect the limitation provided by subsection (a)(2) for any taxable year beginning after December 31, 1960. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

(2) ELECTION AFTER REVOCATION.—If a taxpayer has made an election under paragraph (1) and such election has been revoked, such taxpayer shall not be eligible to make a new election under paragraph (1) for any taxable year, unless the Secretary or his delegate consents to such new election.

(3) FORM AND TIME OF ELECTION AND REVOCATION.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner as the Secretary or his delegate may by regulations prescribe. Such an election or revocation with respect to any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year.

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[22] Sec. 11 was added as a floor amendment in the Senate and is discussed in House Conference Report No. 2214, Amendment No. 10, page 859, this Bulletin.

[23] Senate Report No. 1393, page 874, this Bulletin; House Report No. 1358, page 865, this Bulletin; House Conference Report No. 2199, page 889, this Bulletin.

(b) Subsection (b) of such section 904 is amended—

(1) by striking out "(b)" at the beginning and inserting in lieu thereof "(c)"; and

(2) by striking out "the limitation under subsection (a)" and inserting in lieu thereof "the applicable limitation under subsection (a)".

(c) Subsection (c) of such section 904 is amended—

(1) by striking out "(c)" at the beginning and inserting in lieu thereof "(d)"; and

(2) by striking out "the limitation under subsection (a)" each place it appears in the first sentence and inserting in lieu thereof "the applicable limitation under subsection (a)".

(d) Such section 904 is amended by adding at the end thereof the following new subsections:

(e) CARRYBACKS AND CARRYOVERS WHERE OVERALL LIMITATIONS IS ELECTED.—

(1) FOREIGN TAXES TO BE AGGREGATED FOR PURPOSES OF SUBSECTION (d).—With respect to each taxable year of the taxpayer to which the limitation provided by subsection (a)(2) applies, the taxes referred to in the first sentence of subsection (d) shall, for purposes of applying such first sentence, be aggregated on an overall basis (rather than taken into account on a per-country basis).

(2) FOREIGN TAXES MAY NOT BE CARRIED FROM PER-COUNTRY YEAR TO OVERALL YEAR OR FROM OVERALL YEAR TO PER-COUNTRY YEAR.—No amount paid or accrued for any taxable year to which the limitation provided by subsection (a)(1) applies shall (except for purposes of determining the number of taxable years which have elapsed) be deemed paid or accrued under subsection (d) in any taxable year to which the limitation provided by subsection (a)(2) applies. No amount paid or accrued for any taxable year to which the limitation provided by subsection (a)(2) applies shall (except for purposes of determining the number of taxable years which have elapsed) be deemed paid or accrued under subsection (d) in any taxable year to which the limitation provided by subsection (a)(1) applies.

(f) CROSS REFERENCE.—For special rule relating to the application of the credit provided by section 901 in the case of affiliated groups which include Western Hemisphere trade corporations for years in which the limitation provided by subsection (a)(2) applies, see section 1503(d).

SEC. 2. Section 1503 of the Internal Revenue Code of 1954 (relating to computation and payment of tax case of consolidated returns) is amended by adding at the end thereof the following new subsection:

(d) SPECIAL RULE FOR APPLICATION OF FOREIGN TAX CREDIT WHEN OVERALL LIMITATION APPLIES.—

(1) IN GENERAL.—If the affiliated group includes one or more Western Hemisphere trade corporations (as defined in section 921), and if for the taxable year an election under section 904(b)(1) (relating to election of overall limitation on foreign tax credit) is in effect, then the amount of taxes paid or accrued to foreign countries and possessions of the United States by such Western Hemisphere trade corporations which may be taken into account for purposes of section 901 shall be reduced by the amount (if any) by which—

(A) the amount of such taxes (or, if smaller, the amount of the tax which would be computed under subsection (a), if such corporations were not Western Hemisphere trade corporations, with respect to the portion of the consolidated taxable income attributable to such corporations), exceeds

(B) the amount of the tax computed under subsection (a) with respect to the portion of the consolidated taxable income attributable to such corporations.

(2) ADJUSTMENT IN CASE OF CERTAIN PUBLIC UTILITIES.—So much of any reduction under paragraph (1) as is attributable to taxes paid or accrued to foreign countries and possessions of the United States by one or more

corporations which are both Western Hemisphere trade corporations and regulated public utilities shall be decreased by the excess of—

(A) the amount of tax computed under subsection (a) with respect to the portion of the consolidated taxable income attributable to income derived, by the corporations in the affiliated group which are not Western Hemisphere trade corporations, from sources within the foreign countries referred to in paragraph (3)(B), over

(B) the amount of taxes paid or accrued to such foreign countries by the corporations referred to in subparagraph (A).

This paragraph shall apply only if the corporations described in subparagraph (A) derive 80 percent or more, of the gross income (computed without regard to capital gains and losses) which they derive from sources within the foreign countries described in paragraph (3)(B), from regulated public utilities and from operations as regulated public utilities.

(3) SPECIAL RULES.—

(A) For purposes of paragraph (2), a corporation is a regulated public utility only if it is a regulated public utility within the meaning of subparagraph (A) (other than clauses (ii) and (iii) thereof) or (D) of subsection (c)(1). For purposes of the preceding sentence, subsection (c)(2) shall be applied as if subsection (c)(1) were limited to subparagraphs (A)(i) and (D) thereof.

(B) For purposes of paragraph (2), the foreign countries referred to in this subparagraph include only any country from which any public utility referred to in the first sentence of paragraph (2) derives the principal part of its income.

(C) For purposes of paragraph (1)(A), the amount of tax which would be computed with respect to the portion of the consolidated taxable income attributable to any corporation or corporations shall be determined without regard to the increase of 2 percent provided in subsection (a).

SEC. 3. (a) Subsections (a) and (b) of section 901 of the Internal Revenue Code of 1954 (relating to taxes of foreign countries and of possessions of the United States) are each amended by striking out "the limitation of section 904" and inserting in lieu thereof "the applicable limitation of section 904".

(b) The second sentence of subsection (a) of such section 901 is amended to read as follows: "Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year."

(c) Section 6501 of such Code (relating to limitations on assessments and collections) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

(i) FOREIGN TAX CARRYBACKS.—In the case of a deficiency attributable to the application to the taxpayer of a carryback under section 904(d) (relating to carryback and carryover of excess foreign taxes), such deficiency may be assessed at any time before the expiration of one year after the expiration of the period within which a deficiency may be assessed for the taxable year of the excess taxes described in section 904(d) which result in such carryback.

SEC. 4. The amendments made by the first section, section 2, and subsection (a) of section 3 of this Act shall apply with respect to taxable years beginning after December 31, 1960. The amendment made by subsection (b) of section 3 of this Act shall apply with respect to taxable years begining after December 31, 1953, and ending after August 16, 1954. The amendments made by subsection (c) of section 3 of this Act shall apply with respect to taxable years beginning after December 31, 1957.

SEC. 5. Any amount received after December 31, 1949, and before October 1, 1955, from a corporation which—

(1) was formed exclusively for the purpose of, and was engaged exclusively in, operating without profit a scientific laboratory for the Atomic Energy Commission, and

(2) operated solely on funds appropriated to the Atomic Energy Commission,

by an individual as reimbursement for moving himself and his immediate family, household goods, and personal effects to a new place of residence in order to accept employment with such corporation shall, for Federal income tax purposes, be treated as an amount which was not includible in the gross income of the individual, to the extent that such amount did not exceed the actual expenses paid or incurred by the individual for such purposes, if the individual was advised, at the time of his employment, by an authorized officer, employee, or agent of such corporation that the amount of such reimbursement would not be includible in gross income. If refund or credit of any overpayment resulting from the application of this section is prevented on the date of enactment of this Act, or within six months after such date, by the operation of any law or rule of law (other than chapter 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises, and the corresponding provisions of prior law), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within six months after such date. No interest shall be paid or allowed on any overpayment resulting from the application of the preceding sentence.

SEC. 6. (a) Subpart A or part III of subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to information concerning persons subject to special provisions) is amended by renumbering section 6038 as 6039, and by inserting after section 6037 the following new section:

SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

(a) REQUIREMENT.—

(1) IN GENERAL.—A domestic corporation shall furnish, with respect to any foreign corporation which it controls (within the meaning of subsection (c)(1)) and with respect to any foreign subsidiary of any such foreign corporation (within the meaning of subsection (c)(2)), such information as the Secretary or his delegate may prescribe by regulations relating to—

(A) the name, the principal place of business, and the nature of business of such foreign corporation or foreign subsidiary, and the country under whose laws incorporated;

(B) the accumulated profits (as defined in section 902(c)) of such foreign corporation or foreign subsidiary, including the items of income (whether or not included in gross income under chapter 1), deductions (whether or not allowed in computing taxable income under chapter 1), and any other items taken into account in computing such accumulated profits;

(C) a balance sheet for such foreign corporation or foreign subsidiary, listing assets, liabilities, and capital;

(D) transactions between such foreign corporation or foreign subsidiary and—

(i) any foreign corporation controlled by the domestic corporation,

(ii) any foreign subsidiary of a foreign corporation controlled by the domestic corporation, and

(iii) the domestic corporation or any shareholder of the domestic corporation owning at the time the transaction takes place 10 percent or more of the value of any class of stock outstanding of the domestic corporation; and

(E) a description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each citizen or resident of the United States and each domestic corporation who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation or foreign subsidiary.

(2) PERIOD FOR WHICH INFORMATION IS TO BE FURNISHED, ETC.—The information required under paragraph (1) shall be furnished—

(A) in the case of a foreign corporation, for its annual accounting period ending with or within the domestic corporation's taxable year, and

(B) in the case of any foreign subsidiary of such foreign corporation, for such subsidiary's annual accounting period ending with or within such foreign corporation's annual accounting period described in subparagraph (A).

The information required under this subsection shall be furnished at such time and in such manner as the Secretary or his delegate shall by regulations prescribe.

(3) LIMITATION.—No information shall be required to be furnished under this subsection with respect to any foreign corporation or foreign subsidiary for any annual accounting period unless such information was required to be furnished under regulations in effect on the first day of such annual accounting period.

(b) EFFECT OF FAILURE TO FURNISH INFORMATION.—If a domestic corporation fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any foreign corporation or foreign subsidiary required under paragraph (1) of subsection (a), then, in applying section 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) to such domestic corporation (or to any person who acquires from any person any portion of the interest of such domestic corporation in any such foreign corporation or foreign subsidiary, but only to the extent of such portion) for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation and foreign subsidiary with respect to which the domestic corporation is required to furnish information during the annual accounting period or periods with respect to which such information is required under such paragraph (2) of subsection (a) shall be reduced by 10 percent. If such failure continues 90 days or more after notice by the Secretary or his delegate to the domestic corporation, then the amount of the reduction under this subsection shall be 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure to furnish information continues after the expiration of such 90-day period. No taxes shall be reduced under this subsection more than once for the same failure. For purposes of this subsection, the time prescribed under paragraph (2) of subsection (a) to furnish information (and the beginning of the 90-day period after notice by the Secretary) shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary or his delegate) reasonable cause existed for failure to furnish such information.

(c) CONTROL, ETC.—For purposes of this section—

(1) If at any time during its taxable year a domestic corporation owns more than 50 percent of the voting stock of a foreign corporation, it shall be deemed to be in control of such foreign corporation.

(2) If at any time during its annual accounting period a foreign corporation owns more than 50 percent of the voting stock of another foreign corporation, such other corporation shall be considered a foreign subsidiary of the corporation owning such stock.

(d) ANNUAL ACCOUNTING PERIOD.—For purposes of this section, the annual accounting period of a foreign corporation or of a foreign subsidiary is the annual period on the basis of which such foreign corporation or such foreign subsidiary regularly computes its income in keeping its books.

(e) CROSS REFERENCE.—For provisions relating to penalties for violations of this section, see section 7203.

(b) (1) The table of sections for such subpart is amended by striking out the last item and inserting in lieu thereof the following:

Sec. 6038. Information with respect to certain foreign corporations.
Sec. 6039. Cross references.

(2) Section 902 of the Internal Revenue Code of 1954 (relating to credit for corporate stockholder in foreign corporation) is amended by adding at the end thereof the following new subsection:

(e) CROSS REFERENCE.—For reduction of credit with respect to dividends paid out of accumulated profits for years for which certain information is not furnished, see section 6038.

(c) The amendments made by subsections (a) and (b) shall apply to taxable years of domestic corporations beginning after December 31, 1960, with respect to information relating to a foreign corporation or a foreign subsidiary described in section 6038(a) of the Internal Revenue Code of 1954 (as added by subsection (a)) for its annual accounting periods beginning after December 31, 1960.

SEC. 7. (a) Section 6046 of the Internal Revenue Code of 1954 (relating to information returns as to formation or reorganization of foreign corporations) is amended to read as follows:

SEC. 6046. RETURNS AS TO CREATION OR ORGANIZATION, OR REORGANIZATION, OF FOREIGN CORPORATIONS.

(a) GENERAL RULE.—On or before the 90th day after the creation or organization, or reorganization, of any foreign corporation—

(e) Each United States citizen or resident who was an officer or director of the corporation at any time within 60 days after the creation or organization, or reorganization thereof, and

(2) Each United States shareholder of the corporation by or for whom, at any time within 60 days after the creation or organization or reorganization of the coropration, 5 percent or more in value of the stock of the corporation then outstanding was owned directly or indirectly (including, in the case of an individual, stock owned by members of his family),

shall make a return in compliance with the provisions of subsection (b).

"(b) FORM AND CONTENTS OF RETURNS.—The returns required by subsection (a) shall be in such form and shall set forth, in respect of the foreign corporation, such information as the Secretary or his delegate prescribes by forms or regulations as necessary for carrying out the provisions of the income tax laws.

(c) MEANING OF TERMS.—For the purpose of this section—

(1) UNITED STATES SHAREHOLDER.—The term "United States shareholder" includes a citizen or resident of the United States, a domestic corporation, a domestic partnership or an estate or trust (other than an estate or trust the gross income of which under subtitle A includes only income from sources within the United States).

(2) MEMBERS OF FAMILY.—The family of an individual shall be considered as including only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(d) CROSS REFERENCE.—For provisions relating to penalties for violations of this section, see section 7203.

(b) The table of sections for subpart B of part III of chapter 61 of the Internal Revenue Code of 1954 is amended by striking out the last item and inserting in lieu thereof the following:

Sec. 6046. Returns as to creation or organization, or reorganization, of foreign corporations.

SEC. 8. The amendments made by section 7 shall apply only with respect to foreign corporations created or organized, or reorganized, after the date of the enactment of this Act.

Approved September 14, 1960.

PUBLIC LAW 86-781
EIGHTY-SIXTH CONGRESS, SEPTEMBER 14, 1960
H.R. 12536 [24]

An act relating to the treatment of charges for local advertising for purposes of determining the manufacturers sale price.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4216 of the Internal Revenue Code of 1954 (relating to definition of price for purposes of the manufacturers excise tax) is amended by adding at the end thereof the following new subsection:

(f) EXCLUSION OF LOCAL ADVERTISING CHARGE FROM SALE PRICE.—

(1) EXCLUSION.—In determining, for purposes of this chapter, the price for which an article is sold, there shall be excluded a charge for local advertising (as defined in paragraph (4)) to the extent that such charge—

(A) does not exceed 5 percent of the price for which the article is sold (as determined under this section by excluding any charge for local advertising),

(B) in a separate charge made when the article is sold, and

(C) is intended to be refunded to the purchaser or any subsequent vendee in reimbursement of costs incurred for local advertising.

In the case of any such charge (or portion thereof) which is not so refunded before the first day of the fifth calendar month following the calendar year during which the article was sold, the exclusion provided by the preceding sentence shall cease to apply as of such first day.

(2) AGGREGATE AMOUNT WHICH MAY BE EXCLUDED.—In the case of articles upon the sale of which tax was imposed under the same section of this chapter—

(A) The sum of (i) the aggregate of the charges for local advertising excluded under paragraph (1), plus (ii) the aggregate of the readjustments for local advertising under section 6416(b)(1) (relating to credits or refunds for price readjustments), shall not exceed

(B) 5 percent of the aggregate of the prices (determined under this section by excluding all charges for local advertising) at which such articles were sold in sales on which tax was imposed by such section of this chapter.

The preceding sentence shall be applied to each manufacturer, producer, and importer as of the close of each calendar quarter, taking into account the items specified in subparagraphs (A) and (B) for such calendar quarter and preceding calendar quarters in the same calendar year.

(3) NO ADJUSTMENT FOR OTHER ADVERTISING CHARGES.—Except to the extent provided by paragraphs (1) and (2), no charge or expenditure for advertising shall serve, for purposes of this section or section 6416(b)(1), as the basis for an exclusion from, or as readjustment of, the price of any article.

(4) LOCAL ADVERTISING DEFINED.—For purposes of this section and section 6416(b)(1), the term 'local advertising' means only advertising which—

(A) is initiated or obtained by the purchaser or any subsequent vendee,

(B) names the article for which the price is determinable under this section and states the location at which such article may be purchased at retail, and

(C) is broadcast over a radio station or television station or appears in a newspaper.

SEC. 2. The first sentence of paragraph (1) of section 6416(b) of the Internal Revenue Code of 1954 (relating to credits or refunds for price readjustments) is amended by inserting after "or allowance," the following: "including (in the case of a tax imposed by chapter

[24] House Report No. 2103, page 898, this Bulletin; Conference Report No. 2213, page 902, this Bulletin; since Senate Report No. 1916 is substantially identical to the House Report, it is not being published in this Bulletin.

32) a readjustment for local advertising (but only to the extent provided in section 4216(f) (2) and (3)),".

SEC. 3. The amendments made by this Act shall apply with respect to articles sold on or after the first day of the first calendar quarter beginning more than twenty days after the date of the enactment of this Act.

SEC. 4. Subsection (c) of section 302 of the Public Debt and Tax Rate Extension Act of 1960 (Public Law 86–564 [page 681, this Bulletin]; 74 Stat. 293) is amended to read as follows:

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by subsections (a) and (b) shall be applicable only with respect to taxable years beginning after December 31, 1960.

(2) CALCIUM CARBONATES, ETC.—

(A) ELECTION FOR PAST YEARS.—In the case of calcium carbonates or other minerals when used in making cement, if an election is made by the taxpayer under subparagraph (C)—

(i) the amendments made by subsection (b) shall apply to taxable years with respect to which such election is effective, and

(ii) provisions having the same effect as the amendments made by subsection (b) shall be deemed to be included in the Internal Revenue Code of 1939 and shall apply to taxable years with respect to which such election is effective in lieu of the corresponding provisions of such Code.

(B) YEARS TO WHICH APPLICABLE.—An election made under subparagraph (C) to have the provisions of this paragraph apply shall be effective for all taxable years beginning before January 1, 1961, in respect of which—

(i) the assessment of a deficiency,

(ii) the refund or credit of an overpayment, or

(iii) the commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954,

is not prevented on the date of the enactment of this paragraph by the operation of any law or rule of law. Such election shall also be effective for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before the date of the enactment of this paragraph.

(C) TIME AND MANNER OF ELECTION.—An election to have the provisions of this paragraph apply shall be made by the taxpayer on or before the 60th day after the date of publication in the Federal Register of final regulations issued under authority of subparagraph (F), and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election, if made, may not be revoked.

(D) STATUTES OF LIMITATION.—Notwithstanding any other law, the period within which an assessment of a deficiency attributable to the application of the amendments made by subsection (b) may be made with respect to any taxable year to which such amendments apply under an election made under subparagraph (C), and the period within which a claim for refund or credit of an overpayment attributable to the application of such amendments may be made with respect to any such taxable year, shall not expire prior to one year after the last day for making an election under subparagraph (C). An election by a taxpayer under subparagraph (C) shall be considered as a consent to the application of the provisions of this subparagraph.

(E) TERMS; APPLICABILITY OF OTHER LAWS.—Except where otherwise distinctly expressed or manifestly intended, terms used in this paragraph shall have the same meanings as when used in the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939) and all provisions of law shall apply with respect to this paragraph as if this paragraph were a part of such Code (or corresponding provisions of the Internal Revenue Code of 1939).

(F) REGULATIONS.—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this paragraph.

SEC. 5. (a) The Iron Workers, Mid-America Pension Fund, which was established by an indenture executed on January 30, 1957, as a result of an agreement between various locals affiliated with the International Association of Bridge, Structural, and Ornamental Iron Workers and three employer associations, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a), of such Code, for years ending on or after December 17, 1958, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning on January 30, 1957, and ending on December 16, 1958, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(b) The Pattern Makers' Pension Trust Fund of Chicago, which was established by an agreement and declaration executed on April 28, 1958, between the Pattern Makers' League of North America, Chicago Association, and the Pattern Manufacturers' Association of Chicago and Vicinity, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, for years ending on or after February 25, 1959, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning on April 28, 1958, and ending on February 24, 1959, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(c) The Pipe and Refrigeration Fitters Local 537 Pension Fund of Boston, Massachusetts, which was created on September 1, 1955, as a result of an agreement between Local 537 of the United Association of Pipe Fitters and Refrigeration Fitters and the Heating, Piping, and Air Conditioning Contractors, Boston Association (now known as Mechanical Contractors Association of Boston), and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, for years ending on or after November 10, 1959, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning on March 1, 1956, and ending on November 9, 1959, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(d) The Annuity Plan of the Electrical Switchboard and Panelboard Manufacturing Industry of New York City, which was created May 16, 1956, as a result of an agreement between Local Union Numbered 3, International Brotherhood of Electrical Workers,

American Federation of Labor and Congress of Industrial Organizations, and the Electrical Manufacturers of New York, Incorporated, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning May 16, 1956, and ending May 22, 1957, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(e) The District Council No. 19 Welfare Fund, now known as Painters District Council No. 19 Welfare and Pension Fund, which was first created as of May 1, 1947, as a result of an agreement between Painters District Council No. 19, Brotherhood of Painters, Decorators and Paperhangers of America, of the State of New Jersey and painting contractors signatory to the union agreement, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a) and under section 165(a) of the Internal Revenue Code of 1939, for the period beginning January 1, 1954, and ending August 6, 1956, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(f) The Local Union Numbered 377 Pension Fund, which was created October 13, 1952, as a result of an agreement between Local Union Numbered 377, Brotherhood of Painters, Decorators and Paperhangers of America, of the State of New Jersey and Painting and Decorating Contractors of America, Hudson County Employers Chapter, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a) and under section 165(a) of the Internal Revenue Code of 1939, for the period beginning October 13, 1952, and ending April 1, 1958, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

SEC. 6. (a) Section 461 of the Internal Revenue Code of 1954 (relating to general rule for taxable year of deduction) is amended by adding at the end thereof the following new subsection:

(d) LIMITATION ON ACCELERATION OF ACCRUAL OF TAXES.—

(1) GENERAL RULE.—In the case of a taxpayer whose taxable income is computed under an accrual method of accounting, to the extent that the time for accruing taxes is earlier than it would be but for any action of any taxing jurisdiction taken after December 31, 1960, then, under regulations

prescribed by the Secretary or his delegate, such taxes shall be treated as accruing at the time they would have accrued but for such action by such taxing jurisdiction.

(2) LIMITATION.—Under regulations prescribed by the Secretary or his delegate, paragraph (1) shall be inapplicable to any item of tax to the extent that its application would (but for this paragraph) prevent all persons (including successors in interest) from ever taking such item into account.

(b) The amendment made by subsection (a) shall apply to taxable years ending after December 31, 1960.

Approved September 14, 1960.

PUBLIC LAW 86-791
EIGHTY-SIXTH CONGRESS, SEPTEMBER 14, 1960
H.R. 816 [25]

An Act to convey certain lands in Oklahoma to the Cheyenne and Arapaho Indians, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That there are hereby eliminated from the Cheyenne and Arapaho subagency reservation at Concho, Oklahoma, approximately four thousand nine hundred acres of land considered excess to the present school and agency reserve needs. The Secretary of the Interior is authorized to convey to the Cheyenne and Arapaho Tribes a fee simple title to approximately three thousand nine hundred acres of such lands, together with the improvements thereon. Approximately one thousand acres of such land shall be transferred by the Secretary of the Interior to the Attorney General for use in connection with the El Reno Reformatory. The land transferred to the Attorney General shall be selected in a reasonably compact unit that will cause a minimum disruption in the agricultural program now conducted by the Bureau of Prisons. The title of the tribes to any land conveyed pursuant to this section shall be subject to no exemption from taxation or restriction on use, management, or disposition because of Indian ownership.

SEC. 2. The Indian Claims Commission is directed to determine in accordance with the provisions of section 2 of the Act of August 13, 1946 (60 Stat. 1050), the extent to which the value of the title conveyed by this Act should or should not be set off against any claim against the United States determined by the Commission.

Approved September 14, 1960.

[25] House Report No. 378 and Senate Report No. 1617 are not published herein.

SUBPART C.—COMMITTEE REPORTS

[H.R. 11405][1]

INCOME TAX TREATMENT OF CERTAIN DISCHARGES OF INDEBTEDNESS OF RAILROAD CORPORATIONS

[Senate Report No. 1416, Eighty-sixth Congress, Second Session, Calendar No. 1478]

[May 24, 1960]

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following report to accompany H.R. 11405.

The Committee on Finance, to whom was referred the bill (H.R. 11405) to provide for the treatment of income from discharge of indebtedness of a railroad corporation in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act commenced before January 1, 1960, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

H.R. 11405 makes two changes in existing law. Both of these changes relate to the continuation of provisions which previously have been in effect.

First, present law provides that the discharge of indebtedness of a railroad corporation in a taxable year beginning before January 1, 1958, is not to result in taxable income for the railroad if the discharge occurred as the result of a court order in a receivership proceeding, or in a proceeding under section 77 of the Bankruptcy Act. The bill continues the application of this provision to discharges after December 31, 1959, but only if the court proceeding involved commenced before January 1, 1960.

Second, Congress in the Technical Amendments Act of 1958 [C.B. 1958–3, 254] provided that a deduction for accrued vacation pay is not to be denied for any taxable year ending before January 1, 1961, solely because the liability for it to a specific person has not been fixed or because the liability for it to each individual cannot be computed with reasonable accuracy. However, for the corporation to obtain the deduction the employee must have performed the qualifying service necessary under a plan or policy which provides for vacations with pay to qualified employees. The bill extends this same treatment to deductions for taxable years ending before January 1, 1963.

The Treasury Department has indicated that it does not object to either of the provisions in the bill.

II. GENERAL EXPLANATION OF BILL

A. DISCHARGE OF INDEBTEDNESS IN THE CASE OF RAILROADS

Section 108(a) of present law provides in general that the discharge of indebtedness by a corporation (or an individual in connection with property used in his trade or business) is not to result in an addition to gross income. However, this treatment is available only if the taxpayer agrees to reduce the basis of his property by an amount equal to the amount of indebtedness discharged. This provision was first added by the Revenue Act of 1939 although at that time this treatment was available only for taxpayers who were in an unsound financial condition. This limitation, however, was removed in the Revenue Act of 1942. When this provision was initially enacted it was intended primarily as a means of aiding hard-pressed ralroads in buying up their obligations which were selling below face value. This provision was needed to prevent the realization of income at the time these securities were repurchased because the Supreme Court had held (in *Kirby Lumber Company* v. *U.S.* (284 U.S. 1), 1931) that a corporation realized income by purchasing and redeeming its bonds at a price less than that for which sold. This had prevented corporations from liquidating their indebtedness in order to place their affairs on a sound financial basis.

What is now section 108(b) of present law, with which the first section of this bill is directly concerned, was added in the Revenue Act of 1942. This subsection also provides that no amount is to be included in gross income as a result of the discharge of indebtedness, but in this case only in the case of a railroad

[1] Public Law 86–496, page 680, this Bulletin.

corporation. Moreover, this provision is also more limited than subsection (a) in that the qualifying discharge of indebtedness can result only from an order of a court in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act. However, the railroads qualifying under this provision need not decrease the basis of their assets by the amount of the indebtedness discharged, as must be done in the case of corporations coming under the general provision.

The Corporate reorganization provisions (sec. 374) already provide for the nonrecognition of gain or loss in the case of property of a railroad corporation transferred to another railroad corporation as a result of a court order in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act. Since under this corporate reorganization provision no gain is recognized to the railroads where there is a transfer of property from one railroad corporate entity to another (in bankruptcy or receivership proceedings) it seemed appropriate to provide for nonrecognition of gain or loss (and no adjustment to basis of assets) where for other than tax reasons it was not desirable, or perhaps it was impossible, to transfer the assets to a second corporate entity. This accounts for the enactment of what is now section 108(b) in the Revenue Act of 1942. The provision in that act was effective only for discharges of indebtedness occurring after December 31, 1939, and before January 1, 1946. In subsequent legislation the application of this provision has been extended to taxable years beginning before January 1, 1958. These extensions occurred because in all of the railroad receivership and bankruptcy proceedings, begun as a result of the depression in the 1930's, had not been completed before 1946.

A few of these railroad receivership proceedings are still in process. Therefore, the House Ways and Means Committee amended section 108(b) to provide that if the discharge of indebtedness (whether by cancellation or modification or otherwise) in the case of a railroad corporation arose as a result of a court order in a receivership proceedings or in a proceeding under section 77 of the Bankruptcy Act, then no amount is to be included in gross income with respect to it so long as the court proceeding involved commenced before January 1, 1960. This will be true in the cases where the court action began before January 1, 1960, without regard to how long after that date the discharge of indebtedness actually occurs. This should make it unnecessary to reconsider the effective date of this provision in the future in order to cover cases which are already in process.

Except for the reference described above, relating to the commencement of the court proceeding before January 1, 1960, no substantive change is made by this bill in section 108(b) other than the deletion of the sentence limiting the application of the subsection to discharges occurring in taxable years beginning before January 1, 1958.

The bill provides that this amendment is to apply to taxable years beginning after December 31, 1959, but only with respect to discharges occurring after that date.

B. Deductibility of Accrued Vacation Pay

Under the 1939 Code (sec. 43) the period for taking deductions was stated to be the taxable year in which the expenses were "paid or accrued" or "paid or incurred," depending upon the method of accounting, "unless in order to clearly reflect the income, the deductions or credits should be taken as of a different period." In this connection, published rulings (GCM 25261, C.B. 1947–2, 44; I.T. 3956, C.B. 1949–1, 78), in general held that vacation pay for the next year could be accrued as of the close of the taxable year in which the qualifying services were rendered if under the employment contract all of the events necessary to fix the liability of the taxpayer for the vacation pay had occurred by the close of the taxable year. In determining whether the events necessary to fix the liability of the taxpayer for vacation pay had occurred, the fact that the employees' rights to a vacation (or payment in lieu of vacation) in the following year might be terminated if his employment ended before the scheduled vacation period was not regarded as making the liability a contingent one, rather than a fixed one. It was held that the liability was not contingent since the employer could expect the employees as a group to receive the vacation pay and, therefore, that only the ultimate amount of the liability to the group remained uncertain at the close of the year.

In Revenue Ruling 54–608 (C.B. 1954–2, 8) the Internal Revenue Service reconsidered its previous rulings on vacation pay. This ruling held that no accrual of vacation pay could occur until the fact of liability with respect to specific employees was clearly established and the amount of the liability to each individual employee was capable of computation with reasonable

accuracy. This ruling was initially made applicable to taxable years ending on or after June 30, 1955. It was then thought that taxpayers accruing vacation pay under plans which did not meet the requirements of the strict accrual rules set forth in this ruling would utilize section 462 of the 1954 Code. This section of the code, however, was repealed and the Treasury Department in a series of actions continued to postpone the effective date of Revenue Ruling 54–608 until January 1, 1959 (the last postponement was made in Rev. Rul. 57–325, C.B. 1957–2, 302, July 8, 1957). It stated that Revenue Ruling 54–608 was to be inapplicable to taxable years ending before January 1, 1959, except in cases involving an agreement with a labor union which was in effect on June 30, 1957, and which expired after December 31, 1958. In such cases Revenue Ruling 54–608 was to be applicable for the first time to taxable years ending on or after the 90th day after the date such agreement expires.

Congress in the Technical Amendments Act of 1958 concluded that more time was required for study before Revenue Ruling 54–608 was made applicable to those taxpayers who were properly accruing vacation pay under I.T. 3956. Therefore, the period in which Revenue Ruling 54–608 is to be inapplicable was extended for 2 more years, or it was provided that deductions for accrued vacation pay were not to be denied for any taxable year ending before January 1, 1961, solely by reason of the fact that the liability for the vacation pay to a specific person has not been clearly established or that the amount of the liability to each individual is not capable of computation with reasonable accuracy.

Still further time is required for study before Revenue Ruling 54–608 is made fully applicable. Therefore, section 2 of this bill amends the section of the Technical Amendments Act of 1958, dealing with this matter (sec. 97) to provide a further 2-year postponement of the period of time before Revenue Ruling 54–608 is to be applicable. It provides that this ruling with respect to deductions for accrued vacation pay is not to be effective for any taxable year beginning before January 1, 1963, instead of before January 1, 1961.

[H.R. 12381] [2]

PUBLIC DEBT AND TAX RATE EXTENSION ACT OF 1960

[House of Representatives Report No. 1699, Eighty-sixth Congress, Second Session]

[June 25, 1960]

MR. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 12381.

The Committee on Ways and Means, to whom was referred the bill (H.R. 12381) to increase for a 1-year period the public debt limit set forth in section 21 of the Second Liberty Bond Act and to extend for 1 year the existing corporate normal-tax rate and certain excise-tax rates, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

H.R. 12381 contains two titles. The first title provides for a temporary increase in the statutory debt limit and the second title continues for 1 year certain existing tax rates.

The bill decreases the temporary debt limitation from $10 billion to $8 billion. The present permanent statutory debt limit is $285 billion. For the period from July 1, 1959, to June 30, 1960, there has been a further temporary increase of $10 billion, raising the maximum statutory debt limitation for this period to $295 billion. Title I of this bill provides an $8 billion temporary increase in the statutory debt limitation for the fiscal year 1961. Thus, under this bill the combined permanent and temporary debt limitation for the period from July 1, 1960, to June 30, 1961, will be $293 billion.

The existing tax rates which title II of this continues for 1 year, or until July 1, 1961, are the present 52-percent corporate income tax rate (which would otherwise revert to 47 percent) and the present rates of excise tax on distilled spirits, beer, wine, cigarettes, passenger cars, automobile parts

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[2] Public Law 86–564, page 681, this Bulletin.

and accessories, general telephone service, and transportation of persons. The latter two taxes were added to the list of taxes subject to automatic reductions by the Tax Rate Extension Act of 1959. The House conferees in agreeing to such an inclusion made it clear that this merely gave assurance that the rates of these taxes would be reviewed in the same manner as the other taxes subject to the automatic reductions. This did not necessarily mean a reduction in these tax rates in 1960.

If these tax rates were not continued, it is estimated that there would be a revenue loss of about $4 billion in a full year of operation and a loss of revenue in the fiscal year 1961 of about $2.6 billion.

This bill is recommended by the Treasury Department.

* * * * * * *

III. TITLE II—EXTENSION OF EXISTING TAX RATES

A. EXPLANATION OF RATES EXTENDED

Title II of this bill provides for a 1-year extension of the present corporate income tax rates and the existing rates of certain excise taxes. The rates of these taxes otherwise are scheduled for reduction on July 1, 1960. The present 52-percent corporate income tax rate, without the 1-year extension provided by this bill, would revert to 47 percent as of July 1, 1960, through a reduction of the normal tax rate from 30 percent to 25 percent.

The excise tax rates, which without this bill would also be decreased as of July 1, 1960, are those on—

(1) distilled spirits, which would be reduced from $10.50 to $9 per proof gallon;

(2) beer, which would be reduced from $9 to $8 per barrel;

(3) wines, which are subject to various tax rates which would be reduced by appropriately 11 percent;

(4) cigarettes, which would be reduced from 8 cents to 7 cents a pack;

(5) passengar cars, which would be reduced from 10 percent to 7 percent of the manufacturer's price;

(6) auto parts and accessories, which would be reduced from 8 percent to 5 percent of the manufacturer's price;

(7) general telephone service, which would be reduced from 10 percent of the amount paid to zero; and

(8) transportation of persons, which would be reduced from 10 percent to 5 percent of the amount paid.

The tax rate reductions which are postponed for another year by this bill relating to alcoholic beverages, tobacco, passenger cars, and auto parts and accessories are rate increases which were initially provided in 1951 at the time of the Korean war. The rates of tax on general telephone service (or local telephone service as it formerly was called) and transportation of persons, which are also extended by this bill, have been at, or above, the present 10 percent levels since the enactment of the Revenue Act of 1942. Actually for the period from 1943 to 1954 the rates of these taxes were 15 percent. Thus, they do not represent increased tax rates imposed at the time of the Korean war and in fact they have already enjoyed some measures of relief from the World War II levels. Provision was first made for the elimination of the general telephone tax and the reduction of the transportation of persons tax to 5 percent in the Tax Rate Extension Act of 1959 [P.L. 86–75, C.B. 1959–2, 679]. In accepting these amendments to the Tax Rate Extension Act of 1959 last year the House conferees made it clear that they were accepting these provisions so that the rates of these taxes would receive the same review as the Korean war excise tax rates. No assurance was given that the rates of these taxes would be reduced in 1960.

B. RECOMMENDATIONS OF THE ADMINISTRATION

This bill is in accord with the recommendatoins of the President in his budget message this last January when he stated:

> In order to maintain Federal revenues, it is necessary that the present tax rates on corporation profits and certain excises be extended for another year beyond their scheduled expiration date of June 30, 1960. The scheduled reductions in the excise tax rates on transportation of persons and the scheduled repeal of the tax on local telephone service, which were enacted in the last session of the Congress, should be similarly postponed.

The Secretary of the Treasury in his appearance before your committee stated:

> The financial position of the Government does not at this time permit a general reduction in individual income taxes, and we do not believe a reduction in corporate tax rates is justified at a time when a reduction for individuals cannot properly be made. Similarly, we do not believe that portions of a prospective modest surplus should be utilized for special relief for some excise taxes when we are not in a position to give consideration to improvements in the whole tax structure.
>
> If this Nation is to maintain reasonable discipline, debt repayment should be established as a normal practice in good times, and adequate surpluses should be in prospect before we can prudently undertake balanced adjustments in our tax structure.

The Director of the Bureau of the Budget in his appearance before your committee stated:

> In prosperous periods like the present, sound fiscal policy dictates a budgetary surplus with some reduction in the public debt, in order to help avoid inflation, and thus to help maintain the confidence of our allies and the rest of the free world in the stability of our currency and the strength of our finances.
>
> I accordingly urge the enactment of the extensions now under consideration.

C. REVENUE EFFECT OF TAX RATE EXTENSIONS

Table 3 shows the revenue effect of the tax rates extended by this bill. This is shown both for a full year of operation and for the fiscal year 1961. The full year effect of the bill will be to maintain receipts of about $4 billion which

TABLE 3.—*Corporation and excise taxes scheduled to be reduced July 1, 1960*

	Unit of tax	Present law rate	Rate to become effective July 1, 1960	Revenue loss (millions)	
				Full year	Fiscal 1961 [1]
Corporations	Normal tax net income.	30 percent	25 percent	$2,375	$1,075
Excises:					
Liquor taxes:					
Distilled spirits	Per proof gallon	$10.50	$9	158	258
Beer	Per barrel	$9	$8	88	96
Wine:					
Still wine:					
Containing less than 14 percent alcohol.	Per wine gallon	17 cents	15 cents	10	14
Containing 14 to 21 percent alcohol.	do	67 cents	60 cents		
Containing 21 to 24 percent alcohol.	do	$2.25	$2		
Containing more than 24 percent alcohol.	do	$10.50	$9		
Sparkling wines, liqueurs, etc.:					
Champagne or sparkling wine.	do	$3.40	$3		
Liqueurs, cordials, etc.	do	$1.92	$1.60		
Artificially carbonated wine.	do	$2.40	$2		
Tobacco taxes: Cigarettes	Per thousand	$4	$3.50	231	251
Manufacturers excise taxes:					
Passenger cars	Manufacturers' sale price.	10 percent	7 percent	420	399
Auto parts and accessories	do	8 percent	5 percent	71	62
Miscellaneous taxes:					
General telephone	Amount charged	10 percent	0	450	338
Transportation of persons	Amount paid	10 percent	5 percent	145	109
Total excises				1,573	1,527
Grand total				3,948	2,602

[1] Includes floor stock refunds.

Source: Staff of the Joint Committee on Internal Revenue Taxation, May 23, 1960.

would otherwise be lost. In the fiscal year 1961, the receipts maintained by the rate extensions will amount to slightly more than $2.6 billion (taking into account the effect floor stock refunds otherwise would have). The difference between the full year effect and the effect in the fiscal year 1961 is primarily attributable to the postponement of the corporate rate reduction which is not fully reflected in receipts in the fiscal year 1961.

On a full year basis nearly $2.4 billion out of the total of about $4 billion of revenue loss prevented by this bill represents corporate tax collections. Of the remainder, $256 million is accounted for by taxes on alcoholic beverages, $231 million by taxes on cigarettes, $491 million by automobile taxes, $450 million by telephone taxes, and $145 million by transportation-of-persons taxes.

The Budget Director in his appearance before your committee stated that the budgetary surplus forecast for the fiscal year 1961 by the President in his budget message this last January was $4.2 billion. He indicated that this surplus was predicated not only on a favorable economic level and high levels of personal income and corporate profits, but also the acceptance by Congress of the President's proposal for the extension of these tax rates, as well as favorable action on his expenditure proposals. With respect to the economic levels assumed in the President's budget, the Director stated that while he does not believe a revision of the revenue estimates of $84 billion for the fiscal year 1961 is presently required, new developments can occur to change these estimates. He also pointed out that the $4.2 billion surplus was predicated upon the President's proposals for other revenue increases amounting to approximately $700 million, as well as maintaining the expenditure level provided in the budget. The failure to extend the tax rates would reduce this $4.2 billion estimated surplus to $1.6 billion as well as provide a further reduction in the fiscal year 1962.

D. REASONS FOR TAX-RATE EXTENSIONS

Your committee finds it necessary to recommend that these corporate and excise tax rates be continued at the present time without change because it does not believe that under the present economic conditions the anticipated surplus for the fiscal year 1961 should be reduced. Under present economic conditions it is believed that the modest surplus which may be obtained in large part as a result of the continuance of these rates should be applied in a reduction of the public debt, especially in view of the fact that not to do so would necessitate further increases in the statutory debt limit.

Moreover, your committee believes that there is no justification for selecting corporate rates or the particular excise taxes involved in this bill for tax reduction before consideration can be given to individual income tax reductions.

Title II of the bill, in addition to postponing the excise tax rates previously referred to, also makes a number of technical changes, including the postponement for 1 more year of the floor stock refunds or credits presently effective with respect to stocks of various tax-paid products on hand on July 1, 1960. These floor stock refunds are available in the case of distilled spirits, wines and beer, cigarettes, and passenger cars.

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[H.R. 12381] [3]

PUBLIC DEBT AND TAX RATE EXTENSION ACT OF 1960

[Senate Report No. 1602, Eighty-Sixth Congress, Second Session, Calendar No. 1664]

[June 6, 1960]

MR. BYRD of Virginia, from the Committee on Finance, submitted the following report to accompany H.R. 12381.

The Committee on Finance, to whom was referred the bill (H.R. 12381) to increase for a 1-year period the public debt limit set forth in section 21 of the Second Liberty Bond Act and to extend for 1 year the existing corporate normal-tax rate and certain excise-tax rates, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY OF BILL

H.R. 12381 contains two titles. The first title provides for a temporary increase in the statutory debt limit. Your committee has accepted the House

[3] Public Law 86–564, page 681, this Bulletin.

version of this title without change. The second title of the House bill provided for the continuation for 1 year of certain existing tax rates. Your committee's version of title II also continues most of these rates for 1 year but provides for the elimination of the excise tax on the transportation of persons and the excise tax on general (formerly local) telephone service and domestic telegraph service.

The bill decreases the temporary debt limitation from $10 billion to $8 billion. The present permanent statutory debt limit is $285 billion. For the period from July 1, 1959, to June 30, 1960, there has been a further temporary increase of $10 billion, raising the maximum statutory debt limitation for this period to $295 billion. Title I of this bill provides an $8 billion temporary increase in the statutory debt limitation for the fiscal year 1961. Thus, under this bill the combined permanent and temporary debt limitation for the period from July 1, 1960, to June 30, 1961, will be $293 billion.

The existing tax rates which under both the House and your committee's versions of title II of this bill are continued for 1 year, or until July 1, 1961, are the present 52-percent corporation income tax rate (which would otherwise revert to 47 percent) and the present rates of excise tax on distilled spirits, beer, wine, cigarettes, passenger cars and automobile parts and accessories.

Under title II of the House bill the present 10-percent tax on general telephone service also is continued for 1 year. Under your committee's bill the elimination of this tax which is scheduled under present law for reduction on July 1, 1960 (generally for amounts paid on or after that date), is permitted to go into effect. However, under your committee's amendments the present 10-percent tax will be retained on amounts paid for the leasing of certain telephone or radiotelephone lines or channels which extend outside of a local exchange area. In addition, your committee's amendments repeal the present 10-percent tax on domestic telegraph service effective as of July 1, 1960. Your committee's amendments also repeal the present tax on the transportation of persons effective for amounts paid on or after July 1, 1960. Presently this tax is 10 percent but is scheduled under present law to go down to 5 percent for amounts paid on or after July 1, 1960. The House bill would have extended the 10-percent rate for 1 more year.

If all of the tax rates were continued as provided by the House bill it is estimated that there would be a revenue gain of about $4 billion in a full year of operation and a gain in the fiscal year 1961 of about $2.6 billion. The action taken by your committee will reduce this gain by about $750 million in a full year of operation or by $565 million in the fiscal year 1961. Thus, the action taken by your committee will result in a revenue gain over present law of about $3.2 billion for a full year of operation or about $2.0 billion in the fiscal year 1961.

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III. TITLE II—EXTENSION OF EXISTING TAX RATES

A. EXPLANATION OF RATES EXTENDED

Title II of the House bill provided for a 1-year extension of the corporate income tax rates and the existing rates of certain excise taxes, including the taxes on general telephone service and transportation of persons. The rates of these taxes otherwise are scheduled for reduction on July 1, 1960.

Title II of your committee's bill also provides for a 1-year extension of the present corporate income tax rates and the existing rates of certain excise taxes. However, it does not extend the existing rates of tax on general telephone service or on transportation of persons. Instead, your committee's amendments repeal these two taxes as of July 1, 1960, and also provide for the repeal of the tax on domestic telegraph service as of the same date.

The present 52-percent corporate income tax rate, without the 1-year extension provided by both the House and your committee's versions of this bill, would revert to 47 percent as of July 1, 1960, through a reduction of the normal tax rate from 30 percent to 25 percent.

The excise tax rates which both the House and your committee's bill extend for another year or until July 1, 1970, are those on—

(1) distilled spirits, which otherwise would be reduced from $10.50 to $9 per proof gallon;

(2) beer, which otherwise would be reduced from $9 to $8 per barrel;

(3) wines, subject to various tax rates which otherwise would be reduced by approximately 11 percent;

(4) cigarettes, which otherwise would be reduced from 8 cents to 7 cents a pack;

(5) passenger cars, which otherwise would be reduced from 10 percent to 7 percent of the manufacturer's price; and

(6) auto parts and accessories, which otherwise would be reduced from 8 percent to 5 percent, of the manufacturer's price.

The taxes which your committee's bill treats differently from the House bill are those on general telephone service (or local telephone service as it formerly was called), domestic telegraph service and transportation of persons, all of which are presently imposed at 10-percent rates. The tax on general telephone service and the tax on transportation of persons, as the result of action initiated by your committee in the Tax Rate Extension Act of 1959 [P.L. 86–75, C.B. 1959–2, 679], presently are scheduled for repeal in the case of the general telephone service tax as of July 1, 1960, and for reduction to 5 percent in the case of the tax on the transportation of persons as of the same date. Your committee's amendments in general would repeal both of these taxes effective for payments made on or after July 1, 1960. However, the 10-percent rate of tax will continue to apply to leased wire service, which is presently included in general telephone service. This service is defined as the leasing of any telephone or radiotelephone line or channel which connects stations between which there otherwise would be a toll telephone charge. In the case of telegraph service, international telegraph service will remain subject to the present 10-percent tax. Such service means a telegraph cable or radio dispatch or message for which the charge is paid within the United States and which originates in the United States and terminates outside of the United States or vice versa.

Table 4 summarizes in tabular form the various rates of the taxes affected by the House and your committee's bill for the coming year showing the present

TABLE 4.—*Tax rates affected by the bill*

	Unit of tax	Present rates	Rates to become effective July 1, 1960 under—		
			Present law	House bill	Committee bill
Rates continued in House and committee bill:					
Corporations	Normal tax net income (percent).	30	25	30	30
Excises:					
Liquor taxes:					
Distilled spirits	Per proof gallon	$10.50	$9.00	$10.50	$10.50
Beer	Per barrel	$9.00	$8.00	$9.00	$9.00
Wine:					
Still wine:					
Containing less than 14 percent alcohol.	Per wine gallon (cents)	17	15	17	17
Containing 14 to 21 percent alcohol.	do	67	60	67	67
Containing 21 to 24 percent alcohol.	Per wine gallon	$2.25	$2.00	$2.25	$2.25
Containing more than 24 percent alcohol.	do	$10.50	$9.00	$10.50	$10.50
Sparkling wines, liqueurs, etc.:					
Champagne or sparkling wine.	do	$3.40	$3.00	$3.40	$3.40
Liqueurs, cordials, etc.	do	$1.92	$1.60	$1.92	$1.92
Artificially carbonated wine.	do	$2.40	$2.00	$2.40	$2.40
Tobacco taxes: Cigarettes	Per thousand	$4.00	$3.50	$4.00	$4.00
Manufacturers excise taxes:					
Passenger cars	Manufacturers sale price (percent).	10	7	10	10
Auto parts and accessories	do	8	5	8	8
Rates repealed under committee bill: Miscellaneous taxes:					
General telephone	Amount charged (percent).	10	0	10	0
Domestic telegraph service	do	10	10	10	0
Transportation of persons	Amount paid (percent)	10	5	10	0

Source: Staff of the Joint Committee on Internal Revenue Taxation.

tax rates and the rates which would be in effect under existing law and the House and your committee's bill.

Title II of the bill, in addition to making the excise tax rate changes referred to above, also makes a number of technical changes, including the postponement for 1 more year of the floor stock refunds or credits presently effective with respect to stocks of various tax-paid products on hand on July 1, 1960. These floor stock refunds are available in the case of distilled spirits, wines and beer, cigarettes, and passenger cars.

B. REASONS FOR YOUR COMMITTEE'S ACTIONS

The continuation of the present corporate tax rate and the excise tax rates on alcoholic beverages, cigarettes, passenger cars and auto parts and accessories are essential in view of the 1961 budgetary requirements. Your committee deemed it essential, however, to make an exception to the continuation of existing rates in the case of the general telephone service, domestic telegraph service, and transportation of persons taxes for the reasons outlined below.

Your committee has approved of the repeal of the tax on general telephone service both because the burden of this tax bears most heavily on those least able to pay, and because a substantial portion of this tax is a business cost item which enters into the costs of other goods and services and therefore is a factor tending toward higher prices generally. The tax on domestic telegraph service is repealed in part on the grounds that this tax also is a substantial business cost item. Also, it should be recognized that these taxes (to the extent they are not reflected in the higher prices) result in reductions in profits subject to the individual or corporate income taxes. Thus, the loss in revenue resulting from the repeal of these taxes can be expected to be offset, to some extent, by increased income tax collections.

In the case of domestic telegraph service your committee also believes that it is desirable to eliminate the tax involved since this has been an industry of declining profits and declining employment where the burden of the tax bears heavily on the industry. Thus, despite the fact that incomes generally more than doubled in the period from 1945 to 1958, public telegraph message volume during this period fell from 193 million messages in 1945 to less than 112 million in 1958, a decrease of more than 40 percent. Corresponding with this decline in volume, employment in the telegraph industry dropped from 64,570 in 1945 to 35,400 in 1958.

In the case of the tax on transportation of persons also the industries involved have been faced with problems of maintaining their volume of business. This, of course, has been especially true in the case of the passenger traffic on the railroads. For example, the passenger operating revenues of the class 1 railways in the first 3 months of the calendar year 1960 amounted to $55 million, $51 million and $52 million respectively, while the operating revenues of these railways in the first 3 months of 1957 were $66 million, $58 million, and $58 million, respectively. To a lesser extent the airlines also have had problems in developing their passenger business. The tax on the transportation of persons also is a substantial business cost item. In addition, discriminatory problems are created as between transportation within and without the United States, since the latter transportation, for the most part, is not subject to tax.

C. REVENUE EFFECT OF HOUSE BILL AND YOUR COMMITTEE'S AMENDMENTS

Table 5 shows the revenue effect of the House bill and your committee's bill, both for a full year of operation and for the fiscal year 1961. The full year effect of the House bill would be to maintain receipts of almost $4 billion which would otherwise be lost. Your committee's bill, on the same basis maintains revenues of about $3.2 billion which would otherwise be lost. In the fiscal year 1961 the House bill would increase revenues over what they would be if present law were allowed to become effective by $2.6 billion while your committee's action would increase revenues over what they otherwise would be by about $2 billion (these figures take into account the effect of floor stock refunds). The differences between the full year effect and the effect in the fiscal year 1961 are primarily attributable to the postponement of the corporate rate reduction which under both versions of the bill is not fully reflected in receipts in the fiscal year 1961.

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TABLE 5.—*Revenue effect of the bill as passed by the House and as amended by your committee; gain (+) or loss (—) of House or your committee's bill over yield under present law (rates scheduled to be in effect on July 1, 1960)*

[Millions of dollars]

	Full year effect		Fiscal 1961 effect	
	House bill	Your committee bill	House bill	Your committee bill
A. Rates extended under both bills—revenue gain:				
52-percent corporate tax rate	+2,375	+2,375	+1,075	+1,075
Excise tax rates:				
Distilled spirits	+158	+158	[1] +258	[1] +258
Beer	+88	+88	[1] +96	[1] +96
Wines	+10	+10	[1] +14	[1] +14
Cigarettes	+231	+231	[1] +251	[1] +251
Passenger cars	+420	+420	[1] +399	[1] +399
Auto parts and accessories	+71	+71	+62	+62
Subtotal, excises	+978	+978	+1,080	[1] +1,080
Total for rates continued under both bills	+3,353	+3,353	+2,155	[1] +2,155
B. Taxes repealed under your committee bill:				
Transportation of persons	+145	−145	+109	−109
General telephone	+450	+5	+338	+4
Domestic telegraph service	0	−17	0	−13
Total	+595	−157	+447	−118
C. Net revenue gain	+3,948	+3,196	+2,602	+2,037

[1] Includes effect of postponing floor stock refunds.

Source: Joint Committee on Internal Revenue Taxation.

On a full year basis both versions of the bill result in an increase of nearly $2.4 billion in corporate income tax collections. Both versions of the bill also result in an increase in revenues of almost $1 billion in the case of the so-called Korean war excise tax rates; namely, those increased at that time on distilled spirits, beer, wine, cigarettes, passenger cars and auto parts and accessories.

The difference between the House bill and your committee's action is reflected in the effect on the transportation and communication taxes. The House bill in the case of the tax on the transportation of persons instead of permitting the rate to decline from 10 percent to 5 percent maintains the present 10-percent rate while your committee's action repeals this tax altogether. This on a full year's basis accounts for a net decrease in revenues otherwise available of $290 million. In the case of the general telephone service tax, the House bill continues the rate which present law would repeal, while your committee's bill, except for the minor effect on leased wires, repeals this tax. This accounts for a decrease in revenues otherwise available of $445 million on a full year's basis. The remainder of the difference can be accounted for by the repeal by your committee of the domestic tax on telegraph service which results in a revenue loss of $17 million.

The President in his budget message this last January forecast a budgetary surplus for the fiscal year 1961 of $4.2 billion. This was predicated upon the acceptance by Congress of the President's proposal for the extension of the tax rates involved in this bill. Therefore, your committee's action can be expected to have the effect in the fiscal year 1961 of reducing this estimated surplus by about $565 million, or reduce the estimated surplus of $4.2 billion to a figure of slightly over $3.6 billion.

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[H.R. 12381][4]

PUBLIC DEBT AND TAX RATE EXTENSION ACT OF 1960

[Conference Report No. 2005, Eighty-Sixth Congress, Second Session]

[June 25, 1960]

MR. MILLS, from the committee of conference, submitted the following conference report to accompany H.R. 12381.

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12381) to increase for one-year period the public debt limit set forth in section 21 of the Second Liberty Bond Act and to extend for one year the existing corporate normal-tax rate and certain excise-tax rates, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its amendment numbered 2.

That the House recede from its disagreement to the amendment of the Senate numbered 1 and agree to the same.

Amendment numbered 3:

That the House recede from its disagreement to the amendment of the Senate numbered 3, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 301. INVESTIGATION OF, AND REPORTS ON, TREATMENT OF ENTERTAINMENT AND CERTAIN OTHER EXPENSES.

(a) INVESTIGATION AND REPORT BY JOINT COMMITTEE ON INTERNAL REVENUE TAXATION.—The Joint Committee on Internal Revenue Taxation is hereby authorized and directed to make a full and complete investigation and study of the operation and effects of present law, regulations, and practices relating to the deduction, as ordinary and necessary business expenses, of expenses for entertainment, gifts, dues or initiation fees in social, athletic, or sporting clubs or organizations, and similar or related items. The Joint Committee shall report to the House of Representatives and to the Senate the results of its investigation and study as soon as practicable during the 87th Congress, together with its recommendations for any changes in the law and administrative practices which in its judgment are necessary or appropriate.

(b) REPORT BY SECRETARY OF THE TREASURY.—The Secretary of the Treasury is hereby authorized and directed to report as soon as practicable during the 87th Congress to the House of Representatives and to the Senate the results of the enforcement program of the Internal Revenue Service (announced in Technical Information Release 221, dated April 4, 1960) relating to the deductions, as ordinary and necessary business expenses, of expenses for entertainment, travel, yachts, hunting lodges, club dues, and similar or related items, together with such recommendations with respect thereto as he considers necessary or appropriate to avoid misuse of the business expense deduction.

(c) CONSULTATION OF STAFFS.—The staff of the Joint Committee on Internal Revenue Taxation, and the staff of the Secretary of the Treasury, shall consult and cooperate with each other in performing any duties assigned to carry out the purposes of this section.

And the Senate agree to the same.

Amendment numbered 4:

That the House recede from its disagreement to the amendment of the Senate numbered 4, and agree to the same with an amendment as follows:

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[4] Public Law 86–564, page 681, this Bulletin.

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 302. DEPLETION RATE FOR CERTAIN CLAYS; TREATMENT PROCESSES CONSIDERED AS MINING FOR COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS AND ORES.

(a) DEPLETION RATE FOR CERTAIN CLAYS.—Subsection (b) of section 613 of the Internal Revenue Code of 1954 (relating to percentage depletion rates) is amended as follows:

(1) Paragraph (3) is amended to read as follows:

"(3) 15 percent—

"(A) metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite; and

"(B) if paragraph (5)(B) does not apply, ball clay, bentonite, china clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties."

(2) Paragraph (5) is amended to read as follows:

"(5) 5 percent—

"(A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

"(B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots and kindred products; and

"(C) if from brine wells—bromine, calcium chloride, and magnesium chloride."

(3) Paragraph (6) is amended by striking "refractory and fire clay,".

(b) TREATMENT PROCESSES CONSIDERED AS MINING.—Subsection (c) of section 613 of the Internal Revenue Code of 1954 (relating to the definition of gross income from property) is amended as follows:

(1) By amending paragraph (2) to read as follows:

"(2) MINING.—The term 'mining' includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), 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 such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate 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."

(2) By striking out paragraph (4) and inserting in lieu thereof the following new paragraphs:

"(4) TREATMENT PROCESSES CONSIDERED AS MINING.—The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

"(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

"(B) in the case of sulfur recovered by the Frasch process—cleaning, pumping to vats, cooling, breaking, and loading for shipment;

"(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and ores or minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, sintering, and substantially equivalent processes to bring to shipping grade and form, and loading for shipment;

"(D) in the case of lead, zinc, copper, gold, silver, uranium, or fluorspar ores, potash, and ores or minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore or the mineral or minerals from other material from the mine or other natural deposit;

"(E) *the pulverization of talc, the burning of magnesite, the sintering and nodulizing of phosphate rock, and the furnacing of quicksilver ores;*

"(F) *in the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process;*

"(G) *in the case of clay to which paragraph (5)(B) of subsection (b) applies—crushing, grinding, and separating the mineral from waste, but not including any subsequent process; and*

"(H) *any other treatment process provided for by regulations prescribed by the Secretary or his delegate which, with respect to the particular ore or mineral, is not inconsistent with the preceding provisions of this paragraph.*

"(5) TREATMENT PROCESSES NOT CONSIDERED AS MINING.—*Unless such processes are otherwise provided for in paragraph (4) (or are necessary or incidental to processes so provided for), the following treatment processes shall not be considered as 'mining': electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping.*"

(c) EFFECTIVE DATE.—*The amendments made by subsections (a) and (b) shall be applicable only with respect to taxable years beginning after December 31, 1960.*

And the Senate agree to the same.

Amend the title so as to read: "An Act to increase for a one-year period the public debt limit set forth in section 21 of the Second Liberty Bond Act and to extend for one year the existing corporate normal-tax rate and certain excise-tax rates, and for other purposes."

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
THOMAS J. O'BRIEN,
N. M. MASON,
JOHN W. BYRNES,
HOWARD H. BAKER,
Managers on the Part of the House.
HARRY F. BYRD,
ROBT. S. KERR,
J. ALLEN FREAR, Jr.,
JOHN J. WILLIAMS,
FRANK CARLSON,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12381) to increase for 1-year period the public debt limit set forth in section 21 of the Second Liberty Bond Act and to extend for 1 year the existing corporate normal-tax rate and certain excise-tax rates, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendment No. 1: This is a technical amendment adding to the bill a new heading "Title III—Miscellaneous Provisions." The House recedes.

Amendment No. 2: Section 34 of the Internal Revenue Code of 1954 provides that there shall be allowed (subject to the limitations provided in the law) to an individual, as a credit against the income tax imposed by subtitle A of the code for the taxable year, an amount equal to 4 percent of the dividends received from domestic corporations which are included in gross income. Senate amendment No. 2 added a new section to the bill which provided, effective with respect to taxable years beginning after December 31, 1960, for the repeal of section 34 of the Internal Revenue Code of 1954. The Senate recedes.

Amendment No. 3: This amendment added a new section 302 to the bill relating to the disallowance, as trade or business expenses, of deductions of certain expenditures for entertainment, gifts, and club dues.

Subsection (a) of the new section 302 amended section 162 of the 1954 Code (relating to trade or business expenses) to provide that no deduction was to be allowed under section 162(a) of the code for any expenses paid or incurred for—

(1) entertainment (unless entertainment is the trade or business of the taxpayer and the expenses are paid or incurred to further such trade or business), except that the expenses paid or incurred for food or beverages for the primary purpose of providing an opportunity to advance the trade or business of the taxpayer may be deducted, if such expenses would have been deductible prior to the enactment of this new provision;

(2) gifts, except that any gift by the taxpayer in the course of his trade or business to any person may be deducted in an amount not exceeding $10 per person per year, if such expenses would have been deductible prior to the enactment of this new provision; or

(3) dues or initiation fees in social, athletic, or sporting clubs or organizations.

Subsection (b) of the new section 302 provided that subsection (2) thereof was to apply to taxable years beginning after the date of the enactment of H.R. 12381.

Under the conference agreement the House recedes on amendment No. 3 with an amendment which is a substitute for the Senate amendment.

Subsection (a) of new section 301 added to the bill under the conference agreement provides for an investigation and report by the Joint Committee on Internal Revenue Taxation with respect to the treatment of entertainment and certain other expenses. Under this provision, the Joint Committee is to make a full and complete investigation and study of the operation and effects of present law, regulations, and practices relating to the deduction (as ordinary and necessary business expenses) of expenses for entertainment, gifts, dues or initiation fees in social, athletic, or sporting clubs or organizations, and similar or related items. The Joint Committee is to report to the House of Representatives and to the Senate the results of its investigation and study as soon as practicable during the 87th Congress, together with the recommendations of the Joint Committee for any changes in the law and administrative practices which in its judgment are necessary or appropriate.

Subsection (b) of the new section 301 provides for a report by the Secretary of the Treasury of the results of the recently adopted enforcement program of the Internal Revenue Service relating to the deduction (as ordinary and necessary business expenses) of expenses for entertainment, travel, yachts, hunting lodges, club dues, and similar or related items, together wtih such recommendations with respect thereto as he considers necessary or appropriate to avoid misuse of the business expense deduction. The report is to be made to the House of Representatives and to the Senate as soon as practicable during the 87th Congress.

On April 4, 1960, the Internal Revenue Service issued Technical Information Release No. 221 in order to secure additional information from corporations, partnerships, and proprietorships at the time when they file their business income returns for taxable years beginning after December 31, 1959.

The additional information required relates to deductions claimed for—

(1) allowances (including expense account allowances) paid to or on behalf of certain officers, employees, partners, and proprietors;

(2) the use of hunting lodges, working ranches and farms, fishing camps, resort properties, pleasure boats and yachts, and similar facilities;

(3) the use of hotel rooms and suites, apartments, and other dwellings;

(4) the attendance of members of families of officers and employees at conventions or business meetings; and

(5) vacations for officers or employees, or members of their families.

Technical Information Release No. 221 also states that the field offices of the Internal Revenue Service have been instructed to place increased emphasis on the examination of returns involving entertainment, travel, and expenses of a similar nature.

Subsection (c) of the new section 301 provides that the staff of the Joint Committee on Internal Revenue Taxation, and the staff of the Secretary of the Treasury, are to consult and cooperate with each other in performing any duties assigned to carry out the purposes of the new section 301.

Amendment No. 4: This amendment added a new section to the bill relating to the depletion rate for certain clays, and to the treatment processes considered as mining for computing percentage depletion in the case of minerals and ores.

SENATE AMENDMENT

Depletion rates for certain clays

Under paragraph (3) of section 613(b) of the Internal Revenue Code of 1954 the percentage depletion rate for ball clay, bentonite, china clay, and sagger clay is 15 percent, and under paragraph (6) of such section (relating to rate for all minerals not provided for in pars. (1) to (5), inclusive) the rate for refractory and fire clay is 15 percent unless it is used or sold for use for specified purposes (in which case the rate is 5 percent). Under the Senate amendment, the percentage depletion rate is 15 percent for ball clay, bentonite, china clay, sagger clay, and "clay used or sold for use for purposes dependent on its refractory properties." However, the 15 percent rate is not to apply to any clay described in the preceding sentence used, or sold for use in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe. flowerpots, and kindred products.

Under paragraph (5) of section 613(b) of the 1954 Code the percentage depletion rate is 5 percent for brick and tile clay. The Senate amendment strikes out the reference to brick and tile clay and provides that the 5 percent rate is to apply to all clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flowerpots, and kindred products.

Treatment processes considered as mining

Subject to the limitation (50 percent of taxable income from the property) in section 613(a) of the code, the allowance for percentage depletion in the case of ores or minerals is the percentage (specified in the statute) of the gross income from mining. Section 613(c)(2) of the 1954 Code provides that the term "mining" includes 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 (within specified limits) transportation to the plants or mills in which the ordinary treatment processes are applied.

Under the Senate amendment, the term "mining" is defined to mean the extraction of the ores or minerals from the ground, the treatment processes considered as mining described in new paragraphs (3) and (4) (which are substituted for existing par. (4) of sec. 613(c) of the 1954 Code), and (within the same limits as provided by existing law) transportation to the plants or mills in which the treatment processes (provided by the amendment) are applied. Under the amendment, the phrase "ordinary treatment processes normally applied by mine owners or operators to obtain the commercially marketable product or products" is deleted.

Specifically included treatment processes.—Under the Senate amendment the treatment processes considered as mining are limited to those specifically listed in the amendment. Subparagraphs (A), (B), and (D) (relating to coal, sulfur, talc, magnesite, quicksilver ores, and phosphate rock) of the new paragraph (3) listed the same processes which under existing law are listed as included in the processes which are ordinary treatment processes. Subparagraph (C) was in effect a substitute for existing subparagraphs (C) and (D) of section 613(c)(4) of the 1954 Code. Under existing subparagraph (C), the listed processes are included in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product. Under existing subparagraph (D), the listed processes are included in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product.

Specifically excluded treatment processes.—Under the new paragraph (4) as contained in the Senate amendment it is provided that the following treatment processes shall not be considered as mining:

(A) In the case of all minerals or ores—electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in the new paragraph (3) contained in the Senate amendment.

(B) Any treatment process which follows a process that is not considered as mining, notwithstanding any other provisions of section 613(c) of the 1954 Code as changed by the Senate amendment.

Effective date

Under the Senate amendment, the changes made by the amendment apply only with respect to taxable years beginning after December 31, 1960.

CONFERENCE SUBSTITUTE

Under the conference agreement the House recedes on Senate amendment No. 4 with an amendment which is a substitute for the Senate amendment.

Depletion rates for certain clays

Subsection (a) of new section 302 added to the bill under the conference agreement relates to the depletion rate for certain clays. Subsection (a) makes the same changes in section 613(b) of the 1954 Code as were proposed by the Senate amendment and explained above.

Treatment processes considered as mining

Under the conference agreement, subsection (b) of the new section 302 added to the bill relates to treatment processes considered as mining.

Paragraph (1) amends paragraph (2) of section 613(c) of the 1954 Code to provide that the term "mining" includes not merely the extraction of the ores or minerals from the ground but also the "treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto)" and (within the same limits as provided by existing law) transportation to the plants or mills in which the treatment processes are applied. As under the Senate amendments, the phrase "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable product or products" is deleted under the conference agreement.

Paragraph (2) of section 302(b) added to the bill under the conference agreement strikes out paragraph (4) of section 613(c) of the 1954 Code and inserts in lieu thereof new paragraphs (4) and (5).

Specifically included treatment processes.—The new paragraph (4) of section 613(c) describes (in subpars. (A) to (H), inclusive) treatment processes which are to be considered as mining, where applied by the mineowner or operator, to the extent such processes are applied to the ore or mineral in respect of which the mine owner or operator is entitled to a deduction for depletion under section 611 of the 1954 Code. As under existing law, a described process is to be treated as mining where performed by another person for the mineowner or operator if the mineowner or operator has not disposed of his depletable interest in the ore or mineral to which such process is applied. Under the language of this provision, a described process is not treated as mining where applied to a purchased ore or mineral.

The changes in the text of existing paragraph (4) which are made under the conference agreement are as follows (matter to be omitted is enclosed in black brackets and new matter is printed in italics):

(4) [ORDINARY] TREATMENT PROCESSES *CONSIDERED AS MINING*—[The term "ordinary treatment processes" includes the following:] *The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:*

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—*cleaning,* pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and *ores or* minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, [and sintering] *sintering, and substantially equivalent processes* to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, *uranium,* or fluorspar ores, potash, and ores *or minerals* which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including [as an ordinary treatment process] electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in

the separation or extraction of the product or products from the ore *or the mineral or minerals from other material from the mine or other natural deposit*; [, including the furnacing of quicksilver ores; and]

(E) the pulverization of talc, the burning of magnesite, [and] the sintering and nodulizing of phosphate [rock] *rock, and the furnacing of quicksilver ores;*

(F) in the case of calcium carbonates and other minerals when used in making cement—all processes (other than pre-heating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process;

(G) in the case of clay to which paragraph (5) (B) of subsection (b) applies—crushing, grinding, and separating the mineral from waste, but not including any subsequent process; and

(H) any other treatment process provided for by regulations prescribed by the Secretary or his delegate which, with respect to the particular ore or mineral, is not inconsistent with the preceding provisions of this paragraph.

The above material indicates that all of the specifically allowed processes under existing law will continue to be allowed under the bill. In addition, certain other processes are specifically provided for. These include cleaning in the case of sulfur recovered by the Frasch process, and in the case of the minerals and ores coming under subparagraph (C) substantially equivalent processes to those named therein. Under the conference agreement, the treatment processes allowable under existing law with respect to coal and sulfur (recovered by the Frasch process) are to continue to be allowable. Under subparagraph (C), "sintering" is to be allowed to the same extent as under existing law. Under the amendment uranium is specifically named in subparagraph (D); and the furnacing of quicksilver ores is shifted to subparagraph (E) which contains the specialized processing allowed by present law. In addition, subparagraphs (C) and (D) have been modified so that each relates to minerals or ores otherwise qualifying under such subparagraph.

For calcium carbonates and other minerals when used in making cement, a new subparagraph (F) has been added providing for the allowance of all processing up to the point of the introduction of the kiln feed into the kiln (except for preheating of the kiln feed), but not including any subsequent process. In the case of clay used or sold for use in the manufacture of building and paving brick, drainage and roofing tile, sewer pipe, flowerpots and kindred products, a new list of allowable processes is provided for in the new subparagraph (G). The allowable processes in the case of clay so used or sold for use include crushing, grinding, and separating the mineral from waste, but not any subsequent process. In addition, new subparagraph (H) includes as an allowable process any other treatment process provided for by regulations prescribed by the Secretary of the Treasury or his delegate which, with respect to the particular ore or mineral, is not inconsistent with the preceding provisions of the new paragraph (4).

Specifically excluded treatment processes.—The new paragraph (5) added to section 613(c) of the 1954 Code under the conference agreement provides that unless such processes are otherwise provided for in paragraph (4) (or are necessary or incidental to processes so provided for), the following treatment processes shall not be considered as "mining": electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping.

Effective date

Subsection (c) of the new section 302 provides that the amendments made by subsections (a) and (b) of the new section 302 are to apply only with respect to taxable years beginning after December 31, 1960.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
THOMAS J. O'BRIEN,
N. M. MASON,
JOHN W. BYRNES,
HOWARD H. BAKER,
Managers on the Part of the House.

[H.R. 4251] [5]

LIMITATION ON DEDUCTION OF EXPLORATION EXPENDITURES

[Senate Report No. 1137, Eighty-sixth Congress, Second Session, Calendar No. 1178]

[February 24 (legislative day, February 15), 1960]

MR. BYRD of Virginia, from the Committee on Finance, submitted the following report to accompany H.R. 4251.

The Committee on Finance, to whom was referred the bill (H.R. 4251) to amend the Internal Revenue Code of 1954 with respect to limitation on the deduction of exploration expenditures, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

Under present law an annual exploration expediture deduction of up to $100,000 is allowed for no more than 4 years. This bill removes the 4-year limitation and substitutes an overall limitation of $400,000. However, the limitation of $100,000 per year remains.

Exploration expenditure deductions may be taken (currently or deferred and taken when the product is sold) for expenditures made in exploring for ore or mineral deposits (but not for oil or gas) prior to the development stage of the mineral deposit.

This change is to be effective for taxable years beginning after the date of enactment of this act.

II. GENERAL STATEMENT

Under present law a deduction may be taken for exploration expenditures made to determine the presence, location, quantity, or quality of any deposit of ore or other mineral. (This is not available in the case of oil and gas wells for which a separate expediture deduction is allowed in the case of intangible drilling and development costs.) This deduction is only for those expenditures occurring before the development stage of the mine or the deposit and in any case does not apply to expenditures for depreciable property. This exploration expenditure deduction is a substitute for adding these expenses to the basis of the mining property (if cost depletion is used, where these expenditures are capitalized this addition to basis is reflected in the depletion allowance).

Under present law the maximum exploration expenditure deduction which may be taken for any year is $100,000. This may be taken in the year the expenditures are paid or incurred, or, if the taxpayer so elects, may be deferred and deducted ratably as the units of ore or minerals are sold. This exploration expenditure deduction is available for 4 taxable years (whether or not consecutive) with respect to all property held by a taxpayer. In determining whether such expenditures have been made in prior years, deductions made by certain prior holders of mineral property are taken into account. The cases where a transfer is covered in general are cases either where substantially all of the property held by a transferee was transferred in a tax-free exchange or where the transferee has a substantial interest in the transferor.

This exploration expenditure deduction was added by the Revenue Act of 1951 during the consideration of that act by the Senate Finance Committee. The Finance Committee report indicates that the limitation (then $75,000 but subsequently raised to the present $100,000) was provided because of the desire to provide a "special incentive for increased exploration for mineral deposits * * *, especially in the case of taxpayers with limited financial resources."

In actual operation, however, this provision has tended to discriminate against the smallest producers. This results from the fact that although a taxpayer may claim deductions of up to $100,000 in any 1 year, he may not take such deductions for more than 4 years. Thus, a relatively large producer may obtain the full benefit of these deductions by claiming $100,000 in each of 4 years, namely, $400,000 in all. However, a smaller producer whose annual exploration

[5] Public Law 86-594, page 685, this Bulletin.

expenditures do not amount to as much as $100,000, will have deductions available to him under this section reduced below the $400,000 ceiling applicable to his larger competitor.

In view of these considerations, your committee has agreed with the House Committee on Ways and Means in rewriting the limitation applicable in the case of exploration expenditures to provide that the ceiling is to be $400,000. A taxpayer still will not be able to claim exploration expenditure deductions with respect to any year in excess of $100,000, but if this exploration expenditures on a yearly basis are less than $100,000, he will be able to claim exploration expenditure deductions over more than a 4-year period so long as the total deductions claimed by him are not in excess of $400,000.

Under this bill since the 4-year limitation is removed it no longer matters whether exploration expenditures have already been deducted in 4 prior years. Under the bill, taxpayers will determine what excess amounts they may still deduct (or defer) by adding all amounts deducted or deferred in taxable years beginning after December 31, 1950, when this provision first became applicable. The $400,000, reduced by this amount, represents the remaining exploration expenditure deductions which may be taken. In determining expenditures which will be taken into account in arriving at the $400,000 ceiling, there is to be taken into account amounts which are deferred at the election of the taxpayer under subsection (b) even though the property was sold before such deferred amount was actually deducted. In such a case, the deferred amount, although treated as a part of the basis of the property in determining gain from the sale, will reduce the exploration expenditure deductions which may subsequently be taken.

Other technical revisions have been made in the bill including the deletion of references to the partnership provisions. These in effect already were inapplicable since in the case of partnerships, exploration expenditure deductions are determined at the level of the partner rather than the partnership.

This bill is to apply to taxable years beginning after the date of enactment of the bill.

III. DEPARTMENTAL REPORT

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, January 12, 1960.

HON. HARRY F. BYRD,
Chairman, Committee on Finance, U.S. Senate,
New Senate Office Building, Washington, D.C.

MY DEAR MR. CHAIRMAN: This is in response to a request for the views of this Department on H.R. 4251, introduced by Mr. Baker and passed by the House of Representatives September 9, 1959, to amend the Internal Revenue Code of 1954 with respect to the limitation on the deduction of exploration expenses.

1. SIMILAR BILLS

We know of no similar bills introduced in the 86th Congress.

2. POSITION OF THE TREASURY

The Treasury is opposed to H.R. 4251.

The Bureau of the Budget has advised the Treasury Department that there is no objection to the presentation of this report.

3. EXPLANATION OF THE BILL

Section 615 of the code permits a taxpayer to deduct in the current year expenditures for mine exploration not in excess of $100,000, or he may elect to defer any part of these expenditures and deduct them ratably as the ores or minerals are sold. The deduction or election is limited to any 4 years. H.R. 4251 would eliminate the 4-year limitation on the deduction of exploration expenditures in mining. The overall limitation of $400,000 with a $100,000 limit per year would remain. The proposed legislation would be effective for taxable years beginning after the date of its enactment.

4. LEGISLATIVE HISTORY

Prior to 1951, exploration and development expenditures were not treated separately, but both were considered to be costs of development. All expenditures

on a mine in excess of net receipts while the mine was in the development stage were capitalized and were to be recoverable through depletion allowances.

The Revenue Act of 1951 distinguished between expenditures prior to the development stage of a mine and expenditures during the development stage. Exploration expenditures were defined as expenses "paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral prior to the beginning of the development stage." Under the 1951 act, taxpayers were permitted to elect to deduct exploration costs currently or to treat them as a deferred expense recoverable ratably over the period during which the resulting ores or minerals were sold. A deduction could be taken with respect to any portion of such costs and the balance treated as a deferral. However, the amount of exploration expenditures which the taxpayer could expense was limited to $75,000 in each of 4 taxable years. This permitted each taxpayer to expense a maximum of $300,000 of such costs. All outlays in excess of this amount were capitalized and recoverable through the depletion allowance.

The Internal Revenue Code of 1954 increased the annual limit on the amount of exploration expenditures which may be expensed from $75,000 to $100,000. Since the 4-year limitation remains, this permits the taxpayer to expense a maximum of $400,000 of exploration costs.

5. COMMENTS

At the time of the passage of the 1951 Revenue Act, the expensing of some mine exploration costs was urged in order to develop strategic mineral deposits for the Korean war effort. The report of the Committee on Finance explained that "It is generally recognized that the presently available mineral resources of this country are in may respects deficient in view of the ever-increasing demands of our economy, especially in an emergency period such as the present."

The provision which was enacted, however, was a limited measure which restricted the tax benefit to a specified number of years and a maximum amount. The provision was not intended as a means whereby each mine operator would be assured of the maximum deduction of $400,000 or of expensing exploration costs over an indefinite number of years. While the annual limit of the exploration deduction was liberalized in 1954 from $75,000 to $100,000, there was no suggestion for a change in the 4-year limitation.

It is notable that the Government has provided considerable assistance outside the tax laws for mineral exploration. For example, the Government provides procurement contracts for mining firms to encourage the mining of high-cost, strategic minerals. Amounts paid to mineral taxpayers by any Federal agency for the encouragement of exploration, development, or the mining of strategic minerals are exempt from income tax. The Office of Minerals Exploration provides direct financial aid to firms and individuals to facilitate the search for new ores. The Government's contribution and interest are repayable from royalties on production, but if no production results, there is no obligation to repay.

Under present tax law, mineral taxpayers may be entitled to expense all of their exploration costs for 4 years. In this sense, the miner who spends less than the $100,000 annual limit can expense proportionately more of his exploration costs than the large miner whose annual outlays exceed $100,000. The proposal, however, would provide further tax relief for those who have already enjoyed 4 years of expensing of exploration costs but who have not reached the maximum of $400,000. The revenue loss of this proposal would be substantial and the benefit would accrue largely to established miners who more or less routinely make outlays which may be classified as exploration expenditures. This would be contrary to the effect of Congress' original provision which chiefly confined relief to the new operator in the exploration stage and obtained the maximum benefits of new mine developments at minimum revenue costs.

The law continues to operate as Congress intended for new or prospective miners exploring for mineral deposits. Their exploration expenditures for any 4 years may be deferred until production is established. Any exploration costs which do not result in productive properties can be fully deducted as losses in the year in which the efforts are abandoned without regard to the 4-year limit. The operator who is successful in finding ore deposits which result in mining income is entitled to percentage depletion based on gross income from the property.

The deduction of exploration costs in addition to percentage depletion has frequently been criticized by some tax experts as commonly permitting a double deduction, once when the costs are incurred and again through percentage depletion. This point was made again before the House Ways and Means Committee in the recent tax hearings which included discussion of the tax treatment of the costs of exploration and development for mines, the intangible drilling costs for oil and gas wells, and the depletion allowances accorded the various mineral industries. The numerous issues raised indicate the desirability of a thorough and comprehensive review of the tax problems in these areas. A proposal for change calls for careful consideration of all its consequences. It should be appraised, not only in the context of our overall tax structure, but in the light of our national policies relating to the development of natural resources. The Treasury Department believes that special tax relief at this time for certain mining expenses would be inappropriate and inconsistent with the objective of a general review and integrated approach to any tax changes in this area.

For these reasons, the Department is opposed to the type of tax relief proposed by the bill.

Sincerely yours,

JAY W. GLASMANN,
Assistant to the Secretary.

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[H.R. 11602] [6]

HAWAII OMNIBUS BILL

[Senate Report No. 1681, Eighty-sixth Congress, Second Session, Calendar No. 1751]

[June 24, 1960]

MR. LONG of Hawaii, from the Committee on Interior and Insular Affairs, submitted the following report to accompany H.R. 11602.

The Committee on Interior and Insular Affairs, to whom was referred the bill (H.R. 11602) to amend certain laws of the United States in light of the admission of the State of Hawaii into the Union, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

Public hearings were held on the Senate companion bill, S. 3054, introduced by the chairman of the committee, Senator James E. Murray of Montana, for himself and 10 other Senators, all of whom are members of the committee, of both political parties.

Committee action in amending and reporting favorably H.R. 11602 was unanimous.

PURPOSE OF MEASURE

H.R. 11602 is the Hawaii omnibus bill, a measure necessary to make complete and perfect the admission of Hawaii into the Union on a free and equal footing with the other 49 States. It amends a number of acts of Congress, some merely technically, such as changing the phraseology in a statute from "Territory of Hawaii" to "State of Hawaii." Other Federal laws are amended substantively, primarily to equalize Federal activities in the new State, especially with respect to grants-in-aid programs.

A similar omnibus bill, gathering up the loose ends, so to speak, of transition from territorial status to statehood was enacted with respect to Alaska last year in the first session of this Congress (Public Law 86–70 [C.B. 1959–2, 678]).

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SECTION-BY-SECTION ANALYSIS

The following analysis of the bill, section by section, which was furnished by the Bureau of the Budget with its original draft of bill, has been modified only to the extent necessary to make it correspond to the provisions of H.R. 11602, as reported.

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[6] Public Law 86–624, page 686, this Bulletin.

SHORT TITLE

Section 1 provides that the act may be cited as the Hawaii Omnibus Act.

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INTERNAL REVENUE

Section 18 contains amendments to the Internal Revenue Code of 1954. All, except for that contained in subsection (a), are perfecting in nature, merely removing references to Hawaii which are now superfluous. Subsection (a) relates to the definition of the term "continental United States" for purposes of the transportation tax. As originally enacted, the term was defined to mean "the existing 48 States and the District of Columbia." Both Alaska and Hawaii were excluded under that definition, and consequently a partial exemption from the transportation tax applied to travel to and from those two areas. Alaska's exclusion from "the continental United States." notwithstanding statehood, was preserved by section 22(b) of the Alaska Omnibus Act, which amended the definition to mean "the District of Columbia and the States other than Alaska." Subsection (a) of this section would preserve the same status for Hawaii, and the arguments for maintaining the existing exemption, which were accepted by the Congress in connection with the Alaska Omnibus legislation, are equally compelling in the case of Hawaii.

The Treasury Department considers that it would be contrary to the intent of the Congress, as expressed in 1956, to remove this partial exemption. The exemption was inserted in the law in 1956 in recognition of the fact that Hawaii is far removed from the States and that transportation between the States and Hawaii involves travel over the high seas. When the exemption amendment was considered in the Senate in 1956, the possible effect of future statehood was discussed in a memorandum submitted by Senator Morse (Congressional Record, Mar. 29, 1956, p. 5212). His statement asserted that statehood should not change the exemption. On this basis, together with the legislative history of the Alaska Omnibus Act, the Treasury Department considers that the partial exemption continues, not withstanding Hawaii's admission to the Union. Enactment of subsection (a) would confirm legislatively this administrative position.

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[H.R. 7726] [7]

AMENDING THE BANKRUPTCY ACT IN REGARD TO THE TRANSMISSION OF DOCUMENTS TO THE SECRETARY OF THE TREASURY IN CHAPTER XIII PROCEEDINGS ("WAGE EARNERS' PLANS")

[Senate Report No. 1709, Eighty-Sixth Congress, Second Session, Calendar No. 1779]

[June 24, 1960]

MR. EASTLAND, from the Committee on the Judiciary, submitted the following report to accompany H.R. 7726.

The Committee on the Judiciary, to which was referred the bill (H.R. 7726) to amend section 678 of the Bankruptcy Act (11 U.S.C. 1078) relating to the transmission of petitions, notices, orders, and other papers to the Secretary of the Treasury in chapter XIII proceedings, having considered the same, reports favorably thereon, without amendment, and recommends that the bill do pass.

PURPOSE

The purpose of the bill is to reduce to a single notice the documents now required by statute to be sent to the Secretary of the Treasury in chapter XIII proceedings ("Wage Earners' Plans") under the Bankruptcy Act.

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[7] Public Law 86-631, page 687, this Bulletin.

STATEMENT

The bill was introduced upon the recommendation of the Administrative Office of the U.S. Courts. It is recommended by the Comptroller General of the United States. The Secretary of the Treasury has advised the Committee on the Judiciary of the House of Representatives that the Treasury Department has no objection to the bill.

Section 678 of the Bankruptcy Act (11 U.S.C. 1078) now provides that in chapter XIII proceedings ("Wage Earners' Plans") the court shall transmit to the Secretary of the Treasury copies of all petitions, notices, and orders in such cases. This provision is similar to the provisions in chapter X ("Corporate Reorganization"), chapter XI ("Arrangements"), and chapter XII ("Real Property Arrangements") under the Bankruptcy Act.

Wage earners' plans proceedings, however, unlike proceedings under corporate reorganization, arrangements, and real property arrangements, seldom involve substantial amounts of Federal taxes, and there has been found to be no practical need for the requirement for the transmission of such documents to the Secretary of the Treasury in wage earners' plans proceedings.

In straight bankruptcy proceedings, which frequently involve considerably larger amounts of taxes than is customarily the case with wage earners' plans proceedings, the applicable provisions of the statute require only the transmission to the Secretary of the Treasury of a notice of the first meeting of creditors and this has proved adequate to protect the interests of the Treasury Department.

The bill would amend section 678 of the Bankruptcy Act (11 U.S.C. 1078) to require only that a copy of the notice of the first meeting of creditors shall be sent to the District Director of Internal Revenue for the district in which the court is located, and that whenever the schedules of the debtor, or the list of creditors of the debtor, or any other papers filed in the case disclose a debt to the United States acting through any department, agency, or instrumentality thereof (except for any internal revenue obligation payable to the Secretary of the Treasury or his delegate), a notice of the first meeting shall be mailed as well to the head of such department, agency, or instrumentality.

The provision that the notice be sent to the district director rather than to the Secretary of the Treasury is for the reason that since the decentralization of the Internal Revenue Service tax matters in proceedings under the Bankruptcy Act are now handled by the district director. The provision of the Bankruptcy Act governing straight bankruptcy proceedings was amended in 1956 to require notices to be transmitted to the district director, rather than the Commissioner of Internal Revenue as previously had been the law. This bill provides similarly that the mailing of notices in chapter XIII proceedings ("Wage Earners' Plans") be to the district director rather than to the Secretary of the Treasury.

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[H.R. 8229] [8]

SUPPLEMENTAL UNEMPLOYMENT BENEFIT TRUSTS

[Senate Report No. 1518, Eighty-sixth Congress, Second Session, Calendar No. 1580]

[June 6, 1960]

MR. BYRD of Virginia, from the Committee on Finance, submitted the following report to accompany H.R. 8229.

The Committee on Finance, to whom was referred the bill (H.R. 8229) to amend the Internal Revenue Code of 1954 to provide an exemption from income tax for supplemental unemployment benefit trusts, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

SUMMARY OF BILL

This bill provides a new exempt category for income tax purposes in the case of trusts providing for the payment of supplemental unemployment compensation

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[8] Public Law 86-667, page 687, this Bulletin.

benefits. These may be the only benefit payments made by the trusts, or may be payments made together with subordinate sick or accident benefits (but not retirement or death benefits). This exempt category differs from the category, already under existing law, under which some of these trusts obtain exemption, in that the new provision does not require the SUB trusts to obtain at least 85 percent of their income from employers or employees (and not from investment income).

The so-called nondiscriminatory provisions of present law applying to qualified pension, profit-sharing, and stock-bonus plans are in general made applicable to the trusts qualifying under the new exemption category. In addition, the "prohibited transaction" provisions, and "unrelated business income" provisions (including the business lease provisions) of present law are made applicable to the new exemption category.

In general this new exemption is to apply to taxable years beginning after December 31, 1959.

GENERAL STATEMENT

Supplementary unemployment benefit plans arose out of attempts of various labor unions to negotiate guaranteed annual wage plans. The concern was primarily directed, however, toward the significant difference between the average weekly earnings received when employed and the unemployment benefits received when unemployed. As a result, supplementary unemployment benefit plans were developed, rathed than guaranteed annual wages.

The first of the main SUB plans were those negotiated with the automobile industry in 1955. The bulk of the plans developed since that time have followed the same general pattern. Under the automobile industry plans a worker is eligible for a SUB payment if he is laid off by the company, either in a reduction in force or in a temporary layoff. Usually these payments also depend upon the concurrent receipt (at least during part of the period) of State unemployment benefits. More recently, these benefits frequently are supplemented with lump-sum separation payments paid to an employee who is laid off for a period of at least 12 months; or is retired on or after reaching age 60 but is not eligible for a company retirement pension, or becomes permanently disabled but does not qualify for a company disability pension. Under these plans the employee has no vested interest in amounts the employer pays into the fund and if the employee leaves the company voluntarily or if he is discharged for misconduct he is not eligible for a benefit.

However, in the glass industry there has developed a second type of plan sometimes referred to as the "income security" type of SUB under which a worker may collect benefits not only because of a layoff but also because of illness. As a result of his vested interest in the fund, if he quits his job he may draw down any balance in his account. Similarly, if he dies, any balance in his account is paid to his estate or heirs.

Most of the plans are set up as separate trusts and are funded by payments by the employer to the trusts of something like 3 to 5 cents per hour per employee. Various rulings of the Internal Revenue Service have held that the contributions to these funds are deductible to the employers and distributions from these funds are taxable to the recipients as income (although not generally subject to withholding).

The income which the trusts earn on the contributions by employers and which is not necessary to meet current benefit payments, generally has qualified for income tax exemption under section 501(a) by the application of section 501(c)(9). This latter paragraph provides exemption for—

> Voluntary employee's beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if—
>
> (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and
>
> (B) 85 percent or more of the income consists of amounts collected from members and amounts contributed to the association by the employer of the members for the sole purpose of making such payments and meeting expenses.

Recently, however, these SUB trusts have had difficulty in qualifying for exemption under the above provision because their investment income has in some cases represented more than 15 percent of their income. As a result, these

trusts do not receive the required 85 percent of their funds from employees or employers.

Your committee believes it is appropriate to exempt from tax trusts providing unemployment compensation benefits, even though investment and other income exceeds the 15-percent limit allowed by section 501(c)(9) since the funds are nonprofit in character and provide worthwhile benefits, but at the same time are not in competition with profitmaking enterprises. A new paragraph (17), therefore, is added to section 501(c) which has the effect of providing such an exemption. In the case of trusts providing sickness and accident benefits, however, because of possible competition with private enterprise, it was thought that such benefits should be a subordinate part of the plan. Retirement and death benefits are not covered, however, since other provisions in the Internal Revenue Code are designed to specify the conditions which must be met to obtain income tax exemption in the case of trusts providing such benefits.

The bill limits exemption under the new paragraph to SUB plans which meet certain conditions as to nondiscrimination. For the most part these are the types of restrictions which presently must be met by qualified pension, profit-sharing, and stock bonus plans. In general these requirements are:

(1) It must not be possible to divert any of the corpus or income to any purpose other than the payment of supplemental unemployment compensation benefits or sick or accident benefits.

(2) The plan must provide for the payment of benefits under a classification which is not discriminatory in favor of officers or stockholders of the company or supervisory or highly paid employees.

(3) The benefits under the plan also must not discriminate in favor of employees who are officers, shareholders, or supervisory or highly paid employees (benefits based on a uniform relationship to total compensation are not considered discriminatory for this purpose).

Also, in determining whether a plan is nondiscriminatory, benefits provided under State or Federal plans may be taken into account in certain cases.

As in the case of the pension, profit-sharing, and stock bonus trusts the so-called prohibited transactions provisions are made applicable to the trusts exempt under the new paragraph, which in general means that these trusts cannot enter into transactions which tend to result in the diversion of the corpus or income of the trust to creators of the trust, those who have made substantial contributions to it, or members of their families, or to corporations controlled by such persons.

Similarly, the "unrelated business income" provisions of present law, including the "business lease" provisions in the case of indebtedness, are made applicable to this new exempt supplemental unemployment compensation benefit category.

The new exempt category and other related provisions generally are made applicable to taxable years beginning after December 31, 1959. The prohibited transaction provisions and business lease indebtedness provisions are also to be effective on and after December 31, 1959. Also the references to loans in the "prohibited transaction" provisions are to apply to those made, renewed, or continued after December 31, 1959.

COMMITTEE AMENDMENT

Your committee has amended the House-passed bill to make it plain that the new paragraph (17) which is added to section 501(c) is not to be the exclusive rule for determining exemption from income tax of organizations which provide supplemental unemployment benefits. Such organizations may continue to qualify for income tax exemption under paragraph (9) if they meet the requirements of that paragraph. Although the House bill itself was silent on the point, the committee report accompanying that bill indicates that the purpose of new paragraph (17) is to prescribe an alternative rule for exempting organizations which provide supplemental unemployment benefits. The committee amendment clarifies this intent.

Your committee also has amended the definition of "supplemental unemployment compensation benefits," which is contained in the new paragraph (17). The purpose of this amendment is to clarify the provisions of the House bill to make certain that the term "supplemental unemployment compensation benefits" includes payments made under a plan although an employee accepts temporary

employment during the period he is not on the employer's payroll. Thus, a laid-off employee could continue to receive supplemental unemployment benefits even though he obtains other part-time or temporary work during the layoff period.

As passed the House, the bill applied to taxable years after December 31, 1958. Because of the passage of time, your committee has amended the effective date of the bill and changed the dates on which the rules relating to prohibited transactions, the unrelated business income tax and business leases are made applicable. As amended, the bill applies to taxable years beginning after December 31, 1960, and the special rules apply with respect to transactions after that date.

TECHNICAL EXPLANATION

The first section of the bill would amend section 501(c) of the Internal Revenue Code of 1954 by adding a new paragraph (17) thereto. The new paragraph (17) sets forth rules under which certain trusts may qualify for exemption under section 501(a).

The new paragraph (17) would apply to any trust or trusts which form a part of a plan providing for the payment of supplemental unemployment compensation benefits, if the plan meets the requirements set forth in the new paragraph (17). A plan under the new paragraph (17) may provide only for the payment of supplemental unemployment compensation benefits, and subparagraph (D) of the new paragraph (17) defines supplemental unemployment compensation benefits. Such definition, as amended by the committee, provides that the term "supplemental unemployment compensation benefits" means (1) benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation was temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and (2) sick and accident benefits subordinate to such unemployment benefits. As a result of the requirement of subparagraph (A)(i) and the definition of subparagraph (D), a qualified plan cannot include any benefits which are not paid because of sickness, accident, or unemployment. Thus, for example, if a plan provides for the payment of a retirement benefit, the plan cannot qualify under the new paragraph (17). Under the definition of supplemental unemployment compensation benefits, a qualified plan may provide for the payment of benefits in installments or in a lump sum when an employee is involuntarily unemployed for a short period or permanently, or for the payment of such benefits on account of unemployment resulting directly from a reduction in force or the discontinuance of a plant or operation or from causes similar to a reduction in force or the discontinuance of a plant or operation. However, a qualified plan cannot provide for the payment of benefits when the unemployment results from a voluntary decision by the employee or results from any cause not described in the preceding sentence.

Under the definition of supplemental unemployment compensation benefits, a qualified plan may provide for the payment of sick and accident benefits in addition to unemployment benefits. However, such sick and accident benefits must be subordinate to the unemployment benefits. Thus, if it is obvious from all the facts and circumstances that the real purpose of a plan is to provide accident and sick benefits rather than unemployment benefits, such plan will not qualify under the new paragraph (17). Since the new paragraph (17) provides for payments only to employees, a qualified plan cannot provide for the payment of a death benefit resulting from sickness or accident.

The first of the requirements set forth in the new paragraph (17) is that under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of sick, accident, or supplemental unemployment compensation benefits. Thus, if the plan provides for the payment of any other benefits, the trust cannot qualify under the new paragraph (17). However, the payment of any necessary or appropriate expenses in connection with the administration of a plan providing sick, accident, or supplemental unemployment compensation benefits is to provide such benefits and does not affect the qualification of the trust. Moreover, if such a plan terminates and there are any remaining assets in the trust after the satisfaction of all liabilities

under the plan, this requirement does not affect any arrangement which may be made for the distribution of such remaining assets.

The second requirement for qualification under the new paragraph (17) is that the benefits under the plan are payable to employees under a classification which is set forth in the plan and which is found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. Thus, the plan must set forth the conditions under which employees will be eligible to receive benefits under the plan, and such conditions for eligibility must not discriminate in favor of the proscribed groups.

The third requirement for qualification under the new paragraph (17) is that the benefits under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. However, it is provided that a plan shall not be considered discriminatory within the meaning of such requirement merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan. Accordingly, the benefits provided for highly paid employees may be greater than the benefits provided for lower paid employees if the benefits are determined by reference to their compensation, but in such a case, the plan will not qualify if the benefits paid to the higher paid employees bear a larger ratio to their compensation than the benefits paid to the lower paid employees bear to their compensation.

Subparagraph (B) of the new paragraph (17) provides that in determining whether a plan meets the nondiscrimination requirements, any benefits provided under any other plan shall not be taken into consideration, except in certain specified situations. Under these exceptions, a plan will not be considered discriminatory (1) merely because the benefits under the plan which are first determined in a nondiscriminatory manner are then reduced by any sick, accident, or unemployment compensation benefits received under State or Federal law (or are reduced by a portion of such benefits if determined in a nondiscriminatory manner), (2) merely because the plan provides only for employees who are not eligible to receive sick, accident, or unemployment compensation benefits under State or Federal law the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such laws if such employees were eligible for such benefits, or (3) merely because the plan provides only for employees who are not eligible under another plan (which meets the requirements of subpar. (A) of the new par. (17)) of sick, accident, or supplemental unemployment compensation benefits provided wholly by the employer the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such other plan if such employees were eligible under such other plan. However, in the last case, the plan is considered nondiscriminatory only if the employees eligible under both plans would make a classification which would be nondiscriminatory.

The rules of subparagraph (B) permit arrangements to combine Federal or State plans providing sick, accident, or unemployment compensation benefits with the benefits provided under a plan set up to qualify under the new paragraph (17), subject to certain restrictions. These restrictions allow reasonable flexibility in combining such plans. For example, a plan may qualify under the new paragraph (17) if it provides for the payment of an unemployment benefit determined as a percentage of the employee's compensation and reduced by any unemployment benefit which the employee receives under a State plan. Such a plan could provide for the reduction of the plan benefit by one-half of the State benefit. A plan may also qualify if it provides for the payment to an unemployed employee of an amount which when added to any State unemployment benefit equals a percentage of his compensation. Moreover, an employer may establish for employees who are not eligible to receive State unemployment benefits a qualified plan providing for such employees the same benefits which they would receive under a State plan. Such a plan could also qualify although it does not provide all of the benefits provided under the State plan. However, in determining whether a plan is discriminatory, the benefits provided under other plans will not be taken into consideration except as

specifically provided in subparagraph (B). Accordingly, if a plan provides for employees who are not eligible to receive benefits under a State plan benefits which are greater or of a different type than those of the State plan, the qualification of the plan must be determined without regard to the State-provided benefits. In such a case, if the plan covers only lower paid employees or any other group which is not discriminatory, the plan will, nevertheless, qualify, but if the plan covers only a discriminatory group (such as a group of highly paid employees), the plan will not qualify.

Subparagraph (C) of the new paragraph (17) provides that a plan shall be considered to meet the nondiscrimination requirements during the whole of any year of the plan if on 1 day in each quarter it satisfies such requirements.

Subparagraph (E) of the new paragraph (17) provides that exemption from income tax shall not be denied to any organization entitled to such exemption as an association described in paragraph (9) of this subsection merely because such organization provides for the payment of supplemental unemployment benefits as defined in subparagraph (D)(i). Organizations entitled to exemption under paragraph (9) could continue their exemption under that paragraph without regard to the new provision in paragraph (17).

Section 2 of the bill would amend section 503 of the Internal Revenue Code of 1954 to make the trusts described in the new section 501(c)(17) subject to the prohibited transaction rules of section 503. Section 503(b), which sets forth the organizations that are subject to section 503, is amended to include a trust described in section 501(c)(17), and section 503(a)(1) is revised to include as a prohibited transaction any prohibited transaction by such a trust occurring after December 31, 1959. Section 503(h) is also amended so that a trust described in section 501(c)(17) may purchase unsecured obligations of the employer or other person referred to in section 503(c), subject to the limitation of section 503(h).

Section 3 of the bill would amend section 511 of the Internal Revenue Code of 1954, relating to the tax on unrelated trade or business income of an exempt organization. A trust described in the new section 501(c)(17) is included among the organizations which are subject to such tax.

Section 4 of the bill would amend section 513 of the Internal Revenue Code of 1954, relating to the definition of unrelated trade or business, to make clear that any trade or business regularly carried on by a trust described in section 501(c)(17) is an unrelated trade or business.

Section 5 of the bill would amend section 514 of the Internal Revenue Code of 1954, relating to business leases of exempt organizations, by adding at the end of subsection (c) a new paragraph (8). This new paragraph provides that any indebtedness incurred by a trust described in section 501(c)(17) before January 1, 1960, in connection with real property which is leased before such date, shall not be considered a business lease indebtedness for purposes of section 514. A similar rule is applicable to indebtedness incurred by a corporation described in section 501(c)(2) all of the stock of which was acquired before January 1, 1960, by a trust described in section 501(c)(17) and to any other indebtedness incurred by such trust or such corporation on or after such date necessary to carry out the terms of such lease. The new paragraph also provides that if a trust described in section 501(c)(17) forming part of a sick, accident, or supplemental unemployment compensation benefit plan lends any money to another trust described in section 501(c)(17) forming part of the same plan, such loan shall not be treated as a business lease indebtedness of the borrowing trust, except to the extent that the loaning trust incurs any indebtedness in order to make such loan, incurred indebtedness before the making of such loan which would not have been incurred but for the making of such loan, or incurred indebtedness after the making of such loan which would not have been incurred but for the making of such loan and which was reasonably foreseeable at the time of making such loan.

The amendments made by sections 2, 3, 4, and 5 of the bill apply to trusts which qualify for exemption from income tax on the basis of the new section 501(c)(17) of the code. Thus, they will not apply in the case of a trust qualifying for such exemption on the basis of section 501(c)(9) of such code.

Section 6 of the bill would provide the effective date for the bill. The bill would be applicable to taxable years beginning after December 31, 1959, and the amendments made to section 503 would apply to loans made, renewed, or continued after December 31, 1959.

[H.R. 8229] [9]

EXEMPTION FROM INCOME TAX FOR SUPPLEMENTAL UNEMPLOYMENT BENEFIT TRUSTS

[Conference Report No. 2073, Eighty-sixth Congress, First Session]

[July 1, 1960]

MR. MILLS, from the committee of conference, submitted the following conference report to accompany H.R. 8229.

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 8229) to amend the Internal Revenue Code of 1954 to provide an exemption from income tax for supplemental unemployment benefit trusts, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its amendment numbered 10.

That the House recede from its disagreement to the amendments of the Senate numbered 1, 2, 3, 4, 5, 6, 7, 8, and 9, and agree to the same.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
N. M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.

HARRY F. BYRD,
ROBT. S. KERR,
J. ALLEN FREAR,
CLINTON P. ANDERSON,
JOHN J. WILLIAMS,
FRANK CARLSON,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R 8229) to amend the Internal Revenue Code of 1954 to provide an exemption from income tax for supplemental unemployment benefit trusts, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendment No. 1: Under the bill as passed by the House, the term "supplemental unemployment compensation benefits" includes benefits which are paid to an employee because of his involuntary unemployment (whether or not temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions. Under Senate amendment No. 1, the term includes benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary). This amendment makes it clear that supplemental unemployment compensation benefits include benefits paid to an employee who has been temporarily separated from the service of his employer even though the employee may have obtained other employment during the period of his temporary separation. The House recedes.

Amendment No. 2: This is a clerical amendment. The House recedes.

Amendment No. 3: This is a clarifying amendment and provides in effect that exemption from income tax shall not be denied under section 501(a) of the 1954 Code to any organization entitled to such exemption as a voluntary employees' beneficiary association under section 501(c)(9) of the 1954 Code merely because such organization provides for the payment of supplemental unemployment benefits (as defined in the new sec. 501(c)(17)(i) added by the bill). The House recedes.

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[9] Public Law 86–667, page 687, this Bulletin.

Amendments Nos. 4, 5, 6, 7, and 9: These amendments change from September 4, 1959, to December 31,, 1959, the dates on which the rules contained in the bill relating to prohibited transactions, the unrelated business income tax, and business bases are made applicable. The House recedes.

Amendment No. 8: Under the House bill, the amendments made by the bill were, in general, to apply to taxable years beginning after December 31, 1958. Under Senate amendment No. 8, the amendments are to apply to taxable years beginning after December 31, 1959. The House recedes.

Amendment No. 10: This amendment added a new section 7 to the bill which provided that for any taxable year beginning before July 1, 1961, exemption shall not be denied under section 501(a) of the 1954 Code, as an organization described in section 501(c)(3) of such code, to any nurses organization or association described in the new section solely on the ground that such organization or association limits its membership to individuals affiliated with a professional society, is principally supported by registration fees, or is controlled or operated by its registrant-members. The Senate recedes.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
N. M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.

[H.R. 7758] [10]

OVERSEAS DIFFERENTIALS AND ALLOWANCES ACT

[House of Representatives Report No. 902, Eighty-Sixth Congress, Second Session]

[August 14, 1959]

MR. MORRISON, from the Committee on Post Office and Civil Service, submitted the following report to accompany H.R. 7758.

The Committee on Post Office and Civil Service, to whom was referred the bill (H.R. 7758) to improve the administration of overseas activities of the Government of the United States, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

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STATEMENT

PURPOSE OF H.R. 7758

The purpose of H.R. 7758, as set forth in section 101, is to improve and strengthen the administration of overseas activities of the Government of the United States. This purpose is to be accomplished by the establishment of a coordinated and reasonably uniform system for more effectively compensating Government employees for additional costs, and for hardships and inconveniences, incident to their working assignments in overseas areas. The bill provides for uniformity of treatment for all overseas employees to the extent justified by relative conditions of employment. The allowances, differentials, and expenses authorized by the bill apply only to citizens of the United States employed by the Government in overseas activities, except as otherwise provided by law.

This legislation carries out the recognized principle that the Government should provide uniform treatment for all of its civilian employees who are assigned to overseas posts of duty with respect to additional expenses, necessarily incurred by such employees in relation to their overseas service, which Government employees within the United States do not incur and with respect to hardships, inconveniences, and other differences in environment or conditions of employment at overseas posts of duty which justify additional compensation or allowances.

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[10] Public Law 86-707, page 690, this Bulletin.

Exemptions From Tax For Certain Allowances

Section 523(a) amends section 912 of the Internal Revenue Code of 1954, which relates to the exemption from Federal income tax of certain allowances. Under paragraph (1) of the existing section 912, in the case of civilian officers and employees of the United States stationed outside the continental United States, amounts received as cost-of-living allowances in accordance with regulations approved by the President are not includible in gross income. Under paragraph (2) of the existing section 912, amounts received by an officer or employee of the Foreign Service of the United States as allowances or otherwise under title IX of the Foreign Service Act of 1946 are not includible in gross income.

Section 523(a) of the bill, as amended by the committee, amends section 912 of the Internal Revenue Code of 1954 to make the changes in it made necessary by reason of the provisions of titles II and III of the bill. The amended paragraph (1) of section 912 provides that in the case of civilian officers and employees of the United States, amounts received as allowances or otherwise under certain designated provisions of law are not to be included in gross income. The designated provisions of law are:

(1) Title IX of the Foreign Service Act of 1946.
(2) Section 4 of the Central Intelligence Agency Act of 1949.
(3) Title II of the bill.
(4) Subsections (e) and (f) of the first section of the Administrative Expenses Act of 1946, and sections 22 and 23 of that Act.

The references to the provisions of law so designated are references to such provisions as amended from time to time, and thus include the amendments made thereto by title III of the bill.

In paragraph (1) of the amended section 912 is is made clear that its provisions do not apply to amounts received as post differentials. For this purpose, the term "post differentials" means, in general, amounts granted on the basis of conditions of environment which differ substantially from conditions of environment in the continental United States, such as amounts granted pursuant to the authority contained in section 231 of the bill.

Under the bill as introduced, paragraph (1)(D) contained a reference to subsection (a) of the first section of the Administrative Expenses Act of 1946. Such subsection (a) provides, in general, that where a civilian officer or employee of the Government is, in the interest of the Government, transferred from one official station to another for permanent duty, his travel expenses, the expenses of transporting his immediate family, and the expenses of transporting or storing his household goods, may be paid from Government funds. The third proviso of this subsection states that no part of such expenses may be paid from Government funds where the transfer is made primarily for the convenience or benefit of the officer or employee or at his request. Under Revenue Ruling 54–429 (1954 Cumulative Bulletin 1954–2, page 53), it has been held that where an employee is transferred in the interest of his employer from one official station to another for permanent duty, the allowance or reimbursement received for moving himself, his immediate family, family goods, and personal effects is not includible in the gross income of the employee if the total amount of the reimbursement or allowance is expended for such purpose. In view of this revenue ruling, the reference to such subsection (a) is stricken by a committee amendment on the grounds that it is unnecessary.

Paragraph (2) of the amended section 912 provides that in the case of civilian officers or employees of the United States who are stationed outside the continental United States, there shall not be included in gross income amounts (other than amounts received under title II of the bill) received as cost-of-living allowances in accordance with regulations approved by the President.

For purposes of the new paragraph (2), Alaska is not treated as part of the continental United States. Thus, in the case of a civilian officer or employee of the United States stationed in Alaska, amounts received as a cost-of-living allowance in accordance with regulations approved by the President are not to be included in gross income.

Section 523(b) of the bill as amended by the committee provides that the amended section 912 of the Internal Revenue Code of 1954 is to apply only with respect to amounts received on or after the date of the enactment of the bill in taxable years ending after that date. In the case of any amount received before the date of the enactment of the bill, its tax treatment is to be determined

under existing law without inferences drawn from the amendment made by the bill. Furthermore, the tax treatment of amounts received on or after the date of the enactment of the bill to which the provisions of the amended section 912 are not expressly made applicable is to be made under the Internal Revenue Code of 1954 without inferences from the fact that such provisions are not expressly made applicable.

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[H.R. 7758] [11]

OVERSEAS DIFFERENTIALS AND ALLOWANCES ACT

[Senate Report No. 1647, Eighty-Sixth Congress, Second Session, Calendar No. 1710]

[June 22, 1960]

Mr. JOHNSTON of South Carolina, from the Committee on Post Office and Civil Service, submitted the following report to accompany H.R. 7758.

The Committee on Post Office and Civil Service, to whom was referred the bill (H.R. 7758) to improve the administration of oversea activities of the Government of the United States, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

PURPOSE

The purpose of this bill is to improve and strengthen Government oversea activities by establishing a uniform system for compensating all Government employees in oversea posts irrespective of the agency by which they are employed. The bill would provide uniformity of treatment for all oversea employees to the extent justified by relative conditions of employment. Current applicable laws do not provide this uniformity. They authorize benefits for the employees of certain agencies, while the employees of other agencies are denied them because of the lack of statutory authority, even though the conditions of employment of the two groups are substantially the same.

Many of the provisions of H.R. 7758 are already authorized for certain agencies by the Foreign Service Act and by other legislation. These agencies, referred to here as foreign affairs agencies, are the Department of State, the U.S. Information Agency, the International Cooperation Administration, the Foreign Agricultural Service, the Federal Aviation Administration, and the Veterans' Administration.

Some of the provisions of this measure are also already authorized for all agencies. These provisions are repeated in this bill, sometimes with minor language changes, in order to clarify and consolidate existing law and to make H.R. 7758 all-inclusive in the field of oversea differential and allowance payments.

Thus, the bill extends certain benefits now authorized only for the foreign affairs agencies to non-foreign-affairs agencies as well.

It adds a limited number of new benefits for all agencies.

It continues benefits now already authorized for all agencies by existing legislation.

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IX. EXEMPTION FROM INCOME TAX

The bill continues for all agencies exemption of allowances (but not differential) from income tax (sec. 523).

Existing law and rulings of the Internal Revenue Service provide that amounts received as cost-of-living allowances are not includible in gross income. These allowances are not considered as part of basic compensation for tax purposes.

Amounts received as salary differential to offset conditions of environment (not living costs) are considered by existing revenue rulings to be a part of compensation and hence taxable.

This bill makes a number of technical amendments to the Internal Revenue Code of 1954 which are necessary in order to conform it to the changes in legal authorities made by this bill.

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[11] Public Law 86-707, page 690, this Bulletin.

[H.R. 12580] [12]

SOCIAL SECURITY AMENDMENTS OF 1960

[House of Representatives Report No. 1799, Eighty-sixth Congress, Second Session]

[June 13, 1960]

MR. MILLS, from the Committee on Ways and Means submitted the following report to accompany H.R. 12580.

The Committee on Ways and Means, to whom was referred the bill (H.R. 12580) to extend and improve coverage under the Federal old-age survivors, and disability insurance system and to remove hardships and inequities, improve the financing of the trust funds, and provide disability benefits to additional individuals under such system; to provide grants to States for medical care for aged individuals of low income; to amend the public assistance and maternal and child welfare provisions of the Social Security Act; to improve the unemployment compensation provisions of such act; and for other purposes, having considered the bill, report favorably thereon without amendment and recommend that the bill do pass.

I. SCOPE OF THE BILL

The soundness and effectiveness of the programs encompassed in the Social Security Act are extremely important to every American family. Your committee believes it has an obligation to determine, from time to time, whether in a diverse and changing economy these programs are fulfilling their objectives within a framework of fiscal and actuarial soundness.

During this Congress your committee has given careful consideration to existing programs under the Social Security Act, and to changes which have been suggested.

As a result of this review and consideration, your committee is proposing in this bill a number of improvements in the programs contained in the Social Security Act, including old-age and survivors insurance, disability insurance, unemployment compensation, public assistance, and maternal and child welfare. In addition, the committee is recommending that a new title be added to the Social Security Act which will initiate a Federal-State grants-in-aid program of medical services to the low-income aged.

II. SUMMARY OF PRINCIPAL PROVISIONS OF THE BILL

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B. The Old-Age, Survivors, and Disability Insurance (OASDI) Provisions

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4. Increased coverage

The coverage of the program would be extended to about 300,000 additional people—self-employed physicians, domestic workers earning at least $25 but not as much as $50 in a calendar quarter from a single employer, parents who work for their sons and daughters in a trade or business, workers in Guam and American Samoa, American citizens employed in the United States by foreign governments and international organizations, and certain policemen and firemen under retirement systems in Virginia.

Another opportunity would be provided for an estimated 60,000 ministers to be covered under the program. If the States take advantage of the opportunity offered them, nearly 2½ million employees of State and local governments could obtain coverage for certain past years on a retroactive basis. Other provisions would facilitate coverage for some of the noncovered people employed in positions covered by State or local retirement systems and for the 100,000 noncovered employees of certain nonprofit organizations.

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D. The Unemployment Compensation Program

Your committee's bill contains provisions to improve and extend the existing Federal-State program of employment security.

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[12] Public Law 86-778, page 693, this Bulletin.

Title V (1) raises the net Federal unemployment tax (the tax that may not be offset by a credit for taxes paid under a State program) from three-tenths to four-tenths of 1 percent on the first $3,000 of covered wages; (2) provides that the proceeds of this higher Federal tax after covering the administrative expenses of the employment security program will be available to build up a larger fund for advances to States whose reserves have been depleted; (3) makes additional improvements in the arrangements for administrative financing; and (4) improves the operation of the Federal unemployment account by tightening the conditions pertaining to eligibility for and repayment of advances.

Title V also extends the coverage of the unemployment compensation programs to several groups not presently covered. It is estimated that from 60,000 to 70,000 additional employees would be brought under the unemployment compensation system by this extension.

Title V, in addition, provides that Puerto Rico will be treated as a State for the purposes of the unemployment compensation program.

IV. GENERAL DISCUSSION OF THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROVISIONS

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D. Extension of Coverage

Your committee's bill would make several further extensions of coverage. The change made by the bill in the insured status requirements for benefits, and discussed earlier in this report, would facilitate the achievement of fully insured status for the newly covered workers.

1. Coverage of self-employed doctors of medicine.

The old-age, survivors, and disability insurance program now covers members of all self-employed professional groups except doctors of medicine. Large numbers of doctors have requested coverage. Your committee believes that the need of doctors for social security protection is comparable to that of other self-employed professional groups. Many self-employed physicians have acquired some old-age, survivors, and disability insurance credits on the basis of past covered employment or self-employment, or as the result of their military service, but will be entitled to little or no benefits because only a small part of their lifetime earnings has been covered.

Your committee's bill covers the approximately 150,000 self-employed doctors of medicine on the same basis as other self-employed professional groups, effective for taxable years ending on or after December 31, 1960.

Coverage would also be extended to services performed by medical and dental interns. The coverage of services as an intern would give young doctors an earlier start in building up social insurance protection and would help many of them to become insured under the program at the time when they need the family survivor protection it provides. This protection is important for physicians who, like members of other professions, in the early years of their practice, may not otherwise have the means to provide adequate survivorship and disability protection for themselves and their families.

2. Coverage of additional domestic workers in private homes and others who perform work not in the course of the employer's business.

Under present law, earnings of domestic workers in private households (other than those on farms operated for profit) are covered only when they amount to at least $50 in a calendar quarter from one employer. Your committee's bill would cover such earnings if they amount to at least $25 from one employer. The new $25 coverage test would cover virtually all persons who depend on earnings from domestic work for their livelihood.

At the same time the bill would exclude from coverage all earnings of domestic workers who are under age 16.

This amendment would extend protection to about 100,000 domestic employees who earn $25 or more from at least one employer but not as much as $50 from any single employer in a calendar quarter. It would also cover additional earnings of other domestic workers who have some earnings covered under the present law but whose additional earnings from other employers are not covered. Coverage of these additional earnings would result in higher benefit amounts, more closely related to actual lifetime earnings of the domestic worker, than is the case under present law.

Persons below age 16 would be excluded because most of them who perform some domestic work for pay are casual or intermittent workers who are employed, for example, as lawn cutters or babysitters, and who do not depend on their earnings for a livelihood. This exclusion should not have any adverse effect on such workers' ultimate earnings records, since an individual's starting date for benefit computation purposes does not occur until he is 22 years old and period of noncoverage before that time do not count against him. With exclusion from coverage of domestic workers under age 16, young workers will not have to pay social security taxes on their earnings and employers will not be required to report relatively small amounts of earnings.

Persons age 16 or over who perform other types of services not in the course of the employer's trade or business would, like domestic workers, be covered under the bill if they are paid $25 in cash wages by an employer in a calendar quarter. Some 5,000 additional persons would be affected. This provision will improve and simplify the coverage of such services and retain the principle underlying the present law of applying the same coverage test to these nonbusiness services as is applied to domestic service performed in private homes. Uniform tests of these two types of work are desirable because certain kinds of nonbusiness services are not, strictly speaking, domestic service in private homes but are similar to domestic service.

3. Coverage of certain services of parents in the employ of their sons or daughters.

Under present law, work performed by certain members of a family for other members of the same family is excluded from coverage. The chief purpose of this exclusion has been to preclude the necessity of making determinations regarding bona fide employment relationships in an area where it is difficult to ascertain the facts. Your committee has concluded that in the light of operating experience with the program, valid determinations can now be made as to whether actual employment relationships exist with respect to the service performed by parents working as employees in businesses owned by adult sons or daughters. Your committee's bill would therefore modify the family employment exclusion to cover certain services performed after 1960 by parents in the employ of their adult children.

The services covered would be those performed only in the course of the employer's trade or business and then only prospectively, that is effective with respect to services performed after 1960. They would not include domestic services performed in or about the home or other work not in the course of the employer's business.

Many of the workers whose employment will be covered under this provision have already earned credits under the program in other work, and the change in the law will fill the gap which would otherwise exist in their coverage. Others who are engaged in such an actual employment relationship will have for the first time an opportunity to build up credits toward their retirement, survivors and disability protection under the program.

4. Coverage of workers in Guam and American Samoa.

The old-age, survivors, and disability insurance program now covers the 50 States, Puerto Rico, the Virgin Islands, and the District of Columbia. Under your committee's bill the coverage of the program would be extended to Guam and American Samoa. The Governments of Guam and American Samoa have expressly requested that the program be extended to these territories. This extension of coverage would apply to about 8,000 workers in Guam and to about 2,000 in American Samoa.

With the exception of employees and officers of the Government of Guam, the Government of American Samoa, any political subdivision of either, or any instrumentality wholly owned thereby, the bill provides that coverage would be effective for employees on January 1, 1961, and for self-employed persons for taxable years beginning after 1960. Coverage of employees and officers of the Governments of Guam and American Samoa (including members of the legislatures), their political subdivisions, and their wholly owned instrumentalities would be on a mandatory basis, rather than under the State-Federal agreement method which applies to the employees of States and localities. The Government of Guam has indicated that it may need a period of time to amend the provisions of the Government of Guam retirement program to adjust contributions and benefits under that program to take into account the extension of old-age, survivors, and disability insurance coverage. Accordingly, the bill

provides that coverage for employees of the Guamanian Government, its political subdivisions, and wholly-owned instrumentalities will not become effective until the calendar quarter following the quarter in which the Governor of Guam certifies to the Secretary of the Treasury that the Guamanian Government has enacted legislation expressing its desire that old-age, survivors, and disability insurance coverage be extended to these employees (and in no event before 1961). A comparable effective date provision is included for employees of the Government of American Samoa.

Under your committee's bill, Filipino workers who come to Guam under contracts to work temporarily would be excluded from coverage. Your committee has been informed that even if these Filipino workers should be covered, practically none of them would acquire sufficient credits to qualify for benefits. Your committee also has been informed that the Philippine Government favors this exclusion.

The taxes to be collected by reason of this extension of the old-age, survivors, and disability insurance program to Guam and American Samoa will be administered by the Secretary of the Treasury or his delegate. Under present law, a delegate of the Secretary of the Treasury must, as a general rule, be an officer, employee, or agency of the Treasury Department. Since the Treasury has no tax-collection officers in Guam or American Samoa at present, the Secretary is given the authority, under your committee's bill, to delegate administration of these taxes to any officer or employee of another Department or agency of the United States, or of any possession, should he find it desirable to do so.

5. Facilitating coverage of additional employees of nonprofit organizations and validation of erroneous returns already filed.

Present law requires that two-thirds of the employees of a nonprofit organization must consent to coverage before the organization can cover the employees who desire coverage and future employees of the organization. Your committee's bill modifies this requirement so that a nonprofit organization could, if so desired, file a certificate electing to provide coverage for all employees hired in the future and such current employees if any, as consent to be covered. An organization could provide coverage for new employees even though none of its current employes desire coverage.

The present requirement is unfair to employees who want to be covered but are not eligible because some of their fellow employees do not desire old-age, survivors, and disability insurance protection. Under your committee's bill, a nonprofit employer would, in effect, be able to establish as a condition of employment a rule that new employees must be covered while offering its present employees an option.

There are about 100,000 employes of nonprofit organizations not now protected under old-age, survivors, and disability insurance for whom coverage would be facilitated by these changes. In the long run all employees of organizations that have elected to cover any of their employees would be covered since all new employees are mandatorily covered.

Your committee's bill would retain the requirement of present law that if some of a nonprofit organization's employees are in jobs covered by a public retirement system and some are not, the employer must divide his employees into two coverage groups for purposes of this provision. The employees who are in positions covered by the public retirement system would be in one coverage group; those who are not would be in the other. Under the bill, the employer may extend coverage to consenting and future employees in either or both groups, without the necessity for concurrence by two-thirds of the current employees.

The bill would also permit the validation of erroneous self-employment returns filed by certain lay missionaries in the belief that they were covered under present law as ministers, if requested by April 15, 1962.

Your committee has been informed that a number of nonprofit organizations have been erroneously reporting and paying taxes on remuneration paid to their employees without first complying with requirements in law for obtaining old-age, survivors, and disabilty, insurance protection for their employees. For example, some organizations have reported their employees without realizing it was necessary to file waiver certificates. In some instances, the nonprofit organization later filed a certificate in accordance with the law, but by that time one or more of the employees whom the organization had previously reported had left its employ. There is no way under present law for such employees

to have their services covered under the organization's certificate. In other instances, nonprofit organizations began to report their employees after the organizations filed certificates without realizing that it was also necessary to obtain the signatures of all of the employees whom they wished to cover on lists of concurring employees. Your committee's bill would, under specified circumstances, permit social security credit for remuneration for services performed before July 1, 1960, erroneously reported as wages, upon appropriate action by the nonprofit organizations and employees involved.

6. Coverage of American citizen employees of certain labor organizations in the Panama Canal Zone.

Social security coverage would be extended to service performed after 1960 by a small group of American citizens in the employ of certain labor organizations outside the United States. Coverage would be accomplished by modifying the definition of "American employer" in present law to include labor organizations in the Panama Canal Zone which are chartered by labor organizations created or organized in the United States.

This provision of your committee's bill would affect only a relatively few workers but would assure coverage of all service they perform for such employers, whether within or outside the United States.

Your committee also recommends that social security credit be given for the remuneration, with respect to which taxes were erroneously paid, for service performed after 1954 and before 1961, by American citizens in the employ of labor organizations which constitute "American employers" under this provision.

7. Provision of an additional opportunity for ministers to obtain coverage.

Coverage was made available to ministers, under the Social Security Amendments of 1954, on an individual voluntary basis because of considerations relating to the separation of church and state. The 1954 legislation provided that ministers and Christian Science practitioners already in practice who desired coverage had to file waiver certificates by April 15, 1957. In 1957, when it appeared that many clergymen who desired coverage had, through lack of knowledge or misunderstanding of the provisions, failed to file timely certificates electing coverage, legislation was enacted to extend the time for electing coverage to April 15, 1959. Under present law, in general, only newly ordained ministers (and ministers who have not had net earnings from self-employment of $400 or more, some part of which was from the exercise of the ministry, for as many as 2 taxable years after 1954) may still file certificates electing coverage.

Your committee is informed that of some 200,000 full-time ministers who could have elected coverage, about 140,000 have come under the program up to this time. Your committee has been advised that there are many ministers who want coverage but are no longer eligible. In some cases, such ministers failed to file timely waiver certificates because they misunderstood the provision or were unaware of the deadline. Other ministers erroneously believe that they met the requirements for electing coverage by filing tax returns, while still others believe they met the requirements by filing waiver certificates although actually they did not because the certificates were defective in some respects.

Your committee is mindful of the need to maintain reasonable restrictions on the time within which a choice must be made under the provision for individual voluntary coverage of ministers. However, your committee recommends that ministers and Christian Science practitioners who under present law are no longer eligible to elect coverage be given additional opportunity to obtain this protection. To this end, persons who have already entered the ministry would be given until April 15, 1962, to file waiver certificates. Certificates filed under this amendment (like those filed under present law by a newly ordained minister) would be effective with the year preceding the latest year for which the tax return due date has not passed.

In addition, the bill would permit the validation of coverage of certain clergymen who filed tax returns reporting self-employment earnings from the ministry for certain years after 1954 and before 1960 even though, through error, they had not filed waiver certificates effective for those years. These ministers or their representatives would be given the opportunity until April 15, 1962, to file waiver certificates or supplemental certificates effective with the first taxable year for which they had filed such a tax return and for all succeeding years. In order for the benefits of this amendment to be secured, taxes due by reason of the validation of the coverage would have to be paid by April 15, 1962.

8. Coverage of American citizens employed in the United States by foreign governments and international organizations.

Under present law, service performed in the employ of a foreign government, an instrumentality wholly owned by a foreign government, or an international organization is generally excluded from old-age, survivors, and disability insurance coverage. Your committee believes that such service, if performed by a citizen of the United States within the United States, should be covered. Coverage of their employment would enable these citizens to build the same basic protection under old-age, survivors, and disability insurance that other Americans possess and would prevent gaps in protection for those citizens who work for a limited period of time for a foreign government or international organization.

This employment has theretofore not been covered because the United States cannot levy the employer tax of the program upon foreign governments or international organizations. Your committee believes that the most feasible way to provide coverage for United States citizens working for these employers would be to treat them as self-employed individuals. Although your committee believes it is generally undesirable to cover as self-employment the services of persons who are actually employees, such coverage offers a practical solution to the unique problem of covering American citizens employed by such governments and organizations. Under your committee's bill, compulsory coverage would be provided for these employees on the same basis as that provided for self-employed persons.

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VII. EMPLOYMENT SECURITY

A. Purpose and Summary

The purpose of title V of your committee's bill is to improve and extend the existing Federal-State program of employment security.

Title V of the bill (1) raises the net Federal unemployment tax (the tax that may not be offset by a credit for taxes paid under a State program) from three-tenths to four-tenths of 1 percent on the first $3,000 of covered wages; (2) provides that the proceeds of this higher Federal tax after covering the administrative expenses of the employment security program will be available to build up a larger fund for advances to States whose reserves have been depleted; (3) makes additional improvements in the arrangements for administrative financing; and (4) improves the operation of the Federal unemployment account by tightening the conditions pertaining to eligibility for and repayment of advances.

Title V also extends the coverage of the unemployment compensation programs to several groups not presently covered. It is estimated that from 60,000 to 70,000 additional employees would be brought under the unemployment compensation system by this extension.

Title V, in addition, provides that Puerto Rico will be treated as a State for the purposes of the unemployment compensation program.

B. General Explanation

Title V of the bill contains four parts. Part 1 provides that this title may be cited as the "Employment Security Act of 1960." Part 2 deals with the increased Federal unemployment tax, with provisions for an increased "loan" fund, and for improved administrative financing. Part 3 extends the coverage of the unemployment compensation program to service performed by additional groups of employees. Part 4 extends the Federal-State unemployment compensation program to Puerto Rico.

Part 2. Employment security administrative financing amendments.

Part 2 amends titles IX and XII of the Social Security Act and chapter 23 of the Internal Revenue Code of 1954. Broadly, the purpose of these amendments is to provide adequate funds for administration and for advances to States whose unemployment reserves have been depleted by heavy unemployment. The amendments will improve the operation of the present "loan" fund in several particulars. The amendments also authorize annual appropriations to cover the expenses of administration of the State unemployment insurance programs and the State public employment offices in amounts more consistent with the current levels of expenditure in this area.

As under present law, funds collected through the Federal and State unemployment tax will be held in the Unemployment Trust Fund and invested in Government securities. Part 2 of title V contains provisions relating to the various accounts within the Unemployment Trust Fund. State unemployment taxes will, as now, be credited to the State's account in the Unemployment Trust Fund. The entire proceeds of the Federal unemployment tax will be credited initially to a new account, the employment security administration account. Part 2 authorizes appropriations for transfer from the employment security administration account of amounts covering the administrative expenses of the employment security program. The amount that may be appropriated for transfer from the employment security administration account to the States for administering their unemployment compensation laws and for the maintenance of public employment offices is limited to $350 million a year. The actual expenditure for these items in fiscal year 1959 was $310 million and the estimated expenditure for fiscal year 1960 is $324 million.

Part 2 also authorizes payment from the employment security administration account for expenses incurred by the Departments of Labor and Treasury in connection with the employment security program (other than the Temporary Unemployment Compensation Act of 1958). The Treasury is permitted to charge against the employment security administration account the expenses of banks for servicing unemployment benefit and clearing accounts which are offset by the maintenance of balances of Treasury funds with such banks. This latter expense is not now treated as an administrative expense of the unemployment compensation program. Historically, the Treasury has maintained deposits in commercial banks, on which the Treasury obtains no interest, in order to offset the costs incurred by such banks in handling Government business.

The additional payments by employers through reduction in tax credits in particular States (1) to pay advances made to the State under title XII, or (2) to restore to the Treasury amounts expended in such States under the Temporary Unemployment Compensation Act of 1958, will also be received in the employment security administration account. These amounts will be appropriately transferred and will not be taken into account in the various provisions described below involving the net balance in the employment security administration account.

It is expected that as a result of the increase in the Federal tax to 0.4 percent there will be an excess in the employment security administration account at the end of fiscal year 1962. This will result from the tax receipts being in larger amounts than necessary to pay for the administrative expenses connected with the employment security program.

The new section 902 provides that any excess in the employment security administration account at the end of any fiscal year will be transferred to the Federal unemployment account, the account out of which advances to States are made. These transfers to the Federal unemployment account will be continued until such account reaches a level of $550 million or four-tenths of 1 percent of total wages subject to State unemployment taxes, whichever is higher. The four-tenths of 1 percent of covered payroll will exceed $550 million when the covered payroll exceeds $137.5 billion. For fiscal year 1960, it is expected that the covered payroll will be about $116 billion.

Under present law, any excess of Federal unemployment tax receipts over administrative expenses is allocated to the Federal unemployment account to bring the Federal unemployment account up to $200 million in cash, but repayments by the States of advances could increase the Federal unemployment account to an amount over $200 million. Under part 2, funds may be transferred to the Federal unemployment account at the end of any fiscal year to bring it up to its statutory limit of $550 million or four-tenths of 1 percent of covered payroll. If repayment of advances from the Federal unemployment account causes such account to exceed the statutory limit at the end of any fiscal year, however, the excess over the statutory limit would be transferred to the employment security administration account. Any amount so transferred shall be included as part of the employment security administration account in computing the excess in the account at the close of that fiscal year.

After the Federal unemployment account is built up to its statutory limit, the bill provides that any remaining excess of Federal unemployment taxes over the administrative expenses will be retained in the employment security administration account until that account shows a net balance at the close of the fiscal year of $250 million. The purpose of this net balance in the employment secu-

rity administration account is to provide funds out of which the administrative expenses can be paid during each fiscal year prior to the receipt of the bulk of the Federal unemployment tax in January and February.

Under the present law, the proceeds of the Federal unemployment tax are covered into the general fund of the Treasury and the administrative expenses and the transfers of excess collections are paid out of the general fund. The creation of the employment security administration account involves a separate funding of these receipts and outlays. Ultimately, it is the purpose of part 2 to provide for financing administrative expenses entirely out of Federal unemployment tax collections. To take care of periods before this ultimate goal is reached, part 2 provides for the creation of a revolving fund in the Treasury for advances to the employment security administration account to cover administrative expenses during the portion of each fiscal year before the bulk of the Federal tax receipts come in. These advances will bear interest equal to the average rate of interest on all interest-bearing obligations of the United States. Since the tax collections are placed in the employment security administration account which, as a part of the Unemployment Trust Fund, will earn interest, such interest will partially offset the interest paid on advances from the revolving fund.

Advances from the revolving fund to the employment security administration account are to be repaid from time to time in such amounts as the Secretary of the Treasury (in consultation with the Secretary of Labor) determines to be available in the employment security administration account for such repayment. It is anticipated that such advances will be made only in such amounts, and for such duration, as will be necessary to provide working funds in the employment security administration account.

Part 2 provides that any excess will be retained in the employment security administration account beyond the end of a fiscal year only after the Federal unemployment account has been built up to its statutory limit. Once an amount has been so retained in the employment security administration account, however, then ftuure determinations of the excess available for transfers from this account may not result in reducing the end-of-the-year net balance below the highest previous beginning-of-the-year net balance.

Part 2 provides that after the Federal unemployment account is built up to it statutory limit, after the year-end net balance of the employment security administration account reaches $250 million, and after any advances from the general fund of the Treasury to the Federal unemployment account have been repaid, any remaining excess in the employment security administration account will be distributed to the State accounts in the same manner as is provided under present law. Unlike present law, however, part 2 provides that if at the time of this distribution of surplus Federal taxes a State has outstanding advances under title XII, that State's share of the surplus funds shall first be used to reduce these outstanding advances.

Part 2 also amends title XII of the Social Security Act, the title that provides for advances to State unemployment funds. Under present law a State may apply for an advance if its reserve at the end of a calendar quarter is less than the total compensation paid out during the preceding four quarters. Your committee found that this was not a sufficient test of a State's need for additional funds. Two States were eligible for and received advances under the present law which they have never used.

Part 2, therefore, permits a State's eligibility for advances to be determined at any time. Advances will be made in amounts which the Secretary of Labor estimates will be required to pay compensation during the current or following month, after taking into account available reserves and income to be received during the month in the State unemployment fund. In making such estimates, the Secretary may include an additional amount to cover unexpected contingencies such as decreases in tax receipts dut to delinquencies, increases in benefit payments due to unusual weather conditions or an unannounced layoff by a large firm, or other factors. The aggregate amount that the Secretary of Labor may certify in any month may not exceed the amount in the Federal unemployment account.

Advances made to a State before enactment of your committee's bill will, in general, be repaid under the present provisions of law. Also, any State that has not received the full amount certified by the Secretary of Labor to the Secretary of the Treasury before enactment of your committee's bill may, through its Governor, request the Secretary of the Treasury to transfer to the State's account

all or part of the remainder of such amount. Upon receipt of such a request the Secretary of the Treasury shall transfer the amount requested or so much of such amount as is available at the time of the transfer. No such amount will be transferred, however, after the 1-year period beginning on the date of the enactment of your committee's bill. The present provisions for repayment will apply to any amount so transferred to a State.

Advances made to a State after the enactment of your committee's bill, if not repaid by the State within the specified period of time, will be repaid under newly added provisions to the section providing for repayment of an advance through reduction in employers' credits against the Federal unemployment tax. Reductions in credit to repay an advance after the enactment of your committee's bill will be made with respect to the taxable year beginning with the second January 1 after the advance is made (rather than as now the fourth January 1). The reduction in credit will also be at a rate double that now provided. Thus, for the taxable year beginning with the second January after an advance is made, the credit will be reduced by 10 percent. For the following taxable year the credit will be reduced by 20 percent, and so on. Your committee believes that these changes are desirable. Economic indexes since World War II show that recessions have not lasted more than about 1½ years. Thus, earlier repayment is economically feasible. Such indexes also show that recessions have recurred at approximately 4-year intervals. Thus, under the present law, the repayment of advances through reduction in tax credits might commence during the recession following that in which an advance is made. The increased rate of repayment proposed will result generally in the repayment of an advance before another recession occurs. It will also replenish the Federal unemployment account so that subsequently requests for advances can be financed without the necessity of securing advances from general funds for this purpose.

In the case of the third and fourth consecutive taxable year for which there has been an outstanding balance of advances as of January 1, if the State has (for the calendar year preceding such taxable year) collected as contributions from employers on remuneration subject to the State law less than an amount equal to 2.7 percent of the total remuneration subject to contributions under the State law (as determined by the State by April 30 of the taxable year, using a March 31 cutoff date), the tax credit against the Federal tax due on wages paid in such taxable year will be further reduced by the amount (rounded to the nearest 0.1 percent) by which the average employer contribution rate is less than 2.7 percent.

In the case of the fifth and succeeding consecutive taxable years for which there has been an outstanding balance of advances as of January 1, if the State has collected (for the calendar year immediately preceding the taxable year) in employer taxes less than an amount equal to one-fifth of the aggregate benefits paid in the first 5 of the last 6 years preceding the taxable year (as determined by the State by the following April 30, using a March 31 cutoff date) or an amount equal to 2.7 percent of the State taxable remuneration (for the calendar year immediately preceding the taxable year), whichever is higher, then the tax credit against the Federal tax will be further reduced. The reduction will be a rate, rounded to the nearest 0.1 percent, which, when applied to the State's taxable wages for such immediately preceding calendar year, would have produced the revenue necessary to make up the difference between the contributions actually paid and the average benefit cost rate (or 2.7 percent if higher). In determining the amount collected by the State, employee contributions may be included, if employer contributions average 2.7 percent or more.

Your committee believes that these provisions will encourage a State that has an outstanding balance of advances to so increase its contribution rates that these further tax credit reductions will not become applicable. Such increased rates should strengthen the State's benefit financing so that its need for further advances would be minimized.

The Federal unemployment tax rate will be raised to 3.1 percent effective with respect to the calendar year 1961 and all calendar years thereafter. This change in the Federal unemployment tax rate will not effect the computation of credits allowable against the Federal tax.

Part 3. Extension of coverage under the unemployment compensation program.

Part 3 of title V extends the protection of the unemployment compensation program to several additional categories of employees.

The first extension applies to employees of certain instrumentalities of the United States. Any instrumentality of the United States which is neither wholly

nor partially owned by the United States will be subject to the Federal unemployment tax unless it is exempt by virtue of a provision of law which grants specific exemption from the Federal unemployment tax. The additional Federal instrumentalities brought under the unemployment compensation program by this change will include the Federal Reserve banks, Federal credit unions, Federal land banks, Federal land bank associations, and Federal home loan banks. Employees of partially owned instrumentalities will be brought under the unemployment compensation program for Federal employees. This will include employees of instrumentalities such as the banks for cooperatives, Federal intermediate credit banks, and some production credit associations.

The second extension is to employees serving on or in connection with American aircraft outside the United States, which will be defined as aircraft registered under the laws of the United States. At present, seamen serving on American vessels are covered when their vessel is outside the United States if they are employed under a contract made in the United States, or if during the performance of their services the vessel touches at a port in the United States. The Federal Unemployment Tax Act is amended by extending coverage to employees of American aircraft under similar circumstances, and will bring coverage under the act in this respect in line with coverage under the Federal Insurance Contributions Act.

The third extension is to employees of so-called "feeder organizations." The exclusion of nonprofit organizations under the Federal Unemployment Tax Act is amended so as to result in the coverage of feeder organizations, as well as nonprofit organizations which are not exempt from income tax.

"Feeder organizations" are establishments operated for the primary purpose of carrying on a trade or business for profit. All of their profits are payable to nonprofit organizations exempt from Federal income tax under section 501(c) of the Internal Revenue Code of 1954, but the feeder organizations themselves are subject to the Federal income tax. In this connection, the term "trade or business" does not include an organization's rental of its real property.

Such feeder organizations engage in a wide variety of commercial and industrial activities. They have, however, a common characteristic; they are operated solely for profitmaking purposes which have no relationship to the nonprofit activities of the parent organization. They compete on the same terms as private concerns with other enterprises in the same field of activity. Their employees are susceptible to the same hazards of unemployment as are the workers in similar establishments not owned by nonprofit organizations.

The other organizations which would be covered by this amendment are those denied an income tax exemption because they are engaged in certain activities, including "prohibited transactions," which do not meet the requirements specified in section 503 or 504 of the Internal Revenue Code of 1954.

The fourth extension is to employees of certain other tax-exempt organizations. The amendment removes a number of the specific exclusions of tax-exempt organizations presently contained in paragraph (10) of section 3306(c) of the Federal Unemployment Tax Act, including service performed for agricultural or horticultural organizations, voluntary employees beneficiary associations, and service performed in connection with the collection of dues or premiums for a fraternal beneficiary society or in connection with a ritualistic service of such a society. Still excluded under such paragraph (10), however, would be services for any organization exempt from Federal income tax (other than a trust created or organized under a qualified pension, profit-sharing, or stock-bonus plan), the remuneration for which is less than $50 in a quarter, and services by students for the school which they attend.

These extensions of coverage will apply with respect to remuneration paid after 1961 for services performed after 1961.

Part 4. Extension of Federal-State unemployment compensation to Puerto Rico.

Part 4 of title V provides that Puerto Rico will be treated as a State for purposes of the several provisions of the Social Security Act dealing with unemployment compensation and the Federal Unemployment Tax Act. At the present time, the Commonwealth of Puerto Rico has an unemployment compensation program completely outside of the Federal-State unemployment compensation system. Employers in Puerto Rico are not subject to the Federal unemployment tax and Puerto Rico is not entitled to Federal grants to cover the administrative expenses of its unemployment compensation program. By separate legislation enacted in 1950, however, Federal grants were authorized to cover the costs of the employment service in Puerto Rico. It is estimated that the Federal

unemployment taxes collected in Puerto Rico will meet all the costs of administering their unemployment compensation program and part of the costs of the employment service.

Part 4 includes provisions relating to the operation in Puerto Rico of title XV of the Social Security Act which deals with payment of unemployment compensation to Federal employees and ex-servicemen. At present, title XV provides generally that unemployed Federal employees and ex-servicemen will receive unemployment compensation paid for by the Federal Government but determined under the law of the particular State in which the individual last worked (in the case of Federal employees) or in which the individual resides (in the case of ex-servicemen). Title XV presently provides also that unemployment compensation to Federal employees and ex-servicemen in Puerto Rico and the Virgin Islands is to be computed under the law of the District of Columbia. Since Puerto Rico is to be considered a State for purposes of the unemployment compensation laws, your committee believes that an indefinite continuation of this use of the District of Columbia law for Federal employees and ex-servicemen in Puerto Rico is inappropriate. However, in view of the low level of Puerto Rican benefits, which (as of June 1, 1960) provided a maximum weekly amount of $12 and a maximum duration of 7 weeks, it does appear appropriate, for a transition period, to continue to determine the unemployment compensation payable to Federal employees and ex-servicemen in Puerto Rico under the law of the District of Columbia, and part 4 so provides. For weeks of unemployment beginning after December 31, 1965, Federal civilian employees and ex-servicemen in Puerto Rico will be paid unemployment compensation under the unemployment compensation law of Puerto Rico.

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X. SECTION-BY-SECTION ANALYSIS

The first section of the bill contains a short title (the "Social Security Amendments of 1960") and a table of contents. The remainder of the bill is divided into seven titles as follows:

Title I—Coverage.
Title II—Eligibility for benefits.
Title III—Benefit amounts.
Title IV—Disability insurance benefits and the disability freeze.
Title V—Employment security.
Title VI—Medical services for the aged.
Title VII—Miscellaneous.

TITLE I—COVERAGE

SECTION 101. EXTENSION OF TIME FOR MINISTERS TO ELECT COVERAGE

Additional period for filing certificate.

Section 101 (a) of the bill amends clause (B) of section 1402(e)(2) of the Internal Revenue Code of 1954 to provide an additional period (somewhat less than 2 years from the date of enactment of the bill) within which certain ministers, members of religious orders (other than persons who have taken a vow of poverty as members of such an order), and Christian Science practitioners may file a certificate electing to be covered under title II of the Social Security Act. Under present law, any member of one of these professions who has had net earnings from self-employment of $400 or more, any part of which was derived from services in such profession, in two or more taxable years beginning after 1954, but who failed to file a certificate within the time prescribed by the present section 1402(e)(2), no longer has an opportunity to elect the coverage. Under the bill, every such individual is afforded a further opportunity to make the election. Such election may be made by filing a certificate on or before the due date of the return (including any extension thereof) for the individual's second taxable year ending after 1959 (generally April 15, 1962).

Effective date of certificate.

Section 101(b) of the bill amends section 1402(e)(3) of the Internal Revenue Code of 1954 to eliminate those portions of it which have ceased to have any effect. As amended by section 101(b) of the bill, section 1402(e)(3) continues to provide, to the same effect as at present, that a certificate filed under section

1402(e) of the code shall be effective for the taxable year immediately preceding the earliest taxable year for which, at the time the certificate is filed, the period for filing a return (including any extension thereof) has not expired, and for all succeeding taxable years. Thus, under present section 1402(e)(3) and under such section as amended by section 101(b) of the bill, where the taxable year is a calendar year and there is no extension of time for the filing of the tax return, a certificate filed on or before April 15 of the year following such taxable year is effective for the 2 taxable years preceding the year in which the certificate is filed, and for all years following such 2 taxable years. If the certificate in such case is filed after April 15, it is effective only for the immediately preceding taxable year and for all years thereafter. However, under the conditions prescribed in section 1402(e)(5) of the code, as added by section 101(c) of the bill (discussed below), a certificate filed under section 1402(e) of the code by April 15, 1962, may be made effective for years earlier than those for which the certificate would be effective under the general rule stated in section 1402(e)(3).

Optional provision for certain certificates filed on or before April 15, 1962.

Section 101(c) of the bill amends section 1402(e) of the Internal Revenue Code of 1954 by adding a new paragraph (5). Pursuant to the new paragraph (5), any individual who has filed a timely return reporting earnings derived by him in any taxable year ending after 1954 and before 1960 from the performance of service as a minister, a member of a religious order (other than one who has taken a vow of poverty as a member of such order), or a Christian Science practitioner, but who does not have self-employment coverage for the first year for which such a return was filed because a certificate under section 1402(e) is not in effect with respect to such year, may, if he wishes, elect to have his self-employment coverage as a minister, member of a religious order, as Christian Science practitioner begin with such first year. The election (which may be made by the individual, by a fiduciary acting for him or his estate, or by any survivor who is or may become entitled to monthly benefits under title II of the Social Security Act on his earnings record) may be made in one of two ways:

(1) If the individual has not filed a valid certificate on or before the date of the enactment of the bill, he (or such fiduciary or survivor) may file such a certificate and indicate thereon an election to have the certificate made effective for the first taxable year ending after 1954 and before 1960 for which such individual filed such a return, and for all succeeding taxable years.

(2) If the individual has filed a valid certificate on or before the date of the enactment of the bill, he (or such fiduciary or survivor) may file a supplemental certificate and indicate thereon an election to have the certificate previously filed by such individual made effective for the first taxable year ending after 1954 and before 1959 for which he filed such a return, and for all succeeding taxable years.

In either case, if the election is to be valid, it must be made on or before April 15, 1962, and all self-employment tax (whether or not attributable to earnings as a minister, member of a religious order, or Christian Science practitioner) due for each taxable year for which the certificate is effective under the new paragraph (5) (but would be ineffective under par. (3)) must be paid on or before April 15, 1962. Moreover, any such tax previously refunded as an overpayment because no valid certificate was then in effect with respect to the year for which paid must be repaid to the United States, together with the interest allowed on the refund, on or before such date. However, any underpayment of the tax which is attributable to an error made in good faith will not invalidate an election which is otherwise valid. Any such tax which is paid or repaid for a year with respect to which the period of limitation on assessment or collection has expired will not be regarded as an overpayment solely because such period has expired. It should be noted that April 15, 1962, falls on a Sunday, and section 7503 of the code provides that an act required to be performed on a Saturday, Sunday, or legal holiday is timely if performed on the next day which is not a Saturday, Sunday, or legal holiday.

Administrative provisions.

Pursuant to section 101(d) of the bill, no interest or penalty will be imposed in respect of self-employment tax paid on or before April 15, 1962, on earnings derived from the performance of service as a minister, member of a religious order, or Christian Science practitioner for taxable years as to which a certificate

is effective under the new paragraph (5) (but would not be effective under par. (3)) of section 1402(e). If such tax is not fully paid (except for underpayments due to errors made in good faith) on or before April 15, 1962, the question of interest does not arise since the certificate in such cases is effective only for the taxable years prescribed in such paragraph (3) and not for the earlier years prescribed in such paragraph (5). However, in the case of an underpayment attributable to an error made in good faith, the additional tax due for any such earlier year must be paid with interest accruing from April 15, 1962, to the date of payment. Moreover, the statutory period for assessing any such underpayment will expire not earlier than 3 years from April 15, 1962.

Sections 101(c) and 101(d) of the bill are relief measures for the benefit of ministers, members of religious orders, and Christian Science practitioners who filed returns of self-employment tax on their earnings as such for years with respect to which they have no self-employment coverage because no certificate under section 1402(e) of the code is in effect for such years. However, your committee does not intend that the amendments made by such section 101(c) should be regarded as invalidating the effect of Revenue Ruling 57–139 (Cumulative Bulletin 1957–1, p. 284) and Revenue Ruling 57–401 (Cumulative Bulletin 1957–2, p. 604) on any certificate under section 1402(e) which is filed on or before the date of the enactment of the bill.

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Effective dates.

Section 101(f) of the bill provides that the amendments made by section 101 of the bill shall be applicable only with respect to certificates (and supplemental certificates) filed after the date of the enactment of the bill.

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SECTION 103. EXTENSION OF THE PROGRAM TO GUAM AND AMERICAN SAMOA

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International Revenue Code amendments relating to coverage for purposes of Social Security taxes.

Imposition of self-employment tax.—Section 103(k) of the bill adds a new paragraph (9) to section 1402(a) of the Internal Revenue Code of 1954, which deals with net earnings from self-employment. Pursuant to the new paragraph (9), Guam and American Samoa are not to be considered as possessions of the United States within the meaning of section 931 and section 932 of the Internal Revenue Code of 1954, but only for purposes of determining liability for the self-employment tax.

Section 931 provides, in effect, an exclusion from gross income, for purposes of the Federal income tax, in respect of certain income derived from sources outside the United States by citizens of the United States who meet the percentage tests stated in section 931 in respect of income derived from sources within certain possessions (including Guam and American Samoa) of the United States. Section 932 provides in effect that gross income, for purposes of the Federal income tax, means only gross income derived from sources within the United States (not including the possessions), in the case of certain citizens of possessions (including Guam and American Samoa) who are not otherwise citizens of the United States and who are not residents of the United States. To the extent that income does not constitute gross income for Federal income tax purposes, there can be no self-employment coverage unless the income tax exclusion is overridden by statute for self-employment purposes. In general, this is the purpose of the amendment made by section 103(k) of the bill in respect of sections 931 and 932 of the Internal Revenue Code of 1954, insofar as such sections have application to Guam and American Samoa. In the area of section 931, the principal effect, in general, is to include in net earnings from self-employment all income derived by United States citizens which is excluded from gross income for Federal income tax purposes only by reason of taking income from Guam or American Samoa into account in the application of such section. In the area of section 932, the effect, in general, is to treat Guamanians and American Samoans the same for self-employment tax purposes as citizens born in any State of the Union.

Aliens in Guam and American Samoa.—Section 103(l) of the bill amends section 1402(b) of the Internal Revenue Code of 1954 to provide that individuals who are not citizens of the United States but who are residents of Guam or American Samoa shall not be regarded as nonresident aliens for self-employment

tax purposes. The effect of this amendment is to accord the same self-employment tax treatment to nonresident aliens who are residents of Guam or American Samoa as that accorded to aliens who are residents of the United States.

Cross reference.—Section 103(m) of the bill amends paragraph (2) of section 1403(b) of the Internal Revenue Code of 1954 to include a reference to Guam and American Samoa in the cross-reference to section 7651 of the Internal Revenue Code of 1954, relating to the collection of taxes imposed in a possession of the United States pursuant to such code.

Officers and employees of the government.—Section 103(n) of the bill amends section 3121(b)(7) of the Internal Revenue Code of 1954 to provide that services performed as an officer or employee of the Government of Guam, the Government of American Samoa, any political subdivision thereof, or any wholly owned instrumentality of any one or more of the foregoing shall not be excepted from "employment", within the meaning of the Federal Insurance Contributions Act, as services performed in the employ of a State, a political subdivision thereof, or an instrumentality wholly owned by any one or more of the foregoing. In general, this has the effect of extending coverage under the Federal Insurance Contributions Act to such services. Members of the legislature of the Government of Guam, the Government of American Samoa, or of any political subdivision of either are specifically included in the coverage so extended. Where an individual performs services as an officer or employee of the Government of Guam, the Government of American Samoa, any political subdivision of either, or an instrumentality wholly owned by any one or more of the foregoing and such services are covered by the Civil Service Retirement Act or by any other retirement system established by a law of the United States, then such services are not included in the coverage so extended. In any case where such services are not covered by such a retirement system, the services are included in the coverage under the Federal Insurance Contributions Act. All remuneration paid for such services, including fees paid to a public official and remuneration paid by the United States or an agency thereof, will be deemed to have been paid by the Government of Guam, the Government of American Samoa, a political subdivision thereof, or a wholly owned instrumentality of any one or more of the foregoing, whichever is appropriate.

Filipino contract workers in Guam.—Section 103(o) of the bill further amends section 3121(b) of the Internal Revenue Code of 1954 by adding a new paragraph (18), which provides an exception from "employment" within the meaning of the Federal Insurance Contributions Act, for services performed in Guam by any resident of the Republic of the Philippines who is admitted to Guam on a temporary basis as a nonimmigrant alien pursuant to section 101(a)(15)-(H)(ii) of the Immigration and Nationality Act.

Definition of "State" and "United States".—Section 103(p) of the bill amends section 3121(e) of the Internal Revenue Code of 1954 to include Guam and American Samoa in the definition of the term "State," and in the definition of the term "United States" when used in a geographical sense, for purposes of the Federal Insurance Contributions Act.

Provisions for tax administration and collection.

Section 103(q) of the bill amends subchapter C of chapter 21 of the Internal Revenue Code of 1954 by redesignating section 3125 as section 3126 and by inserting a new section 3125. Subsection (a) of the new section 3125 relates to the employee and employer taxes imposed with respect to certain services performed as officers or employees of the Government of Guam, any political subdivision thereof, or any instrumentality wholly owned by any one or more of the foregoing. The return and payment of such taxes may be made by the Governor of Guam or by such agents as he may designate. A person making such return may, for convenience of administration, make payments of the employer tax imposed under section 3111 without regard to the $4,800 limitation in section 3121(a)(1) (although this subsection would not authorize such person to disregard the $4,800 limitation as to remuneration includible in returns made by him). The purpose is to relieve a person making a return on behalf of any department or agency of the Government of Guam, any political subdivision thereof, or any instrumentality wholly owned by any one or more of the foregoing of any necessity for ascertaining whether any wages have been reported for a particular employee by any other reporting unit of such government, political subdivision, or instrumentality.

Subsection (b) of the new section 3125 contains identical provisions in respect of American Samoa.

Section 103(r)(1) of the bill amends section 6205(a) of the Internal Revenue Code of 1954 by adding a new paragraph (3). The new paragraph (3) provides that each agent designated by the Governor of Guam or the Governor of American Samoa, pursuant to the new section 3125 of the code, to make returns of the employee and employer taxes imposed under the Federal Insurance Contributions Act shall be deemed to be a separate employer for purposes of section 6205(a) of the code, relating to adjustments of underpayments of such taxes. Thus, adjustments of underpayments will be made by the reporting unit by which the underpayment was made.

Section 103(r)(2) of the bill amends section 6413(a) of the Internal Revenue Code of 1954 by adding a new paragraph (3). The new paragraph (3) provides that each agent designated by the Governor of Guam or the Governor of American Samoa, pursuant to the new section 3125 of the code, to make returns of the employee and employer taxes imposed under the Federal Insurance Contributions Act shall be deemed to be a separate employer for purposes of section 6413(a) of the code, relating to adjustments of overpayments of such taxes. Thus, adjustments of overpayments will be made by the reporting unit by which the overpayment was made.

Section 103(r)(3) of the bill amends section 6413(c)(2) of the Internal Revenue Code of 1954 by adding thereto new subparagraphs (D) and (E). The new subparagraph (D) provides that for purposes of the special credit or refund provisions contained in section 6413(c)(1), the Governor of Guam and each of the agents he designates to make returns of the employee tax and employer tax imposed under the Federal Insurance Contributions Act shall be treated as separate employers. The new subparagraph (E) contains identical provisions in respect of American Samoa. The effect of these amendments is to permit a claim for special credit or refund, rather than a general claim for refund under section 6402(a), in any case where an employee receives more than $4,800 of wages in a calendar year by reason of his having performed services for two or more reporting units of the government of Guam, the government of American Samoa, any political subdivision of either, or any instrumentality wholly owned by one or more of the foregoing.

Section 103(s) of the bill amends section 7213 of the Internal Revenue Code of 1954 by redesignating subsection (d) as subsection (e) and by inserting a new subsection (d). Pursuant to the new subsection (d), all provisions of law relating to the disclosure of information, and all provisions of law relating to the unauthorized disclosure of information, which apply to an officer or employee of the Treasury Department shall also apply to any delegate who is an officer or employee of another department or agency of the United States, or of a possession, who is authorized, directly or indirectly, by the Secretary of the Treasury to perform any function in the administration of the self-employment tax under chapter 2, or the employee and employer taxes under chapter 21 (the Federal Insurance Contributions Act), in Guam or American Samoa.

Section 103(t) of the bill amends section 7701(a)(12) of the Internal Revenue Code of 1954 by inserting a new subparagraph (B) and by designating the existing provisions of section 7701(a)(12) as subparagraph (A). The new subparagraph (B) defines the term "delegate" to include any officer or employee of a department of the United States other than the Treasury Department, or of any agency of the United States not a part of the Treasury Department, or of any possession of the United States, who is authorized, directly or indirectly, by the Secretary of the Treasury to perform any function in Guam or American Samoa with respect to the self-employment tax under chapter 2 or the employee and employer taxes under chapter 21. Since the Treasury Department does not now maintain tax-collection offices in Guam or American Samoa, the Secretary of the Treasury may find it desirable and expedient that the performance of functions in respect of such taxes be delegated, directly or indirectly, to an officer or employee of another department or agency of the United States, or of Guam or American Samoa. The new subparagraph (B) of section 7701(a)(12) provides authority for such a delegation.

Section 103(u) of the bill amends section 30 of the Organic Act of Guam so as to exclude the self-employment tax under chapter 2 of the Internal Revenue Code of 1954, and the employee and employer taxes under chapter 21 of such code, from the taxes which, pursuant to section 30 of the organic act, are to be covered into the treasury of Guam.

Effective dates.

Section 103(v)(1) of the bill provides effective dates for the amendments made by section 103 of the bill.

The amendments relating to reinterments (subsec. (a) of sec. 103) apply with respect to reinterments after the date of enactment of the bill.

The amendments relating to noncovered remunerative activity outside the United States for purposes of the old-age, survivors, and disability insurance "retirement test" (subsec. (b) of sec. 103) and the amendments defining "State" and "United States" to include Guam and American Samoa for purposes of title II of the Social Security Act (subsecs. (e) and (f) of sec. 103) are effective with respect to service performed after 1960, except that, in the case of a trade or business (other than the performance of service as an employee), such amendments are effective with respect to taxable years beginning after 1960.

The amendments relating to the exclusion from coverage of residents of the Republic of the Philippines admitted to Guam on a temporary basis, excluding Guam and American Samoa from the definition of State for purposes of coverage under a State agreement entered into pursuant to section 218 of the Social Security Act, and defining "State" and "United States" for purposes of the Federal Insurance Contributions Act (subsecs. (d), (i), (o), and (p) of sec. 103) are effective with respect to service performed after 1960.

The amendments relating to the extension of self-employment coverage to Guam and American Samoa (subsecs. (g), (h), (k), and (l) of sec. 103) are effective with respect to taxable years beginning after 1960. Insofar as subsections (g) and (k) relate to the Virgin Islands, the amendments made by such subsections are merely technical and clarifying, and such amendments are effective with respect to the Virgin Islands for taxable years beginning after 1950.

The amendments relating to the coverage of officers and employees of the Government of Guam, the Government of American Samoa, any political subdivision of either, or any instrumentality wholly owned by any one or more of the foregoing (subsecs. (c), (n), (q), and (r) of sec. 103) are effective, in the case of Guam, with respect to service performed on or after the first day of the calendar quarter following the calendar quarter in which the Secretary of the Treasury receives a certification by the Governor of Guam that the Legislature of Guam has expressed its desire for the coverage and, in the case of American Samoa, not earlier than 1961. Thus, if the coverage is to commence the calendar quarter following the calendar quarter in which the Secretary of the Treasury receives a certification from the Governor of American Samoa that its Government desires the coverage: but, in the case of both Guam and American Samoa, not earlier than 1961. Thus, if the coverage is to commence with reference to the earliest possible effective date (Jan. 1, 1961), the certification must be received prior to 1961.

The amendments relating to the delegation of functions in Guam or American Samoa to an officer or employee of a department of the United States Government other than the Treasury Department, an officer or employee of an agency of the United States outside the Treasury Department, or an officer or employee of Guam or American Samoa (subsecs. (s) and (t) of sec. 103) are effective on the date of the enactment of the bill, and authority is provided for appropriating such sums as may be necessary for the performance of such functions by such officer or employee. Such sums are to be appropriated directly to the delegate, or to the agency which normally receives appropriations for such delegate, rather than to the Treasury, in order to avoid any need for charges to and reimbursements by the Treasury.

Section 103(v)(2) of the bill provides that the amendments made by sections 103 (c) and (n) shall not affect the determination of whether an officer or employee of the Government of Guam, the Government of American Samoa, any political subdivision of either, or any wholly owned instrumentality thereof is an employee of an agency or instrumentality of the United States for any purpose other than the old-age, survivors, and disability insurance program.

Section 103(v)(3) of the bill provides that the repeal of the provisions concerning the beginning date of coverage in Puerto Rico, and the related conforming amendments, shall not affect the date on which this coverage extension became effective, the manner or consequences of the extension, or the status of any individual with respect to whom the eliminated provisions are applicable.

SECTION 104. DOCTORS OF MEDICINE

* * * * * * *

Conforming amendments in the Internal Revenue Code of 1954.

Removal of exclusion for doctors of medicine.—Under existing law, services performed by a self-employed person in the exercise of his profession as a doctor of medicine, or as a member of a partnership engaged in the practice of medicine, are excepted from the term "trade or business" under section 1402(c)(5) of the Internal Revenue Code of 1954. Section 104(d)(1) of the bill amends section 1402(c)(5) of the code by removing the exception provided for services performed as a doctor of medicine or as a member of a partnership engaged in the practice of medicine. In general, the effect of this amendment is to subject the net earnings derived by an individual from the practice of medicine on his own account or by a partnership of which he is a member to the self-employment tax.

Section 104(d)(2) of the bill merely conforms the provisions of the last two sentences of section 1402(c) of the Internal Revenue Code of 1954 to the amendment made by section 104(d)(1). The changes made in such provisions of section 1402(c) are technical changes and have no substantive effect.

Technical amendments.—Section 104(e) of the bill merely conforms the language of sections 1402(e)(1) and 1402(e)(2) of the code to the amendment made by section 104(d)(1). The changes made are technical changes and have not substantive effect.

Removal of exclusion for interns in Federal hospitals.—Present section 3121(b)(6)(C)(iv) of the Internal Revenue Code of 1954 excludes from "employment," and thus from coverage under the Federal Insurance Contributions Act, services performed by certain interns, student nurses, and other student employees of hospitals of the Federal Government. Section 104(f) of the bill amends such section 3121(b)(6)(C)(iv) so as to remove the exclusion insofar as it pertains to medical or dental interns and medical or dental residents-in-training. The effect of this amendment is to make the remuneration of such individuals for services performed by them as such interns or residents-in-training in the employ of hospitals of the Federal Government subject to the Federal Insurance Contributions Act.

Removal of exclusion for student interns.—Present section 3121(b)(13) of the Internal Revenue Code of 1954 excludes from employment, and thus from coverage under the Federal Insurance Contributions Act, services performed by certain student nurses in the employ of a privately operated hospital or nurses' training school, and services performed as an intern in the employ of a privately operated hospital by an individual who has completed a 4-year course in a medical school chartered or approved pursuant to State law. Section 104(g) of the bill amends such section 3121(b)(13) so as to remove the exclusion insofar as it pertains to interns. The effect of this amendment is to extend coverage under the Federal Insurance Contributions Act to such individuals unless their services are excluded under provisions other than section 3121(b)(13). Thus, the services of an intern are covered if he is employed by a hospital which is *not* exempt from income tax as an organization described in section 501(c)(3) of the Internal Revenue Code of 1954. If the intern is employed by a hospital which is exempt from income tax and which has a waiver certificate in effect under section 3121(k) of the code, he is not excluded from coverage by section 3121(b)(8)(B) of the code if (1) he was an employee of the hospital at the time the waiver certificate was filed and continuously thereafter, and he elects to be covered within the 24-month period prescribed in section 3121(k), or (2) he became an employee of the hospital after the calendar quarter in which the certificate was filed.

Effective date.

Section 104(h) of the bill provides that the amendments made by subsections (a), (d), and (e), relating to the self-employment coverage of doctors of medicine, are effective for taxable years ending on or after December 31, 1960. This will provide coverage for most self-employed doctors of medicine beginning January 1, 1960. The amendments made by subsections (b), (c), (f), and (g), relating to social security coverage of interns and residents-in-training, are effective with respect to services performed after 1960.

SECTION 105. SERVICE OF PARENT FOR SON OR DAUGHTER

Removal of exclusion for services performed by a parent for his child.

Present section 210(a)(3) of the Social Security Act excludes from "employment," and thus from old-age, survivors, and disability insurance coverage, service performed by an individual in the employ of his son, daughter, or spouse, and service performed by a child under the age of 21 in the employ of his father or mother. Section 105(a) of the bill amends such section 210(a)(3) so as to remove from the exclusion service (other than service not in the course of the employer's trade or business, or domestic service in a private home of the employer) performed by an individual in the employ of his son or daughter. The effect of this amendment is to extend coverage to most services performed by a parent in the employ of his child. Only service by a parent for a child which is not in the course of the child's trade or business, or which is domestic service in the child's private home, will continue to be excluded. Service not in the course of the child's trade or business, and domestic service in the child's private home, which constitutes agricultural labor pursuant to section 210(f) of the Social Security Act because performed on a farm operated for profit, would continue to be excluded under section 210(a)(3) of the act.

Section 105(b) of the bill makes identical changes in section 3121(b)(3) of the Internal Revenue Code of 1954.

Effective date.

Section 105(c) of the bill provides that the amendments made by subsections (a) and (b) shall apply with respect to services performed after 1960.

SECTION 106. EMPLOYEES OF NONPROFIT ORGANIZATIONS

Elimination of requirement that religious, charitable, etc., organization may file waiver certificate only if two-thirds of its employees concur.

Section 106(a) of the bill amends section 3121(k)(1)(A) of the Internal Revenue Code of 1954, relating to waivers of tax exemption which may be filed by certain religious, charitable, etc., organizations. Pursuant to present law, such an organization may file a certificate electing to have old-age, survivors, and disability insurance coverage extended to services performed in its employ only if two-thirds or more of its employees concur in the filing of such certificate, and such certificate is accompanied by a list containing the signature, address, and social security account number (if any) of each employee who concurs. Section 106(a) of the bill eliminates the requirement that two-thirds or more of such employees must concur before the certificate can be filed. This amendment has the effect of permitting the organization to elect coverage in respect of all employees of the organization hired after the quarter in which a certificate is filed by the organization even though less than two-thirds, or none, of the employees in its employ in such quarter concur in the filing of the certificate. As under present law, a list showing the names, addresses, and social security account numbers of all concurring employees must accompany the certificate, and, in general, only the services of those employees (if any) whose names appear on such list will be covered when the certificate takes effect. However, the 24-month period prescribed in present law for signing a supplemental list of concurring employees is continued, and employees who decline the coverage at the time the certificate is filed but later desire to have it may acquire such coverage prospectively by signing a supplemental list within the prescribed period.

Section 106(a) of the bill also amends section 3121(k)(1)(E) of the code, relating to the filing of waiver certificates by organizations some of whose employees are in positions covered by a pension, annuity, retirement, or similar fund or system established by a State or political subdivision thereof and some of whose employees are not in such positions. Under present law such organization must divide its employees who are in such positions and its employees who are not in such positions into separate coverage groups, and a waiver certificate in respect of either group may be filed only if two-thirds of the employees in the group concur in the filing of the certificate. Section 106(a) of the bill eliminates the requirement that two-thirds or more of the employees in such group must concur before a certificate can be filed in respect of such group. Under the amendment made by section 106(a), a certificate may be filed in respect of either group, or separate certificates may be filed in respect of each group, even though less than two-thirds, or none, of the employees in the group concur in the filing of the certificate.

Validation of remuneration erroneously reported as wages by nonprofit organizations.

Section 106(b) of the bill relates to service performed after 1950 which is excepted from covered "employment" solely because the service is performed for an organization, described in section 501(c)(3) of the Internal Revenue Code of 1954 (or sec. 101(6) of the Internal Revenue Code of 1939) and exempt from income tax, which does not have a waiver certificate under section 3121(k) of the Internal Revenue Code of 1954 (or sec. 1426(1) of the Internal Revenue Code of 1939) in effect with respect to such service. The service may be excepted from employment because no such certificate was filed by the organization or, if a certificate was filed, because the person performing the service could acquire coverage only by signing the list of employees concurring in the filing of the certificate and he failed to do so.

Section 106(b) of the bill makes provision whereby the remuneration paid by an organization to an individual before July 1, 1960, for such service may be deemed to constitute remuneration for employment for purposes of title II of the Social Security Act, to the extent that an amount has been paid before August 11, 1960, as taxes under the Federal Insurance Contributions Act with respect to such remuneration. Such remuneration will be deemed to constitute remuneration for employment for purposes of such title II if the following conditions are met:

(1) The person who performed the service (or a fiduciary acting for him or his estate, or a survivor of such individual who is or may become entitled to monthly benefits under title II of the Social Security Act on his earnings record) makes a request (in such form and manner, and with such official as the Secretary of Health, Education, and Welfare may by regulations prescribe) that such remuneration be deemed to constitute remuneration for employment for purposes of title II of the Social Security Act.

(2) If any part of the amount paid as taxes before August 11, 1960, with respect to such remuneration paid to an individual is credited or refunded, the amount credited or refunded, plus any interest allowed, is repaid before January 1, 1963.

(3) A certificate under section 3121(k) of the Internal Revenue Code of 1954 is filed by the organization not later than the date on which the request is made, unless the organization has previously filed a certificate under that section or section 1426(1) of the Internal Revenue Code of 1939, or the organization no longer has any individual in its employ for remuneration at the time the request is made.

(4) In the case of an organization which has filed a certificate on or before the date on which the individual's request is made, amounts are paid as taxes with respect to some portion of the remuneration paid by the organization to the individual during the 24-month period following the calendar quarter in which the certificate is filed, if the individual is in the employ of the organization at any time during such 24-month period.

Pursuant to section 106(b)(5) of the bill, an organization's certificate is made applicable in the future to an individual if remuneration paid by such organization to the individual before July 1, 1960, is deemed, pursuant to a request made under section 106(b), to constitute remuneration for employment, and if the individual performs service in the employ of the organization on or after the date on which the request is made. If the certificate is not effective with respect to service performed by such individual before the first day of the calendar quarter following the quarter in which the request is made, the effect of paragraph (5) is to make the certificate applicable to service performed by the individual on and after such first day.

After the date of enactment of the bill, section 106(b) will supersede provisions of section 403(a) of the Social Security Amendments of 1954 which permit certain remuneration paid for service performed before 1957 to be deemed remuneration for employment. Section 403(a) will continue to apply to requests made pursuant to such section on or before the enactment of this bill, but not to requests made after the date of enactment.

Remuneration erroneously reported as self-employment income by certain employees of charitable, religious, etc., organizations.

Section 106(c)(1) of the bill amends section 1402 of the Internal Revenue Code of 1954 by adding a new subsection (g). Pursuant to the new subsection (g), any individual who, for any taxable year ending after 1954 and before 1962,

erroneously reported as self-employment income (and paid self-employment tax on) remuneration received by him for services performed in the employ of an organization which is exempt from income tax as an organization described in section 501(c)(3) may request (or a fiduciary acting for such individual or for his estate, or a survivor of such individual who is or may become entitled to monthly benefits under title II of the Social Security Act on his wage record may request) that such remuneration reported for such taxable year (other than remuneration for services performed by the individual as a duly ordained, commissioned, or licensed minister of a church or as a member of a religious order) be deemed to constitute net earnings from self-employment. The request will be effective if—

(1) it is made after the date of enactment of the new section 1402(g) of the code and on or before April 15, 1962;

(2) the return on which the remuneration was reported was timely filed;

(3) a certificate under section 3121(k) of the code is filed by the organization on or before the date the request is made; and

(4) no credit or refund of any part of the amount erroneously paid for such taxable year as self-employment tax on such remuneration is obtained before the date on which the request is filed, or, if obtained, is repaid on or before the date of the request;

but only to the extent that such remuneration was paid to the individual before the calendar quarter in which the request was filed (or, in some cases, before the next calendar quarter), and no employment tax under chapter 21 has been paid on such remuneration.

In any case where remuneration paid to an individual by a religious, charitable, etc., organization is deemed to be net earnings from self-employment by reason of a request filed pursuant to the new section 1402(g), the certificate filed by the organization, if it is not effective with respect to services performed by the individual on or before the first day of the calendar quarter in which the request is filed, shall be effective with respect to services (if any) performed by the individual for the organization on and after the first day of the next calendar quarter.

Section 106(c)(2) of the bill contains complementary provisions for purposes of title II of the Social Security Act.

United States citizen employees of certain labor organizations in the Panama Canal Zone.

Services performed outside the geographical limits of the United States (as defined in title II of the Social Security Act and in the Federal Insurance Contributions Act) by citizens of the United States are covered under such acts if they are performed for an "American employer." Under existing law, labor organizations created or organized in the Canal Zone or elsewhere outside the United States do not meet the definition of "American employer" and the services of their United States citizen employees performed outside the United States are excluded from coverage. Paragraphs (1) and (2) of section 106(d) of the bill amend section 3121(h) of the Internal Revenue Code of 1954 and section 210(e) of the Social Security Act, respectively, to include in the definition of "American employer" labor organizations created or organized in the Canal Zone, if they are chartered by labor organizations created or organized in the United States which are described in section 501(c)(5) and exempt from income tax under section 501(a) of the Internal Revenue Code. In effect, these amendments extend coverage compulsorily to service performed after 1960 outside the United States by United States citizens in the employ of such labor organizations.

Section 106(d)(3) of the bill permits the validation as wages of certain remuneration which was erroneously reported as wages by any labor organization which qualifies as an "American employer" under the amendments made by section 106(d)(1) and (2) of the bill. For purposes of title II of the Social Security Act, remuneration paid in any calendar quarter by such an organization to a citizen of the United States for services performed after 1954 and before 1961 is deemed to constitute remuneration for employment, if amounts representing the social security taxes with respect to such remuneration were timely paid, no claim for credit or refund of any part of such amounts paid with respect to such calendar quarter is filed before the expiration of the period

prescribed for filing claim for credit or refund, and (in effect) there was a timely payment before the date of the enactment of the bill of an amount representing the social security taxes for a period before the enactment of the bill.

Effective dates.

Section 106(e) of the bill provides effective dates for the amendments relating to employees of nonprofit organizations.

Paragraph (1) provides that the amendments made by subsection (a) shall be effective with respect to certificates filed under section 3121(k)(1) of the Internal Revenue Code of 1954 after the date of the enactment of the bill.

Paragraph (2) provides that the amendments made by paragraphs (1) and (2) of subsection (d), relating to coverage of service performed by United States citizen employees of certain labor organizations in the Canal Zone, shall be effective with respect to service performed after December 31, 1960.

Paragraph (3) provides that no monthly benefits shall be payable or increased for the month of enactment or prior months by reason of the provisions of or amendments made by subsections (b), (c), and (d), relating to validation of remuneration erroneously reported as wages by nonprofit organizations, as net earnings from self-employment by certain employees of nonprofit organizations, and as wages by certain labor organizations in the Canal Zone. No lump-sum death payment under such title II would be payable or increased by reason of such provisions or amendemnts in the case of any individual who died prior to the date of enactment of the bill.

SECTION 107. AMERICAN CITIZEN EMPLOYEES OF FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS

Self-employment coverage for benefit purposes.

Section 211(c)(2) of the Social Security Act now provides three exceptions to the general rule that services performed as an employee are excluded from the definition of "trade or business," and thus from self-employment coverage. The effect of these exceptions is to include the services excepted in the definition of "trade or business," and thus to extend self-employment coverage to such services. These services are (1) services performed by certain news vendors, (2) certain services performed by an individual under share-farming arrangements, and (3) services performed by an individual in the exercise of his ministry or as a member of a religious order. Section 107(a) of the bill amends section 211(c)(2) so as to include a fourth category of employee services in the term "trade or business." The services thus included under the amendment are those performed in the United States (including the Virgin Islands, Puerto Rico, and, effective January 1, 1961, Guam and American Samoa) by a citizen of the United States in the employ of a foreign government, in the employ of an instrumentality wholly owned by a foreign government, or in the employ of an international organization entitled to enjoy privileges, exemptions, and immunities under the International Organizations Immunities Act, to the extent that such services are excluded from "employment" by section 210(a)(11), 210(a)(12), or 210(a)(15) of the Social Security Act. In effect, this change extends self-employment coverage under title II of the Act to such services.

Coverage for self-employment tax purposes.

Section 107(b) of the bill makes corresponding amendments to section 1402(c)(2) of the Internal Revenue Code of 1954. The effect of these amendments is to require that income derived by a United States citizen from service performed in the United States (including the Virgin Islands, Puerto Rico, and, effective January 1, 1961, Guam and American Samoa) as an employee of a foreign government, an instrumentality wholly owned by a foreign government, or an international organization, must be taken into account in determining liability for the self-employment tax, to the extent that such service is excepted from the definition of "employment" by section 3121(b)(11), 3121(b)(12), or 3121(b)(15) of the code.

Effective dates.

Section 107(c) of the bill provides that the amendments made by section 107 with respect to services in the employ of foreign governments, instrumentalities wholly owned by foreign governments, and international organizations shall be

effective for taxable years ending on or after December 31, 1960. (It shoulld be noted, however that such services performed in Guam or American Samoa will not be covered for taxable years ending before 1961 since the inclusion of Guam and American Samoa in the definition of United States for old-age, survivors, and disability insurance purposes is not effective until January 1, 1961; see discussion of sec. 103 of the bill, above.) For purposes of section 203(b) of the Social Security Act, relating to the "retirement test" under the old-age, survivors, and disability insurance program, earnings derived by an individual which are covered as net earnings from self-employment pursuant to the amendments made by section 107 of the bill will be treated as "wages" for taxable years beginning on or befor the date of enactment of the bill, but as "net earnings from self-employment" for taxable years beginning after the date of enactment.

SECTION 108. DOMESTIC SERVICE AND CASUAL LABOR

Reduction in qualifying amount of wages.

Section 108(a) of the bill amends paragraph (2) (relating to domestic service in a private home) and paragraph (3) (relating to service not in the course of the employer's trade or business) of section 209(g) of the Social Security Act. These paragraphs now provide for the exclusion from wages, for purposes of old-age, survivors, and disability insurance, of cash remuneration paid by an employer to an employee in a calendar quarter for domestic service in a private home of the employer, or for service not in the course of the employer's trade or business, unless such remuneration paid in such quarter is $50 or more. The amendments made by section 108(a) would reduce from the present $50 to $25 the amount of cash remuneration which is required to be paid by an employer to an employee in a calendar quarter for service in these types of employment in order to have such remuneration constitute "wages."

Exclusion of service performed by individual under 16.

Section 108(b) of the bill amends section 210(a) of the Social Security Act by adding a new paragraph (19) to provide for the exclusion from employment for purposes of old-age, survivors, and disability insurance of service not in the course of the employer's trade or business, or domestic service in a private home of the employer, performed by an individual under the age of 16. Under present law such service is not excluded from employment and the definition of wages determines whether remuneration for the employment is covered by old-age, survivors, and disability insurance.

Conforming amendments in Interal Revenue Code of 1954.

Section 108(c) (relating to the definition of wages) and section 108(d) (relating to the definition of employment) of the bill make conforming amendments in the Internal Revenue Code of 1954.

Effective dates.

Section 108(e) of the bill provides that the amendments made by subsections (a) and (c), relating to the definition of wages, are effective with respect to remuneration paid after 1960, and that the amendments made by subsections (b) and (d), relating to the definition of employment, are effective with respect to service performed after 1960.

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TITLE V—EMPLOYMENT SECURITY

Part 1 of title V of the bill provides that title V may be cited as the "Employment Security Act of 1960." The remainder of title V is divided into three parts as follows:

Part 2 (secs. 521 to 524, inclusive) revises the provisions relating to the financing of the administration of the employment security program, advances out of the Federal unemployment account to States whose reserves are inadequate to pay unemployment compensation, and the repayment of such advances. Part 2 also increases the Federal unemployment tax from 3 percent of wages to 3.1 percent of wages.

Part 3 (secs. 531 to 535, inclusive) provides for extension of coverage under the unemployment compensation program.

Part 4 (secs. 541 to 543, inclusive) provides for extension of the Federal-State unemployment compensation program to Puerto Rico.

Part 2.—Employment Security Administrative Financing Amendments

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SECTION 523. FEDERAL UNEMPLOYMENT TAX ACT

(a) *Increase in tax rate.*—Section 3301 of the Internal Revenue Code of 1954 (relating to rate of tax under the Federal Unemployment Tax Act) is amended by subsection (a) to increase the excise tax imposed on each employer (as defined in sec. 3306(a) of such code). The rate is increased from 3 percent of total wages (as defined in sec. 3306(b) of such code) to 3.1 percent, effective with respect to wages paid after 1960.

(b) *Computation of credits against tax.*—Subsection (b) of section 523 of the bill amends section 3302 of the Internal Revenue Code of 1954, by striking out subsection (c) and inserting in lieu thereof new subsections (c) and (d).

Section 3302(a) permits credit against the Federal tax for contributions with respect to the taxable year paid into a State unemployment fund on or before the due date of the Federal return for such year. Credit is also permitted under existing law for contributions paid after the due date of the Federal return but this credit is not to exceed 90 percent of the amount which would have been allowable as credit on account of such contributions had they been paid on or before the due date of the Federal return. An additional credit is allowable under section 3302(b) with respect to the amount of contributions which a taxpayer is relieved from paying to an unemployment fund under the experience rating provisions of a State law which has been certified for the taxable year as provided in section 3303 of the code. Section 3302(c)(1) provides that the total credits allowed to a taxpayer shall not exceed 90 percent of the tax against which such credits are allowable.

The amendment to section 3302 makes no change in the credits allowable under subsections (a), (b), (c)(1) of section 3302 of existing law. As provided in subsection (d)(1), the credits will continue to be calculated as a percentage of a 3 percent tax rate, even though the total Federal unemployment tax has been increased to 3.1 percent. Subsection (c)(2) of existing law, which provides for a reduction in the amount of total credits allowable under certain circumstances, appears as a new subsection (c)(2) with no substantive change (other than changing the December 1 date to November 10, and placing such date in new subsection (d)(3)), but is limited in application to an advance or advances made before the date of enactment of your committee's bill. If an advance or advances made under title XII of the Social Security Act before the date of the enactment of this bill remain unreturned on January 1 of each of 4 consecutive taxable years, the total credits allowable to a taxpayer subject to the unemployment compensation law of such State are reduced (by 5 percent of 3 percent or 0.15 percent with respect to wages paid by such taxpayer during such taxable year which are attributable to such State) for the taxable year beginning with the fourth such January 1, unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned. The total credits otherwise allowable will be further reduced (by an additional 5 percent of 3 percent for each such succeeding taxable year with respect to wages paid by such taxpayer during each such taxable year which are attributable to such State) in the case of any succeeding taxable year beginning with a consecutive January 1 on which a balance of an unreturned advance or advances exists, unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of the State prior to such date is fully returned.

Section 3302 is further amended by providing a new subsection (c)(3). New subsection (c)(3)(A) provides that if an advance or advances made under title XII of the Social Security Act on or after the date of the enactment of this bill remain unreturned on January 1 of each of 2 consecutive taxable years, the total credits (after applying subsecs. (a), (b), and (c) (1) and (2) of sec. 3302) allowable to a taxpayer subject to the unemployment compensation law of such State are reduced (by 10 percent of 3 percent or 0.3 percent with respect to wages paid by such taxpayer during such taxable year which are attributable to such State) for the taxable year beginning with the second such January 1, unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned. Thus, if there is a balance outstanding as of the beginning of November 10, the reduced credit provisions will apply to the State even though there may have

been no balance outstanding for some period between January 1 and November 10 of the taxable year. The total credits will be further reduced (by an additional 10 percent of 3 percent for each such succeeding taxable year with respect to wages paid by such taxpayer during such taxable year which are attributable to such State) in the case of any succeeding taxable year beginning with a consecutive January 1 on which a balance of unreturned advances exists unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of the State prior to such date is fully returned.

New subsection (c)(3)(B) provides that the total credits otherwise allowable to the taxpayer for the taxable year will be further reduced (in addition to the reduction provided in subsec. (c)(3)(A)) in the case of a taxable year beginning with the third or fourth consecutive January 1 as of the beginning of which there is such a balance of advances, unless prior to November 10 of the taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned, or unless the average employer contribution rate for such State for the calendar year preceding such taxable year is at least 2.7 percent. The additional reduction, if any, for each such taxable year shall be an amount determined by multiplying wages paid by such taxpayer during such taxable year which are attributable to such State by the percentage by which 2.7 percent exceeds the average employer contribution rate for such State for the calendar year immediately preceding such taxable year. The average employer contribution rate is defined in new subsection (d)(4) as the percentage obtained by dividing the total of the contributions paid into the State unemployment fund with respect to such calendar year, by the total of the remuneration subject to contributions under the State unemployment compensation law (State taxable wages) with respect to such calendar year. New subsection (c)(3)(C) provides that the total credits otherwise allowable to the taxpayer for the taxable year will be further reduced (in addition to the reduction provided in subsec. (c)(3)(A)) in the case of a taxable year beginning with the fifth or any succeeding consecutive January 1 as of the beginning of which there is such a balance of advances, unless prior to November 10 of the taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned, or unless the average employer contribution rate for such State for the calendar year preceding such taxable year was equal to the 5-year benefit-cost rate applicable to such State or 2.7 percent, whichever is higher. The additional reduction, if any, for each such taxable year shall be an amount determined by multiplying the wages paid by such taxpayer during such taxable year which are attributable to such State by the percentage by which the 5-year benefit-cost rate applicable to such State for such taxable year, or (if higher) 2.7 percent, exceeds the average employer contribution rate for such State for the calendar year preceding such taxable year. The 5-year benefit-cost rate is defined in new subsection (d)(5) as the percentage obtained by dividing one-fifth of the total of the compensation paid under the State unemployment compensation law during the 5-year period ending at the close of the second calendar year preceding such taxable year by the total of the remuneration subject to contributions under the State unemployment compensation law (State taxable wages) with respect to the first calendar year preceding such taxable year. If the average employer contribution rate for purposes of reductions described in section 3302(c)(3)(C), is 2.7 percent or higher, such rate shall be recomputed and determined by dividing the sum of employer contributions paid into the unemployment fund of such State and employee payments into the fund which are to be used solely in payment of unemployment compensation by the total of the remuneration subject to contributions under the State unemployment compensation law (State taxable wages) with respect to such calendar year.

The amendments of section 3302(c) contemplate that the reduced credit provisions are to apply separately for old advances and for new advances. Thus, if the additional tax collected by reason of section 3302(c)(2) exceeds the balance of advances described in that paragraph, the excess goes to the State account and not to reduce the balance of advances described in section 3302(c)(3). The same principle would apply to excess collections under section 3302(c)(3) where a balance of advances described in section 3302(c)(2) continued to exist.

A new subsection (d) is added to section 3302, providing definitions and special rules relating to subsection (c). Paragraph (1) of subsection (d) provides that in applying the reduced credits prescribed in subsection (c) the

tax imposed by section 3301 shall be computed at the rate of 3 percent in lieu of 3.1 percent. Paragraph (2) provides, as does the present law, that the wages attributable to a particular State are those subject to the unemployment compensation law of the State, or if not covered by any State law, as determined under rules and regulations prescribed by the Secretary of the Treasury or his delegate. Paragraph (3) provides that reductions in credits under paragraph (2) or (3) of section 3302(c) with respect to any State shall not apply for a taxable year if as of the beginning of November 10 of such year there is no balance of advances referred to in such paragraph (2) or (3) of subsection (c). Paragraph (4) defines average employer contribution rate. Paragraph (5) defines the 5-year benefit-cost rate. Paragraph (6) provides that if any percentage referred to in either subparagraph (B) or (C) of subsection (c)(3) is not a multiple of 0.1 percent, it shall be rounded to the nearest multiple of 0.1 percent. Thus, if a percentage is 2.57 percent, it shall be rounded to 2.6 percent; if it is 2.53 percent, it shall be rounded to 2.5 percent; or if it is 2.96 percent, it shall be rounded to 3.0 percent. In the case of subparagraph (C) of section 3302(c)(3), the two rates referred to shall not be rounded until the difference is determined. For example, if the 5-year benefit-cost rate is 3.26 and the average employer contribution rate is 3.14, the difference is 0.12 and the reduction in credit would be 0.1 percent of wages. If these two rates were rounded separately, 3.26 would be increased to 3.3 percent and 3.14 would be decreased to 3.1 percent, and the difference would be 0.2 percent. Paragraph (7) provides that the percentages referred to in subsection (c)(3)(B) or (C) shall be determined by the Secretary of Labor and certified to the Secretary of the Treasury before June 1 of a taxable year on the basis of a report furnished to the Secretary of Labor by the State before May 1 of such year. Any State report shall be as of the close of March 31 of the taxable year. Paragraph (8) is a cross reference to section 104 of the Temporary Unemployment Compensation Act of 1958 which relates to the reduction of total credits allowable under susbection (c). Subsection (c) of section 523 of the bill provides that the amendments made by subsection (a) shall apply only with respect to the calendar year 1961 and calendar years thereafter.

The application of section 3302(c) as amended by section 523 of your committee's bill may be illustrated by the following example:

Example.—Assume that State Z received an advance of $30 million on July 10, 1957, and that after the enactment of the bill State Z receives advances in July, August, September, October, and November of 1960 totaling $170 million, and additional advances in May, June, July, August, September, and October of 1964 totaling $260 million. The 1960 loan balance is repaid on March 5, 1964. The following tables will show the application of the reduction of credit provisions of section 3302(c).

TABLE A.—*Reduction of credits*

Federal taxable year	Percentage of credit reduction under 3302(c)(2)	Percentage of credit reduction under 3302 (c)(3)(A)	Percentage reduction attributable to effect of 3302(c)(3)(B)	Percentage reduction attributable to effect of 3302(c)(3)(C)	Date of additional tax paid by reason of reduction provisions	Reduction attributable to effect of 3302(c) based on wages paid in
1961 [1]	.15				Jan. 31, 1962	1961
1962 [2]	.3	.3			Jan. 31, 1963	1962
1963 [3]		.6	[6] .4 (2.7–2.3)		Jan. 31, 1964	1963
1964 [4] [5]		.9	[6] .3 (2.7–2.41)		Jan. 31, 1965	1964
1965		1.2		[7] .2 (2.88–2.7)	Jan. 31, 1966	1965
1966		1.5		[7] .1 (2.82–2.71)	Jan. 31, 1967	1966

[1] 4th consecutive Jan. 1 has passed and the 1957 advance has not been repaid by Nov. 10.
[2] 2d consecutive Jan. 1 has passed and the new advances have not been repaid by Nov. 10. Also, the 5th consecutive Jan. 1 has passed for the 1957 advance without repayment.
[3] 3d consecutive Jan. 1 has passed and the new advances have not been repaid by Nov. 10. The credit reductions under sec. 3302(c)(2) have discharged the 1957 advance.
[4] 4th consecutive Jan. 1 has passed and the new advances have not been repaid by Nov. 10.
[5] (Note: There is still a balance of advances made after the enactment of the Employment Security Act of 1960, since all such new advances are aggregated and only a portion of the aggregate has been repaid.)
[6] See tables B and D.
[7] See tables B, C, and D.

TABLE B.—*State Z's financial experience*

[Amounts in millions of dollars]

Year	Benefits paid by State	Employer contributions	State taxable wages	Employer contribution as percent of State taxable wages	Federal taxable wages
1959	$260	$186	$7,950	2.34	$7,150
1960	180	144	8,150	1.77	7,350
1961	160	157	8,500	1.85	7,650
1962	195	198	8,600	2.30	7,750
1963	385	195	8,100	2.41	7,300
1964	263	221	8,200	2.70	7,380
1965	185	228	8,400	2.71	7,550
1966	190	255	8,500	2.65	7,650

TABLE C.—*Determination of 5-year benefit-cost rate*

[Amounts in millions of dollars]

Taxable year	5-year period	Total benefit payments	Average annual benefit payments	State taxable wages	Benefit-cost rate (percent)
1965	1959 to 1963	$1,180	$236	[1] $8,200	2.88
1966	1960 to 1964	1,183	237	[2] 8,400	2.82

[1] For 1964.
[2] For 1965.

TABLE D.—*Automatic repayment of advances through reduced tax credits under sec. 3302(c) (2) and (3) (A)*

[Amounts in millions of dollars]

Federal taxable year	Amount of federally taxable wages	To be paid by Jan. 31 of—	Percent of credit reduction under 3302(c)(2)	Additional taxes under 3302(c)(2)	Percent of credit reduction under 3302(c)(3)(A)	Additional taxes under 3302(c)(3)(A)
1961	$7,650	1962	0.15	$11.475	----------	----------
1962	7,750	1963	.3	23.25	0.3	$23.25
1963	7,300	1964	----------	----------	.6	43.8
1964	7,380	1965	----------	----------	.9	66.42
1965	7,550	1966	----------	----------	1.2	90.6
1966	7,650	1967	----------	----------	1.5	114.75

TABLE E.—*Additional taxes resulting from provisions pertaining to State tax yields (sec. 3302(c) (3) (B) and (C))*

Federal taxable year	Actually paid by Jan. 31—	Based on State tax rate in—	Amount of tax equal to (in millions of dollars)—
1963	1964	1962	1963 Federal wages (from table B)×(2.7−1962 actual average State employer contribution rate).[1] $7,300×(2.7−2.30)=$7,300×0.4=$29.2.
1964	1965	1963	1964 Federal wages (from table B)×(2.7−1963 actual average State employer contribution rate). $7,380×(2.7−2.41)=$7,380×0.3=$22.14.
1965	1966	1964	1965 Federal wages (from table B)×(higher of 2.7 or 1959–63 cost rate minus 1964 actual average State employer contribution rate). $7,550×(2.88−2.7)=$7,550×0.2=$15.1.
1966	1967	1965	1966 Federal wages (from table B)×(higher of 2.7 or 1960–64 cost rate minus 1965 actual average State employer contribution rate). $7,650×(2.82−2.71)=$7,650×0.1=$7.65.

[1] No employee contributions in State Z.

TABLE F.—*Summary of repayment of advances*

[Amounts in millions of dollars]

Date on which paid	Additional taxes under 3302(c)(2)	Additional taxes under 3302(c)(3)(A)	Reduced credit when tax yield is inadequate	1957 outstanding loan balance	1960 loan balance	1964 loan balance	To State trust fund
Jan. 31, 1962	$11.475			$18.525	$170.0		
Jan. 31, 1963	23.25	$23.25		[1] 0	146.75		$4.725
Jan. 31, 1964		43.8	$29.2		[2] 73.75	$260.0	
					0	260.0	
Jan. 31, 1965		66.42	22.14		0	171.44	
Jan. 31, 1966		90.6	15.1		0	65.74	
Jan. 31, 1967		114.75	7.65				56.66

[1] On Nov. 10, 1963, the balance of the advance of $30,000,000 made in July 1957 is zero.
[2] On Mar. 5, 1964, the balance of the 1960 advances totaling $170,000,000 is repaid by a payment of $73,750,000. Additional 1964 advances totaling $260,000,000 are made between May 1 and Oct. 31, 1964.

(c) *Effective date.*—Subsection (c) of section 523 of the bill provides that the amendments made by subsection (a) shall apply only with respect to the calendar year 1961 and calendar years thereafter.

SECTION 524. CONFORMING AMENDMENTS

* * * * * * *

(b) *Section 104 of Temporary Unemployment Compensation Act of 1958.*—Subsection (b) of section 524 of the bill strikes out subsection (b) of section 104 of the Temporary Unemployment Compensation Act of 1958, which relates to the transfer to a State unemployment account of amounts of additional tax received in excess of amounts restorable by the State under such act. Under the amendment made by section 521 of the bill, these transfers are to be provided for by section 901(d)(2) of the Social Security Act. Subsection (b) also amends section 104(a) of the Temporary Unemployment Compensation Act of 1958 by striking out the words "by December 1" and substituting therefor "before November 10" to conform to a similar change made in section 3302(d)(3) of the Federal Unemployment Tax Act by section 523(b) of the bill.

Part 3.—Extension of Coverage Under Unemployment Compensation Program

SECTION 531. FEDERAL INSTRUMENTALITIES

Section 531 of the bill amends sections 3305(b), 3305(g), and 3306(c)(6) of the Internal Revenue Code of 1954 to authorize, with appropriate safeguards, the legislature of any State to tax as private employers those Federal instrumentalities which are neither wholly nor partially owned by the United States unless they are exempt from taxation by a law granting a specific exemption by reference to section 3301 of such code (or the corresponding section of prior law) from the unemployment tax imposed by such section. A further safeguard would be added for the protection of the employees of the taxable instrumentalities. This would permit State taxation only if these employees are treated by the State law in the same way as are employees of other employers. Paragraph (6) of section 3306(c) of the code is amended to exclude from employment any service performed in the employ of an instrumentality which is partially owned by the United States or which is exempt from the tax imposed by section 3301 by virtue of any provision of law which specifically refers to such section (or the corresponding section of prior law) in granting such exemption. Service performed in the employ of wholly owned Federal instrumentalities is already excluded.

The effect of these amendments is to extend the protection of the unemployment insurance program to employees of certain Federal instrumentalities which are neither wholly nor partially owned by the United States. At the present time, employees of a non-wholly-owned instrumentality are not covered by the program for Federal employees and are not protected by the system applicable to employees of private employers if the instrumentality is exempt from taxation by other provisions of law. In this connection, section 3308, SHORT TITLE, has been renumbered "3309" and a new section 3308 inserted to make it clear that the unemployment tax is to apply to nonowned instrumentali-

ties unless they are exempted by a law, whether enacted before or after enactment of this bill, which grants a specific exemption by reference to section 3301 (or the corresponding section of prior law) from the tax imposed by such section.

Sections 1501(a) and 1507(a) of the Social Security Act are amended by striking out the word "wholly" in the first sentence of each section and inserting in lieu thereof the words "wholly or partially". This brings employees of partially owned Federal instrumentalities under the unemployment insurance program for Federal employees provided in title XV of the Social Security Act, which already covers employees of wholly owned instrumentalities.

SECTION 532. AMERICAN AIRCRAFT

Section 532 of the bill amends both clause (B) of the introductory provision of section 3306(c) of the Internal Revenue Code of 1954 and paragraph (4) of such section to provide the same unemployment insurance protection for employees employed on or in connection with American aircraft engaged in oversea operations as is provided for employees employed on or in connection with American vessels engaged in oversea operations. Also, section 3306(m), which defines the term "American vessel" is amended to include a definition of "American aircraft" i.e., "aircraft registered under the laws of the United States."

SECTION 533. FEEDER ORGANIZATION, ETC.

Section 533 of the bill amends paragraph (8) of section 3306(c) of the Internal Revenue Code of 1954 to limit the exception from employment provided by that paragraph to service performed in the employ of a religious, charitable, educational, or other organization described in section 501(c)(3) of the code which is exempt from income tax under section 501(a). This extends unemployment insurance protection to the employees of feeder organizations which are subject to income tax by reason of section 502 of the code. Section 502 provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from income tax under section 501 on the grounds that all of its profits are payable to one or more organizations exempt from income tax under section 501.

The amendment to paragraph (8) of section 3306(c) of the code would also extend coverage to the organizations described in section 501(c)(3) with respect to year for which they are denied income tax exemption under the provisions of section 503 or 504 of the code.

SECTION 534. FRATERNAL BENEFICIARY SOCIETIES, AGRICULTURAL ORGANIZATIONS, VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATIONS, ETC.

Section 3306(c) of the Internal Revenue Code of 1954 defines the term "employment" for purposes of the Federal Unemployment Tax Act. Paragraph (10) of this section excludes from the term "employment" the service described therein.

The effect of section 534 of the bill is, in general, to extend the term "employment" (unless the service is excluded by some other paragraph of sec. 3306(c)) to include—

(1) Service performed in the employ of organizations which are exempt from income tax where—

(A) such service is in connection with the collection of dues or premiums for a fraternal beneficiary society, order, or association, and is performed away from the home office, or is ritualistic service in connection with any such society, order, or association; or

(B) such service is performed by a student who is enrolled and is regularly attending classes at a school, college, or university, unless the service is performed for such school, college, or university.

(2) Service performed in the employ of agricultural or horticultural organizations which are exempt from income tax.

(3) Service performed in the employ of voluntary employees' beneficiary associations (described in subpars. (C) and (D) of existing par. (10)) providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or their designated beneficiaries.

Under the amendment made by section 534 of the bill, the following service will continue to be excluded from the term "employment" by reason of section 3306(c)(10):

(1) Service performed in any calendar quarter in the employ of any organization exempt from income tax (other than a trust created or organized under a qualified pension, profit-sharing, or stock-bonus plan), if the remuneration for such service is less than $50.

(2) Service performed in the employ of a school, college, or university, if such service is performed by a student who is enrolled and is regularly attending classes at such school, college, or university.

SECTION 535. EFFECTIVE DATE

Under section 535 of the bill, the amendments made by part 3 of title V of the bill (other than the amendments to title XV of the Social Security Act made by subsecs. (e) and (f) of sec. 531 of the bill) are to apply with respect to remuneration paid after 1961 for services performed after 1961. The amendments made by subsections (e) and (f) of section 531 of the bill are to apply with respect to any week of unemployment which begins after December 31, 1960.

Part 4.—Extension of Federal-State Unemployment Compensation Program to Puerto Rico

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SECTION 543. EXTENSION OF FEDERAL UNEMPLOYMENT TAX ACT

Subsection (a) of section 543 of the bill amends section 3306(j) of the Internal Revenue Code of 1954 to include the Commonwealth of Puerto Rico in the terms "State" and (when used in the geographical sense) "United States". (Technical changes are also made in sec. 3306(j) to take account of the fact that Hawaii is now a State instead of a territory.) The amendment also provides that an individual who is a citizen of the Commonwealth of Puerto Rico (but not otherwise a citizen of the United States) shall be considered (for purposes of sec. 3306 of the code) to be a citizen of the United States. The amendment applies with respect to remuneration paid after December 31, 1960, for services performed after such date.

Section 3304 of the Internal Revenue Code of 1954 and section 303 of the Social Security Act contain provisions requiring the Secretary of Labor to approve a State unemployment compensation law if he finds that its provisions meet the requirements of such sections.

Section 3304(a)(2) of the code requires the State law to provide that no compensation shall be payable with respect to any day of unemployment occurring within 2 years after the first day of the first period with respect to which contributions are required. Subsection (b)(1) of section 543 of the bill makes it clear that this requirement is satisfied in the case of Puerto Rico if the law provides that no compensation is payable with respect to any day of unemployment occurring before January 1, 1959, since the first day of the first period with respect to which contributions were required was January 1, 1957.

Section 3304(a)(3) of the code and section 303(a)(4) of the Social Security Act require the State law to provide that all money received in the State unemployment fund shall (except for certain refunds) immediately upon such receipt be paid over to the Secretary of the Treasury to the credit of the Unemployment Trust Fund. Subsection (b)(2) of section 543 of the bill provides that these requirements are to be considered as met if the unemployment compensation law of the Commonwealth of Puerto Rico contains the provisions required by section 3304(a)(3) of the code and section 303(a)(4) of the Social Security Act and if it requires that, on or before February 1, 1961, there be paid over to the Secretary of the Treasury, for credit to the Puerto Rico account in the Unemployment Trust Fund, an amount equal to the excess of—

(1) the aggregate of the moneys received in the Puerto Rico unemployment fund before January 1, 1961; over

(2) the aggregate of the moneys paid from such fund before January 1, 1961, as unemployment compensation or as refunds of contributions erroneously paid.

This modification is necessary in view of the fact that the Puerto Rican unemployment compensation law has been in operation since the beginning of 1957. Accordingly, moneys have been paid into the unemployment compensation fund of Puerto Rico since then, and have been paid therefrom since January 1, 1959.

[H.R. 12580] [13]

SOCIAL SECURITY AMENDMENTS OF 1960

[Senate Report No. 1856, Eighty-sixth Congress, Second Session, Calendar No. 1928]

[August 19, 1960]

MR. BYRD of Virginia, from the Committee on Finance, submitted the following report together with minority views to accompany H.R. 12580.

The Committee on Finance, to whom was referred the bill (H.R. 12580) to extend and improve coverage under the Federal old-age, survivors, and disability insurance system and to remove hardships, and inequities, improve the financing of the trust funds, and provide disability benefits to additional individuals under such system; to provide grants to States for medical care for aged individuals of low income; to amend the public assistance and maternal and child welfare provisions of the Social Security Act; to improve the unemployment compensation provisions of such act; and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill do pass.

I. SCOPE OF THE BILL

In this 25th anniversary year of the Social Security Act, the committee has examined proposals relating to almost every title of the Social Security Act. As a result of our consideration, the committee is reporting a bill which makes changes and improvements in all of the programs encompassed by this legislation.

The major issue presented to the committee this year has been the increasing cost of adequate medical care for older people. The evidence presented to the committee indicated that these costs derive, to a large extent, from the fact that impressive improvements have been made in medicines and medical technology, which assist in better diagnosis and treatment, and from improved hospital and other facilities and their wider availability to the public. The knowledge that these costs are unpredictable, and sometimes very heavy, especially for our older men and women living on reduced retirement incomes, has been a matter of grave concern to this committee.

As a result, we are recommending a program of Federal assistance in providing, through the cooperation of the States, an expanded program of medical care for persons aged 65 and over. Under this proposal the Federal share of existing old-age assistance plans will be substantially increased to encourage States to strengthen their medical programs for these people or to initiate new programs. In addition, Federal money will be made available, on a generous matching formula, to assist the States in aiding those aged persons, many of them otherwise self-sufficient, who need help only in meeting the costs of medical care of a very expensive nature.

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III. SUMMARY OF OTHER PROVISIONS OF THE BILL

A. THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE (OASDI) PROVISIONS

* * * * * * *

6. Increased coverage.

Another opportunity would be provided for an estimated 60,000 ministers to be covered under the program, in the same manner as is provided in the House bill. In addition, if the States take advantage of the opportunity offered them, nearly 2½ million employees of State and local governments could obtain coverage for certain past years on a retroactive basis. The provision of the House bill covering American citizens employed in the United States by foreign governments was also approved, as was the House provision making possible the coverage of certain policemen and firemen under retirement systems in Virginia. Other approved provisions would facilitate coverage for some of the noncovered people employed in positions covered by State or local retirement systems, and for the 100,000 noncovered employees of certain nonprofit organizations.

The provision in the House bill extending coverage to physicians has been deleted because of lack of definitive information on whether a majority of doc-

[13] Public Law 86-778, page 693, this Bulletin.

tors wish to come under the program. The coverage of domestic and casual workers who earn between $25 and $50 a quarter from one employer, as provided in the House bill, was eliminated, together with the coverage of parents who work for their sons or daughters. In both of these instances it was not clear that the administrative problems which constituted the reasons for these exclusions had been completely eliminated. Also eliminated from the House bill were the extensions of coverage to American Samoa and Guam, to Americans employed in the United States by international organizations, and to certain American employees of labor organizations in the Panama Canal Zone. The committee believes that further examination and hearings should be undertaken before coverages should be extended to these groups of workers.

* * * * * * *

D. THE UNEMPLOYMENT COMPENSATION PROGRAM

The committee's bill makes two changes affecting the so-called George-Reed loan fund which is used to make advances to States with depleted reserve accounts:

(1) The maximum amount authorized in the loan fund from Federal unemployment tax revenues is increased from $200 million to $500 million;

(2) More realistic eligibility requirements for States applying for advances are provided and also increases in the rate of repayment of advances.

The committee deleted the provisions contained in the House bill raising the Federal unemployment tax, establishing a new procedure for financing administrative expenses, extending coverage to several groups of workers, and including Puerto Rico in the unemployment compensation program.

IV. GENERAL DISCUSSION OF THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROVISIONS

* * * * * * *

E. INCREASED COVERAGE

The committee's bill would make several further extensions of coverage.

1. Facilitating coverage of additional employees of nonprofit organizations and validation of erroneous returns already filed.

Present law requires that two-thirds of the employees of a nonprofit organization must consent to coverage before the organization can cover the employees who desire coverage and future employees of the organization. The committee's bill modifies this requirement so that a nonprofit organization could, if it so desired, file a certificate electing to provide coverage for all employees hired in the future and such current employees, if any, as consent to be covered. An organization could provide coverage for new employees even though none of its current employees desire coverage.

The present requirement is unfair to employees who want to be covered but are not eligible because some of their fellow employees do not desire old-age, survivors, and disability insurance protection. Under the committee's bill, a nonprofit employer would, in effect, be able to establish as a condition of employment a rule that new employees must be covered while offering its present employees an option.

There are about 100,000 employees of nonprofit organizations not now protected under old-age, survivors, and disability insurance for whom coverage would be facilitated by these changes. In the long run all employees of organizations that have elected to cover any of their employees would be covered since all new employees are mandatorily covered.

The bill would retain the requirement of present law that if some of a nonprofit organization's employees are in jobs covered by a public retirement system and some are not, the employer must divide his employees into two coverage groups for purposes of this provision. The employees who are in positions covered by the public retirement system would be in one coverage group; those who are not would be in the other. Under the bill, the employer may extend coverage to consenting and future employees in either or both groups, without the necessity for concurrence by two-thirds of the current employees.

The bill would also permit the validation of erroneous self-employment returns filed by certain lay missionaries in the belief that they were covered under present law as ministers, if requested by April 15, 1962.

The committee has been informed that a number of nonprofit organizations have been erroneously reporting and paying taxes on remuneration paid to their employees without first complying with requirements in the law for obtaining old-age, survivors, and disability insurance protection for their employees. For example, some organizations have reported their employees without realizing it was necessary to file waiver certificates. In some instances, the nonprofit organization later filed a certificate in accordance with the law, but by that time one or more of the employees whom the organization had previously reported had left its employ. There is no way under present law for such employees to have their services covered under the organization's certificate. In other instances, nonprofit organizations began to report their employees after the organizations filed certificates without realizing that it was also necessary to obtain the signatures of all of the employees whom they wished to cover on lists of concurring employees. The bill would, under specified circumstances, permit social security credit for remuneration for services performed before July 1, 1960, erroneously reported as wages, upon appropriate action by the nonprofit organizations and employees involved.

2. Provision of an additional opportunity for ministers to obtain coverage.

Coverage was made available to ministers, under the Social Security Amendments of 1954, on an individual voluntary basis because of considerations relating to the separation of church and state. The 1954 legislation provided that ministers and Christian Science practitioners already in practice who desired coverage had to file waiver certificates by April 15, 1957. In 1957, when it appeared that many clergymen who desired coverage had, through lack of knowledge or misunderstanding of the provisions, failed to file timely certificates electing coverage, legislation was enacted to extend the time for electing coverage to April 15, 1959. Under present law, in general, only newly ordained ministers (and ministers who have not had net earnings from self-employment of $400 or more, some part of which was from the exercise of the ministry, for as many as 2 taxable years after 1954) may still file certificates electing coverage.

Of some 200,000 full-time ministers who could have elected coverage, about 140,000 have come under the program up to this time. There are many ministers who want coverage but are no longer eligible. In some cases, such ministers failed to file timely waiver certificates because they misunderstood the provision or were unaware of the deadline. Other ministers erroneously believe that they met the requirements for electing coverage by filing tax returns, while still others believe they met the requirements by filing waiver certificates although actually they did not because the certificates were defective in some respects.

The committee is mindful of the need to maintain reasonable restrictions on the time within which a choice must be made under the provision for individual voluntary coverage of ministers. However, the committee recommends that ministers and Christian Science practitioners who under present law are no longer eligible to elect coverage be given additional opportunity to obtain this protection. To this end, persons who have already entered the ministry would be given until April 15, 1962, to file waiver certificates. Certificates filed under this amendment (like those filed under present law by a newly ordained minister) would be effective with the year preceding the latest year for which the tax return due date has not passed.

In addition, the bill would permit the validation of coverage of certain clergymen who filed tax returns reporting self-employment earnings from the ministry for certain years after 1954 and before 1960 even though, through error, they had not filed waiver certificates effective for those years. These ministers or their representatives would be given the opportunity until April 15, 1962, to file waiver certificates or supplemental certificates effective with the first taxable year for which they had filed such a tax return and for all succeeding years. In order for the benefits of this amendment to be secured, any taxes due by reason of the validation of the coverage would have to be paid by April 15, 1962.

Also a provision is added to the House bill which would give a further opportunity to certain ministers who previously filed certificates effective with their first taxable year ending after 1956—as required under the law in effect at the time when their certificates were filed—to amend their certificates to make them effective for the preceding taxable year. Under present law, such ministers generally had until April 15, 1959, to amend their certificates for this purpose and under the bill they would have until April 15, 1962, to do so.

3. Coverage of American citizens employed in the United States by foreign governments.

Under present law, service performed in the employ of a foreign government or an instrumentality wholly owned by a foreign government, is generally excluded from old-age, survivors, and disability insurance coverage. The committee believes that such service, if performed by a citizen of the United States within the United States, should be covered. Coverage of their employment would enable these citizens to build the same basic protection under old-age, survivors, and disability insurance that other Americans possess and would prevent gaps in protection for those citizens who work for a limited period of time for a foreign government.

This employment has heretofore not been covered because the United States cannot levy the employer tax of the program upon foreign governments. The committee believes that the most feasible way to provide coverage for United States citizens working for these foreign employers would be to treat them as self-employed individuals. Although the committee believes it is generally undesirable to cover as self-employment the services of persons who are actually employees, such coverage offers a practical solution to the unique problem of covering American citizens employed by foreign governments. Under the bill, compulsory coverage would be provided for these employees on the same basis as that provided for self-employed persons.

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VIII. THE UNEMPLOYMENT COMPENSATION PROGRAM

A. Purpose and Summary

The House bill contained a number of amendments affecting the Federal-State program of employment security. These included: (1) a raise in the Federal unemployment tax rate from 3.0 percent to 3.1 percent; (2) provisions governing financing of the administrative expenses of the Federal-State employment security program; (3) improvements in the operation of the Federal unemployment account (George-Reed loan fund) by tightening the conditions pertaining to eligibility for and repayment of advances to States with depleted reserve accounts; (4) extension of coverage of the unemployment compensation program to several groups of workers; and (5) treating Puerto Rico as a State for the purposes of the unemployment compensation program.

The committee's bill adopts only one of these changes—the one relating to eligibility for and repayment of advances. In addition, the committee's bill provides for a larger "George-Reed" loan fund by increasing the amount authorized to be built up in the Federal unemployment account from $200 million to $500 million.

The committee does not believe that the unemployment tax needs to be increased at the present time. It is anticipated that a continually rising level of covered employment will provide sufficient revenue to pay for administrative expenses and to build up the loan fund to the amount authorized by the committee's bill. Moreover, if a rise in the level of covered payroll sufficient to accomplish these purposes fails to materialize, the Congress will reconvene in a few months and will have an opportunity to conduct a more thorough examination concerning the adequacy of unemployment tax revenues and take any steps thought necessary at that time.

The committee did not approve of the remaining provisions of the House bill because during the limited time afforded the committee to consider the bill as a whole we did not feel we had sufficient time, nor was any testimony received, concerning the amendments relating to administrative financing, extending coverage to new groups of workers, and incorporating Puerto Rico into the unemployment compensation system. These changes raise many complicated problems which should be studied more thoroughly than the committee was able to in considering the present bill.

B. General Explanation

1. Increase in the loan fund.

Under present law, any excess of Federal unemployment tax receipts over administrative expenses is allocated to the Federal unemployment account to

bring it up to $200 million in cash, but repayments of advances by the States can increase the account to an amount over $200 million. After the Federal unemployment account is built up to its statutory limit any remaining excess Federal unemployment tax receipts are distributed to the State accounts in proportion to their respective covered payrolls.

The committee's bill would raise the statutory limit of the Federal unemployment account from $200 to $500 million. The bill also provides that if at the time a distribution of excess Federal unemployment taxes is made to the State accounts a State has outstanding advances under title XII, that State's share of the excess funds will first be used to reduce these outstanding advances.

2. Eligibility for and repayment of advances.

The bill amends title XII of the Social Security Act, the title that provides for advances to State unemployment funds. Under present law a State may apply for an advance if its reserve at the end of a calendar quarter is less than the total compensation paid out during the preceding four quarters. The committee found that this was not a sufficient test of a State's need for additional funds. Two States were eligible for and received advances under the present law which they have never used.

The bill, therefore, permits a State's eligibility for advances to be determined at any time. Advances will be made in amounts which the Secretary of Labor estimates will be required to pay compensation during the current or following month, after taking into account available reserves and income to be received during the month in the State unemployment fund. In making such estimates, the Secretary may include an additional amount to cover unexpected contingencies such as decreases in tax receipts due to delinquencies, increases in benefit payments due to unusual weather conditions or an unannounced layoff by a large firm, or other factors. The aggregate amount that the Secretary of Labor may certify in any month may not exceed the amount in the Federal unemployment account.

Advances made to a State before enactment of your committee's bill will, in general, be repaid under the present provisions of law. Also, any State that has not received the full amount certified by the Secretary of Labor to the Secretary of the Treasury before enactment of the committee's bill may, through its Governor, request the Secretary of the Treasury to transfer to the State's account all or part of the remainder of such amount. Upon receipt of such a request the Secretary of the Treasury shall transfer the amount requested or so much of such amount as is available at the time of the transfer. No such amount will be transferred, however, after the 1-year period beginning on the date of the enactment of your committee's bill. The present provisions for repayment will apply to any amount so transferred to a State.

Advances made to a State after the enactment of your committee's bill, if not repaid by the State within the specified period of time, will be repaid under newly added provisions to the section providing for repayment of an advance through reduction in employers' credits against the Federal unemployment tax. Reductions in credit to repay an advance after the enactment of your committee's bill will be made with respect to the taxable year beginning with the second January 1 after the advance is made (rather than as now the fourth January 1). The reduction in credit will also be at a rate double that now provided. Thus, for the taxable year beginning with the second January after an advance is made, the credit will be reduced by 10 percent. For the following taxable year the credit will be reduced by 20 percent, and so on. The committee believes that these changes are desirable. Economic indexes since World War II show that recessions have not lasted more than about 1½ years. Thus, earlier repayment is economically feasible. Such indexes also show that recessions have recurred at approximately 4-year intervals. Thus, under the present law, the repayment of advances through reduction in tax credits might commence during the recession following that in which an advance is made. The increased rate of repayment proposed will result generally in the repayment of an advance before another recession occurs. It will also replenish the Federal unemployment account so that subsequent requests for advances can be financed without the necessity of securing advances from general funds for this purpose.

In the case of the third and fourth consecutive taxable year for which there has been an outstanding balance of advances as of January 1, if the State has (for the calendar year preceding such taxable year) collected as contributions from employers on remuneration subject to the State law less than an amount

equal to 2.7 percent of the total remuneration subject to contributions under the State law (as determined by the State by April 30 of the taxable year, using a March 31 cutoff date), the tax credit against the Federal tax due on wages paid in such taxable year will be further reduced by the amount (rounded to the nearest 0.1 percent) by which the average employer contribution rate is less than 2.7 percent.

In the case of the fifth and succeeding consecutive taxable years for which there has been an outstanding balance of advances as of January 1, if the State has collected (for the calendar year immediately preceding the taxable year) in employer taxes less than an amount equal to one-fifth of the aggregate benefits paid in the first 5 of the last 6 years preceding the taxable year (as determined by the State by the following April 30, using a March 31 cutoff date) or an amount equal to 2.7 percent of the State taxable remuneration (for the calendar year immediately preceding the taxable year), whichever is higher, then the tax credit against the Federal tax will be further reduced. The reduction will be a rate, rounded to the nearest 0.1 percent, which, when applied to the State's taxable wages for such immediately preceding calendar year, would have produced the revenue necessary to make up the difference between the contributions actually paid and the average benefit cost rate (or 2.7 percent if higher). In determining the amount collected by the State, employee contributions may be included, if employer contributions average 2.7 percent or more.

The committee believes that these provisions will encourage a State that has an outstanding balance of advances to so increase its contribution rates that these further tax credit reductions will not become applicable. Such increased rates should strengthen the State's benefit financing so that its need for further advances would be minimized.

IX. SECTION-BY-SECTION ANALYSIS

The first section of the bill contains a short title (the "Social Security Amendments of 1960") and a table of contents. The remainder of the bill is divided into seven titles as follows:

Title I—Coverage.
Title II—Eligibility for benefits.
Title III—Benefit amounts.
Title IV—Disability insurance benefits and the disability freeze.
Title V—Employment security.
Title VI—Medical services for the aged.
Title VII—Miscellaneous.

TITLE I—COVERAGE

SECTION 101. EXTENSION OF TIME FOR MINISTERS TO ELECT COVERAGE

Additional period for filing certificate.

Section 101(a) of the bill amends clause (B) of section 1402(e)(2) of the Internal Revenue Code of 1954 to provide an additional period (somewhat less than 2 years from the date of enactment of the bill) within which certain ministers, members of religious orders (other than persons who have taken a vow of poverty as members of such an order), and Christian Science practitioners may file a certificate electing to be covered under title II of the Social Security Act. Under present law, any member of one of these professions who has had net earnings from self-employment of $400 or more, any part of which was derived from services in such profession, in two or more taxable years beginning after 1954, but who failed to file a certificate within the time prescribed by the present section 1402(e)(2), no longer has an opportunity to elect the coverage. Under the bill, every such individual is afforded a further opportunity to make the election. Such election may be made by filing a certificate on or before the due date of the return (including any extension thereof) for the individual's second taxable year ending after 1959 (generally April 15, 1962).

Effective date of certificate.

Section 101(b) of the bill amends section 1402(e)(3) of the Internal Revenue Code of 1954 to eliminate those portions of it which have ceased to have any effect and by redesignating paragraph (3) to (3)(A) and adding a new subparagraph (B). As amended by section 101(b) of the bill, section 1402(e)(3)(A) continues to provide, to the same effect as at present, that a certificate filed

under section 1402(e) of the code shall be effective for the taxable year immediately preceding the earliest taxable year for which, at the time the certificate is filed, the period for filing a return (including any extension thereof) has not expired, and for all succeeding taxable years. Thus, under present section 1402 (e)(3) and under section 1402(e)(3)(A) as amended by section 101(b) of the bill, where the taxable year is a calendar year and there is no extension of time for the filing of the tax return, a certificate filed on or before April 15 of the year following such taxable year is effective for the 2 taxable years preceding the year in which the certificate is filed, and for all years following such 2 taxable years. If the certificate in such case is filed after April 15, it is effective only for the immediate preceding taxable year and for all years thereafter. However, under the conditions prescribed in section 1402(e)(5) of the code, as added by section 101(c) of the bill (discussed below) a certificate filed under section 1402(e) of the code by April 15, 1962, may be made effective for years earlier than those for which the certificate would be effective under the general rule stated in section 1402(e)(3)(A).

The new subparagraph (B) would modify the general rule stated in subparagraph (A) with respect to certain ministers who filed certificates before enactment of the amendment which were effective only for taxable years ending after 1956. Under subparagraph (B) such certificates will be effective for taxable years ending after 1955 if such individual files a supplemental certificate before April 15, 1962, if any tax in respect of self-employment income for his first taxable year after 1955 is paid on or before April 15, 1962, and any refund made of any such tax which, but for the new subparagraph (B) would be an overpayment, is repaid on or before April 15, 1962. Any such tax which is paid or repaid for a year with respect to which the period of limitation on assessment or collection has expired will not be regarded as an overpayment solely because such period has expired.

Optional provision for certain certificates filed on or before April 15, 1962.

Section 101(c) of the bill amends section 1402(e) of the Internal Revenue Code of 1954 by adding a new paragraph (5). Pursuant to the new paragraph (5), any individual who has filed a timely return reporting earnings derived by him in any taxable year ending after 1954 and before 1960 from the performance of service as a minister, a member of a religious order (other than one who has taken a vow of poverty as a member of such order), or a Christian Science practitioner, but who does not have self-employment coverage for the first year for which such a return was filed because a certificate under section 1402(e) is not in effect with respect to such year, may, if he wishes, elect to have his self-employment coverage as a minister, member of a religious order, or Christian Science practitioner begin with such first year. The election (which may be made by the individual, by a fiduciary acting for him or his estate, or by any survivor who is or may become entitled to monthly benefits under title II of the Social Security Act on his earnings record) may be made in one of two ways:

(1) If the individual has not filed a valid certificate on or before the date of the enactment of the bill, he (or such fiduciary or survivor) may file such a certificate and indicate thereon an election to have the certificate made effective for the first taxable year ending after 1954 and before 1960 for which such individual filed such a return, and for all succeeding taxable years.

(2) If the individual has filed a valid certificate on or before the date of the enactment of the bill, he (or such fiduciary or survivor) may file a supplemental certificate and indicate thereon an election to have the certificate previously filed by such individual made effective for the first taxable year ending after 1954 and before 1959 for which he filed such a return, and for all succeeding taxable years.

In either case, if the election is to be valid, it must be made on or before April 15, 1962, and all self-employment tax (whether or not attributable to earnings as a minister, member of a religious order, or Christian Science practitioner) due for each taxable year for which the certificate is effective under the new paragraph (5) (but would be ineffective under par. (3)) must be paid on or before April 15, 1962. Moreover, any such tax previously refunded as an overpayment because no valid certificate was then in effect with respect to the year for which paid must be repaid to the United States, together with the interest allowed on the refund, on or before such date. However, any underpayment of the tax which is attributable to an error made in good faith will not invalidate an election which is otherwise valid. Any such tax which is paid or repaid for

a year with respect to which the period of limitation on assessment or collection has expired will not be regarded as an overpayment solely because such period has expired. It should be noted that April 15, 1962, falls on a Sunday, and section 7503 of the code provides that an act required to be performed on a Saturday, Sunday, or legal holiday is timely if performed on the next day which is not a Saturday, Sunday, or legal holiday.

Administrative provisions.

Pursuant to section 101(d) of the bill, no interest or penalty will be imposed in respect of self-employment tax paid on or before April 15, 1962, on earnings derived from the performance of service as a minister, member of a religious order, or Christian Science practitioner for taxable years as to which a certificate is effective under the new paragraph (5), or under the new subparagraph (B) of paragraph 3, (but would not be effective under the existing par. (3)) of section 1402(e). If such tax is not fully paid (except for underpayments due to errors made in good faith) on or before April 15, 1962, the question of interest does not arise since the certificate in such cases is effective only for the taxable years prescribed in the existing paragraph (3) and not for the earlier years prescribed in such paragraph (5) or such subparagraph (B). However, in the case of an underpayment attributable to an error made in good faith, the additional tax due for any such earlier year must be paid with interest accruing from April 15, 1962, to the date of payment. Moreover, the statutory period for assessing any such underpayment will expire not earlier than 3 years from April 15, 1962.

Sections 101(c) and 101(d) of the bill are relief measures for the benefit of ministers, members of religious orders, and Christian Science practitioners who filed returns of self-employment tax on their earnings as such for years with respect to which they have no self-employment coverage because no certificate under section 1402(e) of the code is in effect for such years or whose certificates were not made effective as early as was permitted under the law in effect at the time of filing. However, your committee does not intend that the amendments made by such section 101(c) should be regarded as invalidating the effect of Revenue Ruling 57–139 (Cumulative Bulletin 1957–1, p. 284) and Revenue Ruling 57–401 (Cumulative Bulletin 1957–2, p. 604) on any certificate under section 1402(e) which is filed on or before the date of the enactment of the bill.

Inclusion of earnings in social security records.

Section 101(e) of the bill provides that the time limitation relating to the inclusion of self-employment income in social security records (sec. 205(c)(5)(F) of the Social Security Act) shall not be applicable to earnings derived in any taxable year ending before 1960 which constitute self-employment income solely by reason of the filing of a certificate which is effective under section 1402(e)(3)(B) or (5).

Effective dates.

Section 101(f) of the bill provides that the amendments made by section 101 of the bill shall be applicable only with respect to certificates (and supplemental certificates) filed after the date of the enactment of the bill. However, no monthly benefits under title II of the Social Security Act will be increased or payable by reason of such amendments for any month earlier than the month after the month of enactment of the bill and no lump-sum death payments under that title in the case of deaths prior to the date of the enactment of the bill will be payable or increased by reason of such amendments.

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SECTION 103. EMPLOYEES OF NONPROFIT ORGANIZATIONS

Elimination of requirement that religious, charitable, etc., organization may file waiver certificate only if two-thirds of its employees concur.

Section 103(a) of the bill amends section 3121(k)(1)(A) of the Internal Revenue Code of 1954, relating to waivers of tax exemption which may be filed by certain religious, charitable, etc., organizations. Pursuant to present law, such an organization may file a certificate electing to have old-age, survivors, and disability insurance coverage extended to services performed in its employ only if two-thirds or more of its employees concur in the filing of such certificate, and such certificate is accompanied by a list containing the signature, address, and social security account number (if any) of each employee who concurs. Section

103(a) of the bill eliminates the requirement that two-thirds or more of such employees must concur before the certificate can be filed. This amendment has the effect of permitting the organization to elect coverage in respect of all employees of the organization hired after the quarter in which a certificate is filed by the organization even though less than two-thirds, or none, of the employees in its employ in such quarter concur in the filing of the certificate. As under present law, a list showing the names, addresses, and social security account numbers of all concurring employees must accompany the certificate, and, in general, only the services of those employees (if any) whose names appear on such list will be covered when the certificate takes effect. However, the 24-month period prescribed in present law for signing a supplemental list of concurring employees is continued, and employees who decline the coverage at the time the certificate is filed but later desire to have it may acquire such coverage prospectively by signing a supplemental list within the prescribed period.

Section 103(a) of the bill also amends section 3121(k)(1)(E) of the code, relating to the filing of waiver certificates by organizations some of whose employees are in positions covered by a pension, annuity, retirement, or similar fund or system established by a State or political subdivision thereof and some of whose employees are not in such positions. Under present law such organization must divide its employees who are in such positions and its employees who are not in such positions into separate coverage groups, and a waiver certificate in respect of either group may be filed only if two-thirds of the employees in the group concur in the filing of the certificate. Section 103(a) of the bill eliminates the requirement that two-thirds or more of the employees in such group must concur before a certificate can be filed in respect of such group. Under the amendment made by section 103(a), a certificate may be filed in respect of either group, or separate certificates may be filed in respect of each group, even though less than two-thirds, or none, of the employees in the group concur in the filing of the certificate.

Validation of remuneration erroneously reported as wages by nonprofit organizations.

Section 103(b) of the bill relates to service performed after 1950 which is excepted from covered "employment" solely because the service is performed for an organization, described in section 501(c)(3) of the Internal Revenue Code of 1954 (or sec. 101(6) of the Internal Revenue Code of 1939) and exempt from income tax, which does not have a waiver certificate under section 3121(k) of the Internal Revenue Code of 1954 (or sec. 1426(1) of the Internal Revenue Code of 1939) in effect with respect to such service. The service may be excepted from employment because no such certificate was filed by the organization or, if a certificate was filed, because the person performing the service could acquire coverage only by signing the list of employees concurring in the filing of the certificate and he failed to do so.

Section 103(b) of the bill makes provision whereby the remuneration paid by an organization to an individual before July 1, 1960, for such service may be deemed to constitute remuneration for employment for purposes of title II of the Social Security Act, to the extent that an amount has been paid before August 11, 1960, as taxes under the Federal Insurance Contributions Act with respect to such remuneration. Such remuneration will be deemed to constitute remuneration for employment for purposes of such title II if the following conditions are met:

(1) The person who performed the service (or a fiduciary acting for him or his estate, or a survivor of such individual who is or may become entitled to monthly benefits under title II of the Social Security Act on his earnings record) makes a request (in such form and manner, and with such official as the Secretary of Health, Education, and Welfare may by regulations prescribe) that such remuneration be deemed to constitute remuneration for employment for purposes of title II of the Social Security Act.

(2) If any part of the amount paid as taxes before August 11, 1960, with respect to such remuneration paid to an individual is credited or refunded, the amount credited or refunded, plus any interest allowed, is repaid before January 1, 1963.

(3) A certificate under section 3121(k) of the Internal Revenue Code of 1954 is filed by the organization not later than the date on which the request is made, unless the organization has previously filed a certificate under that section

or section 1426(1) of the Internal Revenue Code of 1939, or the organization no longer has any individual in its employ for remuneration at the time the request is made.

(4) In the case of an organization which has filed a certificate on or before the date on which the individual's request is made, amounts are paid as taxes with respect to some portion of the remuneration paid by the organization to the individual during the 24-month period following the calendar quarter in which the certificate is filed, if the individual is in the employ of the organization at any time during such 24-month period.

Pursuant to section 103(b)(5) of the bill, an organization's certificate is made applicable in the future to an individual if remuneration paid by such organization to the individual before July 1, 1960, is deemed, pursuant to a request made under section 103(b), to constitute remuneration for employment, and if the individual performs service in the employ of the organization on or after the date on which the request is made. If the certificate is not effective with respect to service performed by such individual before the first day of the calendar quarter following the quarter in which the request is made, the effect of paragraph (5) is to make the certificate applicable to service performed by the individual on and after such first day.

After the date of enactment of the bill, section 103(b) will supersede provisions of section 403(a) of the Social Security Amendments of 1954 which permit certain remuneration paid for service performed before 1957 to be deemed remuneration for employment. Section 403(a) will continue to apply to requests made pursuant to such section on or before the enactment of this bill, but not to requests made after the date of enactment.

Remuneration erroneously reported as self-employment income by certain employees of charitable, religious, etc., organizations.

Section 103(c)(1) of the bill amends section 1402 of the Internal Revenue Code of 1954 by adding a new subsection (g). Pursuant to the new subsection (g), any individual who, for any taxable year ending after 1954 and before 1962, erroneously reported as self-employment income (and paid self-employment tax on) remuneration received by him for services performed in the employ of an organization which is exempt from income tax as an organization described in section 501(c)(3) may request (or a fiduciary acting for such individual or for his estate, or a survivor of such individual who is or may become entitled to monthly benefits under title II of the Social Security Act on his wage record may request) that such remuneration reported for such taxable year (other than remuneration for services performed by the individual as a duly ordained, commissioned, or licensed minister of a church or as a member of a religious order) be deemed to constitute net earnings from self-employment. The request will be effective if—

(1) it is made after the date of enactment of the new section 1402(g) of the code and on or before April 15, 1962;

(2) the return on which the remuneration was reported was timely filed;

(3) a certificate under section 3121(k) of the code is filed by the organization on or before the date the request is made; and

(4) no credit or refund of any part of the amount erroneously paid for such taxable year as self-employment tax on such remuneration is obtained before the date on which the request is filed, or, if obtained, is repaid on or before the date of the request;

but only to the extent that such remuneration was paid to the individual before the calendar quarter in which the request was filed (or, in some cases, before the next calendar quarter), and no employment tax under chapter 21 has been paid on such remuneration.

In any case where remuneration paid to an individual by a religious, charitable, etc., organization is deemed to be net earnings from self-employment by reason of a request filed pursuant to the new section 1402(g), the certificate filed by the organization, if it is not effective with respect to services performed by the individual on or before the first day of the calendar quarter in which the request is filed, shall be effective with respect to services (if any) performed by the individual for the organization on and after the first day of the next calendar quarter.

Section 103(c)(2) of the bill contains complementary provisions for purposes of title II of the Social Security Act.

Effective dates.

Section 103(d) of the bill provides effective dates for the amendments relating to employees of nonprofit organizations.

Paragraph (1) provides that the amendments made by subsection (a) shall be effective with respect to certificates filed under section 3121(k)(1) of the Internal Revenue Code of 1954 after the date of the enactment of the bill.

Paragraph (2) provides that no monthly benefits shall be payable or increased for the month of enactment or prior months by reason of the provisions of or amendments made by subsections (b) and (c), relating to validation of remuneration erroneously reported as wages by nonprofit organizations and as net earnings from self-employment by certain employees of nonprofit organizations. No lump-sum death payment under such title II would be payable or increased by reason of such provisions or amendments in the case of any individual who died prior to the date of enactment of the bill.

SECTION 104. AMERICAN CITIZEN EMPLOYEES OF FOREIGN GOVERNMENTS

Self-employment coverage for benefit purposes.

Section 211(c)(2) of the Social Security Act now provides three exceptions to the general rule that services performed as an employee are excluded from the definition of "trade or business," and thus from self-employment coverage. The effect of these exceptions is to include the services excepted in the definition of "trade or business," and thus to extend self-employment coverage to such services. These services are (1) services performed by certain news vendors, (2) certain services performed by an individual under share-farming arrangements, and (3) services performed by an individual in the exercise of his ministry or as a member of a religious order. Section 104(a) of the bill amends section 211(c)(2) so as to include a fourth category of employee services in the term "trade or business." The services thus included under the amendments are those performed in the United States (including the Virgin Islands and Puerto Rico) by a citizen of the United States in the employ of a foreign government or in the employ of an instrumentality wholly owned by a foreign government to the extent that such services are excluded from "employment" by section 210(a)(11) or 210(a)(12) of the Social Security Act. In effect, this change extends self-employment coverage under title II of the Act to such services.

Coverage for self-employment tax purposes.

Section 104(b) of the bill makes corresponding amendments to section 1402(c)(2) of the Internal Revenue Code of 1954. The effect of these amendments is to require that income derived by a United States citizen from service performed in the United States (including the Virgin Islands and Puerto Rico) as an employee of a foreign government or an instrumentality wholly owned by a foreign government, must be taken into account in determining liability for the self-employment tax, to the extent that such service is excepted from the definition of "employment" by section 3121(b)(11) or 3121(b)(12) of the code.

Effective dates.

Section 104(c) of the bill provides that the amendments made by section 104 with respect to services in the employ of foreign governments or instrumentalities wholly owned by foreign governments shall be effective for taxable years ending on or after December 31, 1960. For purposes of section 203(b) the Social Security Act, relating to the "retirement test" under the old-age, survivors, and disability insurance program, earnings derived by an individual which are covered as net earnings from self-employment pursuant to the amendments made by section 104 of the bill will be treated as "wages" for taxable years beginning on or before the date of enactment of the bill, but as "net earnings from self-employment" for taxable years beginning after the date of enactment.

SECTION 105. DOMESTIC SERVICE AND CASUAL LABOR

Exclusion of service performed by individual under 16.

Section 105(a) of the bill amends section 210(a) of the Social Security Act by adding a new paragraph (18) to provide for the exclusion from employment for purposes of old-age, survivors, and disability insurance of service not in the course of the employer's trade or business, or domestic service in a private home of the employer, preformed by an individual under the age of 16. Under present law such service is not excluded from employment and the definition of wages

determines whether remuneration for the employment is covered by old-age, survivors, and disability insurance.

Conforming amendments in Internal Revenue Code of 1954.

Section 105(b) (relating to the definition of employment) of the bill makes conforming amendments in the Internal Revenue Code of 1954.

Effective dates.

Section 105(c) of the bill provides that the amendments made by subsections (a) and (b), relating to the definition of employment, are effective with respect to service performed after 1960.

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TITLE V—EMPLOYMENT SECURITY

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SECTION 503. FEDERAL UNEMPLOYMENT TAX ACT

Section 503 of the bill amends section 3302 of the Internal Revenue Code of 1954, relating to computations of credits against the tax by striking out subsection (2) and inserting in lieu thereof new subsections (c) and (d).

Section 3302(a) permits credit against the Federal tax for contributions with respect to the taxable year paid into a State unemployment fund on or before the due date of the Federal return for such year. Credit is also permitted under existing law for contributions paid after the due date of the Federal return but this credit is not to exceed 90 percent of the amount which would have been allowable as credit on account of such contributions had they been paid on or before the due date of the Federal return. An additional credit is allowable under section 3302(b) with respect to the amount of contributions which a taxpayer is relieved from paying to an unemployment fund under the experience rating provisions of a State law which has been certified for the taxable year as provided in section 3303 of the code. Section 3302(c)(1) provides that the total credits allowed to a taxpayer shall not exceed 90 percent of the tax against which such credits are allowable.

The amendment to section 3302 makes no change in the credits allowable under subsections (a), (b), and (c)(1) of section 3302 of existing law. Subsection (c)(2) of existing law, which provides for a reduction in the amount of total credits allowable under certain circumstances, appears as a new subsection (c)(2) with no substantive change (other than changing the December 1 date to November 10, and placing such date in new subsection (d)(3)), but is limited in application to an advance or advances made before the date of enactment of your committee's bill. If an advance or advances made under title XII of the Social Security Act before the date of the enactment of this bill remain unreturned on January 1 of each of 4 consecutive taxable years, the total credits allowable to a taxpayer subject to the unemployment compensation law of such State are reduced (by 5 percent of 3 percent or 0.15 percent with respect to wages paid by such taxpayer during such taxable year which are attributable to such State) for the taxable year beginning with the fourth such January 1, unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned. The total credits otherwise allowable will be further reduced (by an additional 5 percent of 3 percent for each such succeeding taxable year with respect to wages paid by such taxpayer during each such taxable year which are attributable to such State) in the case of any succeeding taxable year beginning with a consecutive January 1 on which a balance of an unreturned advance or advances exists, unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of the State prior to which date is fully returned.

Section 3302 is further amended by providing a new subsection (c)(3). New subsection (c)(3)(A) provides that if an advance or advances made under title XII of the Social Security Act on or after the date of the enactment of this bill remain unreturned on January 1 of each of 2 consecutive taxable years, the total credits (after applying subsecs. (a), (b), and (c) (1) and (2) of sec. 3302) allowable to a taxpayer subject to the unemployment compensation law of such State are reduced (by 10 percent of 3 percent or 0.3 percent with respect to wages paid by such taxpayer during such taxable year which are attributable to such State) for the taxable year beginning with

the second such January 1, unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned. Thus, if there is a balance outstanding as of the beginning of November 10, the reduced credit provisions will apply to the State even though there may have been no balance outstanding for some period between January 1 and November 10 of the taxable year. The total credits will be further reduced (by an additional 10 percent of 3 percent for each such succeeding taxable year with respect to wages paid by such taxpayer during such taxable year which are attributable to such State) in the case of any succeeding taxable year beginning with a consecutive January 1 on which a balance of unreturned advances exists unless prior to November 10 of that taxable year the aggregate amount of all such advances theretofore made to the account of the State prior to such date is fully returned.

New subsection (c)(3)(B) provides that the total credits otherwise allowable to the taxpayer for the taxable year will be further reduced (in addition to the reduction provided in subsec. (c)(3)(A)) in the case of a taxable year beginning with the third or fourth consecutive January 1 as of the beginning of which there is such a balance of advances, unless prior to November 10 of the taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned, or unless the average employer contribution rate for such State for the calendar year preceding such taxable year is at least 2.7 percent. The additional reduction, if any, for each such taxable year shall be an amount determined by multiplying wages paid by such taxpayer during such taxable year which are attributable to such State by the percentage by which 2.7 percent exceeds the average employer contribution rate for such State for the calendar year immediately preceding such taxable year. The average employer contribution rate is defined in new subsection (d)(4) as the percentage obtained by dividing the total of the contributions paid into the State unemployment fund with respect to such calendar year, by the total of the remuneration subject to contributions under the State unemployment compensation law (State taxable wages) with respect to such calendar year. New subsection (c)(3)(C) provides that the total credits otherwise allowable to the taxpayer for the taxable year will be further reduced (in addition to the reduction provided in subsec. (c)(3)(A)) in the case of a taxable year beginning with the fifth or any succeeding consecutive January 1 as of the beginning of which there is such a balance of advances, unless prior to November 10 of the taxable year the aggregate amount of all such advances theretofore made to the account of such State has been fully returned, or unless the average employer contribution rate for such State for the calendar year preceding such taxable year was equal to the 5-year benefit-cost rate applicable to such State or 2.7 percent, whichever is higher. The additional reduction, if any, for each such taxable year shall be an amount determined by multiplying the wages paid by such taxpayer during such taxable year which are attributable to such State by the percentage by which the 5-year benefit-cost rate applicable to such State for such taxable year, or (if higher) 2.7 percent, exceeds the average employer contribution rate for such State for the calendar year preceding such taxable year. The 5-year benefit-cost rate is defined in new subsection (d)(5) as the percentage obtained by dividing one fifth of the total of the compensation paid under the State unemployment compensation law during the 5-year period ending at the close of the second calendar year preceding such taxable year by the total of the remuneration subject to contributions under the State unemployment compensation law (State taxable wages) with respect to the first calendar year preceding such taxable year. If the average employer contribution rate for purposes of reductions described in section 3302(c)(3)(C), is 2.7 percent or higher, such rate shall be recomputed and determined by dividing the sum of employer contributions paid into the unemployment fund of such State and employee payments into the fund which are to be used solely in payment of unemployment compensation by the total of the remuneration subject to contributions under the State unemployment compensation law (State taxable wages) with respect to such calendar year.

The amendments of section 3302(c) contemplate that the reduced credit provisions are to apply separately for old advances and for new advances. Thus, if the additional tax collected by reason of section 3302(c)(2) exceeds the balance of advances described in that paragraph, the excess goes to the State account and not to reduce the balance of advances described in section 3302(c)

(3). The same principle would apply to excess collections under section 3302 (c) (3) where a balance of advances described in section 3302(c) (2) continued to exist.

A new subsection (d) is added to section 3302, providing definitions and special rules relating to subsection (c). Paragraph (1) provides, as does the present law, that the wages attributable to a particular State are those subject to the unemployment compensation law of the State, or if not covered by any State law, as determined under rules and regulations prescribed by the Secretary of the Treasury or his delegate. Paragraph (2) provides that reductions in credits under paragraph (2) or (3) of section 3302(c) with respect to any State shall not apply for a taxable year if as of the beginning of November 10 of such year there is no balance of advances referred to in such paragraph (2) or (3) of subsection (c). Paragraph (3) defines average employer contribution rate. Paragraph (4) defines the 5-year benefit-cost rate. Paragraph (5) provides that if any percentage referred to in either subparagraph (B) or (C) of subsection (c) (3) is not a multiple of 0.1 percent, it shall be rounded to the nearest multiple of 0.1 percent. Thus, if a percentage is 2.57 percent, it shall be rounded to 2.6 percent: if it is 2.53 percent, it shall be rounded to 2.5 percent; or if it is 2.96 percent, it shall be rounded to 3.0 percent. In the case of subparagraph (C) of section 3302(c) (3), the two rates referred to shall not be rounded until the difference is determined. For example, if the 5-year benefit-cost rate is 3.26 and the average employer contribution rate is 3.14, the difference is 0.12 and the reduction in credit would be 0.1 percent of wages. If these two rates were rounded separately, 3.26 would be increased to 3.3 percent and 3.14 would be decreased to 3.1 percent, and the difference would be 0.2 percent. Paragraph (6) provides that the percentages referred to in subsection (c) (3) (B) or (C) shall be determined by the Secretary of Labor and certified to the Secretary of the Treasury before June 1 of a taxable year on the basis of a report furnished to the Secretary of Labor by the State before May 1 of such year. Any State report shall be as of the close of March 31 of the taxable year. Paragraph (7) is a cross reference to section 104 of the Temporary Unemployment Compensation Act of 1958 which relates to the reduction of total credits allowable under subsection (c). Subsection (c) of section 523 of the bill provides that the amendments made by subsection (a) shall apply only with respect to the calendar year 1961 and calendar years thereafter.

The application of section 3302(c) as amended by section 503 of the committee's bill may be illustrated by the following example:

Example.—Assume that State Z received an advance of $30 million on July 10, 1957, and that after the enactment of the bill State Z receives advances in July, August, September, October, and November of 1960 totaling $170 million, and additional advances in May, June, July, August, September, and October of 1964 totaling $260 million. The 1960 loan balance is repaid on March 5, 1964. The following tables will show the application of the reduction of credit provisions of section 3302(c).

TABLE A.—*Reduction of credits*

Federal taxable year	Percentage of credit reduction under 3302(c)(2)	Percentage of credit reduction under 3302 (c)(3)(A)	Percentage reduction attributable to effect of 3302(c)(3)(B)	Percentage reduction attributable to effect of 3302(c)(3)(C)	Date of additional tax paid by reason of reduction provisions	Reduction attributable to effect of 3302(c) based on wages paid in
1961 [1]	0.15				Jan. 31, 1962	1961
1962 [2]	.3	0.3			Jan. 31, 1963	1962
1963 [3]		.6	[6] 0.4 (2.7—2.3)		Jan. 31, 1964	1963
1964 [4] [5]		.9	[6] .3 (2.7—2.41)		Jan. 31, 1965	1964
1965		1.2		[7] 0.2 (2.88—2.7)	Jan. 31, 1966	1965
1966		1.5		[7] .1 (2.82—2.71)	Jan. 31, 1967	1966

[1] 4th consecutive Jan. 1 has passed and the 1957 advance has not been repaid by Nov. 10.
[2] 2d consecutive Jan. 1 has passed and the new advances have not been repaid by Nov. 10. Also, the 5th consecutive Jan. 1 has passed for the 1957 advance without repayment.
[3] 3d consecutive Jan. 1 has passed and the new advances have not been repaid by Nov. 10. The credit reductions under sec. 3302(c)(2) have discharged the 1957 advance.
[4] 4th consecutive Jan. 1 has passed and the new advances have not been repaid by Nov. 10.
[5] (Note: There is still a balance of advances made after the enactment of the Employment Security Act of 1960, since all such new advances are aggregated and only a portion of the aggregate has been repaid.)
[6] See tables B and D.
[7] See tables B, C, and D.

TABLE B.—*State Z's financial experience*

[Amounts in millions of dollars]

Year	Benefits paid by State	Employer contributions	State taxable wages	Employer contribution as percent of State taxable wages	Federal taxable wages
1959	$260	$186	$7,950	2.34	$7,150
1960	180	144	8,150	1.77	7,350
1961	160	157	8,500	1.85	7,650
1962	195	198	8,600	2.30	7,750
1963	385	195	8,100	2.41	7,300
1964	263	221	8,200	2.70	7,380
1965	185	228	8,400	2.71	7,550
1966	190	225	8,500	2.65	7,650

TABLE C.—*Determination of 5-year benefit-cost rate*

[Amounts in millions of dollars]

Taxable year	5-year period	Total benefit payments	Average annual benefit payments	State taxable wages	Benefit-cost rate (percent)
1965	1959 to 1963	$1,180	$236	[1] $8,200	2.88
1966	1960 to 1964	1,183	237	[2] 8,400	2.82

[1] For 1964.
[2] For 1965.

TABLE D.—*Automatic repayment of advances through reduced tax credits under sec. 3302(c) (2) and (3) (A)*

[Amounts in millions of dollars]

Federal taxable year	Amount of federally taxable wages	To be paid by Jan. 31 of—	Percent of credit reduction under 3302(c)(2)	Additional taxes under 3302(c)(2)	Percent of credit reduction under 3302(c)(3)(A)	Additional taxes under 3302(c)(3)(A)
1961	$7,650	1962	0.15	$11.475	----------	----------
1962	7,750	1963	.3	23.25	0.3	$23.25
1963	7,300	1964	----------	----------	.6	43.8
1964	7,380	1965	----------	----------	.9	66.42
1965	7,550	1966	----------	----------	1.2	90.6
1966	7,650	1967	----------	----------	1.5	114.75

TABLE E.—*Additional taxes resulting from provisions pertaining to State tax yields (sec. 3302(c)(3) (B) and (C))*

Federal taxable year	Actually paid by Jan. 31—	Based on State tax rate in—	Amount of tax equal to (in millions of dollars)—
1963	1964	1962	1963 Federal wages (from table B)×(2.7−1962 actual average State employer contribution rate).[1] $7,300×(2.7−2.30)=$7,300×0.4=$29.2.
1964	1965	1963	1964 Federal wages (from table B)×(2.7−1963 actual average State employer contribution rate). $7,380×(2.7−2.41)=$7,380×0.3=$22.14.
1965	1966	1964	1965 Federal wages (from table B)×(higher of 2.7 or 1959–63 cost rate minus 1964 actual average State employer contribution rate). $7,550×(2.88−2.7)=$7,550×0.2=$15.1.
1966	1967	1965	1966 Federal wages (from table B)×(higher of 2.7 or 1960–64 cost rate minus 1965 actual average State employer contribution rate). $7,650×(2.82−2.71)=$7,650×0.1=$7.65.

[1] No employee contributions in State Z.

TABLE F.—*Summary of repayment of advances*

[Amounts in millions of dollars]

Date on which paid	Additional taxes under 3302(c)(2)	Additional taxes under 3302(c)(3)(A)	Reduced credit when tax yield is inadequate	1957 outstanding loan balance	1960 loan balance	1964 loan balance	To State trust fund
Jan. 31, 1962	$11.475			$18.525	$170.0		
Jan. 31, 1963	23.25	$23.25		[1] 0	146.75		$4.725
Jan. 31, 1964		43.8	$29.2		[2] 73.75	$260.0	
					0	260.0	
Jan. 31, 1965		66.42	22.14		0	171.44	
Jan. 31, 1966		90.6	15.1		0	65.74	
Jan. 31, 1967		114.75	7.65				56.66

[1] On Nov. 10, 1963, the balance of the advance of $30,000,000 made in July 1957 is zero.
[2] On Mar. 5, 1964, the balance of the 1960 advances totaling $170,000,000 is repaid by a payment of $73,750,000. Additional 1964 advances totaling $260,000,000 are made between May 1 and Oct. 31, 1964.

SECTION 504. CONFORMING AMENDMENT

Section 104 of Temporary Unemployment Compensation Act of 1958.—Section 504 of the bill amends section 104(a) of the Temporary Unemployment Compensation Act of 1958 by striking out the words "by December 1" and substituting therefor "before November 10" to conform to a similar change made in section 3302(d)(3) of the Federal Unemployment Tax Act by section 503 of the bill.

[H.R. 12580] [14]

SOCIAL SECURITY AMENDMENTS OF 1960

[Conference Report No. 2165, Eighty-sixth Congress, Second Session]

[August 25, 1960]

Mr. MILLS, from the committee of conference, submitted the following conference report to accompany H.R. 12580.

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12580) to extend and improve coverage under the Federal Old-Age, Survivors, and Disability Insurance System and to remove hardships and inequities, improve the financing of the trust funds, and provide disability benefits to additional individuals under such system; to provide grants to States for medical care for aged individuals of low income; to amend the public assistance and maternal and child welfare provisions of the Social Security Act; to improve the unemployment compensation provisions of such Act; and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its amendments numbered 21, 23, 24, 25, 26, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 41, 45, 46, 48, 49, 51, 52, 53, 54, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 83, 84, 85, 86, 87, 88, 89, 100, and 101.

That the House recede from its disagreement to the amendments of the Senate numbered 2, 3, 4, 5, 6, 8, 9, 11, 13, 16, 17, 18, 19, 20, 38, 39, 40, 91, 92, 93, 94, 95, 97, 98, 99, 102, 103, 104, and 105, and agree to the same.

* * * * * * *

Amendment numbered 12:

That the House recede from its disagreement to the amendment of the Senate numbered 12, and agree to the same with amendments as follows:

Restore the matter proposed to be stricken out by the Senate amendment, and—

On page 28, line 4, of the House engrossed bill, strike out the comma after "Puerto Rico".

On page 30, line 4, of the House engrossed bill, strike out "a semicolon" and insert: *; or*

On page 30, line 12, of the House engrossed bill, strike out "; or" and insert a period.

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[14] Public Law 86-778, page 693, this Bulletin.

On page 35, line 25, of the House engrossed bill, strike out "a semicolon" and insert: *; or*

On page 36, line 8, of the House engrossed bill, strike out "; or" and insert a period.

And the Senate agree to the same.

Amendment numbered 14:

That the House recede from its disagreement to the amendment of the Senate numbered 14, and agree to the same with amendments as follows:

Restore the matter proposed to be stricken out by the Senate amendment, and on page 48, line 5, of the House engrossed bill, strike out "105" and insert the following: *104*

And the Senate agree to the same.

Amendment numbered 15:

That the House recede from its disagreement to the amendment of the Senate numbered 15, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following: *105*

And the Senate agree to the same.

Amendment numbered 22:

That the House recede from its disagreement to the amendment of the Senate numbered 22, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following: *106*

And the Senate agree to the same.

Amendment numbered 27:

That the House recede from its disagreement to the amendment of the Senate numbered 27, and agree to the same with amendments as follows:

Restore the matter proposed to be stricken out by the Senate amendment, and in the House engrossed bill, beginning with page 59, line 22, strike out all through line 23 on page 60.

And the Senate agree to the same.

Amendment numbered 82:

That the House recede from its disagreement to the amendment of the Senate numbered 82, and agree to the same with amendments as follows:

Restore the matter proposed to be stricken out by the Senate amendment, and on page 146 of the House engrossed bill, after line 10, insert the following:

(g) Notwithstanding section 203(b) of the Farm Credit Act of 1959, sections 3305(b), 3306(c)(6), and 3308 of the Internal Revenue Code of 1954 and sections 1501(a) and 1507(a) of the Social Security Act shall be applicable, according to their terms, to the Federal land banks, Federal intermediate credit banks, and banks for cooperatives.

And the Senate agree to the same.

Amendment numbered 90:

That the House recede from its disagreement to the amendment of the Senate numbered 90, and agree to the same with amendments as follows:

Omit the matter proposed to be inserted by the Senate amendment, restore the matter proposed to be stricken out by the Senate amendment, and on page 153 of the House engrossed bill, after line 25, insert the following:

(c) Effective on and after January 1, 1961, section 5(b) of the Act of June 6, 1933, as amended (29 U.S.C., sec. 49d(b)), is amended by striking out "Puerto Rico, Guam," and inserting in lieu thereof "Guam".

And the Senate agree to the same.

* * * * * * *

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
THOMAS J. O'BRIEN,
N. M. MASON,
JOHN W. BYRNES,
HOWARD H. BAKER,
Managers on the Part of the House.

HARRY F. BYRD,
ROBT. S. KERR,
J. ALLEN FREAR,
JOHN J. WILLIAMS,
FRANK CARLSON,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12580) to extend and improve coverage under the Federal Old-Age, Survivors, and Disability Insurance System and to remove hardship and inequities, improve the financing of the trust funds, and provide disability benefits to additional individuals under such system; to provide grants to States for medical care for aged individuals of low income; to amend the public assistance and maternal and child welfare provisions of the Social Security Act; to improve the unemployment compensation provisions of such Act; and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

The following Senate amendments made technical, clerical, clarifying, or conforming changes: 1, 2, 4, 5, 6, 15, 17, 18, 19, 20, 21, 22, 23, 25, 28, 29, 30, 32, 33, 34, 35, 36, 37, 38, 39, 41, 43, 44, 46, 47, 48, 52, 53, 54, 55, 56, 92, 94, 95, 98, 100, 102, 103, 104, and 105. With respect to these amendments (1) the House either recedes or recedes with amendments which are technical, clerical, clarifying, or conforming in nature, or (2) the Senate recedes in order to conform to other action agreed upon by the committee of conference.

EXTENSION OF TIME FOR MINISTERS TO ELECT COVERAGE

Amendment No. 3: The Senate amendment added to section 101(b) of the House bill a new provision amending section 1402(e)(3) of the Internal Revenue Code of 1954. It would under certain conditions permit a minister who, before the enactment of the amendment, had filed a certificate electing to be covered under the old-age, survivors, and disability insurance program effective beginning with his first taxable year ending after 1956, to file a supplemental certificate making the original certificate effective beginning with his first taxable year ending after 1955. The House recedes.

* * * * * * *

EXTENSION OF COVERAGE TO GUAM AND AMERICAN SAMOA

Amendment No. 12: Section 103 of the House bill extensively amended title II of the Social Security Act, the Internal Revenue Code of 1954, and related laws so as to extend coverage under the old-age, survivors, and disability insurance program to employees and self-employed individuals in Guam and American Samoa and to provide for the effective administration of the program as so extended. The Senate amendment deleted this section of the House bill. The conference agreement provides (with technical amendments) for the extension of coverage under the program to Guam and American Samoa as contained in the House bill.

DOCTORS OF MEDICINE

Amendment No. 13: Section 104 of the House bill amended section 211(c) of the Social Security Act and section 1402(c) of the Internal Revenue Code of 1954 so as to extend coverage under the old-age, survivors, and disability insurance system to earnings derived by self-employed doctors from the practice of medicine. It also amended section 210(a) of the Social Security Act and section 3121(b) of the Internal Revenue Code of 1954 to extend coverage to services performed by medical and dental interns in the same manner as for other employees of training schools and hospitals for which they are employed. The Senate amendment deleted this provision of the House bill, thereby continuing in effect the present exclusions from coverage of self-employed physicians and interns. The House recedes.

SERVICE OF PARENT FOR SON OR DAUGHTER

Amendment No. 14: Section 105 of the House bill amended section 210(a)(3) of the Social Security Act and section 3121(b)(3) of the Internal Revenue Code of 1954 so as to provide coverage under the old-age, survivors, and disability insurance program for service (other than domestic service or casual labor) performed by an individual in the employ of his son or daughter. The Senate

amendment deleted this section of the House bill. The conference agreement (with a technical amendment) follows the House bill and extends coverage to individuals performing service of this type.

EMPLOYEES OF CERTAIN LABOR ORGANIZATIONS IN THE CANAL ZONE

Amendment No. 16: Section 106(d) of the House bill amended section 210(e) of the Social Security Act and section 3121(h) of the Internal Revenue Code of 1954 so as to include in the definition of "American employer" certain tax-exempt labor organizations created or organized in the Canal Zone, if they are chartered by labor organizations created or organized in the United States. This provision of the House bill would have extended coverage to service performed outside the United States by U.S. citizens in the employ of such organizations. The provision would also have permitted the validation of certain remuneration erroneously reported by an organization which qualifies as an "American employer" under the provision. The Senate amendment deleted this provision of the House bill. The House recedes.

AMERICAN CITIZEN EMPLOYEES OF FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS

Amendments Nos. 24 and 26: Section 107 of the House bill amended section 211(c)(2) of the Social Security Act and section 1402(c)(2) of the Internal Revenue Code of 1954 in order to provide coverage as self-employed individuals for American citizen employees of foreign governments, wholly owned foreign government instrumentalities, and international organizations. The Senate amendment deleted the provisions of this section which extended such coverage to employees of international organizations. The Senate recedes.

DOMESTIC SERVICE AND CASUAL LABOR

Amendments Nos. 27 and 31: Section 108 of the House bill reduced from $50 to $25 the amount of cash wages which an individual must receive in a calendar quarter for domestic service in a private home or for service not in the course of the employer's trade or business in order to be covered under the old-age, survivors, and disability insurance program, and excluded from coverage all earnings in such domestic service and casual labor performed by persons who are under age 16. The Senate amendment deleted the provision reducing the cash wage requirement. The House recedes with an amendment deleting the provision excluding earnings in such domestic service and casual labor performed by persons who are under age 16.

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THE UNEMPLOYMENT COMPENSATION PROGRAM

Amendments Nos. 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, and 90:

The bill as passed the House contained a number of amendments affecting the Federal-State program of employment security. These included: (1) a raise in the Federal unemployment tax rate from 3.0 percent to 3.1 percent; (2) provisions governing financing of the administrative expenses of the Federal-State employment security program; (3) improvements in the operation of the Federal unemployment account (the loan fund) by tightening the conditions pertaining to eligibility for and repayment of advances to States with depleted reserve accounts; (4) extension of coverage of the unemployment compensation program to several groups of workers; and (5) treating Puerto Rico as a State for the purposes of the unemployment compensation program.

The Senate amendments adopted only one of these changes—the one relating to eligibility for and repayment of advances. In addition, the Senate amendments provided for a larger loan fund by increasing the amount authorized to be built up in the Federal unemployment account from $200 million to $500 million (under the bill as passed the House the Federal unemployment account would be permitted to increase to $550 million or, if greater, four-tenths of 1 percent of the total wages subject to contributions under all State unemployment compensation laws for the applicable calendar year).

The conference agreement contains the provisions of the bill as passed the House with two technical amendments.

* * * * * * *

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
THOMAS J. O'BRIEN,
N. M. MASON,
JOHN W. BYRNES,
HOWARD H. BAKER,
Managers on the Part of the House.

[H.R. 5547] [15]

INTERNAL REVENUE CODE PROVISIONS RELATING TO POSSESSIONS

[House Report No. 1131, Eighty-Sixth Congress, First Session]

[September 2, 1959]

MR. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 5547.

The Committee on Ways and Means, to whom was referred the bill (H.R. 5547) to amend certain provisions of the Internal Revenue Code of 1954 relating to possessions of the United States, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 1, strike out line 3 and all that follows through line 2 on page 2, and insert:

That (a) subpart D of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1954 (relating to possessions of the United States) is amended by adding at the end thereof the following new section:

SEC. 934. LIMITATION ON REDUCTION IN INCOME TAX LIABILITY INCURRED TO THE VIRGIN ISLANDS.

"(a) GENERAL RULE.—Tax liability incurred to the Virgin Islands pursuant to this subtitle, as made applicable in the Virgin Islands by the Act entitled 'An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes', approved July 12, 1921 (48 U.S.C. 1397), or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), shall not be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands, except to the extent provided in subsection (b) or (c).

"(b) EXCEPTION FOR CERTAIN DOMESTIC AND VIRGIN ISLANDS CORPORATIONS.—In the case of a domestic corporation or a Virgin Islands corporation, subsection (a) shall not apply (if the information required by subsection (d) is supplied) to the extent such corporation derived its income from sources without the United States if the conditions of both paragraph (1) and paragraph (2) are satisfied:

"(1) THREE-YEAR PERIOD.—If 80 percent or more of the gross income of such corporation (computed without the benefit of section 931) for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Virgin Islands; and

"(2) TRADE OR BUSINESS.—If 50 percent or more of the gross income of such corporation (computed without the benefit of section 931) for such period or such part thereof was derived from the active conduct of a trade or business within the Virgin Islands.

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[15] Sec. 4 of P.L. 86–779 (H.R. 10960), page 709, this Bulletin.

For purposes of this subsection, all amounts received by such corporation within the United States, whether derived from sources within or without the United States, shall be considered as being derived from sources within the United States.

"(c) EXCEPTION FOR CERTAIN RESIDENTS OF THE VIRGIN ISLANDS.—Subsection (a) shall not apply in the case of an individual citizen of the United States who is a bona fide resident of the Virgin Islands during the entire taxable year (if the information required by subsection (d) is supplied), to the extent his income is derived from sources within the Virgin Islands (except that subsection (a) shall apply in the case of amounts received for services performed as an employee of the United States or any agency thereof).

"(d) REQUIREMENT TO SUPPLY INFORMATION.—Subsections (b) and (c) shall apply only in the case of persons who supply (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) such information as the Secretary or his delegate may by regulations prescribe for purposes of determining the applicability of such subsections."

(b) The table of sections for such subpart D is amended by adding at the end thereof the following:

"Sec. 934. Limitation on reduction in income tax liability incurred to the Virgin Islands."

Page 3, line 16, after "SEC. 4.", insert "(a)".

Page 4, strike out lines 6 and 7, and insert:

(b) Section 2501(a) of such Code is amended by striking out "nonresident who is not a citizen of the United States and" and inserting in lieu thereof "nonresident not a citizen of the United States".

SEC. 5. (a) The amendments made by the first section of this Act shall apply to tax liability incurred with respect to taxable years beginning on or after January 1, 1959.

(b) The amendments made by sections 2 and 3 of this Act shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

(c) The amendment made by section 4 of this Act shall apply with respect to gifts made after the date of the enactment of this Act.

I. SUMMARY OF BILL

This bill deals with two basic subjects. The first is concerned with the extent to which income tax liability incurred to the Virgin Islands can be reduced by grants, subsidies, or other similar payments. The second is concerned with the application of U.S. estate and gift taxes to residents of U.S. possessions who are also citizens of the United States by reason of citizenship in the possession.

First, the bill provides that income tax liability incurred to the Virgin Islands may be reduced by grants, subsidies, or similar payments in the case of corporations only if they are United States or Virgin Islands corporations, and in general only if in past 3 years they have derived 80 percent of their income from sources within the Virgin Islands and 50 percent from the active conduct of a trade or business. Where such conditions are met the income tax liability of the corporations may be reduced only with respect to their income from sources without the United States. In the case of individuals, the bill provides that tax liability may be reduced only in the case of citizens of the United States (whether or not also citizens of the Virgin Islands) only if they are bona fide residents of the Virgin Islands for the entire year. Where these conditions are met the tax liability of the individuals may be reduced only with respect to income from sources within the Virgin Islands. These amendments are to apply to tax liability for taxable years beginning on or after January 1, 1959.

Second, the bill provides that the estate and gift taxes are to apply to those who are U.S. citizens only by reason of citizenship in a U.S. possession and who are residents of a U.S. possession at the time they die or make a gift, in the same manner as in the case of those who are "nonresidents not citizens of the United States." In general this means that they are to be subject to estate or gift tax only with respect to property situated in the United States (but not in the case of property situated in the possessions or elsewhere). The estate and gift tax amendments are to apply to estates of decedents dying after, or gifts made after, the date of enactment of this bill.

This bill is being reported unanimously by your committee and is favored by the Treasury Department.

II. LIMITATION IN REDUCTION OF INCOME TAX LIABILTY INCURRED TO THE VIRGIN ISLANDS

For many years (since the Naval Appropriations Act of 1921) the income tax laws of the United States have been applicable to the Virgin Islands as if these laws had been separately enacted for the Virgin Islands, substituting the name "Virgin Islands" for references to the United States in the income tax laws. The effect of this dual tax system, or "mirror system" as it has sometimes been called, has been to require the filing of a return and the payment of income tax to both the United States and to the Virgin Islands. However, double taxation was prevented through the allowance by the United States of a foreign tax credit with respect to income derived from sources within the Virgin Islands, and by the application by the Virgin Islands of a foreign tax credit with respect to income derived from sources within the United States.

The Revised Organic Act for the Virgin Islands of the United States, passed in 1954 (Public Law 517, 83d Cong., 2d sess., S. 3378), however, made substantial changes in this tax treatment. This act provided:

> That the term "inhabitants of the Virgin Islands" as used in this section (section 28a) shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and without the Virgin Islands into the Treasury of the Virgin Islands.

The effect of this change was to require inhabitants of the Virgin Islands, namely residents of those islands, to pay their entire income taxes to the Virgin Islands, even though part of their income was derived from sources within the United States. As a result, income of residents of the islands from sources within the United States now is being covered into the Virgin Islands Treasury rather than into the U.S. Treasury.

This change became particularly significant in view of the passage by the Virgin Islands Legislature, and signing by the Virgin Islands' Governor, of Act No. 224, designed to encourage the establishment of new businesses and industries in the Virgin Islands through the granting of special subsidies. Although the Revised Organic Act provided the Virgin Islands no authority to rebate income taxes paid to it either with respect to income derived from sources within the Virgin Islands or from sources derived in the United States, nevertheless the legislature achieved substantially the same effect in Act No. 224 by providing subsidies ranging from 50 to 75 percent of the income taxes paid by corporations and residents with respect to certain specified types of new investment. These subsidies were granted with respect to the tax attributable both to income from sources within the Virgin Islands and from sources within the United States. Specifically, the income tax subsidies provided by that act were in the following five general categories:

1. Seventy-five percent of the income tax payable for a period of 10 years by persons, firms or corporations qualifying as "new industries." A "new business" in this case is, in general, defined as one involving manufacture of an article, or the application of a process, which was not being manufactured or applied in the islands prior to January 1, 1947, if the industry has a capital investment of at least $10,000, but only to the extent not in competition with existing enterprises.

2. Seventy-five percent of income taxes payable for a period of from 10 to 16 years by persons, firms or corporations operating hotels and guesthouses in the islands in which there is an investment of at least $100,000.

3. Seventy-five percent of the income taxes payable for a period of 10 years by persons, firms, or corporations constructing or operating apartment houses, housing projects, or industrial or commercial buildings in the islands in which there is an investment of at least $100,000.

4. Fifty percent of the income taxes paid for a period of 10 years by persons, firms, or corporations on the portion of their income derived from the purchase, transfer, assignment, or sale of stocks, bonds, and other securities purchased or sold through an investment company located in and authorized to do business in the Virgin Islands. The subsidy granted to any one person under this provision may not exceed $100,000 a year and

for more than half of this subsidy to be paid to a taxpayer, one-half of the subsidy must be invested in the Virgin Islands in projects which will further the economic development of the islands.

5. Fifty percent of the income taxes paid by stockholders or partners of firms or corporations which qualify for a subsidy in any of the four above categories.

Your committee, while recognizing the desirability of the economic development of the Virgin Islands, does not in any case believe that this should be attained by granting windfall gains to taxpayers with respect to income derived from investments in corporations on the continental United States, or with respect to income in any other manner derived from continental United States sources. In this connection your committee is glad to note that on April 29, 1959, the Virgin Islands government enacted Act No. 395, amending Act No. 224 to eliminate the subsidy program with respect to securities and also designed to limit the subsidy program to income derived from sources outside the United States. Although this in large measure removes the aspects of the Virgin Islands subsidy program with which your committee was most concerned, it doubts the desirability of leaving the opportunity to the Virgin Islands to adopt such a program at any time in the future that it may see fit.

For these reasons your committee in the first section of this bill, with two specified exceptions noted below, denies the right to the Virgin Islands to make any grant, subsidy, or other payment which has the effect either directly or indirectly of reducing tax liability incurred to the Virgin Islands under the Internal Revenue Code as made applicable to the Virgin Islands by the original Organic Act (the Naval Appropriations Act of 1921) or by section 28(a) of the Revised Organic Act of the Virgin Islands (approved in 1954).

The first exception relates to United States or Virgin Islands corporations and, in general, provides that subsidies can be paid to these corporations under much the same conditions as those under which income tax exemptions are presently available in the case of U.S. corporations carrying on a trade or business in most other U.S. possessions (sec. 931 of the code). The second exception relates to citizens of the United States (both those who are citizens by reason of the Organic Act establishing the government in the possession and those who are citizens by reason of birth in the continental United States, naturalization, etc.) who are bona fide residents of the Virgin Islands and permits the granting of subsidies in much the same manner as bona fide residents of Puerto Rico may claim an exemption from U.S. income tax with respect to their income derived from sources within Puerto Rico (sec. 933 of the code). In general terms, these exceptions permit the Virgin Islands to provide, through the subsidy program, what amounts to much the same treatment as that already provided by income tax exemption with respect to other possessions in the case of U.S. corporations, or along the lines of the treatment provided residents of Puerto Rico in the case of citizen residents. This appeared to your committee to be in accord with the purpose of the special tax treatment long accorded possessions of the United States, namely, to encourage the development of the economic resources of the possessions by citizens of the United States or by U.S. corporations.

More specifically, the extent to which subsidies may be granted to domestic or Virgin Islands corporations is limited to the portions of their income which these corporations derive from sources without the United States. In addition, two income requirements must be met. First, to be eligible for this treatment 80 percent or more of the corporation's income for the 3-year period preceding the close of the taxable year (or for the part of that period in which the corporation carried on any trade or business within the Virgin Islands) must have been derived from sources within the Virgin Islands. Second, 50 percent or more of the gross income of the corporation for the same period of time must have been derived from the active conduct of a trade or business within the Virgin Islands. In making these computations all amounts received by these corporations within the United States, whether or not actually derived from sources within or without the United States, are to be considered as being derived from sources within the United States. The effect of this is to deny any subsidy with respect to this portion of the tax payments made by the corporation as well as to treat this income as derived from sources without the Virgin Islands in the case of the 80 percent test.

The subsidy in the case of individuals is limited to citizens of the United States. This includes those who are citizens of the United States by reason of

being a citizen or resident of a possession, and by reason of birth or residence in a possession as well as all other citizens of the United States. However, the citizen must also have been a bona fide resident of the Virgin Islands during the entire taxable year in question. One who meets both the citizenship and residence requirements may qualify for a subsidy payment to the extent his income is derived from sources within the Virgin Islands. However, there is one exception to this rule: subsidy payments may not be made with respect to amounts received for services performed as an employee of the United States, or any agency of the United States.

For the subsidy payments to be permitted, either in the case of corporations or individuals, information must be supplied to the Secretary of the Treasury or his delegate to the extent that he considers the information necessary in order to determine whether the individual or company receiving the subsidy properly qualifies.

These amendments are to apply to tax liability for taxable years beginning on or after January 1, 1959.

III. ESTATE AND GIFT TAX TREATMENT OF CERTAIN CITIZEN RESIDENTS OF POSSESSIONS

Present law provides that upon the death of a citizen or resident of the United States, an estate tax is to be imposed with respect to all property left by the decedent wherever situated except real property situated outside of the United States. In the case of the death of nonresidents who are not citizens of the United States, present law imposes an estate tax only with respect to property situated in the United States. However, in the case of deaths of residents of U.S. possessions the courts have held that such residents fell in neither of the two above categories with the result that in these cases the imposition of the estate tax was avoided entirely.

In *Estate of Albert D. Smallwood* (11 T.C. 740; 1948) the Tax Court held that the estate of a citizen of the United States who resided in, and acquired citizenship in, Puerto Rico was not subject to estate tax as a citizen of the United States. Subsequently, in 1955 the Tax Court in *Estate of Arthur S. Fairchild* (24 T.C. 408) held that the estate of a citizen of the United States resident in the Virgin Islands was not subject to the estate tax. In addition, in *Estate of Rivera* (19 T.C. 271, aff'd 214 F. 2d 60; 2d Cir. 1954) the courts have held that the estate of a citizen of Puerto Rico who was not otherwise a citizen of the United States was not subject to the estate tax as a nonresident decedent not a citizen of the United States.

The results reached in these decisions are based on the theory that the United States does not extend its Federal tax system to possessions unless Congress expressly so provides and the courts have, therefore, held that Congress by not extending the scope of the estate tax had not extended the scope of the estate tax to include citizens of U.S. possessions whether or not they otherwise were U.S. citizens. The Internal Revenue Service not only followed these decisions but also believed that the legal conclusions upon which they were based were equally applicable to the gift tax.

As a result of these decisions, Congress last year in the Technical Amendments Act of 1958 made the estate and gift taxes specifically applicable in the case of citizens of the United States who are residents of a possession but only if the citizen did not become a citizen of United States solely by being a citizen of a possession or solely by reason of his birth within a possession of the United States or solely by reason of his residence within the possession. (Hereafter those who attained U.S. citizenship solely as a result of one of these factors will for convenience be referred to as being a citizen of a U.S. possession.) With respect to these citizens of United States who are residents of a possession but whose citizenship was not derived from citizenship in a U.S. possession, the estate and gift tax provisions were made applicable in the same manner as is generally true in the case of citizens of the United States. As a result, such citizens who are residents of a possession are subject to U.S. estate tax with respect to all property, real or personal, tangible or intangible wherever situated, except real property situated outside of the United States. Similarly, in the case of the gift tax, such U.S. citizens who are residents of a possession at the time they make a gift are subject to gift tax with respect to all gifts of property which is real or personal, tangible or intangible and without regard to whether the property is situated within or without the United States.

Although making the estate and gift taxes applicable to U.S. citizens who were

residents of a possession, if their citizenship arose other than from citizenship of a possession, Congress did not deal last year with the problem of those residents of a possession whose citizenship was derived from the possession. The problem was recognized last year but it was believed that further time was required for the study of the appropriate tax treatment for these citizens of a U.S. possession.

Your committee in this bill recommends that these citizens of a U.S. possession be subject to the estate and gift tax imposed by the United States, in general, to the same extent as in the case of nonresidents not a citizen of the United States.

The effect of this, in the case of the estate tax, is to impose the U.S. estate tax with respect to the portion of the gross estate of these citizens of U.S. possessions who are residents of the possessions at the time of their death, only with respect to that part of their gross estate which at the time of their death is situated in the United States. For this purpose shares of stock held by the decedent are treated as property situated in the United States only if issued by a domestic corporation. On the other hand, property such as proceeds from life insurance and bank deposits, even though physically in the United States at the time of the decedent's death are not considered property situated within the United States unless the decedent was engaged in business in the United States at the time of his death.

The $60,000 estate tax exemption generally available to citizens of United States and to residents of United States is to be available to citizens of U.S. possessions only in the same proportion in which their gross estate situated within the United States bears to their total gross estate, except that in no case is the exemption to be less than $2,000. This can be illustrated by a citizen of the Virgin Islands (or Puerto Rico) who died owning bonds valued at $45,000 which were situated in the Virgin Islands (or Puerto Rico) and shares of U.S. corporations valued at $30,000. In this case his gross estate situated in the United States is $30,000 or 30/75ths of his entire gross estate. As a result, his exemption in this case would be 30/75ths of $60,000 or $24,000.

In the case of the gift tax, this bill provides that a donor who is a citizen of a U.S. possession, as well as a resident of such a possession, is for purposes of this tax to be treated as a nonresident who is not a citizen of the United States. This means in the case of the gift tax that one of these citizens and residents of a U.S. possession at the time he makes a gift will be subject to the gift tax if, but only if, the property transferred is situated within the United States. For this purpose stock issued by a corporation is considered property within the United States only in the case of domestic corporations.

The estate tax amendments made by this bill are to be effective with respect to decedents dying after the date of enactment of this bill. The gift tax amendments made by this bill are to be effective with respect to gifts made on or after the date of enactment of this bill.

This bill is being reported unanimously by your committee and is favored by the Treasury Department.

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[H.R. 7885] [16]

INCOME TAX TREATMENT OF NONREFUNDABLE CAPITAL CONTRIBUTIONS TO FEDERAL NATIONAL MORTGAGE ASSOCIATION

[House Report No. 1662, Eighty-Sixth Congress, Second Session]

[May 26, 1960]

MR. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 7885.

The Committee on Ways and Means, to whom was referred the bill (H.R. 7885) relating to the income tax treatment of nonrefundable capital contributions to Federal National Mortgage Association, having considered the same,

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[16] Sec. 8 of P.L. 86-779 (H.R. 10960), page 709, this Bulletin.

report favorably thereon with an amendment and recommended that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert the following:

That section 162 of the Internal Revenue Code of 1954 (relating to trade or business expenses) is amended by redesignating subsection (d) as subsection (e), and by inserting after subsection (c) the following new subsection:

(d) CAPITAL CONTRIBUTIONS TO FEDERAL NATIONAL MORTGAGE ASSOCIATION.—For purposes of this subtitle, whenever the amount of capital contributions evidenced by a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718) exceeds the fair market value of the stock as of the issue date of such stock, the initial holder of the stock shall treat the excess as ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business.

SEC. 2. (a) Part IV of subchapter 0 of chapter 1 of the Internal Revenue Code of 1954 (relating to special rules as to basis of property) is amended by redesignating section 1054 as 1055, and by inserting after section 1053 the following new section:

SEC. 1054. CERTAIN STOCK OF FEDERAL NATIONAL MORTGAGE ASSOCIATION.

"In the case of a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718), the basis of such share in the hands of the initial holder shall be an amount equal to the capital contributions evidenced by such share reduced by the amount (if any) required by section 162(d) to be treated (with respect to such share) as ordinary and necessary expenses paid or incurred in carrying on a trade or business."

(b) The table of sections for such part IV is amended by striking out the last line and inserting in lieu thereof the following:

"Sec. 1054. Certain stock of Federal National Mortgage Association.
"Sec. 1055. Cross references."

SEC. 3. The amendments made by the first section and section 2 of this Act shall apply with respect to taxable years beginning after December 31, 1959.

I. SUMMARY OF BILL

Financial institutions selling mortgage paper to the Federal National Mortgage Association must subscribe to its common stock in an amount equal to 2 percent of the mortgages sold. This stock, which is issued at a par value of $100, has been selling on the market at appreciably less than the issuance price.

This bill provides that where FNMA stock is purchased under these conditions, any excess of the issuance price over the fair market value on the date of issuance is to be treated as an ordinary and necessary business expense in the year of purchase rather than as a part of the cost of acquiring the stock. The year of purchase for this purpose is to be the taxable year in which occurs the date of issuance rather than the date of payment. This treatment is to be available for taxable years beginning after December 31, 1959.

A bill (H.R. 7947) identical to this bill, except that it also applied in certain cases in past years, has previously been passed by this Congress but vetoed by the President. The vetoed bill made the deduction described above available for prior years to which the 1954 code generally applied if for those past years the deduction did not result in a refund or credit. The President in his veto message stated that he was sympathetic with the objectives of the bill but indicated that he objected to the retroactive application of the proposed amendment, particularly in that it applied in some cases but not where it would result in refunds or credits. As noted above, this bill entirely removes the retroactive application of the provision to which the President objected. The Treasury Department has indicated that it has no objection to this bill in its present form.

The bill has been reported unanimously by your committee.

II. GENERAL STATEMENT

The Federal National Mortgage Association is a mixed-ownership Federal corporation, having on January 1, 1960, preferred stock of $142,820,000 owned

by the Federal Government and common stock of $53,319,200 owned by more than 5,800 different private shareholders. The Association was originally chartered by Congress in 1938 and rechartered in 1954. One of its principal purposes is to supplement the general secondary market for home mortgages. As a result, when a financial institution such as a bank or other mortgage lender or investor desires to obtain more liquid funds, it may sell qualifying mortgages to the Federal National Mortgage Association.

The 1954 act rechartering the Association provided, however, that the Association was to accumulate capital funds by requiring each mortgage seller to make payments of specified amounts of nonrefundable capital contributions to the Association in exchange for capital stock of the Association. Currently, the amount to be paid by a taxpayer-subscriber must equal 2 percent of the unpaid principal of the mortgages he is selling to the Association and for this the Association issues stock on the first day of the succeeding month.

Problems have arisen as to the tax treatment provided for this stock which must be purchased by a taxpayer when he sells mortgage paper to FNMA. The problems have arisen because, although there is a market for the FNMA stock, the market price is appreciably below the stock issuance price, currently the market price being around 55 percent of the issuance price.

Taxpayer-subscribers generally have assumed that any excess of the issuance price over the market price of this stock represented an ordinary and necessary expense incurred in carrying on their trade or business since they acquired the stock in order to sell their excess supply of mortgage paper. In 1958, however, the Internal Revenue Service ruled (Rev. Rul. 58–41, 1958–1 CB 86) that no part of the purchase price of stock of FNMA constituted a deductible business expense. Instead, it was held that the entire amount paid for the stock must be capitalized and treated as the cost of the stock so acquired. Thus, this ruling holds that there is no tax effect at the time of the purchase or issuance of the stock even though the market price of the stock then is substantially below the issuance price. Instead, the tax effect occurs only when the stock is sold by the taxpayer.

Your committee believes that it is unfortunate to require the capitalization of these expenditures for FNMA stock by taxpayer-subscribers to the extent they represent the excess of purchase price over market price. Viewed from such a taxpayer's standpoint, the excess appears clearly to be expenditures which he must incur in order to sell the mortgage paper he holds. In view of this, your committee believes that such amounts should be treated as ordinary and necessary expenses incurred in carrying on a trade or business. This, of course, means that in the transaction which occurs when the stock is sold (usually a capital transaction) the basis of the stock should not include this amount previously taken as a deduction.

As a result, the bill adds a new subsection (d) to the section of existing law relating to the deductions of trade or business expenses (sec. 162). The new provision relates to the purchase of FNMA stock where this stock is purchased in order to sell mortgage paper to the Association. In such cases the bill provides that any excess of the issue price of the stock over its fair market value on the date of issue is to be treated as an ordinary and necessary business expense of that year in carrying on a trade or business. As a result, this excess will be a deduction against ordinary income of the taxpayer for the year the stock is purchased or issued.

The bill also provides that the basis of the FNMA stock is to be reduced by the amount required to be deducted against ordinary income under the new provision. As a result, the taxpayer cannot, upon the sale of the stock, receive a tax benefit a second time for the amount previously deducted as an ordinary expense item.

This change is to be effective for taxable years beginning after December 31, 1959. In making this statutory amendment, however, your committee intends no inferences to be drawn as to the tax treatment accorded FNMA stock before the enactment of this provision.

The Treasury Department has indicated that it has no objection to the bill as it is being reported unanimously by your committee.

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[H.R. 12559] [17]

REAL ESTATE INVESTMENT TRUSTS

[House Report No. 2020, Eighty-Sixth Congress, Second Session]

[June 28, 1960]

Mr. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 12559.

The Committee on Ways and Means, to whom was referred the bill (H.R. 12559) to amend the Internal Revenue Code of 1954 to provide a special method of taxation for real estate investment trusts, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 1, strike out lines 3 and 4.

Page 1, line 7, after "chapter 1" insert "of the Internal Revenue Code of 1954".

Page 4, line 16, strike out "share" and insert "shares".

Page 5, line 3, after "years;" insert "and".

Page 7, line 12, strike out "(b)," and insert "(c),".

Page 7, line 15, after "accrued" insert ", directly or indirectly,".

Page 8, line 9, strike out "person." and insert "person; and".

Page 8, lines 11 and 12, strike out "trust or association" and insert "real estate investment trust".

Page 8, line 15, strike out "or association".

Page 9, strike out lines 6 to 11, inclusive, and insert:

> For purposes of paragraphs (2) and (3), the rules prescribed by section 318(a) for determining the ownership of stock shall apply in determining the ownership of stock, assets, or net profits of any person; except that '10 percent' shall be substituted for '50 percent' in subparagraph (C) of section 318(a)(2).

Page 13, strike out line 23 and all that follows through line 18 on page 14, and insert:

"(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—For purposes of section 34(a) (relating to credit for dividends received by individuals), section 116 (relating to an exclusion for dividends received by individuals), and section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

"(d) EARNINGS AND PROFITS.—The earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year. For purposes of this subsection, the term 'real estate investment trust' includes a domestic unincorporated trust or association which is a real estate investment trust determined wihout regard to the requirements of subsection (a)."

Page 16, line 2, after "chapter 1" insert "of the Internal Revenue Code of 1954."

Page 16, line 15, after "chapter 1" insert "of such Code".

Page 16, strike out lines 16 and 17 and insert:

by inserting—

and real estate investment trusts

after—

Regulated investment companies.

Page 16, line 18, after "Section 11(d)(3)" insert "of such Code".

Page 16, line 21, after "Section 34(c)" insert "of such Code".

Page 17, line 8, after "Section 116(b)" insert "of such Code".

Page 17, line 18, after "Section 243(c)" insert "of such Code".

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[17] Sec. 10 of P.L. 86-779 (H.R. 10960), page 709, this Bulletin.

Page 17, line 21, strike out "any" and insert "Any".
Page 18, line 1, after "Section 318(b)" insert "of such Code".
Page 18, strike out lines 7, 8, and 9, and insert:
(6) section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts).
Page 18, line 10, after "Section 443(d)" insert "of such Code".
Page 18, strike out lines 13 and 14, and insert:
(5) The taxable income of a real estate investment trust, see section 857(b)(2)(D).
Page 18, line 15, after "Section 1504(b)(6)" insert "of such Code".
Page 18, strike out lines 18 and 19, and insert:
SEC. 3. EFFECTIVE DATE.
The amendments made by sections 1 and 2 of this Act shall apply with respect to

I. SUMMARY STATEMENT

H.R. 12559 provides substantially the same tax treatment for real estate investment trusts as present law provides for regulated investment companies. Real estate trusts are organizations specializing in investments in real estate and real estate mortgages, while the regulated investment companies specialize in investments in stocks and securities. Under present law regulated investment companies which distribute 90 percent or more of their ordinary income are taxed only on their retained earnings. Thus, the distributed earnings of these companies are taxed only to the shareholders. This same type of tax treatment is accorded by this bill to real estate investment trusts. This bill restricts this "pass through" of the income for tax purposes to what is clearly passive income from real estate investments, as contrasted to income from the active operation of businesses involving real estate.

This bill has been reported unanimously by your committee and the Treasury Department has indicated that it has no objection to the passage of this bill.

II. REASONS FOR THE BILL

In the case of regulated investment companies, individuals desiring to invest in stocks and securities pool their funds by buying shares in investment companies, which in turn invest these resources in stocks and securities of operating companies.

These companies investing in stock and securities are known as regulated investment companies if they meet various requirements with respect to asset diversification, capital structure, and operations. Such companies if they distribute at least 90 percent of their ordinary income are taxed only on their undistributed income. Dividends paid by such companies generally are taxed in the usual manner to shareholders, except that dividends arising from capital gains realized by the company receive capital gains treatment in the hands of the recipient and dividends, which to an important degree are attributable to interest or other nondividend income, are, to the extent of that portion of the distribution by the regulated investment company, not eligible for the dividends received credit, exclusion, or deduction.

The omission of the corporate income tax in the case of distributed earnings, which present law provides for regulated investment companies, secures for investors in these companies essentially the same tax treatment as they would have received if they had invested directly in the operating companies. H.R. 12559 extends this same type of tax treatment to real estate investment trusts specializing in investments in real estate equities and mortgages as distinct from the stock and security holdings of regulated investment companies. Thus this secures for the trust beneficiaries the same type of tax treatment they would receive if they held the real estate equities and mortgages directly and, therefore, equates their treatment with that accorded investors in regulated investment companies.

Your committee believes that the equality of tax treatment between the beneficiaries of real estate investment trusts and the shareholders of regulated investment companies is desirable since in both cases the methods of investment constitute pooling arrangements whereby small investors can secure advantages normally available only to those with larger resources. These advantages include the spreading of the risk of loss by the greater diversification of investment which can be secured through the pooling arrangements; the opportunity to secure the benefits of expert investment counsel; and the means of collectively financing projects which the investors could not undertake singly.

In addition to providing equality of tax treatment between the trust beneficiaries and the investment company shareholders, your committee believes it is also desirable to remove taxation to the extent possible as a factor in determining the relative size of investments in stocks and securities on one hand, and real estate equities and mortgages on the other. This is particularly important at the present time because of the shortage of private capital and mortgage money for individual homes, apartment houses, office buildings, factories, and hotels. At the present time the financing of these real estate equities and mortgages is dependent largely on Government-guaranteed money, and investments by special groups, such as insurance companies and pension trusts.

It has sometimes been argued that real estate investment trusts differ from regulated investment companies in that the income of the latter already has been subjected to income tax while the income of the former has not. This refers to the fact that the dividend income of the regulated investment company already has been taxed as a part of a corporation's income before it was received by the regulated investment company while the rental income received by the real estate trust has not.

This overlooks the fact that the interest income of regulated investment companies, as well as their capital gain income, has not previously been subjected to the corporate income tax. Moreover, this interest income is an important element in the portfolios of these companies. This absence of a prior tax in the case of a significant portion of the income of regulated investment companies demonstrates that the concept of a regulated investment company is not to impose, or retain, any specified number of taxes with respect to income, but rather to accord individuals of small means an opportunity to pool their investments in one of these companies, yet receive the same treatment as those of greater wealth can obtain by direct investments.

As is pointed out in the next part of this report, H.R. 12559, to the full extent feasible, makes the requirements and conditions now applicable to regulated investment trusts, applicable to the real estate investment trusts. In addition, your committee has also taken care to draw a sharp line between passive investments and the active operation of business, and has extended the regulated investment company type of tax treatment only to income from the passive investments of real estate investment trusts. Your committee believes that any real estate trust engaging in active business operations should continue to be subject to the corporate tax in the same manner as is true in the case of similar operations carried on by other comparable enterprises.

III. GENERAL EXPLANATION OF THE BILL

A. Definition of Real Estate Investment Trust

1. *General requirements.*—In general terms, real estate investment trusts are defined as unincorporated trusts or associations meeting certain general requirements and, in addition, meeting a series of requirements as to amounts of various types of gross income and as to types of investments. Most of these requirements are similar to requirements now applying in the case of regulated investment companies but are adapted to real estate, rather than stock, investments. The general requirements include provisions that the trusts be managed by trustees, have transferable shares or certificates of beneficial interest, and that they be a type of organization which would be taxed as an ordinary domestic corporation in the absence of the provisions of this bill. These are the commonly accepted characteristics of real estate trusts.

The bill also provides that: the beneficial ownership of qualifying real estate trusts must be held by 100 or more persons; the trust, apart from the nature of its gross income, must not be a personal holding company (i.e., no five individuals may directly or indirectly own more than 50 percent of the trust); it must elect to be treated as a real estate investment trust; and it may not hold any property primarily for sale to customers in the ordinary course of its trade or business.

Three of the above requirements are similar to conditions which must be met by regulated investment companies. The 100-or-more ownership test, is substantially the equivalent of a requirement which regulated investment companies must meet in complying with the Investment Company Act of 1940. The test which requires the trust not to be a personal holding company, apart from the gross income requirement, also is derived from the requirement that a regulated

investment company may not be a personal holding company. In addition, the provision as to the election is substantially the same as a provision applying at present to regulated investment companies.

The requirement that the trust not hold property primarily for sale to customers in the ordinary course of its trade or business is designed to make sure that the trust does not engage in an active business enterprise. Another provision of this type is discussed further below.

2. *Income requirements.*—The income requirements, all of which must be met by a qualifying real estate trust, are divided into three categories. The first of these tests provides that 90 percent or more of a trust's gross income must be of the type specified if it is to qualify. The types of income which qualify for the 90-percent test are dividends; interest; rents from real property; gains from the sale of stock, securities, and real property; and abatements and refunds of taxes on real property. This provision is substantially the same as the present 90-percent test provided for regulated investment companies, except for the addition of the various types of income derived from real property.

The second income test provided for real estate trusts is entirely new; there is no corresponding provision for the regulated investment companies. Under this test at least 75 percent of the trust's income must, in one manner or another, be derived from real property. The types of income within the 75 percent category include rents from real property, interest on obligations secured by mortgages on real property, gain from the sale of real property, dividends and other distributions from other real estate trusts qualifying under this bill, and abatements and refunds of taxes on real property.

The interaction of the 90-percent and 75-percent tests requires at least 75 percent of the trust's income to be derived from real property; another 15 percent must be derived either from real property or from sources from which a regulated investment company would be required to derive most of its income.

The third income requirement is concerned with relatively short-term gains from the sale of property. This test provides that short-term gains on security sales and gains on the sale of real property held for less than 4 years (apart from involuntary conversions) must represent less than 30 percent of the trust's gross income. This provision is somewht similar to a provision in present law applying to regulated investment companies. The 30 percent in the case of the trust applies to sales of real property held for less than 4 years and to sales of securities held for less than 6 months, while that for regulated investment companies in present law applies only to sales of securities held for less than 3 months.

The application of the 30 percent limitation in the case of gross income which may be derived from the sale of real property held for less than 4 years, in conjunction with the general requirement that the trust must not hold any property primarily for sale to customers in the ordinary course of its trade or business will give assurance of qualifying little, if any, income from trading in real property, thus substantially restricting these transactions to sales of investment property.

3. *Investment requirements.*—Two tests as to the nature of their investments must also be met by qualifying real estate investment trusts. Both of these tests are somewhat similar to tests which must be met by regulated investment companies. The first test is designed to give assurance that the bulk of the trusts' investments are in real estate: this requires that 75 percent of the value of its assets be in real estate assets, cash and cash items and Government securities. The second test is designed to provide diversification in any of the trust investments other than the real estate assets (or cash, cash items, or Government securities): this test requires that not more than 25 percent of the value of the trusts' assets may be represented by securities (other than those described above) of any one issuer in an amount greater in value than 5 percent of the trusts' total assets and not more than 10 percent of the voting securities of the issuer.

Rules are provided to make sure that a real estate trust does not become disqualified under these investment tests because of changes in values of property after acquisitions. The rules also provide that where disqualification otherwise would occur because of the purchase of property this disqualification can be overcome if the investment tests are met within 30 days after the close of the calendar quarter in question.

4. Definition of rents from real property.—One of the principal purposes of your committee in imposing restrictions on types of income of a qualifying real

estate investment trust is to be sure that the bulk of its income is from passive income sources and not from the active conduct of a trade or business. This, for example, accounted for the limitation in the general provisions providing that the trust must not hold any property primarily for sale to customers in the ordinary course of its trade or business. This interest in restricting the income of the trust to that of a passive nature also accounts for two of the restrictions provided in the definition of "rents from real property." This definition is important because such rents are one of the principal types of income allowed under the 90-percent and 75-percent gross income tests.

One of the restrictions provided to limit this income to that of a passive nature, specifies that rental income from real property does not include amounts received from such property where the determination of this amount depends in whole or in part on the income or profits derived from the property. This gives assurance that no profit-sharing arrangement will in effect make the trust an active participant in the operation of the property.

An exception to the general rule is provided for amounts based on a fixed percentage or percentages of receipts or sales since these are customary types of rental contracts and are not generally considered related to the profit or loss of the lessee. Generally speaking, therefore, rents received from real property would not be disqualified solely by reason of the fact that the rent is based on a fixed percentage of total receipts or sales of the lessee.

A second restriction, intended to limit the definition of rents from real property to those of a passive nature, excludes from the definition amounts where the trust directly furnishes or renders services to the tenants or manages or operates the property. However, the bill permits these services, or management or operation of the property to be provided through an independent contractor. The independence of the contractor is assured by providing that: The trust may not receive any income from the contractor; the contractor may not own more than a 35 percent interest in the trust; and not more than 35 percent of the stock (or voting power) of a corporate contractor (or interest in the assets and profits if not a corporation) can be held by a person or persons holding a 35 percent or greater interest in the trust.

Still a third restriction provided in the case of rents from real property excludes from the definition of rents amounts received from any person if the trust has an interest of 10 percent or more in the assets or profits of that person. This prevents the avoidance of the restrictions described above with respect to rents from real property through the device of setting up a related organization. It also forecloses the opportunity of any substantial relationship between the trust and the business of any tenant.

B. Taxation of Real Estate Investment Trusts and Their Beneficiaries

As has been previously indicated, this bill provides the regulated investment company type of tax treatment in the case of real estate investment trusts which distribute 90 percent or more of their ordinary taxable income (exclusive of net long-term and short-term capital gains). Any amount in excess of the 90 percent which the trust retains, however, is to be subject to the regular corporate income tax.

The real estate investment trust taxable income which is distributed will be taxable to the beneficiaries as ordinary income. No dividend received deductions, credits or exclusions will be allowed even for the portion of the trust income received as dividends, since the purpose of these provisions is to encourage the investment in rental real estate and real estate mortgages. Capital gains of the trust, however, to the extent they are distributed, are to be taxed at the beneficiary level as long-term capital gains rather than as ordinary income. No provision is made, however, to extend to real estate investment trusts the procedure, presently available for regulated investment companies, whereby capital gains which are not distributed can be taxed to the beneficiaries rather than to the trust.

As is similarily provided in the case of regulated investment companies, where a share or interest in a real estate investment trust is held for 30 days or less any loss on the sale or exchange of the share or interest, to the extent of any capital gain dividend received in the 30-day period, is to be a long-term capital loss.

The treatment outlined above for real estate investment trusts is substantially that now provided in the case of regulated investment companies although there

are several differences, such as the variations noted above in the treatment of dividend income and undistributed capital gains, and also the absence of any provision permitting companies specializing in foreign investments to pass on the benefits of any foreign tax credit to their shareholders.

The provisions of this bill are to apply as of taxable years beginning after December 31, 1960.

IV. TECHNICAL EXPLANATION OF THE BILL

This bill amends subchapter M of chapter 1 of the code by adding a part II thereto which provides a special method of taxation for real estate investment trusts.

New section 856(a) defines a real estate investment trust as an unincorporated trust or association (1) which is managed by one or more trustees, (2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest, (3) which (but for the provisions of this new pt. II) would be taxable as a domestic corporation, (4) which does not hold any property primarily for sale to customers in the ordinary course of its trade or business, (5) the beneficial ownership of which is held by 100 or more persons, (6) which would not be a personal holding company (as defined in sec. 542) if all of its gross income constituted personal holding company income (as defined in sec. 543) and (7) which meets certain specified gross income and other requirements.

Subsection (b) of section 856 provides that to qualify under subchapter M, the trust must meet the conditions described in items (1) through (4) above during the entire taxable year of the trust, while the condition described in item (5) must be met during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months.

Under section 856(c)(1) the provisions of the bill will not apply unless the trust elects to be treated as a real estate investment trust. It must also meet the gross income, diversification, and distribution requirements under section 856(c).

The gross income requirements of section 856(c) are divided into three categories. First, under section 856(c)(2), at least 90 percent of the trust's gross income must be derived from dividends, interest, rents from real property, gains from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property), and abatements and refunds of taxes on real property. This corresponds to the 90 percent income test provided for regulated investment companies.

Under the second gross income test (provided by sec. 856(c)(3)) at least 75 percent of the trust's gross income must be derived from real property; that is, from rents from real property, from interest on obligations secured by mortgages on real property or on interests in real property, gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property), dividends or other distributions on and gain from the sale or other disposition of, transferable shares in other qualifying real estate investment trusts, and abatements and refunds of taxes on real property.

The third gross income requirement (provided by sec. 856(c)(4)) relates to the sale or other disposition of stock, securities, and real property. Under this requirement, the aggregate of the gains from the sale or other disposition of stock or securities held for less than 6 months and gains on the sale or other disposition of real property (including interests in real property) held for less than 4 years (and not involuntarily converted within the meaning of sec. 1033) must represent less than 30 percent of the trust's gross income. For the purpose of this test losses are not netted with gains.

Under section 856(c)(5) at the close of each quarter of the taxable year at least 75 percent of the value of the trust's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities. Further, at the close of each quarter of the taxable year not more than 25 percent of the value of the trust's total assets may be represented by securities of other corporation's limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the trust's total assets and to not more than 10 percent of the outstanding voting securities of the issuer. Paragraph (5) also provides that variations from the required percentages resulting from mere fluctuations in the value of any security or

other property shall not result in the loss of status of a real estate investment trust. Also, failure to meet these asset requirements at the end of any quarter by reason of acquisitions of any security or other property during such quarter shall not cause the trust to lose its status as a real estate investment trust if such discrepancy is eliminated within 30 days after the close of such quarter. This provision is similar to that in section 851(d) relating to regulated investment companies.

Section 856(c)(6) defines the terms "value," "real estate assets," and "interest in real property." The definition of "value" is consistent with the definition of the same term in section 851(c)(4) (relating to regulated investment companies) with such changes as are necessary to adapt it to the conditions laid down with respect to real estate investment trusts. "Real estate assets" are defined as including not only real property but interests in real property and interests in mortgages on real property as well as shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of the new part II. The term "interest in real property" is defined to include fee ownership and coownership of land or improvements thereon and leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests. All other terms are to have the same meaning as when used in the Investment Company Act of 1940, as amended.

Section 856(d) defines "rents from real property." Restrictions and limitations are provided in the definition to prevent income from active business operations from being included therein. This is designed to insure that active business income is not to be given "conduit" tax treatment. Specifically, under section 856(d)(3), the term "rents from real property" does not include amounts received with respect to real property if the trust furnishes or renders services to the tenants of the property or manages or operates the property, other than through an independent contractor from whom the trust itself does not derive or receive any income. If any services are performed for tenants, or if management fees are received therefor, these services must be performed and these fees must be received by an independent contractor rather than by the real estate investment trust itself. This provision is not intended to require the trustees to delegate or contract out their fiduciary duty to manage the trust, as distinguished from the servicing and the operation of the building, or buildings, owned by the trust. The requirement that the trust not receive any income from the independent contractor requires that the relationship between the two be an arm's length relationship. In furtherance of this objective, the term "independent contractor" is specifically defined in section 856(d)(3). Under that definition, the independent contractor cannot own more than 35 percent of the shares, or certificates of beneficial interest, in the trust; and one or more persons owning more than 35 percent or more of the trust cannot own more than 35 percent of the stock, assets, or net profits of the "independent contractor."

Section 856(d)(2) prevents any substantial relationship between the trust and the business of any tenant by excluding from the definition of rents from real property amounts received from any person if the trust has an interest of 10 percent or more in the stock, assets, or net profits of that person.

The rules prescribed by section 318(a) are made applicable in determining ownership of stock, assets, or net profits for purposes of section 856(d)(2) and (3), except that "10 percent" is substituted for the "50 percent" in section 318(a)(2)(C).

Furthermore, section 856(d)(1) excludes from the definition of "rents from real property" any amount derived from real property if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property. An exception is provided for amounts based on a fixed percentage or percentages of receipts or sales of the lessee (whether or not adjusted for such items as returned merchandise, or Federal, State, or local sales taxes). It is not intended to disqualify rents under situations where the lease provides for differing percentages of receipts or sales from different departments or from separate floors of a retail store, for example, so long as each percentage is fixed at the time of entering into the lease.

However, the fact that a lease is based upon a percentage of total receipts would not necessarily qualify the amount received or accrued as "rent from real property." Thus, for example, an amount would not qualify as rent from real property if the lease provides for an amount measured by varying percentages of receipts and the arrangement does not conform with normal business prac-

tices where rental percentages are based on receipts but is in reality used as a means of basing the rent on income or profits.

Section 857 sets forth the method of taxation of real estate investment trusts and their beneficiaries. Section 857(b)(1) imposes the corporate income tax prescribed in section 11 on the real estate investment trust's taxable income. The definition of real estate investment trust taxable income is given in section 857(b)(2). The definition follows that used for regulated investment companies in 852(b)(2). The taxable income of the trust is adjusted as follows: a deduction is permitted for dividends paid (other than capital gains dividends), the excess of net long-term capital gains over net short-term capital losses is excluded, the corporate deductions provided in part VIII (except sec. 248) of subchapter B are not allowed, section 443(b) is disregarded and the net operation of loss deduction provided in section 172 is not allowed. Section 857(b)(3) provides for the imposition of a 25 percent tax in the case of the trust on the excess of the net long-term capital gains over the sum of the net short-term capital loss and the deduction for dividends paid (as defined in sec. 561) determined with reference to capital gains dividends only. Section 857(b)(3)(B) provides that a capital gain dividend (which is defined in sec. 857(b)(3)(C)) shall be treated by the shareholder or holders of beneficial interests as a gain from the sale or exchange of a capital asset held for more than 6 months. Section 857(b)(4) contains a restriction relating to losses on the sale or exchange of stock or interests in real estate investment trusts held for less than 31 days similar to that provided with respect to regulated investment companies. In such case any loss on the sale or exchange of a share or interest, to the extent of any capital gain dividend received during that period, is to be treated as a long-term capital loss.

The tax treatment for real estate investment trusts and their shareholders as just specified is limited by section 857(a) to a real estate investment trust with respect to which the deduction for dividends paid during the taxable year (as defined in sec. 561 of the Code, but without regard to capital gains dividends) equals or exceeds 90 percent of its real estate investment trust taxable income (computed without regard to the deduction for dividends paid). The trust must also comply with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining actual ownership of shares of certificates of beneficial interest.

Section 857(c) provides that dividends received from real estate investment trusts meeting the requirements of the new part II shall not qualify for the credit for dividends received by individuals (sec. 34), for the exclusion of dividends received by individuals (sec. 116), or for the deduction for dividends received by corporations (sec. 243).

Section 857(d) provides that a real estate investment trust's earnings and profits for any taxable year (but not its accumulated earnings and profits) are not to be reduced by amounts which it cannot deduct in computing its taxable income.

Section 858 is substantially the same as section 855. It provides rules under which dividends paid by a real estate investment trust after the close of its taxable year may be deemed to have been paid during such taxable year.

Section 2 of the bill contains a number of technical amendments. It makes conforming amendments to sections 34, 116, and 243 of the code to exclude from the benefits of those sections dividends received from a real estate investment trust which for the taxable years of the trust in which the dividends are paid (or are deemed to have been paid under sec. 858) qualify under part II of subchapter M for conduit treatment. Thus, for example, trust W qualifies as a real estate investment trust under subchapter M for the taxable year ending December 31, 1961. In February 1962, the W trust declares and pays an ordinary dividend to its shareholders. The trust makes an election under section 858 to treat that dividend as having been paid during 1961 so that it can meet the 90-percent income distribution requirement of section 857(a) for 1961. Whether or not the W trust qualifies in 1962 as a real estate investment trust under subchapter M, the dividend which it paid in February 1962 and which related to the taxable year 1961 (by reason of sec. 858) is not considered a dividend for purposes of the dividend received credit, exclusion, or deduction under section 34, 116, or 243, respectively.

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[H.R. 12036] [18]

DIVIDENDS RECEIVED DEDUCTION FOR DIVIDENDS PAID BY A FOREIGN CORPORATION FROM EARNINGS AND PROFITS ACCUMULATED BY A DOMESTIC CORPORATION

[House Report No. 2101, Eighty-Sixth Congress, Second Session]

[August 15, 1960]

Mr. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 12036.

The Committee on Ways and Means, to whom was referred the bill (H.R. 12036) to amend section 902 of the Internal Revenue Code of 1954 with respect to foreign taxes paid by certain predecessor corporations, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike out all after the enacting clause and insert:

That section 243 of the Internal Revenue Code of 1954 (relating to deduction for dividends received by corporations) is amended by adding at the end thereof the following new subsection:

"(d) CERTAIN DIVIDENDS FROM FOREIGN CORPORATIONS.—For purposes of subsections (a) and (b) of this section and for purposes of section 245, any dividend from a foreign corporation from earnings and profits accumulated by a domestic corporation during a period with respect to which such domestic corporation was subject to taxation under this chapter (or corresponding provisions of prior law) shall be treated as a dividend from a domestic corporation which is subject to taxation under this chapter."

SEC. 2. Section 861(a)(2) of the Internal Revenue Code of 1954 (relating to treatment of dividends as income from sources within the United States) is amended by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or", and by adding after subparagraph (B) the following new subparagraph:

"(C) from a foreign corporation to the extent that such amount is required by section 243(d) (relating to certain dividends from foreign corporations) to be treated as dividends from a domestic corporation which is subject to taxation under this chapter, and to such extent subparagraph (B) shall not apply to such amount."

SEC. 3. The amendment made by the first section of this Act shall apply to dividends received after December 31, 1959, in taxable years ending after such date.

Amend the title so as to read:

A bill to amend the Internal Revenue Code of 1954 with respect to certain dividends paid by foreign corporations.

I. SUMMARY OF BILL

This bill provides that the 85-percent intercorporate dividends received deduction is to be available when a foreign corporation pays a dividend out of its earnings and profits if they were accumulated by a predecessor domestic corporation which was subject to the regular U.S. corporate income tax when these earnings were accumulated. This amendment is to apply to distributions received after December 31, 1959, in taxable years ending after that date.

The Treasury Department has indicated that it does not object to the enactment of this bill, and this bill has been reported unanimously by your committee.

II. GENERAL STATEMENT

Under present law when a U.S. corporation has a domestic subsidiary which operates abroad, this subsidiary is taxed currently by the United States on its

[18] Sec. 3 of P.L. 86-779 (H.R. 10960), page 709, this Bulletin.

foreign source income, after the allowance of a credit against the U.S. tax (as tentatively computed) for the foreign taxes it has paid. If the subsidiary and the U.S. parent corporation file a consolidated return, the taxable income of the group is computed on a combined basis, in effect ignoring any dividends paid by the subsidiary to the parent in computing the consolidated taxable income. In such a case generally an additional tax must be paid equal to 2 percent of the consolidated taxable income of the affiliated group. If on the other hand separate returns are filed by the domestic subsidiary and its parent, each pays a separate tax based upon its own income and any dividends paid by the subsidiary to its parent are included in the latter's taxable income but offset by a deduction equal to 85 percent of the dividend income. Thus in this case in effect 15 percent of the dividend income is included in the tax base of the parent.

The attention of your committee has been called to a hardship which may arise where one of these domestic subsidiaries operating abroad, by means of a tax-free exchange approved by the Internal Revenue Service, is reincorporated as a foreign corporation under the laws of a foreign country, or is merged into a foreign corporation. In such cases the earnings and profits of the domestic subsidiary, which have not already been paid out as dividends, are carried over to the foreign corporation as accumulated earnings and profits of that corporation. For such a reincorporation or merger to occur without imposition of a capital gains tax, it must be established to the satisfaction of the Secretary of the Treasury or his delegate that the exchange involved is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes (sec. 367). In the cases called to the attention of your committee the businesses were required to incorporate in the foreign country involved because the foreign country required businesses of the type in which the taxpayer was engaged to be carried on by corporations organized in that country.

The difficulty arises in such a situation with the tax treatment accorded dividens paid out of the earnings and profits of the business, accumulated during the period it was a domestic corporation, which had been transferred to the foreign corporation. Under present law when earnings and profits of a foreign corporation are distributed to a U.S. corporation, generally no intercorporate dividends received deduction is available, since in the usual case these earnings and profits have not previously been subject to U.S. tax. Instead, a foreign tax credit is available to the U.S. corporation for foreign taxes paid by the foreign corporation to the extent they are attributable to the dividend income. In the types of cases in question, however, the foreign corporations did not themselves pay any foreign taxes with respect to these particular earnings and profits (instead, the foreign taxes on these earnings and profits were paid by a predecessor corporation which was a domestic corporation). As a result, under present law such earnings and profits, when distributed by the foreign corporation to its domestic parent, are fully subject to U.S. tax with no credits being available for any foreign taxes paid by the predecessor corporation. Moreover, this double taxation of these earnings and profits by the United States (once to the predecessor domestic corporation and a second time to the parent when it receives dividends from the foreign corporation) occurs without any relief through the application of a 85 percent intercorporate dividends received deduction.

Your committee's bill relieves this double U.S. taxation by providing the same tax treatment which would have applied upon distribution of these earnings and profits by one of these foreign corporations, had it remained a domestic corporation. That is, this bill provides that the 85 percent intercorporate dividends received deduction is to be available for any dividend received from a foreign corporation where the dividend is paid out of earnings and profits which were accumulated by a domestic corporation during a period when the domestic corporation was subject to the regular U.S. corporate income tax. This will, therefore, treat these earnings and profits accumulated by a predecessor domestic corporation in the same manner as if the business had not been required to obtain a foreign charter and instead had, at the time it paid the dividends, remained a domestic corporation.

In determining the extent to which the foreign corporatoin is paying dividends out of accumulated earnings and profits initially accumulated by the domestic corporation, the present rules applicable to foreign corporations are to apply, i.e., any dividends paid insofar as paid out of accumulated earnings and profits are to first be considered as paid out of the most recently accumulated earnings

and profits (without regard to the time such earnings and profits were first attributed to the foreign corporation).

Your committee's bill also amends the code (sec. 861(a)(2)) to provide that income eligible for the intercorporate dividends received deduction under the provision described above is to be treated as domestic income in determining the source of these dividends paid by the foreign corporation. This will have application whether or not less than 50 percent of the foreign corporation's income is from U.S. sources.

These amendments apply to dividends received after December 31, 1959, and taxable years ending after that date.

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[H.R. 5547] [19]

INTERNAL REVENUE CODE PROVISIONS RELATING TO POSSESSIONS

[Senate Report No. 1767, Eighty-Sixth Congress, Second Session, Calendar No. 1838]

[June 29, 1960]

Mr. KERR, from the Committee on Finance, submitted the following report together with minority views to accompany H.R. 5547.

The Committeee on Finance, to whom was referred the bill (H.R. 5547) to amend certain provisions of the Internal Revenue Code of 1954 relating to possessions of the United States, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY OF BILL

The House bill deals with two basic subjects. The first of these imposed limits on the extent to which income tax liability incurred in the Virgin Islands can be reduced by grants, subsidies or similar payments. The second subject provided that the U.S. estate and gift taxes were to apply to residents of U.S. possessions who are also citizens of the United States only by reason of citizenship in the possession in the same manner as "nonresidents who are not citizens of the United States." With relatively minor amendments, your committee has accepted these provisions of the House bill. In addition, it has added to the bill the following amendments relating to other matters:

1. Section 6 of the bill treats capital contributions to the Federal National Mortgage Association, to the extent they exceed the value of the stock on the issue date, as ordinary and necessary business expenses to the initial holder of the stock (a corresponding reduction in the basis of the stock is also provided for).

2. Section 7 of the bill, under certain conditions, provides a charitable contribution deduction (not over $50 a month) for high school or elementary school students maintained in the taxpayer's home under the sponsorship of a charitable organization, veterans' organization, or fraternal society.

3. Section 8 of the bill provides that expenditures by farmers for fertilizer, lime, limestone, or marle can be expensed rather than treated as capital items and written off over a period of more than a year.

4. Section 9 of the bill is designed to prevent a doubling up of deductions for State taxes in the case of accrual basis taxpayers where the doubling up is a result of the action of a taxing jurisdiction taken after December 31, 1960.

5. Section 10 of the bill provides that certain pension trusts established under collective-bargaining agreements are to be considered as qualified trusts from the date they were established.

6. Section 11 of the bill amends the business lease provision of the code to provide a new exception in the case of a lease by a medical research organization to a medical clinic of adjacent premises. Thus, rent received by a medical research organization under these circumstances will be exempt from the unrelated business income tax.

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[19] Secs. 4, 6, 7, and 8 of P.L. 86-779 (H.R. 10960), page 709, this Bulletin.

7. Section 12 of the bill provides that stock owned by a trust or estate, for purposes of determining whether a corporation is a personal holding company, will be treated as being owned by the beneficiaries of the trust or estate in proportion to their actuarial interest in the trust or estate.

8. Section 13 of the bill would add new sections 1111 and 1112 to the Internal Revenue Code of 1954 to provide special tax treatment for shareholders to whom stock is distributed pursuant to an order enforcing the antitrust laws.

9. Section 14 of the bill provides that the ratio for determining the limitation on the amount of the gift tax to be allowed as a credit against the estate tax is to be determined on the basis of the taxable estate (with adjustments) rather than on the basis of the gross estate. This section also provides that where gifts are included in the gross estate for estate tax purposes, any gift tax paid on gifts made after the date of enactment of this act also is to be included in the estate tax base and the limitation on the gift tax credit is to be inoperative with respect to these gifts.

10. Section 15 of the bill imposes import taxes on lead and zinc.

11. Section 16 of the bill permits foreign embassies and legations to withdraw from a customs-bonded warehouse for consumption in the United States certain distilled spirits and wine which have been bottled in bond for export or which have been labeled for export.

II. LIMITATION IN REDUCTION OF INCOME TAX LIABILITY INCURRED TO THE VIRGIN ISLANDS (SEC. 1 AND PART OF SEC. 5)

For many years (since the Naval Appropriations Act of 1921) the income tax laws of the United States have been applicable to the Virgin Islands as if these laws had been separately enacted for the Virgin Islands, substituting the name "Virgin Islands" for references to the United States in the income tax laws. The effect of this dual tax system, or "mirror system" as it has sometimes been called, has been to require persons incurring liability to both the United States and the Virgin Islands to report and pay tax to both. However, double taxation was prevented through the allowance by the United States of a foreign tax credit with respect to income derived from sources within the Virgin Islands, and by the application by the Virgin Islands of a foreign tax credit with respect to income derived from sources within the United States.

The Revised Organic Act for the Virgin Islands of the United States, passed in 1954 (Public Law 517, 83d Cong., 2d sess., S. 3378), however, made substantial changes in this tax treatment. This act provided:

> That the term "inhabitants of the Virgin Islands" as used in this section (section 28a) shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and without the Virgin Islands into the Treasury of the Virgin Islands.

The effect of this change was to require inhabitants of the Virgin Islands, namely permanent residents of those islands, to pay their entire income taxes to the Virgin Islands, even though part of their income was derived from sources within the United States. As a result, the tax on the income of permanent residents of the islands from sources within the United States now is being covered into the Virgin Islands Treasury rather than into the U.S. Treasury.

This change became particularly significant in view of the passage by the Virgin Islands Legislature, and signing by the Virgin Islands' Governor, of Act No. 224, designed to encourage the establishment of new businesses and industries in the Virgin Islands through the granting of special subsidies. Although the Revised Organic Act provided the Virgin Islands no authority to rebate income taxes paid to it, either with respect to income derived from sources within the Virgin Islands or from sources derived in the United States, nevertheless the legislature achieved substantially the same effect in Act No. 224 by providing subsidies ranging from 50 to 75 percent of the income taxes paid by corporations and residents with respect to certain specified types of new investment. These subsidies were granted with respect to the tax attributable both to income from sources within the Virgin Islands and from sources within the United States. Specifically, the income tax subsidies provided by that act were in the following five general categories:

> 1. Seventy-five percent of the income tax payable for a period of 10 years by persons, firms or corporations qualifying as "new businesses." A "new business" in this case is, in general, defined as one involving manufacture

of an article, or the application of a process, which was not being manufactured or applied in the islands prior to January 1, 1947, if the industry has a capital investment of at least $10,000, but only to the extent not in competition with existing enterprises.

2. Seventy-five percent of income taxes payable for a period of from 10 to 16 years by persons, firms or corporations operating hotels and guesthouses in the islands in which there is an investment of at least $100,000.

3. Seventy-five percent of the income taxes payable for a period of 10 years by persons, firms, or corporations constructing or operating apartment houses, housing projects, or industrial or commercial buildings in the islands in which there is an investment of at least $100,000.

4. Fifty percent of the income taxes paid for a period of 10 years by persons, firms, or corporations on the portion of their income derived from the purchase, transfer, assignment or sale of stocks, bonds and other securities purchased or sold through an investment company located in and authorized to do business in the Virgin Islands. The subsidy granted to any one person under this provision may not exceed $100,000 a year and for more than half of this subsidy to be paid to a taxpayer, one-half of the subsidy must be invested in the Virgin Islands in projects which will further the economic development of the islands.

5. Fifty percent of the income taxes paid on income derived by stockholders or partners from the operation of firms or corporations which qualify for a subsidy in any of the four above categories.

Your committee, while recognizing the desirability of the economic development of the Virgin Islands, agrees with the House that in no case should this be attained by granting windfall gains to taxpayers with respect to income derived from investments in corporations in the continental United States, or with respect to income in any other manner derived from sources outside of the Virgin Islands. In this connection your committee is glad to note that on April 29, 1959, the Virgin Islands government enacted Act No. 395, amending Act No. 224 to eliminate the subsidy program with respect to securities and also designed to limit the subsidy program to income derived from sources outside the United States. Although this in large measure removes the aspects of the Virgin Islands subsidy program with which your committee was most concerned, it doubts the desirability of leaving the opportunity to the Virgin Islands to adopt such a program at any time in the future that it may see fit.

For these reasons both the House and your committee in the first section of this bill, with two specified exceptions noted below, deny the right to the Virgin Islands to make any grant, subsidy, or other payment which has the effect either directly or indirectly of reducing tax liability incurred to the Virgin Islands under the Internal Revenue Code as made applicable to the Virgin Islands by the Naval Appropriations Act of 1921 or by section 28a of the Revised Organic Act of the Virgin Islands (approved in 1954).

The first exception relates to United States or Virgin Islands corporations and, in general, provides that subsidies can be paid to these corporations under much the same conditions as those under which income tax exemptions are presently available in the case of U.S. corporations carrying on a trade or business in most other U.S. possessions (sec. 931 of the code). The second exception relates to citizens of the United States (both those who are citizens by reason of the special act of Congress relating to the possession, and those who are citizens by reason of birth in the continental United States, naturalization, etc.) who are bona fide residents of the Virgin Islands and permits the granting of subsidies in much the same manner as bona fide residents of Puerto Rico may claim an exemption from U.S. income tax with respect to their income derived from sources within Puerto Rico (sec. 933 of the code). In general terms, these exceptions permit the Virgin Islands to provide, through the subsidy program, what amounts to much the same treatment as that already provided by income tax exemption with respect to other possessions in the case of U.S. corporations, or along the lines of the treatment provided residents of Puerto Rico in the case of citizen residents. This appeared to your committee to be in accord with the purpose of the special tax treatment long accorded possessions of the United States, namely, to encourage the development of the economic resources of the possessions by citizens of the United States or by U.S. corporations.

More specifically, the extent to which subsidies may be granted to domestic or Virgin Islands corporations is limited to the portions of their income which these corporations derive from sources without the United States. In addition two income requirements must be met. First, to be eligible for this treatment

80 percent or more of the corporation's income for the 3-year period preceding the close of the taxable year (or for the applicable part of that period) must have been derived from sources within the Virgin Islands. Second, 50 percent or more of the gross income of the corporation for the same period of time must have been derived from the active conduct of a trade or business within the Virgin Islands. In making these computations all amounts received by these corporations within the United States, whether or not actually derived from sources within or without the United States, are to be considered as being derived from sources within the United States. The effect of this is to deny any subsidy with respect to this portion of the tax payments made by the corporation as well as to treat this income as derived from sources without the Virgin Islands in the case of the 80-percent test.

Both in applying the 80-percent test and the 50-percent test the House bill provided that they were to be computed without the benefit of section 931. Further analysis of the provisions makes it apparent that this exception is unnecessary in view of the fact that the gross income of a corporation which meets the requirements of section 931 is limited to income from sources within the United States. Therefore, your committee has deleted these two exceptions. It has also provided that in applying the foregoing tests gross income of a Virgin Islands corporation, and the sources from which the income of such a corporation is derived, is to be determined as if such a corporation were a domestic corporation. This appears necessary since a Virgin Islands corporation is for other purposes of the United States tax laws treated as a foreign corporation and, therefore, its income from Virgin Islands sources would not otherwise constitute gross income and the 80 percent and 50 percent tests would be ineffective.

The subsidy in the case of individuals is limited to citizens of the United States. This includes those who are citizens of the United States by reason of being a citizen or resident of the Virgin Islands as well as all other citizens of the United States. However, the citizen must also have been a bona fide resident of the Virgin Islands during the entire taxable year in question. One who meets both the citizenship and residence requirements may qualify for a subsidy payment to the extent his income is derived from sources within the Virgin Islands. However, there is one exception to this rule: subsidy payments may not be made with respect to amounts received for services performed as an employee of the United States, or any agency of the United States.

Your committee has modified the House provision limiting subsidies in the case of individuals to provide that gain or loss from the sale of securities is not to be treated as income derived from sources within the Virgin Islands. This is designed to prevent the granting of subsidies for stock in American and other corporations merely on the grounds that the sale of the stock occurs in the Virgin Islands.

For the subsidy payments to be permitted, either in the case of corporations or individuals, information must be supplied to the Secretary of the Treasury or his delegate to the extent that he considers the information necessary in order to determine whether the individual or company receiving the subsidy properly qualifies.

These provisions as amended by your committee are to apply to tax liability for taxable years beginning on or after January 1, 1960.

III. ESTATE AND GIFT TAX TREATMENT OF CERTAIN CITIZEN RESIDENTS OF POSSESSIONS (SECS. 2, 3, 4 AND PART OF 5)

Present law provides that upon the death of a citizen or resident of the United States, an estate tax is to be imposed with respect to all property left by the decedent wherever situated except real property situated outside of the United States. In the case of the death of nonresidents who are not citizens of the United States, present law imposes an estate tax only with respect to property situated in the United States. However, in the case of deaths of residents of U.S. possessions whose citizenship was derived from citizenship in a possession, the courts have held that such residents fell in neither of the two above categories with the result that in these cases the imposition of the estate tax was avoided entirely.

In *Estate of Albert D. Smallwood* (11 T.C. 740; 1948) the Tax Court held that the estate of a citizen of the United States who resided in, and acquired citizenship in, Puerto Rico was not subject to estate tax as a citizen of the United States. Subsequently, in 1955 the Tax Court in *Estate of Arthur S. Fairchild* (24 T.C. 408) held that the estate of a citizen of the United States

resident in the Virgin Islands was not subject to the estate tax. In addition, in *Estate of Rivera* (19 T.C. 271, aff'd. 214 F. 2d 60; 2d Cir. 1954) the courts have held that the estate of a citizen of Puerto Rico who was not otherwise a citizen of the United States was not subject to the estate tax as a nonresident decedent not a citizen of the United States.

The results reached in these decisions are based on the theory that the United States does not extend its Federal tax system to possessions unless Congress expressly so provides and the courts have, therefore, held that Congress by not extending the scope of the estate tax had not extended the scope of the estate tax to include citizens of U.S. possessions whether or not they otherwise were U.S. citizens. The Internal Revenue Service not only followed these decisions but also believed that the legal conclusions upon which they were based were equally applicable to the gift tax.

As a result of these decisions, Congress in the Technical Amendments Act of 1958 made the estate and gift taxes specifically applicable in the case of citizens of the United States who are residents of a possession but only if the citizen did not become a citizen of United States solely by being a citizen of a possession or solely by reason of his birth within a possession of the United States or solely by reason of his residence within the possession. (Hereafter those who attained U.S. citizenship solely as a result of one of these factors will for convenience be referred to as being a citizen of a U.S. possession.) With respect to these citizens of United States who are residents of a possession but whose citizenship was not derived from citizenship in a U.S. possession, the estate and gift tax provisions were made applicable in the same manner as is generally true in the case of citizens of the United States. As a result, such citizens who are residents of a possession are subject to U.S. estate tax with respect to all property, real or personal, tangible or intangible wherever situated, except real property situated outside of the United States. Similarly, in the case of the gift tax, such U.S. citizens who are residents of a possession at the time they make a gift are subject to gift tax with respect to all gifts of property which is real or personal, tangible or intangible and without regard to whether the property is situated within or without the United States.

Although making the estate and gift taxes applicable to U.S. citizens who were residents of a possession, if their citizenship arose other than from citizenship of a possession, Congress did not in 1958 deal with the problem of those residents of a possession whose citizenship was derived from the possession. The problem was recognized but it was believed that further time was required for the study of the appropriate tax treatment for these citizens of a U.S. possession.

The House and your committee in this bill recommend that these citizens of a U.S. possession be subject to the estate and gift tax imposed by the United States, in general, to the same extent as in the case of nonresidents not citizens of the United States.

The effect of this, in the case of the estate tax, is to impose the U.S. estate tax with respect to the portion of the gross estate of these citizens of U.S. possessions who are residents of the possessions at the time of their death, only with respect to that part of their gross estate which at the time of their death is situated in the United States. For this purpose shares of stock held by the decedent are treated as property situated in the United States only if issued by a domestic corporation. On the other hand, property such as proceeds from life insurance and bank deposits, even though physically in the United States at the time of the decedent's death are not considered property situated within the United States unless the decedent was engaged in business in the United States at the time of his death.

The $60,000 estate tax exemption generally available to citizens of United States and to residents of United States is to be available to citizens of U.S. possessions only in the same proportion which their gross estate situated within the United States bears to their total gross estate, except that in no case is the exemption to be less than $2,000. This can be illustrated by a citizen of the Virgin Islands (or Puerto Rico) who died owning bonds valued at $45,000 which were situated in the Virgin Islands (or Puerto Rico) and shares of U.S. corporations valued at $30,000. In this case his gross estate situated in the United States is $30,000 or thirty seventy-fifths of his entire gross estate. As a result, his exemption in this case would be thirty seventy-fifths of $60,000 or $24,000.

In the case of the gift tax, this bill provides that a donor who is a citizen of a U.S. possession, as well as a resident of such a possession, is for purposes of

this tax to be treated as a nonresident not a citizen of the United States. This means in the case of the gift tax that one of these citizens and residents of a U.S. possession at the time he makes a gift will be subject to the gift tax if, but only if, the property transferred is situated within the United States. For this purpose stock issued by a corporation is considered property situated within the United States only in the case of domestic corporations, but the making of a gift of stock of a domestic corporation, or any other intangible property with a situs within the United States is subject to the gift tax only if the donor resident of the possession is engaged in business in the United States at any time during the year in which the gift of the stock is made.

The estate tax amendments made by this bill are to be effective with respect to estates of decedents dying after the date of enactment of this bill. The gift tax amendments made by this bill are to be effective with respect to gifts made after the date of enactment of this bill.

IV. NONREFUNDABLE CONTRIBUTIONS TO FEDERAL NATIONAL MORTGAGE ASSOCIATION (SEC. 6)

The Federal National Mortgage Association is a mixed-ownership Federal corporation, having on January 1, 1960, preferred stock of $142,820,000 owned by the Federal Government and common stock of $53,319,200 owned by more than 5,800 different private shareholders. The Association was originally chartered by Congress in 1938 and rechartered in 1954. One of its principal purposes is to supplement the general secondary market for home mortgages. As a result, when a financial institution such as a bank or other mortgage lender or investor desires to obtain more liquid funds, it may sell qualifying mortgages to the Federal National Mortgage Association.

The 1954 act rechartering the Association provided, however, that the Association was to accumulate capital funds by requiring each mortgage seller to make payments of specified amounts of nonrefundable capital contributions to the Association in exchange for capital stock of the Association. Currently, the amount to be paid by a taxpayer-subscriber must equal 2 percent of the unpaid principal of the mortgages he is selling to the Association and for this the Association issues stock on the first day of the succeeding month.

Problems have arisen as to the tax treatment provided for this stock which must be purchased by a taxpayer when he sells mortgage paper to FNMA. The problems have arisen because, although there is a market for the FNMA stock, the market price is appreciably below the stock issuance price, currently the market price being around 55 percent of the issuance price.

Taxpayer-subscribers generally have assumed that any excess of the issuance price over the market price of this stock represented an ordinary and necessary expense incurred in carrying on their trade or business since they acquired the stock in order to sell their excess supply of mortgage paper. In 1958, however, the Internal Revenue Service ruled (Rev. Rul. 58–41, 1958–1 CB 86) that no part of the purchase price of stock of FNMA constituted a deductible business expense. Instead, it was held that the entire amount paid for the stock must be capitalized and treated as the cost of the stock so acquired. Thus, this ruling holds that there is no tax effect at the time of the purchase or issuance of the stock even though the market price of the stock then is substantially below the issuance price. Instead, the tax effect occurs only when the stock is sold by the taxpayer.

Your committee believes that it is unfortunate to require the capitalization of these expenditures for FNMA stock by taxpayer-subscribers to the extent they represent the excess of purchase price over market price. Viewed from such a taxpayer's standpoint, the excess appears clearly to be expenditures which he must incur in order to sell the mortgage paper he holds. In view of this, your committee believes that such amounts should be treated as ordinary and necessary expenses incurred in carrying on a trade or business. This, of course, means that in the transaction which occurs when the stock is sold (usually a capital transaction) the basis of the stock should not include this amount previously taken as a deduction.

As a result, section 6 of the bill adds a new subsection (d) to the section of existing law relating to the deductions of trade or business expenses (sec. 162). The new provision relates to the purchase of FNMA stock where this stock is purchased in order to sell mortgage paper to the Association. In such cases the bill provides that any excess of the issue price of the stock over its fair market value on the date of issue is to be treated as an ordinary and necessary business

expense of that year in carrying on a trade or business. As a result, this excess will be a deduction against ordinary income of the taxpayer for the year the stock is purchased or issued.

Section 6 also provides that the basis of the FNMA stock is to be reduced by the amount required to be deducted against ordinary income under the new provision. As a result, the taxpayer cannot, upon the sale of the stock, receive a tax benefit a second time for the amount previously deducted as an ordinary expense item.

This change is to be effective for taxable years beginning after December 31, 1959. In making this statutory amendment, however, your committee intends no inferences to be drawn as to the tax treatment accorded FNMA stock before the enactment of this provision.

V. CHARITABLE CONTRIBUTIONS FOR CERTAIN STUDENTS MAINTAINED IN TAXPAYER'S HOME (SEC. 7)

A. GENERAL STATEMENT

Under present law charitable contributions are deductible for Federal income tax purposes only if they are paid to or for the use of an organization described in the statute. Amounts paid to or for the use of any individual do not qualify for deduction, even though they are paid for a charitable purpose.

This provision amends section 170 of the Internal Revenue Code to allow a deduction, as a charitable contribution, of amounts, not averaging more than $50 per month, which are paid by the taxpayer to maintain in his household certain individuals who are not his dependents and who are not related to him. This new deduction will be available with respect to an individual who is a full-time student or pupil in the 12th or any lower grade at an educational institution provided he is a member of the taxpayer's household under a written agreement between the taxpayer and certain charitable organizations, veterans' organizations or fraternal societies described in the Internal Revenue Code to which contributions are presently deductible for income tax purposes. Under your committee's bill, amounts paid to maintain such an individual in the taxpayer's home are treated as if they had been paid directly to or for the use of the specified charitable, religious or educational organization with which the written agreement is made. However, this new deduction will not be available if the taxpayer receives any money or other property as compensation or reimbursement for maintaining the individual in his household even though such money or property is used for the care of the individual.

Your committee believes that this provision will encourage taxpayers to take into their homes Indian children, and also foreign children whose presence in this country is sponsored by a charitable institution, under a program of the organization designed to provide educational opportunities for pupils or students in private homes. However, this new deduction is not restricted to Indian and foreign children, but is available with respect to any individual, under a program of a charitable institution, who is not related to or dependent upon the taxpayer and who is attending school on a full-time basis in the 12th, or any lower, grade.

This provision shall apply with respect to taxable years beginning after December 31, 1959.

B. TECHNICAL STATEMENT

This section amends section 170 of the Internal Revenue Code of 1954 (relating to charitable, etc., contributions and gifts) by adding a new sentence at the end of subsection (c) which would include in the term "charitable contribution" an amount treated under the new subsection (d) (added by the bill) as paid for the use of certain organizations described in subsection (c). Present subsections (d) and (e) are redesignated as subsections (e) and (f), respectively.

Under present law, a taxpayer is not entitled to a deduction under section 170 for any amounts paid directly to or on behalf of an individual. In general, section 7 of the bill makes such a deduction possible by treating as charitable contributions amounts paid by a taxpayer to maintain a nondependent and unrelated individual while such individual is both a member of the taxpayer's household under an agreement implementing an educational program sponsored by an organization described in paragraph (2), (3), or (4) of subsection (c), and a full-time student at an educational institution described in the bill.

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Individuals

Under the bill, the individual with respect to whom maintenance payments are made must not be a dependent, as defined in section 152, or a relative of the taxpayer. The term "relative of the taxpayer" means an individual who, with respect to the taxpayer, bears any of the relationships described in paragraphs (1) through (8) of section 152(a). The individual must also be a full-time pupil or student in the 12th or any lower grade at an educational institution (as defined in sec. 151(e)(4)) located in the United States. The bill further provides that the individual must be a member of the taxpayer's household under a written agreement between the taxpayer and the organization which sponsors the individual.

Certain organizations

The organization which sponsors the individual must meet two requirements. First, it must be an organization described in paragraph (2), (3), or (4) of section 170(c). Secondly, the organization must be engaged in a program to provide educational opportunities for pupils or students placed in private homes by such organization.

Limited deduction

A deduction is not permitted for any taxable year for an amount in excess of $50 multiplied by the number of full calendar months which fall within the taxpayer's taxable year and during which the individual referred to is a member of the taxpayer's household and a full-time pupil or student. For purposes of determining whether an individual is a member of the taxpayer's household and a full-time student for a calendar month, 15 or more days are treated as a full calendar month.

Temporary absences

To be considered a full-time pupil or student an individual must be enrolled in school and be actively attending classes. However, if an individual is temporarily absent from class due to special circumstances, he may be considered a full-time student so long as he is enrolled in school and resumes classroom attendance upon the termination of the special circumstances. For example, if an individual regularly enrolled in school is absent from class for 20 days of a calendar month due to illness, he is nonetheless considered a full-time student for the calendar month, provided that the individual resumes classroom attendance upon recovering from the illness. Similar rules apply in determining whether an individual is a member of the taxpayer's household. That is, a student may be considered a member of the taxpayer's household notwithstanding temporary absences due to special circumstances.

Maintenance

Amounts paid to maintain an individual do not have to be paid pursuant to a written contract with the sponsoring organization in order to be deductible, although the status of the individual as a member of the taxpayer's household must arise under a written contract. Subject to the monetary limitation, a deduction is permitted for any amount paid to ensure the well-being of the individual, and to carry out the purpose for which the individual was placed in the taxpayer's home. Thus, amounts paid for books, tuition, food, clothing, and a reasonable allowance for the entertainment of the individual may be used in determining whether the limitation to an average of $50 a calendar month is reached. However, depreciation sustained on the taxpayer's house is not to be included, since depreciation is not paid by the taxpayer. Also, no deduction is permitted for the value of services rendered to the individual by the taxpayer or members of the taxpayer's household. This is in accord with the denial of a deduction for services generally under section 170.

Compensation or reimbursement

Subsection (a)(2) of this section expressly provides that the taxpayer may not receive money or other property as compensation or reimbursement for maintaining a qualifying individual. This provision is designed to limit the deduction to those cases where a taxpayer enters into a written contract with a sponsoring organization with the intent to relieve the organization of the costs of carrying on a program to provide educational opportunities for pupils or students in private homes. It is not intended, however, to deter a taxpayer

from prepaying certain extraordinary or nonrecurring expenses of the organization or of some other person, such as the individual's parents. The following examples will serve to make the operation of this provision clear:

Example 1.—A taxpayer who otherwise qualifies under the bill agrees to maintain a student as a member of his household with the understanding that the sponsoring organization will pay to him $30 a month. The total cost of maintaining the student is $50 a month. The taxpayer is not entitled to a deduction with respect to the difference of $20, since he is receiving monthly compensation from the organization.

Example 2.—A taxpayer who otherwise qualifies under the bill takes a student whom he is maintaining as a member of his household to Florida on vacation during Christmas, which is a holiday celebrated by the school in which the student is enrolled. It is a yearly practice of the taxpayer to take such a trip during the Christmas season, but the student accompanied the taxpayer at the request of the student's parents. The parents reimbursed the taxpayer for the portion of the cost of the trip attributable to the student. No portion of the cost of the trip is deductible under the bill; however, other amounts spent for the student's maintenance would be deductible, since the taxpayer in this case merely prepaid a special, nonschool expense which was properly the obligation of another person.

Example 3.—A taxpayer who otherwise qualifies under the bill requires the student whom he is maintaining as a member of his household to work in the taxpayer's business after school hours and during weekends. The services the student renders to the taxpayer are substantial and the taxpayer would ordinarily pay $15 per week for them. The taxpayer does not pay the student any cash for the services rendered. Nevertheless, the taxpayer is not entitled to a deduction for amounts paid for the maintenance of the student, since the taxpayer has, in effect, received money from the student for maintenance.

No other amount allowed as deduction

Subsection (a)(2) of this section further provides that no deduction shall be allowed for any amount paid to maintain an individual under a program to provide educational opportunities for such individual unless such amount is deemed to be a charitable contribution under the provisions of the bill. This provision denies a deduction for any amount paid in excess of the limit provided in the bill, regardless of some other theory of deductibility. It also denies any deduction under section 170 for amounts paid to maintain an individual under such a program where the program is administered by an organization other than one described in paragraph (2), (3), or (4) of section 170(c).

Subsection (b) of this section amends section 162(b) of the code to prohibit a deduction under section 162(a) for any amount which would be allowable as a deduction under subsection (a) were it not for the dollar limitations set forth therein. Subsection (c) provides that the amendments made by this section of the bill shall apply with respect to taxable years beginning after December 31, 1959.

VI. EXPENDITURES BY FARMERS FOR FERTILIZER, LIME, ETC. (SEC. 8)

For many years it has been the universal practice for farmers to deduct the cost of fertilizer and lime in the year in which it is paid or incurred. Recently, however, cases have been called to the attention of the committee in which the Internal Revenue Service has questioned a deduction for lime and fertilizer on the ground that its cost is a capital expense which should be spread over the beneficial life. This is contrary to the long-accepted and widespread practice of deducting fertilizer and lime expenditures in the year they are paid or incurred.

In order to make certain the intention of Congress that these expenses be treated as business expenses, your committee has added a new section 180 to the Internal Revenue Code which permits a taxpayer to elect to treat expenditures for fertilizer, lime, ground limestone, marle, or other materials used by him to enrich, neutralize, or condition his farmland, or for the application of such materials, as expenses which are not chargeable to capital account. Thus, such expenses, as in the past, may be deductible in full in the year in which they are paid or incurred if the farmer so elects. This new provision is merely

declaratory of existing law and makes no substantive change in the application of the statute.

While the amendment made by this section applies to taxable years beginning after December 31, 1959, since it is declaratory of existing law it should be applied to past years as well.

VII. LIMITATION ON ACCELERATION OF ACCRUAL OF STATE TAXES (SEC. 9)

Section 164(a) of the Code allows a deduction for "taxes paid or accrued within the taxable year." Under this language, the accrual basis taxpayer is allowed a deduction in the year the taxes accrue regardless of when they are paid. As a general rule, developed through judicial and administrative interpretations, the date of the event which renders the taxpayer unconditionally liable for the tax is considered the proper accrual date. With respect to personal and real property taxes, the accrual date is generally considered either the assessment date, personal liability date, or the lien date, or a combination of these dates. Section 461(c) of the code allows accrual basis taxpayers, at their election, to accrue real property taxes ratably over the period of time to which they relate. Section 461(c) is limited to real property taxes and few taxpayers have elected to accrue those taxes ratably. Therefore, most taxpayers on the accrual basis accrue and deduct taxes in the taxable year in which the accrual date occurs.

Several States have recently enacted legislation which has enabled accrual basis taxpayers to claim that they are entitled to deduct in 1 Federal taxable year property taxes for 2 full property tax years. The technique employed by the State legislatures to accomplish this is simply to cause the accrual event, such as the assessment date, for 2 years' property taxes, to fall within 1 year. Thus, in a State where real property taxes for the calendar year 1961 were assessed and became a personal liability on January 1, 1961, the State legislature would pass a law changing the assessment and personal liability dates for 1962 real property taxes from January 1, 1962, to December 31, 1961. In such a case, the accrual basis calendar year taxpayer might argue that present law permits him to accrue and deduct in the Federal taxable year 1961 the real property taxes assessed for both 1961 and 1962. If the same State continues to assess property taxes for 1963 and all subsequent years on December 31 of the preceding year, the same taxpayer, having claimed the deduction for 2 years' property taxes in 1961, will still claim a deduction for 1 year's taxes in 1962 and for 1 year's taxes in each succeeding year in which taxes are assessed.

This type of State legislation has been widely publicized as being a "tax gimmick." At least one State has specifically provided that for State income tax purposes, the new accrual date shall be disregarded. It is evident that in many cases the primary purpose of such State legislation is to enable accrual basis taxpayers in those States to obtain a Federal income tax benefit.

If the State legislation accomplishes its purpose, a permanent and significant loss of revenue will result and unless remedial legislation is enacted the revenue loss may be significantly increased as other States may well take action similar to that taken by the States mentioned.

To cope with this problem, your committee has included in the bill an amendment which in general would deny an accrual basis taxpayer the right to deduct more than 1 year's State taxes in 1 Federal taxable year. This is done by providing that where the accrual date is earlier than it would be but for any action of any taxing jurisdiction taken after December 31, 1960, such taxes shall be treated as accruing at the time they would have accrued but for such action. This new provision will not apply however, to certain situations where present law properly allows a doubling of deductions, so long as the doubling of deductions is not the result of any action of a taxing jurisdiction.

This section will apply only to taxable years ending after December 31, 1960. Since the section is not retroactive, it is not intended that it apply to taxable years ending prior to January 1, 1961.

VIII. INCOME TAX EXEMPTION AND DEDUCTIONS FOR CERTAIN UNION-NEGOTIATED, MULTIEMPLOYER PENSION PLANS (SEC. 10)

A. GENERAL STATEMENT

Under present law, a pension trust is qualified for income tax exemption only if it meets certain requirements relating to coverage of employees and nondis-

crimination of contributions or benefits. Where the pension trust is properly qualified, not only is it exempt from Federal taxation with respect to its income, but contributions paid to it by an employer on behalf of his employees are deductible for Federal income tax purposes. Thus, there is considerable incentive for a pension trust to meet the requirements of the Internal Revenue Code and thereby become a qualified trust.

Occasionally, however, it is difficult for a pension trust to achieve qualified status before employer contributions are received by it. This is particularly true in the case of pension plans negotiated under collective-bargaining agreements with many employers, both large and small. Often, considerable time is required to obtain sufficient factual data upon which to insure the actuarial soundness of the plan. Sometimes a formality is not properly performed.

In such cases, where the pension plan operates for some period as a nonqualified plan prior to securing qualification under the Internal Revenue Code, any income it may earn during such period is subject to income tax, thereby reducing amounts which would otherwise serve to provide employee benefits under the plan. In addition, employer contributions are not allowed as deductions.

Your committee believes these are rather severe consequences, particularly where failure to meet the conditions of the statute for qualification is due to mere inadvertence and it was the initial intention of both the employers and the unions to meet those conditions. If the pension trust has never been operated in a manner which would jeopardize the interest of its beneficiaries, and if, when completed, the pension plan of which the trust is a part conforms with the Internal Revenue Code and has received the approval of the Internal Revenue Service, your committee believes it is just, under such circumstances, to provide that the pension plan be treated as a qualified trust during the intervening period between its inception and the time it actually qualified for tax exemption.

This section therefore provides that with respect to certain stated periods of time the following specified pension trusts are to be considered as qualified trusts.

1. The Iron Workers' Mid-American Pension Fund, for the period beginning on January 30, 1957, and ending on December 16, 1958.

2. The Pattern Makers' Pension Trust Fund of Chicago, for the period beginning on April 28, 1958, and ending on February 24, 1959.

3. The Pipe and Refrigeration Fitters Local 537 Pension Fund of Boston, Mass., for the period beginning on March 1, 1956, and ending on November 9, 1959.

4. The Annuity Plan of the Electrical Switchboard and Panelboard Manufacturing Industry of New York City, for the period beginning May 16, 1956, and ending May 22, 1957.

5. The District Council No. 19 Welfare Fund, now known as Painters District Council No. 19 Welfare and Pension Fund, for the period beginning on January 1, 1954, and ending on August 6, 1956.

6. The Local Union No. 377 Pension Fund, for the period beginning October 13, 1952, and ending April 1, 1958.

B. TECHNICAL STATEMENT

This section provides that certain union-negotiated, multiemployer pension funds shall be deemed to constitute qualified trusts for a specified period of time.

Section 10(a) of the bill provides that the Iron Workers' Mid-America Pension Fund shall be considered to have been a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and shall be considered exempt from tax under section 501(a) of such code, for the period beginning on January 30, 1957, and ending on December 16, 1958.

Section 10(b) of the bill provides that the Pattern Makers' Pension Trust Fund of Chicago shall be considered to have been a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to have been exempt from tax under section 501(a) of such code, for the period beginning on April 28, 1958, and ending on February 24, 1959.

Section 10(c) of the bill provides that the Pipe and Refrigeration Fitters Local 537 Pension Fund of Boston, Mass., shall be considered to have been a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to have been exempt from tax under section 501(a) of such code, for the period beginning on March 1, 1956, and ending on November 9, 1959.

Section 10(d) of the bill provides that the Annuity Plan of the Electrical Switchboard and Panelboard Manufacturing Industry of New York City shall

be considered to have been a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to have been exempt from tax under section 501(a) of such code, for the period beginning May 16, 1956, and ending May 22, 1957.

Section 10(e) of the bill provides that the District Council No. 19 Welfare Fund, now known as Painters District Council No. 19 Welfare and Pension Fund shall be considered to have been a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to have been exempt from tax under section 501(a) of such code and under section 165(a) of the Internal Revenue Code of 1939, for the period beginning January 1, 1954, and ending August 6, 1956. For any taxable year for which this welfare fund is, by reason of the provisions of section 10(e) of the bill, considered to be exempt from tax under section 165(a) of the Internal Revenue Code of 1939, contributions to the fund shall not be allowed as a deduction under section 23(a) of such code.

Section 10(f) of the bill provides that the Local Union No. 377 Pension Fund shall be considered to have been a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to have been exempt from tax under section 501(a) of such code and under section 165(a) of the Internal Revenue Code of 1939, for the period beginning October 13, 1952, and ending April 1, 1958.

IX. CERTAIN LEASES BY MEDICAL RESEARCH ORGANIZATIONS (SEC. 11)

A. GENERAL STATEMENT

Present law (sec. 514) provides that in the case of education, charitable, and certain other tax-exempt organizations, the proceeds from certain so-called business leases are to be subject to tax, although the receipt of rent, usually, is not taxed to these organizations. The exception to the general rule as to rental income received by one of these exempt organizations applies where there is indebtedness outstanding with respect to the leased property, or, in other words, where the tax-exempt organization is in effect purchasing the property with the rental income. In such cases, Congress has generally taxed the receipt of rental income because of the belief that in such cases the exempt organizations were in effect using their tax exemption to acquire the property. It has been recognized, however, that where the leased property (although subject to indebtedness) is used for a purpose which is related to the functions of the tax-exempt organization, the motive for obtaining special tax exemption is not likely to be present. As a result, Congress has provided that these business leases are to be taxable only where the operations of the lessee are unrelated to those of the exempt organization.

The attention of our committee has been called to situations where the Internal Revenue Service has defined "related" leases for purposes of this provision in what your committee believes is too narrow a manner. The specific problem presented to your committee was that of a medical research foundation which leases a substantial portion of the buildings which it owns, and in which it is located, to a clinic of doctors. In this case it is understood that the medical foundation relies heavily on treatment of the clinic's patients, medical histories of these patients, and services of the clinic doctors in the conduct of its medical research activities. In fact, it is understood that many of the foundation's research projects could not be carried on without a readily available group of patients, and that several of these projects were first initiated as a result of the observation of the conditions of clinic patients. In addition, clinic doctors provide a readily available reservoir of experience and information for use in the foundation's research. Several doctors split their time between the foundation and the clinic and are compensated proportionately by the two organizations. Most of the clinic doctors customarily donate their services in assisting with many of the foundation's research projects.

In view of your committee's comment in its report on this provision in the Revenue Act of 1950, when this provision was first adopted, your committee believes that the term "related," for purposes of this business lease provision, should include the type of case referred to above. In that report your committee said:

> "Related" is defined in a similar fashion as in the case of a related trade or business and is, for example, intended to exclude from the application of this tax leases by tax-exempt hospitals of part of the hospitals to doctors' associations to use as clinics. It is believed that leases

of this type are entered into primarily to further the purpose of the exempt organization rather than to make special benefits from tax exemptions.

Your committee believes that the case cited above is related in a similar manner to the example given of the hospitals and the doctors' clinics. Moreover, it believes that, usually, leases entered into by medical foundations with doctors' clinics are primarily to further the stated purpose of the exempt organization rather than to gain special benefits from tax exemption.

As a result, your committee has added a sentence to the special rules applicable in defining a business lease. This sentence provides that a lease to a medical clinic by a medical research foundation of premises adjacent to those occupied by the foundation shall be considered as "related" if treatment of clinic patients, medical histories of clinic patients, and donated services of clinic doctors are used by the foundation for medical research purposes.

Since the purpose of this amendment is to make explicit the meaning of the term "related" which Congress intended when the tax on unrelated business lease income was first imposed, this provision is made applicable to taxable years beginning after December 31, 1950—the effective date of the tax on business lease income.

B. TECHNICAL STATEMENT

This section amends section 514(b)(3)(A) of the 1954 code, relating to exceptions to the definition of business lease.

Under existing law, exempt organizations subject to the unrelated business income tax imposed by section 511 must include as an item of gross income derived from an unrelated trade or business a percentage of the rentals derived from business leases of their real property. The term "business lease" is defined in section 514(b), and exceptions to this definition are provided in section 514(b)(3). Section 514(b)(3)(A) provides that no lease by an organization shall be considered as a business lease, if it is entered into primarily for purposes which are substantially related (aside from the need for income) to the exercise or performance of the charitable, educational, or other purpose or function which constitutes the basis of the organization's exemption, or if the lease is of premises in a building which is primarily designed for occupancy, and which is occupied, by the organization.

Subsection (a) of section 11 of the bill adds a sentence at the end of section 514(b)(3)(A). This sentence provides that a lease to a medical clinic by a scientific organization engaged in medical research of premises adjacent to those occupied by such scientific organization shall be considered a lease entered into primarily for purposes substantially related to the organization's exempt purposes and functions (and thus shall not be considered a business lease), if the treatment of patients of the medical clinic, their medical histories, and donated services of doctors of the medical clinic are utilized by the scientific organization for medical research purposes.

Under subsection (b) of section 11 of the bill, the amendment made to section 514(b)(3)(A) is effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954 (i.e., years to which the Internal Revenue Code of 1954 applies).

Subsection (b) of section 11 of the bill further provides that a provision having the same effect as the provision added to the Internal Revenue Code of 1954 by subsection (a) shall be deemed to be included in the Internal Revenue Code of 1939 and shall apply with respect to taxable years beginning after December 31, 1950.

X. ATTRIBUTION OF STOCK OWNERSHIP FOR PURPOSES OF PERSONAL HOLDING COMPANY TAX (SEC. 12)

Under the Internal Revenue Code a "personal holding company" generally is any corporation which derives at least 80 percent of its income from certain specified sources if more than 50 percent of its stock is owned directly or indirectly, by or for, not more than five individuals. In determining stock ownership, section 544 of the Internal Revenue Code provides that stock owned by a trust or estate shall be considered as being owned proportionately by its beneficiaries.

However, a question has arisen as to the proper method of attributing the ownership of shares of stock held by a trust if one of its beneficiaries has only a life interest in the trust and other beneficiaries have remainder interests. In such a case the Internal Revenue Service has determined that the life beneficiary

is to be considered as owning the entire interest in the trust for purposes of applying the constructive ownership rules in section 544. Thus the interests of remainder beneficiaries are ignored even though in many instances the actuarial value of their interests are as great, or even greater than the interest of the income beneficiary. This action apparently is founded on statements contained in a 1943 opinion of the Tax Court. *Steuben Securities Corporation* v. *Commissioner*, (1 T.C. 395). Recently, however, the U.S. Court of Appeals for the Fifth Circuit apparently rejected those statements in the Tax Court opinion. (*Phinney* v. *Tuboscope Co.*, 268 F. (2d) 233.) In this case, the court held that individuals who did not own a present interest in a trust were clearly beneficiaries within the meaning of the Internal Revenue Code and their interest must be taken into account in applying constructive ownership rules.

Your committee believes that where present and future interests in a trust are held by different persons, it is appropriate that ownership of the assets of the trust be apportioned between them on the basis of an actuarial determination of the value of each interest. In adopting the personal holding company provisions in 1934 Congress stated that stock owned by an estate or trust "shall be considered as being owned proportionately by its * * * beneficiaries." In order to insure that the ownership of a trust will be apportioned among its beneficiaries on an actuarial basis a parenthetical clause is added at the end of section 544(a)(1). This will make it certain that ownership of the entire trust will not be attributed to a beneficiary who only has a life interest.

This section is made applicable to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

XI. CERTAIN DISTRIBUTIONS OF STOCK PURSUANT TO ANTITRUST ORDERS (SEC. 13)

A. SUMMARY OF PROVISION

This section of the bill would add a new section 1111 to the Internal Revenue Code of 1954 which provides, in general, that where a corporation distributes stock in another corporation to its shareholders pursuant to an order enforcing the antitrust laws, gain or dividend income, as otherwise determined under existing law, will be recognized, but not in excess of the tax basis to the distributing corporation of the stock received. In the case of a distribution of stock to which this new section applies, the stockholder's tax basis for his total investment after the distribution shall be the same as his former tax basis, increased only by the amount on which he is subject to tax under this section. The proposed new section 1111 is generally similar to the section 1111 proposed by S. 200 (January 12, 1959) as modified by the draft amendment proposed and described by Senator Frear in the course of the hearings on S. 200 (May 26 and 27, 1959). The proposed new section 1111 is identical to the section 1111 proposed by H.R. 8126 reported to the House by the Committee on Ways and Means on September 2, 1959 (H. Rept. 1128, 86th Cong., 1st sess.).

This section of the bill would also add a new section 1112 to provide that if stock is distributed by one corporation to another corporation which, in turn, distributes the stock pursuant to an antitrust order, the recipient of the stock from the second corporation is treated as if he had received the stock directly from the first corporation. The purpose of this provision is to provide the same tax treatment as that provided for in proposed section 1111 to the ultimate recipient of stock which is ordered distributed by an antitrust order but which first passes from one corporation to another corporation before it reaches the ultimate recipient. Under the proposed new section 1112 the corporation which acts merely as a conduit incurs no income tax liability.

The proposed new sections apply only to distributions of stock which take place after the enactment of the bill.

B. REASONS FOR THE PROVISION

Your committee believes that the provisions of this section carry out the policies already established by Congress with respect to the income tax treatment of other situations in which a taxpayer is compelled to divest himself of property as a result of Government action. In these situations it has been considered inappropriate to impose a tax where there is an involuntary realization of gain. The statutory provisions relating to enforced divestitures for which Congress has provided for the deferral of tax include:

(1) Section 1033, insofar as it provides for nonrecognition of gain upon involuntary conversions of property as the result of its seizure, requisition, or condemnation and as the result of the sale of property pursuant to the acreage limitation provisions of Federal reclamation laws.

(2) Section 1071, which provides for the nonrecognition of gain from sales or exchanges of property to effectuate a change in a policy of (or the adoption of a new policy by) the Federal Communications Commission.

(3) Section 1081, which provides for the nonrecognition of gain or loss on exchanges or distributions in obedience to orders of the Securities and Exchange Commission pursuant to the Public Utility Holding Company Act of 1935.

(4) Section 1101, which provides for the nonrecognition of gain in the case of distributions and exchanges made to comply with the provisions of the Bank Holding Company Act of 1956.

In addition, in the Settlement of War Claims Act of 1928, Congress provided that properties sold or exchanged by the Alien Property Custodian were to be treated as involuntary conversions for purposes of the tax law. This treatment also has been ruled to apply where during World War II property has been seized by the United States and subsequently sold by the Alien Property Custodian.

The above provisions of existing law all relate to dispositions required by governmental action. The provisions of this section of the bill also relate to dispositions required by governmental action. Moreover, while this section applies to dispositions required by the longstanding provisions of the Sherman Act and the Clayton Act, your committee believes that it is important to bear in mind that both the Sherman Act and the Clayton Act are expressed in extremely broad terms and that as a consequence antitrust law is developed through judicial decisions over the years. The requirements under the antitrust laws are not static nor is the development of the law readily predictable. An important decision in the antitrust area, such as the decision of the Supreme Court in *United States* v. *E. I. du Pont de Nemours and Company et al.* (353 U.S. 586 (1957)), may have an effect very similar to the enactment of new legislation requiring divestiture of property. For all of these reasons, this provision would extend to antitrust proceedings the treatment which Congress has already provided in the case of the statutory and administrative provisions referred to above which require divestiture.

In addition to carrying out the policies already established by Congress with respect to the tax treatment of divestitures required by law, your committee also believes that this provision will meet the problems pointed out by the Department of Justice at the public hearings, and will contribute to improved enforcement of the antitrust laws. This will be accomplished by removing the reluctance of defendants to accept divestiture in consent decrees where such relief is properly indicated and by making courts more willing to order divestiture where needed without concern as to the tax consequences. In this connection, Hon. Robert A. Bicks, Acting Assistant Attorney General of the Antitrust Division of the Department of Justice, in presenting the views of the Department of Justice before your committee in public hearings on S. 200, testified that—

> Our view is that an appropriately fashioned tax proposal, designed to eliminate tax barriers to antitrust divestiture, would serve the ends of effective antitrust enforcement.

At the hearings before the Committee on Ways and Means of the House of Representatives on H.R. 8126, he also pointed out that—

> * * * the courts may be reluctant to grant divestiture, deeming it "harsh" and "an extraordinarily difficult and expensive undertaking."

Mr. Bicks' fear that it would be difficult to persuade a court to grant a divestiture order seems reasonable in view of what has occurred in the *Du Pont* case, since the time Mr. Bicks testified. At the time he testified, that case was pending in the district court, to which it had been returned by the Supreme Court. On October 2, 1959, the district court gave its decision refusing to order divestiture as requested by the United States (177 Fed. Supp. 1). In its opinion the court said in part:

> The shocking tax impact would impel the court not to order a distribution of General Motors stock by Du Pont, if any other means of removing the effects offensive to the statute are available, and there are such means.
>
> In case tax legislation, such as S. 200, were to pass, this tax result from ordering a distribution would, of course, be eliminated (p. 21).

It was pointed out to your committee that in addition to the large dividend taxes which would result from the distribution of the General Motors stock there

would be very substantial sales of General Motors stock by shareholders who needed the money to pay their taxes. These sales would depress the market for that stock to the detriment of the many General Motors shareholders who have no connection whatever with the antitrust litigation.

It may well be that the enactment of this legislation would permit the Department of Justice to obtain an order from the district court requiring divestiture of the General Motors stock. While the district court has heretofore refused to grant such an order, and while the district court's decision is now on appeal to the Supreme Court (which agreed to review the decision on May 23, 1960), it is worth noting that in its opinion of October 2, 1959, the district court reserved jurisdiction of the matter to leave the door open for reconsideration in the event of enactment of legislation changing the tax consequences. The court's decision states in part:

> The court and the parties are aware of the pendency of bills previously referred to which, presumably, will be considered in the 2d session of the 86th Congress and which would, if enacted, substantially ameliorate the tax consequences of a distribution of Du Pont's legal title to the General Motors shares. It is impossible, however, to foretell whether such legislation will be enacted and, if so, the form it will take. Quite possibly a change in policy on the part of the Internal Revenue Service might also affect the tax consequences of any such distribution. The court should not be foreclosed from considering such new legislation or rulings nor should the parties be foreclosed from bringing them to the attention of the court. While a distribution of the legal title to the General Motors shares by Du Pont is not, in the opinion of the court, at all necessary to remedy the effects offensive to the statute in view of the other provisions of the decree to be included, such a distribution would leave a more simplified structure from the corporate standpoint. Consequently, the final judgment should make specific provision for the possibility of such developments and should authorize any party to come before the court and seek modification of the judgment in the light of any such developments (p. 50).

Your committee wishes to make it clear that this legislation will be of great value in facilitating enforcement of the antitrust laws generally and that it is not for the purpose of providing tax relief for any one particular case. It agrees with the statement made by Hon. Robert A. Bicks in the public hearings on H.R. 8126 before the Ways and Means Committee that—

> There is no question that the Du Pont-General Motors litigation has pointed up this problem, thrust the tax barriers to effective and prompt divestiture uppermost in our mind. But it is equally true that this sort of proposal has significance away beyond this particular litigation.

Your committee believes it important to emphasize that, under the bill, the shareholders will be subject to an immediate tax on dividend income and will not be exempted from eventual payment of a tax on any possible appreciation.

The bill does not eliminate the tax on the dividend income which the shareholders would have received if there had been no antitrust violation. This is because the effect of the bill is to cause shareholders, receiving stock in a distribution under an antitrust order, to pay a tax, either on the full amount of the dividend or on an amount equal to the money originally used to purchase the stock distributed. Thus the bill is based on the reasonable assumption that, if the stock had not been purchased, the money used for the purchase would instead have been distributed as a taxable dividend. In effect, the bill treats that as done which ought to have been done. Accordingly, the tax on the dividend income, which would have been received if no antitrust violation had occurred, is not eliminated.

It is further stressed that the bill provides merely for a postponement of the tax on the appreciation in a shareholder's stock and not for an exemption. In the case of a receipt of stock to which the bill would apply, it is required that the shareholder's tax basis for his investment in the distributing corporation before the distribution be used in determining his tax basis for his investment after the distribution, increased only by the amount on which he has paid tax. Thus, when, at any later date, he sells either the stock of the distributing corporation or the stock received, he will be subject to tax in the same manner as if the antitrust distribution had not occurred.

C. GENERAL EXPLANATION OF THE PROVISION

This provision would add a new part IX to subchapter O of chapter 1 of the Internal Revenue Code of 1954. The new part IX consists of two sections, both

of which deal with distributions of stock to shareholders pursuant to orders enforcing the antitrust laws. Section 1111 relates to distributions made by the corporation which held such stock directly to an individual or corporate shareholder. Section 1112 relates to a case in which, pursuant to an antitrust order (or orders), a corporation receives stock and must distribute it again to its own shareholders.

Section 1111

The new section 1111 applies where a corporation distributes to its shareholders stock which, in their hands, is "divested stock" as defined in section 1111(f). Such stock must be the subject of a judgment, decree, or other order of a court or of a commission or board in a suit or proceeding under the Sherman Act or the Clayton Act, or both, to which the United States or such a commission or board is a party. Distributions of such stock are taxed as follows:

(1) If the distribution is treated as a dividend (i.e., is a distribution to which sec. 301 applies) the amount of the distribution, for purposes of computing the dividend tax, may not exceed the average basis to the distributing corporation of the divested stock;

(2) if the distribution consists solely of divested stock, is in exchange for stock of the distributing corporation, and is treated as a sale or exchange, the shareholder's gain may not exceed the average basis to the distributing corporation of the divested stock.

The determination of the amount of the distribution under section 1111 in the case of distributions treated as dividends is substantially the same as the determination under section 301 of the 1954 Code in the case of distributions of property to corporate shareholders. This same approach is applied under the new section 1111 to limit the recognition of gain in the case of exchanges of divested stock where such exchanges are treated as in payment for the stock of the distributing corporation surrendered.

Under existing law, on a distribution of property in kind to an individual shareholder the amount of the dividend is determined by the fair market value of the property distributed. The new section 1111 which would be added by the bill provides for a different treatment in view of the involuntary nature of the distribution. The so-called section 301 approach adopted by the new section 1111, by imposing an immediate dividend tax of an amount equal to the cost to the distributing corporation of the divested stock, contains a built-in safeguard in the case of recent corporate acquisitions. The new section will aid the enforcement of the antitrust laws primarily in those cases in which the divested stock has a low basis relative to its fair market value. Such a low basis would exist ordinarily where the divested stock had been acquired by the distributing corporation many years prior to the court order requiring divestiture.

Under the so-called section 301 approach adopted by the new section 1111, gain or dividend income will qualify for nonrecognition treatment only to the extent that it is attributable to unrealized appreciation in the hands of the distributing corporation. Thus, the portion of the dividend income which is recognized will be equal to that which would have been recognized if the distributing corporation had originally not purchased the stock resulting in the antitrust violation, but had instead, at that time, distributed the money as a cash dividend.

The approach adopted by your committee differs from the approach applied under section 301 in the case of corporate shareholders in two important respects: First, under the new section 1111, the shareholder's gain or dividend income, as the case may be, is determined by reference to the average adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the divested stock, such average adjusted basis being determined under regulations prescribed by the Secretary or his delegate. Under section 301, the amount of dividend income in the case of a corporate shareholder is determined by reference to the adjusted basis to the distributing corporation of the identifiable property received by the particular corporate shareholder. The average adjusted basis rule provided under the new section 1111 is applicable to all shareholders, corporate or individual. In addition, it is provided under the new section 1111 that in the case of a dividend distribution the shareholder's basis for his stock in the distributing corporation, increased by the amount of gain taxed to the shareholder, is allocated between the divested stock received and the stock with respect to which the distribution is made on the basis of the fair market values of such stocks immediately after the distribution. Under section 301 of existing law no allocation of basis is made in the case of a dis-

tribution of property to a corporate shareholder. The allocation of basis provided under the new section 1111 is applicable both to individual and to corporate shareholders. However, under proposed section 1112 certain special exceptions are made to the rules of section 1111 if a recipient corporation must again distribute the stocks pursuant to an antitrust order.

The new section 1111 does not apply in the case of distributions to avoid Federal income tax. Section 1111(a)(4) provides that nonrecognition treatment shall not be accorded to any transaction one of the principal purposes of which is the distribution of the earnings and profits of the distributing corporation or of the corporation whose stock is distributed, or both. This provision is generally the same as that contained in section 355(a)(1)(B) of the 1954 Code (relating to distributions of stock and securities of a controlled corporation) and is for the purpose of insuring that nonrecognition treatment shall be denied in the case of any distribution of divested stock pursuant to a court order if the distribution is part of a plan with a principal purpose of avoiding dividend tax on a distribution of earnings and profits. Your committee believes it desirable to make clear that the mere fact that either corporation has accummulated earnings and profits shall not be construed to mean that one of the principal purposes of the transaction is the distribution of the earnings and profits of either corporation, or both.

Subsection (f)(1) of the new section 1111 defines the term "divested stock." Divested stock is defined as stock which is the subject of an antitrust order entered after June 1, 1959, meeting the following conditions:

(1) The order must direct the corporation to divest itself of such stock by distributing it to its shareholders, or must require such distribution as an alternative action.

(2) The order must specify and identify the stock to be divested.

(3) The court must find divestiture necessary or appropriate to effectuate the policies of the antitrust laws.

(4) The court must find that the partial nonrecognition treatment provided by subsection (a) is required to reach an equitable antitrust order in such suit or proceeding.

It is also provided that stock shall not be divested stock if the court order finds its divestiture is required because of a violation of the antitrust laws which was intentional.

Subsection (f)(2) of the new section 1111 provides that notwithstanding the definition of "divested stock" contained in subsection (f)(1), shares of stock shall not be divested stock unless the court finds, as to such shares of stock, that following the distribution or distributions of such shares to a shareholder (or to a group of shareholders found to be cohesive by reason of their business interests or other relationships or for other reasons found by the court) and following the application of other provisions of the antitrust order, there will not be power in such shareholder, or group of shareholders, to influence the commercial relations of more than one of the corporations whose stock is being distributed, or of the distributing corporation and one or more of the corporations whose stock is being distributed, to the competitive advantage of the distributing corporation or one or more of the corporations whose stock is distributed.

The provision described in the preceding paragraph is for the purpose of insuring that this section will be available only where necessary for effective antitrust relief. There will not be nonrecognition treatment in cases where, with respect to particular shares of stock, a sale or other disposition or arrangement would be more appropriate under the antitrust laws than a distribution of such stock. In the absence of this provision, it is believed that courts might be most reluctant to order a sale of stock (which would have substantial tax consequences) if the statute permitted limited tax consequences on a distribution of such stock if ordered by the court. Section 1111(f)(2) will make it unnecessary for a court to choose between these alternatives because the benefits of the bill will be available only where distribution is completely compatible with antitrust objectives. If it is shown that following a distribution and after compliance with all the provisions of an antitrust order, such as prohibitions on interlocking directorates and voting of stock, any stockholder or group of stockholders will be in a position to act improperly under the policies of the antitrust laws, as set forth in the bill, those shareholders will be denied the benefits of the bill. Their disqualification will, of course, in no way affect the balance of the shareholders.

Proposed new section 1111 is effective only with respect to distributions of divested stock made after the date of enactment.

Section 1112

Section 1112 provides that if stock is distributed by one corporation to another corporation which, in turn, distributes the stock pursuant to an antitrust order, the recipient of the stock from the second corporation is treated as if he had received the stock directly from the first corporation. The purpose of this provision is to provide for the same tax treatment to individuals receiving divested stock, whether they receive such stock directly from the first distributing corporation, or whether they receive such stock indirectly through one or more intermediate holding companies. Under this section, if a corporation receives stock pursuant to an antitrust order and has to distribute it within 1 year from such receipt, also under an antitrust order, such a conduit corporation incurs no income tax liability, although the basis of its stock in the distributing corporation is readjusted because of section 1111. In determining the tax treatment of an individual shareholder who ultimately receives the divested stock, the basis of such stock to the conduit corporation and the earnings and profits of the conduit corporation are not taken into account.

Section 1112 applies only to distributions of stock which take place after the date of enactment.

D. TECHNICAL EXPLANATION OF THE AMENDMENT

The amendment amends subchapter O of part I of the Internal Revenue Code of 1954 by adding a new part IX consisting of two new sections, section 1111 and section 1112. Both sections limit the amount includible in income in the case of distributions of stock pursuant to certain orders enforcing the antitrust laws. Stock eligible for the special treatment provided must be "divested stock" as defined in section 1111.

Section 1111. Distribution of stock pursuant to orders enforcing the antitrust laws

Section 1111(a)(1) defines a "distribution of divested stock" to include a distribution by a corporation to a shareholder, with respect to his stock in the distributing corporation, whether or not the distribution is pro rata with respect to all the shareholders of the corporation and whether or not the shareholder surrenders any of his stock in the distributing corporation. If the shareholder receiving a distribution of divested stock is a corporation, a further distribution to its shareholders may also constitute a distribution of divested stock.

Section 1111(a)(2) provides that the amount of the distribution, for purposes of section 301 of the code, shall be the fair market value of the divested stock or the average adjusted basis of such stock in the hands of the distributing corporation immediately before the distribution, whichever is less. For example, shareholder A owns 20 shares of common stock of corporation X. Pursuant to an antitrust order, corporation X distributes 2 shares of stock in corporation Y, which qualify as divested stock, for each share of common stock of corporation X outstanding. The amount of divested stock of corporation Y owned and distributed by corporation X is 1,000 shares, 500 of which have a basis to corporation X of $20 a share and 500 of which have a basis to corporation X of $40 a share. Thus, the average adjusted basis of the corporation Y stock to corporation X is $30 a share. The fair market value of such divested stock at the time of the distribution is $100 a share. The amount of the distribution for purposes of section 301 of the code is $30 a share (the average adjusted basis to corporation X). Accordingly, the amount of the distribution to shareholder A for purposes of section 301 is $1,200 (40 shares times $30).

Section 1111(a)(3) limits the amount of gain to be recognized where the shareholder surrenders stock in the distributing corporation solely for divested stock which is treated as in part or in full payment therefor. In such a case the gain may not exceed the average adjusted basis of the divested stock in the hands of the distributing corporation immediately before the distribution. For example, shareholder B owns 5 shares of common stock of corporation Y. B surrenders his 5 shares to corporation Y for 10 shares of divested stock in corporation Z in a redemption which is treated as a distribution in payment for the stock under section 302(a). The basis to B of the stock surrendered is $200. The fair market value of the divested stock in corporation Z received by B is $500 and it has an average adjusted basis to corporation Y of $10 per share. The amount of gain realized by shareholder B on the exchange is $300 ($500 fair

market value of corporation Z stock received less $200 basis of corporation Y stock surrendered). The amount of such gain recognized is limited to $100 (the average adjusted basis of corporation Z stock in the hands of corporation Y times the number of shares received by B).

Section 1111(a)(4) provides that the special rules of section 1111(a) (2) and (3) will not apply to any transaction one of the principal purposes of which is the distribution of the earnings and profits of the distributing corporation or the corporation whose stock is distributed, or both. The fact that stock was purchased in contemplation of an antitrust order requiring its distribution may be evidence of the prohibited tax avoidance purpose. Even if such contemplation did not exist at the time of acquisition, such a principal purpose might nevertheless be found to exist because of events occurring after such acquisition. However, the fact that an antitrust order requires, in the alternative, either a sale by the corporation or a distribution to shareholders, and the corporation elects to distribute the stock in order to minimize tax consequences, would not of itself be sufficient to show that one of the principal purposes of the transaction is the distribution of earnings and profits. The existence of accumulated earnings and profits in either the distributing corporation or the corporation whose stock is distributed would not in itself mean that such a purpose existed. The fact that stock is divested stock within the meaning of section 1111(f) is not conclusive upon the issue of whether one of the principal purposes of the transaction is the prohibited tax avoidance purpose. Thus, even if the court, commission, or board does not find an intentional violation of the Sherman Act or the Clayton Act and does find that the application of section 1111(a) is required to reach an equitable antitrust order, the Commissioner of Internal Revenue may make an independent determination as to whether such a purpose existed.

Section 1111(a)(5) provides that the average adjusted basis of divested stock shall be determined under regulations prescribed by the Secretary or his delegate.

Section 1111(a)(6) defines the term "stock" to include rights to receive fractional shares.

Section 1111(b)(1) provides rules for determining the basis of the divested stock and of the stock of the distributing corporation in the case of a distribution of divested stock the amount of which was determined under section 1111(a)(2). Under section 1111(b)(1) the adjusted basis, immediately before the distribution, of the stock with respect to which the distribution was received is allocated between such stock and the divested stock received in accordance with regulations. Such adjusted basis is increased by an amount treated as a dividend or as gain from the sale or exchange of property under section 301(c)(3)(A) of the code. For example, shareholder A owns one share of common stock of corporation X which has a basis to him of $80. Corporation X distributes to shareholder A one share of divested stock in corporation Y. The corporation Y stock has an average adjusted basis to corporation X of $20 a share and a fair market value of $60 a share. The amount of the distribution to shareholder A is $20, which is taxed as a dividend pursuant to section 301 of the code. After the distribution shareholder A as a total basis for both his corporation X stock and corporation Y stock of $100, that is, $80 (A's basis for his share of stock in corporation X) plus the $20 treated as a dividend. Following the distribution, A's corporation X stock has a fair market value of $140 and his corporation Y stock has a fair market value of $60, for a combined total of $200. Assume that, under regulations prescribed by the Secretary or his delegate, A's total basis of $100 is allocated between his corporation X stock and his corporation Y stock in accordance with their fair market values. A's basis for his corporation X stock will be 140/200 of $100, or $70, and his basis for his corporation Y stock will be 60/200 of $100, or $30. However, section 1112 modifies this rule of allocation in a case where the stock received is again distributed as divested stock.

Section 1111(b)(2) provides a rule for determining the basis of divested stock received in exchange for stock in the distributing corporation and with respect to which the amount of gain recognized was determined under section 1111(a)(3). In such case the basis of divested stock received is the same as that of the stock in the distributing corporation surrendered by the shareholder, increased by the amount of any gain recognized upon the exchange. For example, shareholder A owns one share of common stock of corporation X which has a basis to him of $80. Corporation X distributes to shareholder A two shares

of divested stock in corporation Y in full payment in exchange for his share of common stock of corporation X. The stock of corporation Y received by shareholder A has a fair market value of $100 a share and an average adjusted basis to corporation X of $30 a share. The amount of gain recognized to shareholder A is limited to $60 (the average adjusted basis to corporation X of the two shares received by A). After the exchange the total basis of the two shares in A's hands is $140 (the basis of the corporation X stock surrendered in the exchange, $80, plus the amount of gain recognized on the exchange, $60).

Section 1111(c) provides that a proper allocation of earnings and profits shall be made under regulations prescribed by the Secretary or his delegate where the divested stock distributed under section 1111(a) (2) or (3) is stock in a corporation controlled by the distributing corporation. Control is defined as the ownership of at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock.

Section 1111(d) defines the term "antitrust order" and, under section 1111(f), only stock which is the subject of an antitrust order as so defined may qualify as divested stock. An "antitrust order" is a judgment, decree, or other order of a court or of a commission or board in a suit or proceeding under the Sherman Act or the Clayton Act, or both, to which the United States or such a commission or board is a party.

Section 1111(e) defines the term "court" to include a commission or board issuing an "antitrust order."

Section 1111(f)(1) defines the term "divested stock" to mean stock which is the subject of an antitrust order entered after June 1, 1959. The order must direct the distributing corporation to distribute the stock to its shareholders (or require such distribution as an alternative to other action by any person) and further must specify and itemize the stock to be divested. It is further required that the court issuing the antitrust order must find that the divesiture of the stock is necessary or appropriate to effectuate the policies of the Sherman Act, or the Clayton Act, or both, and must also find that the special tax treatment provided by section 1111 is required to reach an equitable antitrust order in the suit or proceeding. Section 1111(f)(1) further provides that no stock shall be divested stock if the court finds that divestiture is required because of an intentional violation of the Sherman Act or the Clayton Act, or both.

Section 1111(f)(2) excepts certain stock from the definition of divested stock even though it may otherwise qualify as divested stock under the rules of section 1111(f)(1). This section provides that shares of stock shall not be divested stock unless the court finds, as to such shares of stock, that following the distribution or distributions of such shares to a shareholder (or to a group of shareholders found to be cohesive by reason of their business interests or other relationships or for other reasons found by the court) and following the application of other provisions of the antitrust order, there will not be power in such shareholder, or group of shareholders, to influence the commercial relations of more than one of the corporations whose stock is being distributed, or of the distributing corporation and one or more of the corporations whose stock is being distributed, to the competitive advantage of the distributing corporation or one or more of the corporations whose stock is distributed. Under section 1111(f)(2) the court may limit such finding to some of the shares distributed pursuant to the antitrust order, and only those shares as to which the finding was not made will fail to qualify as divested stock by virtue of section 1111(f)(2).

Section 1111(g) provides that for purposes of determining control under section 351 of the code, dispositions of divested stock received in a distribution to which section 1111(a) applies shall not be taken into account if such dispositions are required by an antitrust order. Thus, if corporation X transfers assets to corporation Y in exchange for all of corporation Y's stock and distributes the corporation Y stock to its shareholders in a distribution to which section 1111(a) is applicable, corporation X will be deemed to have acquired control of corporation Y for purposes of section 351 of the code even though, in obedience to the antitrust order, the shareholders of corporation X immediately dispose of the corporation Y stock received by them.

Section 1111(h) provides certain cross references.

Section 1111 applies only to distributions of stock which take place after the date of enactment.

Section 1112. Successive distributions of divested stock

Section 1112 provides that if (1) a corporation is a distributee of divested stock in a distribution to which section 1111(a)(2) applies, and (2) such distributee is required to redistribute the stock received by an antitrust order within 1 year from the time of receipt (or such longer period as the Secretary of the Treasury may provide), and (3) such redistribution is also a distribution of divested stock to which section 1111(a)(2) applies, then no gain or loss shall be recognized to (and no amount shall be includible in the income of) the redistributing corporation on the receipt of such divested stock.

Section 1112 further provides that a shareholder receiving divested stock from a redistributing corporation shall have his tax determined as if he had received such stock directly from the corporation originally distributing it. Thus, the allocation of basis in the hands of the conduit corporation, and the earnings and profits of such corporation have no effect on the determination of the tax of a shareholder receiving divested stock through it.

Section 1112 applies only to distributions of stock which take place after the date of enactment.

Amendment to section 1223, holding period of property

Section 13 of the bill also amends section 1223 of the code to make it applicable to stock distributions to which proposed sections 1111 and 1112 apply to limit the income realized.

XII. GIFT TAX TO BE INCLUDED IN GROSS ESTATE IN CERTAIN CASES, ETC. (SEC. 14)

A. INCLUSION OF GIFT TAX IN GROSS ESTATE

Under present law a gift made within 3 years of the donor's death is presumed to have been made in contemplation of death. If it is found to have been so made the value of the gift is required to be included in the donor's gross estate and, as described below, a credit against the estate tax is allowed for the gift tax paid at the time the gift was made. This treatment was designed to place the estate of the decedent in the same position it would have been had no gift, in fact, been made. Present law, however, does not fully accomplish this purpose. Under such circumstances, the donor's overall estate tax burden is reduced because the gift tax is permitted to offset estate tax liability even though the amount of the gift tax *per se* is not included in the estate tax base.

This provision of the bill, which is added by your committee, requires that where a gift is subsequently included in the donor's gross estate (for example, where it was made in contemplation of death) the gift tax paid on that gift also is to be included in the gross estate. Your committee believes that this amendment serves to restore the estate to the same position it would have been if no gift had been made. In such a case the gross estate would have been larger, not only by the value of the gift, but also by the amount of the gift tax. This amendment eliminates what your committee believes is a device whereby taxpayers have been able to reduce their estate tax burden simply by making deathbed gifts. Under the bill this amendment will apply with respect to gifts made after the date of enactment of this bill.

B. CREDIT FOR GIFT TAX

Present law allows a credit against the estate tax for any gift tax paid with respect to gifts of property which subsequently are required to be included in the gross estate. The credit is subject to two limitations. First, it cannot exceed the gift tax paid with respect to that property. Second, the credit cannot exceed the estate tax attributable to the inclusion of the gift in the gross estate. This is determined by a ratio which generally relates the value of the gift to the value of the gross estate. However, because the estate tax is imposed upon the taxable estate, not the gross estate, in a case where debts must be paid from probate property the ratio does not truly reflect the proportion of the taxed property which the gift property actually represents.

Thus under this ratio an estate with unpaid debts at the date of the decedent's death may receive a smaller gift tax credit than that received by another estate having the same taxable estate but no indebtedness, even though both decedents made the same gifts and paid the same gift tax. This may be illustrated by the following example:

	Decedent A	Decedent B
1. Gross estate	$250,000	$150,000
Less outstanding debts	100,000	
Net estate	150,000	150,000
2. Amount of gift included in gross estate	50,000	50,000
3. Prior gifts (above annual exclusion)	30,000	30,000
4. Gift tax paid on gift in line 2	5,250	5,250
5. Net estate	150,000	150,000
6. Estate tax on net estate in line 5	17,500	17,500
7. Gift tax credit with limitation based on gross estate	[1] 3,500	[2] 5,250

[1] $\frac{50,000}{250,000} \times \$17,500 = \$3,500$.

[2] $\frac{50,000}{150,000} \times \$17,500 = \$5,833$ (but not to exceed the gift tax paid).

Your committee believes that full credit should be permitted for gift tax paid where the gift property subsequently is included in the donor's gross estate. To accomplish this purpose, and thereby eliminate what the Treasury Department concedes is an inequity in the present law, the bill makes two amendments with respect to the above-described ratio.

First, a technical amendment is made to section 2012(a) to relate gifts to the taxable estate rather than the gross estate. This provision is made applicable with respect to decedents dying after the date of enactment of this bill. However, because of the next amendment, described below, this technical amendment will continue to be effective only with respect to such decedents in the case of gifts made before the enactment of this bill. Second, the bill adds a new provision to the Internal Revenue Code which makes the above-described ratio inoperative where a gift tax, as well as the gift property, is included in the gross estate. Because gift tax will be included in the gross estate only with respect to gifts made after the date of enactment of this bill, this second amendment also will apply only with respect to gifts made after the date of enactment of this bill.

XIII. IMPORT TAX ON LEAD AND ZINC (SEC. 15)

The lead and zinc mining industry of the United States has for several years tried all of the various avenues provided by law which might lead to the regulation of imports so that domestic mines and smelters might operate on a sound and stable basis. The Tariff Commission recently concluded its fourth study since mid-1954. Two of these studies were pursuant to section 7 of the Trade Agreements Act, or escape-clause investigations. In both of these the Commission was unanimous in a finding of injury to the domestic industry.

On June 19, 1958, the President announced that he was suspending consideration of the Commission's recommendation with respect to lead and zinc, stating that a final decision would be appropriate after the Congress completed its consideration of the minerals stabilization plan, presented with his approval by the Secretary of the Interior.

Congress did not approve the proposed minerals stabilization plan, and on September 22, 1958, the President announced that he had accepted the unanimous finding of the Commission that escape clause relief was warranted. Effective October 1, 1958, the President limited imports of unmanufactured lead and zinc to 80 percent of the average annual commercial imports during the 5-year period 1953–57.

Such quotas have been in effect since that date and in recent months the Finance Committee has received many appeals for changes in the method of import regulation. Without regard to the merits of the quota system during its first year of operation, there is evidence from many sources that a change now is not only desirable but imperative.

The Tariff Commission in its report issued in March 1960, unanimously made the following statement (pp. 109–110):

> In summary, import quotas affecting such a large and complex industry as lead and zinc have not proved a satisfactory means of curtailing excessive imports of these metals. The quotas adopted are rigid and in-

flexible and, being incapable of adjusting the changing elements of domestic supplies to the changing and varied needs of industrial consumers, have tended to increase, rather than to reduce instability of market prices, and thereby to thwart the best interests both of domestic producers and consumers of lead and zinc. The system of import quotas has been discriminatory in its effects upon various producers, importers, and consumers, and has created unusual difficulties for some while it has brought windfall advantages to others. In zinc smelting, especially, the absolute quota system has tended to eliminate small, though efficient, producers who, with little or no control over domestic ore supplies, are rendered increasingly dependent upon precarious foreign ore supplies. On the one hand, this has tended to reduce nearby markets for ores produced by domestic mines in areas near the location of such smelters. On the other hand, it has tended to concentrate control over domestic ore supplies in the hands of a few powerful integrated corporations, and, with imports strictly limited by quotas, to increase their control over domestic supplies and market prices. Finally, import quotas have seriously interfered with normal trade relations between smelters or importers and their suppliers and between producers or importers and their customers, thereby forcing unusual, unnatural, vexing, and often uneconomic, adjustments.

At the public hearing before the Tariff Commission in January 1960, all interested parties, domestic and foreign alike, spoke against continuance of import quotas. Even the representatives of the domestic lead- and zinc-mining industry, which the quotas were designed to protect, made no defense of them and proposed import duties or import taxes in place of quotas.

The Finance Committee, because of the urgency of the matter, adopted an amendment to H.R. 5547 which would combine the best features of several proposals made respectively by representatives of the Department of the Interior, by the mining industry, and by the processing industry. It is assumed that the amendment would serve to replace the quotas now in effect.

The amendment would add to chapter 38 of the Internal Revenue Code of 1954 (relating to import taxes) a new subchapter providing for the following:

Import taxes on lead:

On lead-bearing ores, flue dust, and mattes of all kinds, 1.4 cents per pound on lead content.

On lead bullion and lead in pigs, bars, etc., 2 cents per pound on lead content.

And, in addition, if the average market price of lead falls below 13½ cents per pound, further taxes at the rate of 0.7 cent per pound on the lead content of ores, flue dust, etc., and 1 cent per pound on the lead content of bullion, pigs, bars, etc. However, when the price of lead is determined to be 14½ cents per pound or more, the additional taxes shall cease to be imposed. A compensatory tax of 2 cents per pound would be imposed on lead products.

Import taxes on zinc:

On zinc fume, 1.05 cents per pound on zinc content.

On zinc-bearing ores, containing not more than 3 per centum of zinc, 1.05 cents per pound on the zinc content.

On the zinc in blocks, pigs, or slabs, 1.5 cents per pound.

On zinc scrap and skimmings, 1.05 cents per pound.

In addition, if the average market price of zinc falls below 12½ cents per pound, further taxes shall be imposed at the rate of 0.7 cent per pound on the zinc content of zinc fume and the same on zinc-bearing ores; 1.0 cent per pound on zinc in blocks, pigs, or slabs; and 0.7 cent per pound on zinc scrap and skimmings. When the price of zinc is determined to be 13½ cents per pound or more, these additional taxes shall cease to be imposed. A compensatory duty of 1.8 cents per pound on the zinc content of manufactured products would also be applied.

The above amendment adopted by the Finance Committee contains features of one industry recommended proposal for a straight tax regardless of the price of lead or zinc as well as features of another industry proposal for an entirely flexible or removable tax. It retains the advantage of a moderate permanent tax plus a small additional removable tax based on the respective prices of lead and zinc. It avoids the disadvantages of a full permanent tax which would continue in effect even when prices are adequate and protection not necessary; at the

same time it would prevent the sudden substantial price changes which would inevitably accompany the assessing of the full tax whenever the price dropped below the peril point.

The amendment contains elements of the proposal made in 1957 by representatives of the Department of the Interior and incorporates the moderate maximums recommended by the members of the Tariff Commission which offered suggestions for the replacement of the present quotas. The maximum taxes in the amendment also approximate those in the earlier suggestions of the spokesmen for the executive departments.

Before making its decision the Committee gave careful consideration to another proposal made by a portion of the industry which would levy taxes at a somewhat higher rate but which would be removed entirely when prices reached specified levels. This proposal would assess taxes on lead-bearing ores at the rate of 2.8 cents per pound on the lead content and 4 cents per pound on lead in bars, pigs, etc.; and taxes on zinc at the rate of 2.8 cents per pound on the zinc content of ores and 4 cents per pound on zinc in blocks, pigs, etc. These taxes would not be applied at all when prices reach the respective levels of 15½ cents per pound for lead or a combined price of 29 cents per pound for lead and zinc, or of 13½ cents per pound for zinc or a combined price of 29 cents for lead and zinc.

The committee rejected this proposal in favor of the amendment which provides for a permanent tax plus an additional removable tax.

XVI. DISTILLED SPIRITS AND WINES FOR USE OF FOREIGN EMBASSIES, LEGATIONS, ETC. (SEC. 16)

A. GENERAL STATEMENT

Under present law, foreign diplomats stationed in this country are not permitted to purchase domestic distilled spirits and wine without paying the U.S. tax although U.S. diplomats stationed in most foreign countries are allowed to purchase similar commodities in those countries tax free. On the other hand, foreign diplomats stationed in the United States may obtain imported distilled spirits and wine from a customs bonded warehouse tax free.

This situation has resulted in two discriminations. First, taxed domestic distilled spirits and wine are unable to compete successfully against tax-free imported spirits and wine for the diplomatic trade. Second, foreign diplomats stationed in this country are placed in a less favorable position with respect to the purchase of domestic spirits and wine than are U.S. diplomats stationed in a foreign country.

Your committee's bill removes both of these inequities. It provides a procedure whereby foreign diplomats may obtain domestic distilled spirits and wine on a tax-free basis. This is done by permitting them to withdraw such commodities from a customs bonded warehouse tax and duty free in the same manner imported spirits and wine presently may be withdrawn. Under the bill, domestic spirits and wine withdrawn tax free may be used only for the official or family use of foreign governments, organizations, and individuals who are permitted to import distilled spirits or wine tax free.

Amendments made by this section will take effect 3 months after the date of enactment of this bill.

B. TECHNICAL STATEMENT

This section was added to the House bill by your committee to provide a procedure whereby American distilled spirits and wines may be withdrawn free of tax for consumption in the United States for the official or family use of foreign governments, organizations, and individuals who are entitled to import distilled spirits or wines free of tax.

The section redesignates section 5066 of the Internal Revenue Code of 1954 as section 5067 and adds a new section 5066 entitled "Distilled Spirits and Wines for Use of Foreign Embassies, Legations, etc."

Subsection (a) of new section 5066 provides for the entry into customs bonded warehouses of distilled spirits bottled in bond for export, bottled distilled spirits eligible for export with benefit of drawback, and of specified bottled wines labeled for export. Such distilled spirits and wines will be entered into customs bonded warehouses in which imported distilled spirits and wines are permitted to be stored in bond.

In general the distilled spirits and wines will be handled under the procedures applicable to the exportation of such commodities and the entry into customs bonded warehouses, as provided in subsection (a), of distilled spirits and wines will be held to have the same effect as though the distilled spirits or wines so entered were exported.

Paragraph (1) of subsection (b) provides for the withdrawal from customs bonded warehouses of distilled spirits and wines entered into such warehouses under the provisions of subsection (a). This subsection provides that pursuant to regulations, distilled spirits or wines so entered may be withdrawn for consumption in the United States by and for the official or family use of foreign governments, organizations and individuals who may now or hereafter be entitled to withdraw imported distilled spirits or wines from such warehouses free of tax. The distilled spirits and wines will be withdrawn in the same manner and under the same conditions and procedures as distilled spirits or wines imported and withdrawn free of tax by such governments, organizations, and individuals. It is intended that all conditions applicable to the withdrawal of imports (for example the reciprocity condition contained in sec. 7511 of the Internal Revenue Code) be applicable in respect to withdrawal of domestic distilled spirits and wines from such customs warehouses.

Paragraph (2) of subsection (b) provides that no distilled spirits or wines withdrawn from such customs bonded warehouses for use of such governments, organizations, or individuals or otherwise brought into the United States free of tax for such use, shall be sold, possessed, or disposed of for use or uses other than as provided in subsection (b). This provision applies to all distilled spirits and wines, whether imported or domestic, which are withdrawn from such customs bonded warehouses for use of such governments, organizations, or individuals or which are otherwise brought into United States free of tax for such use. This provision is intended to make applicable criminal and forfeiture provisions of the Internal Revenue Code with respect to all such distilled spirits or wines, imported or domestic, which are sold, possessed, or disposed of for use or uses other than as provided in this section.

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MINORITY VIEWS OF SENATOR DOUGLAS AND SENATOR GORE

THE DU PONT AMENDMENT (SEC. 13)

We are opposed to the amendment (sec. 13 of the bill) which would provide very great tax relief for the individual stockholders of the Du Pont Corp. in the event the court ordered Du Pont to divest itself of its General Motors holdings.

COURT CASE STILL PENDING

In the first place, there is no present need for this bill. The case is still pending in the courts. No divestiture has yet been ordered. An appeal from a district court decision, which did not order divestiture, is still pending. The case will not be before the Supreme Court for some time and even after it is heard it will have to be sent back to the district court for whatever action is ordered.

It would certainly seem the better course of action to wait for these court decisions in order to determine what relief, if any, is justified. Further, if no divestiture is ordered, no relief will ever be necessary.

TAX EFFECTS IF DIVESTITURE IS ORDERED

What would be the tax effects of this bill if the courts ordered Du Pont and its family-controlled corporations, Christiana and Delaware Realty Corps., to divest themselves of General Motors stock? We should first establish some facts.

Of the 63 million shares of General Motors stock now owned by Du Pont, roughly 65 percent is owned by individuals, 29 percent by Christiana and Delaware Realty (controlled by the Du Pont family), and 6 percent by other corporations. At the present time these shares are worth about $45 apiece, or $2.8 billion. The original cost of the General Motors stock to the Du Pont Corp. was about $2.10 per share.

Under present law

What would be the tax consequences under present law if divestiture were ordered?

(1) Under the present law, the shares owned by individuals would be taxed as dividend income, estimated (for purposes of revenue effect determination) to be at an average rate of 50 percent to these shareholders. This would bring in revenues of $900 million.

(2) If Christiana and Delaware Realty were ordered to divest themselves of General Motors stock, these shares would also go to individuals and the tax would also be at the dividend income rate again, for revenue effect determination, to be at an average of 50 percent for these individuals. This would bring in revenues of approximately $400 milllion.

(3) The 6 percent of the stock now owned by corporations other than Christiana and Delaware Realty would be taxed at only about 16 cents per share, or a tax of about $604,000. This is true because dividends distributed between corporations are taxed on the basic value of the shares ($2.10 in the case of Du Pont) and there is an 85-percent intercorporate dividend deduction ($2.10 less 85 percent equals 32 cents times effective tax rate of 50 percent equals 16 cents).

Under the Du Pont amendment

Under the Du Pont amendment to the bill, these tax consequences would be enormously reduced.

(1) The shares owned by individuals would be taxed at the "basis cost" to Du Pont. Since this is $2.10 and these groups would pay about a 50 percent effective tax rate on the average, the tax would be about $1.05 per share instead of $22.50 per share. The tax revenues would be reduced from about $900 million under present law to about $43 million under the bill, or a loss in revenues of over $850 million.

(2) The shares owned by Christiana and Delaware Realty would also be taxed at $1.05 instead of $22.50. This would bring in $19 million instead of about $400 million, or a tax loss of about $380 million.

If Christiana and Delaware Realty were not required to divest, the tax would be only 16 cents per share (i.e., 52 percent of 15 percent of $2.10). On holdings of 18.3 million shares, the total tax for Christiana and Delaware Realty would be only $3 million.

(3) The 6 percent of the shares owned by other corporations would be taxed at the same effective rate as under present law, or about 16 cents per share, and there would be no effective tax changes.

The total tax losses would be the difference between taxes at $1.3 billion and taxes at $62.6 million, or about $1.23 billion.

The following table may help to make this clear.

Tax effects if Du Pont were ordered to divest itself of General Motors stock

Class	Shares of General Motors stock now indirectly held (millions)	Percent	Estimated tax under present law (millions)	Estimated tax under amendment to this bill (millions)
Individuals	40.9	65	$900	$43
Stockholders of Christiana and Delaware Realty	18.3	29	400	19
Other corporations	3.8	6	.6	.6
Total	63	100	1,300	62.6

CONCLUSIONS

Certainly such potential tax relief is neither necessary nor in the public interest. This is especially true since the courts have not even settled the case. The effect of such a tax law, in this as well as in other cases, would be an incentive to violate the antitrust laws. A company would know that there would be no tax penalty for such violation, even when divestiture was ordered. Since there would be no penalty, what incentive would there be for any corporation to carry out either the spirit or the letter of the law?

If some different treatment is felt to be necessary in cases of divestiture under the antitrust laws than now exists, it would seem that paying at the

capital gains rate of 25 percent would be more appropriate than any other method of treatment. This would yield close to $700 million.

Tax relief of the enormous amounts contemplated is against the public interest. Never have such enormous amounts been given by so many to so few.

IMPORT TAX ON LEAD AND ZINC (SEC. 15)

Section 15 of the subject bill contains the substance of the bill S. 3698 which was introduced on June 18, 1960. There have been no public hearings on this bill and, in our opinion, no adequate study by the Finance Committee.

Similar bills have been introduced in the past and, in fact, approved by the Finance Committee. In this connection, we would call attention to our minority views contained in Senate Report 1053, 85th Congress, 1st session. We consider those views to be still valid.

Section 15 represents an attempt to undermine our reciprocal trade program and a return to logrolling on tariffs. It may well harm our entire domestic economy without furthering our foreign policy objectives or providing effective aid to this particular industry. This section would impose a fixed duty on lead and zinc with a flexible additional tax to be applied when the domestic prices of these commodities fall below specified levels. The duty is quite large as compared with the present price of these commodities and would signal a return to a protective tariff.

We should never forget that the last increase in the protective tariff; namely, the Smoot-Hawley Act of 1930, directly stimulated reprisals all over the world. This further shrank the volume of world trade and among other consequences stimulated the Empire Preference Agreements within the British Empire. It distinctly increased economic nationalism and intensified the world depression.

If the present proposal is enacted, and similar proposals follow, they would invite and in all probability would have similar bad effects.

Adoption of this proposal would be a major reversal of the Cordell Hull reciprocal trade policy. It is well known that the tariff issue has in the past given rise to some of the worst abuses in our legislative history.

By the establishment of the Tariff Commission and the reciprocal trade program, Congress put our trade and tariff policy upon a sounder footing. Under the program of Cordell Hull we moved toward greater world trade, to the advantage of our own as well as of other countries. Then to protect American industry from temporary and localized losses, we set up the procedures of the so-called peril-point and escape clause. This transferred to the President and to the Tariff Commission the vexatious task of dealing with the claims to protection of a wide variety of industries.

Despite the decrease in domestic production, the United States remains the world's leading consumer of lead and zinc.

The preservation of the lead and zinc mining industry is important. It is important to those who are engaged in this industry, both those who invest their capital and those who invest their labor. It is also important for national strategic reasons.

Higher U.S. tariffs on lead and zinc will directly operate to decrease our exports to the four countries from which we import most of our lead and zinc, namely, Canada, Mexico, Peru, and Australia. Since the amount of goods which these four countries can sell to us will be appreciably reduced, this will automatically reduce the amounts which they can buy from us. International trade is ultimately a process of balance in barter, in which the goods and services of a given country such as ours are exchanged for the goods and services of other countries. These countries cannot buy from us unless they can sell to us and when we cut our purchases from them, they will have to cut theirs from us.

As for national strategic considerations, it would appear that the United States is in a favorable position. Several programs have been undertaken in recent years toward this end. Lead and zinc have been stockpiled through a Government purchase program and direct subsidies have been granted for exploration and development work.

The Federal Government has not been oblivious to the needs and difficulties of the domestic lead and zinc mining industry. Several programs have been undertaken to assist the industry. Exploration grants as of December 31, 1959, had amounted to $6,129,000 for lead-zinc and $3,823,000 for lead-zinc-copper,

or a total of almost $10 million. Numerous companies have had their explorations certified as discoveries as a result of this program. The Government has also, under the Defense Production Act of 1950, authorized loans to increase the production of lead and zinc.

In addition to the above programs for the direct and specific benefit of the lead and zinc mining industry, the companies operating in this field also have available the tax deductions for exploration and development, in addition to percentage depletion allowances. The percentage depletion allowance in the Internal Revenue Code of 1954 was increased to 23 percent for production within the United States but the old 15-percent level for operations outside the United States was retained.

In considering a program designed to benefit lead and zinc mining, we must keep in mind not only domestic economic and national strategic considerations, but foreign policy objectives as well.

As we have pointed out, the United States is the world's largest consumer and importer of lead and zinc. Most of the lead which enters international trade is mined in Australia, Mexico, Canada, Peru, Morocco, the Union of South Africa, and Yugoslavia. Most of the zinc ore which enters international trade is mined in Canada, Australia, Mexico, Peru, the Belgian Congo, and Italy. Cooperation with most of these countries in economic matters is a part of overall U.S. foreign policy. The type of unilateral action represented by this section will adversely affect the economy of some of these countries and will run counter to other programs which the Government of the United States is fostering in these countries.

It might also be pointed out here that, as in so many other instances, efforts to cure the problems faced by the lead and zinc mining industry in the United States cannot be considered in isolation. In most of the foreign countries listed above as furnishing lead or zinc for international trade, a large part of the ore is produced by concerns in which U.S. mining or smelting and refining companies have substantial financial nterest. During this session of the Congress, the Senate has approved the bill, H.R. 10087, which liberalizes provisions of law relating to the foreign tax credit and thus acts as an inducement to further U.S. investment abroad in the extractive industries where the branch, rather than the subsidiary, is the customary form of organization. Section 15 of the subject bill now works at cross purposes by attempting to destroy a part of the market for these foreign mines. The upshot of both these actions taken together, however, will be an increased burden on the American consumer, with lead and zinc producers, foreign and domestic alike, taking advantage of the additional, artificially induced profits.

The worldwide imbalance between production and consumption of lead and zinc in recent years is a worldwide problem. It cannot be solved by unilateral action by the United States. Efforts are being made, however, to solve this problem. Several meetings have already been held under the auspices of the United Nations. Meetings were held in London in September 1958, in Geneva in November 1958, in New York in April and May 1959, and again in Geneva early this year.

At the November 1958 meeting, it was agreed that this problem should be treated as a matter of urgency. At the May 1959 meeting, several representatives of governments and private companies announced cuts in production and export of lead and zinc. At the meeting held in Geneva early this year, several lead producers offered to reduce the amounts of lead they would market and it was expected that the estimated lead surplus would be cut in half during the first 9 months of 1960. Another meeting is to be held early in September of this year.

To sum up, we do not feel that such a direct attack on the Cordell Hull reciprocal trade program as the one embodied in section 15 of this bill should be enacted by the Congress, and certainly not without thorough study. Should the solution to the domestic lead and zinc problem be sought along the lines proposed, the artificially high and rigid price levels induced thereby may well be hurtful to the whole economy and, indeed, may result in the widespread use of substitutes for lead and zinc, thereby dealing a death blow to domestic mining of these minerals. Seeking a solution to the world problem of imbalance between production and consumption of lead and zinc by unilateral U.S. action of the type outlined in section 15 of this bill will not further our foreign policy objectives.

The provisions of this section would signify a return to the legislative determination of tariff schedules. We predict that it will open up the floodgates and that a host of other increases will be proposed. For if the tariffs on lead and zinc are skyrocketed by special legislation, then we can expect that the producers of textiles, copper, and a myriad of other products, metallic, manufactured, and agricultural, will demand and quite possibly obtain similar favors. We will indeed have opened Pandora's box.

In the process, the reciprocal trade program will go down the drain. The painful efforts to bind the free world closer together economically will be defeated and the world will tend to relapse into economic nationalism.

We do not believe that the people of this country want this. We are convinced that it would be against the longrun best interests of the United States. Section 15 should be stricken from the bill.

PAUL H. DOUGLAS.
ALBERT GORE.

[H.R. 10960][20]

DETERMINATION OF RETAIL PRICE FOR PURPOSES OF EXCISE TAX ON CIGARS

[Senate Report No. 1915, Eighty-Sixth Congress, Second Session, Calendar No. 1982]

[August 25 (legislative day August 24), 1960]

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following report to accompany H.R. 10960.

The Committee on Finance, to whom was referred the bill (H.R. 10960) to amend section 5701 of the Internal Revenue Code of 1954 with respect to the excise tax upon cigars, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

The Federal excise tax on large cigars is paid by the manufacturer but based on the intended retail price of the cigars. Seven different tax brackets provide tax rates, increasing with the intended retail price of the cigar. This intended retail price of the cigar is determined in the principal market of the cigar, or the locality where most of a particular brand is sold. Under present law this price is determined by excluding State and local *retail* sales taxes from the price. Under this bill the price is determined by excluding "any State or local taxes *imposed on cigars as a commodity*." This excludes not only retail sales taxes but taxes such as manufacturers and wholesalers sales taxes in determining the intended retail price of large cigars. This amendment is to apply to cigars removed on or after the ninth day of the first month beginning after the date of enactment of this bill.

The Treasury Department favors the enactment of this bill.

II. GENERAL STATEMENT

Under present law (sec. 5701(b)(2)) the tax on large cigars (those weighing more than 3 pounds per thousand) begins at $2.50 per thousand for those intended to retail at not more than 2½ cents, and in seven tax brackets increases to $20 per thousand for those intended to retail at more than 20 cents each. In determining the retail price at which cigars are sold for purposes of these seven tax categories, present law states that "regard shall be had to the ordinary retail price of a single cigar in its principal market, exclusive of any State or local taxes imposed on the retail sale of cigars." The principal market of a cigar, according to Treasury Department interpretation (Rev. Rul. 55–20, C.B. 1955–1, p. 516), is the locality in which the bulk of such cigars are sold singly at retail.

As indicated above, the ordinary retail price of a single cigar in its principal

[20] Public Law 86–779, page 709, this Bulletin.

market is to be determined by excluding any retail State or local taxes imposed on the sale of the cigar in its principal market. However, the Treasury Department is connection with a Minnesota statute imposing a 15-percent tax (now 20 percent) on the wholesale price of certain tobacco products, including cigars, has ruled that the price which determines the Federal tax category is not to exclude any State or local wholesale or manufacturer tax imposed on cigars (Rev. Rul. 55–698, C.B. 1955–2, p. 474).

The problem which has been called to the attention of your committee involves a 20-percent Michigan wholesale tax on cigars. It is understood that one manufacturer located in Michigan produces a cigar intended to retail at 15 cents exclusive of State or local taxes. However, as a result of the Michigan wholesale tax of 20 percent, the cigars now sell at retail in Michigan for more than 15 cents (including tax). Moreover, Michigan is the principal market in this case. Under present law the Federal cigar tax is $10 per thousand for cigars selling at retail for more than 8 cents but not more than 15 cents and is $15 per thousand for those in the category above 15 cents but not above 20 cents. As a result, in the case in question the Michigan wholesale tax in effect has increased the Federal tax from $10 to $15 per thousand. However, manufacturers of competing cigars, also intended for sale at 15 cents exclusive of State or local taxes, can be sold in Michigan and elsewhere without the payment of the additional Federal tax of $5 per thousand if their principal market is in an area where there is no State or local wholesale tax.

Your committee does not believe that differences in State or local taxes on cigars in general should make a difference in the Federal rate of taxation for cigars. To permit such taxes to be taken into account creates an artificial distinction among various cigars and leads to competitive discrimination.

For the reasons given above, your committee has amended the code (sec. 5701(b)(2)) to provide that in determining the retail price for tax purposes regard is to be had for the ordinary retail price of a single cigar in its principal market, exclusive of any State or local taxes imposed on cigars as a commodity, whether they are taxes on the wholesale, retail, or manufacturers' price. However, this is not intended to provide any exclusion for taxes such as those on gross receipts, income, or personal property.

This provision is to be effective with respect to cigars removed from the factory or released from customs custody on or after the ninth day of the first month which begins after the date of enactment of this bill.

The Treasury Department has indicated that while some revenue will be lost as a result of preventing certain cigars from being forced into higher tax brackets as a result of State wholesale taxes, it does not believe that this result was the intent of Congress and, therefore, does not believe that this should be considered as a revenue loss in the usual sense in which this term is used.

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[H.R. 10960][21]

DETERMINATION OF RETAIL PRICE FOR PURPOSES OF EXCISE TAX ON CIGARS

[Conference Report No. 2214, Eighty-Sixth Congress, Second Session]

[August 30, 1960]

Mr. MILLS, from the committee of conference, submitted the following Conference Report to accompany H.R. 10960.

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 10960) to amend section 5701 of the Internal Revenue Code of 1954 with respect to the excise tax upon cigars, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

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[21] Public Law 86–779, page 709, this Bulletin.

That the Senate recede from its amendment numbered 2.

That the House recede from its disagreement to the amendment of the Senate numbered 1 and agree to the same.

Amendment numbered 3:

That the House recede from its disagreement to the amendment of the Senate numbered 3, and agree to the same with an amendment as follows:

On page 3 of the Senate engrossed amendments, line 17, strike out "SEC. 5" and insert *Sec. 4*; and the Senate agree to the same.

Amendment numbered 4:

That the House recede from its disagreement to the amendment of the Senate numbered 4, and agree to the same with an amendment as follows:

On page 9 of the Senate engrossed amendments, line 5, strike out "SEC. 6" and insert *Sec. 5*; and the Senate agree to the same.

Amendment numbered 5:

That the House recede from its disagreement to the amendment of the Senate numbered 5, and agree to the same with the following amendments:

On page 11 of the Senate engrossed amendments, line 2, strike out "SEC. 7" and insert the following: *Sec. 6*

On page 11 of the Senate engrossed amendments, line 12, strike out "marle" and insert the following: *marl*

On page 11 of the Senate engrossed amendments, strike out lines 16, 17, and 18, and insert the following:

"*(b) Land Used in Farming.—For purposes of subsection (a), the term 'land used in farming' means land used (before or simultaneously with the expenditures described in subsection (a)) by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.*

And the Senate agree to the same.

Amendment numbered 6:

That the House recede from its disagreement to the amendment of the Senate numbered 6, and agree to the same with an amendment as follows:

On page 12 of the Senate engrossed amendments, line 20, strike out "SEC. 8" and insert *Sec. 7*; and the Senate agree to the same.

Amendment numbered 7:

That the House recede from its disagreement to the amendment of the Senate numbered 7, and agree to the same with an amendment as follows:

On page 15 of the Senate engrossed amendments, line 18, strike out "SEC. 9" and insert *Sec. 8*; and the Senate agree to the same.

Amendment numbered 8:

That the House recede from its disagreement to the amendment of the Senate numbered 8, and agree to the same with an amendment as follows:

On page 17 of the Senate engrossed amendments, line 7, strike out "SEC. 10" and insert *Sec. 9*; and the Senate agree to the same.

Amendment numbered 9:

That the House recede from its disagreement to the amendment of the Senate numbered 9, and agree to the same with an amendment as follows:

On page 18 of the Senate engrossed amendments, line 5, strike out "SEC. 11" and insert *Sec. 10*; and the Senate agree to the same.

Amendment numbered 10:

That the House recede from its disagreement to the amendment of the Senate numbered 10, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

Sec. 11. The Pension Fund, Plumbers' Local Union Numbered 775, which was created May 1, 1957, as a result of an agreement between Plumbers' Local Union Numbered 775, of Suffolk County, New York, affiliated with the United Association of Journeymen and Apprentices of the Plumbing and Pipe Fitting Industry of the United States and Canada, and the Suffolk County Plumbing and Heating Contractors Association, Inc., and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning May 1, 1957, and ending May 11, 1959, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate

that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

And the Senate agree to the same.

That the House recede from its disagreement to the amendment of the Senate to the title of the bill and agree to the same.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
NOAH M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.

HARRY F. BYRD,
ROBT. S. KERR,
J. ALLEN FREAR, JR.,
ROBT. S. KERR,
By Harry F. Byrd,
JOHN J. WILLIAMS,
FRANK CARLSON,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 10960) to amend section 5701 of the Internal Revenue Code of 1954 with respect to the excise tax upon cigars, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

CERTAIN DIVIDENDS FROM FOREIGN CORPORATIONS

Amendment No. 1: This amendment adds a new section to the bill as passed by the House which amends section 243 of the Internal Revenue Code of 1954 by adding a new subsection (d). Under the new subsection (d), the 85-percent intercorporate dividends received deduction is to apply with respect to dividends paid by a foreign corporation out of its earnings and profits if such earnings and profits were accumulated by a predecessor domestic corporation which was subject to the income tax under chapter 1 of the 1954 Code (or corresponding provisions of prior law). The new section of the bill also contains a technical amendment to section 861(a)(2) of the 1954 Code. These amendments apply to dividends received after December 31, 1959, in taxable years ending after such date.

This new section added by Senate amendment No. 1 is substantially the same as H.R. 12036 as passed by the House.

The House recedes.

DEFINITION OF BUSINESS LEASE

Amendment No. 2: Senate amendment No. 2 would add a new section to the bill, relating to exceptions to the definition of business lease.

The new section would add a sentence at the end of section 514(b)(3)(A). This sentence provides that a lease to a medical clinic by a scientific organization engaged in medical research of premises adjacent to those occupied by such scientific organization shall be considered a lease entered into primarily for purposes substantially related to the organization's exempt purposes and functions (and thus shall not be considered a business lease), if the treatment of patients of the medical clinic, their medical histories, and donated services of doctors of the medical clinic are utilized by the scientific organization for medical research purposes.

The Senate recedes.

PROVISIONS RELATING TO POSSESSIONS OF THE UNITED STATES

Amendment No. 3: This amendment adds a new section 5 to the bill, relating to limitation on reduction in income tax liability incurred to the Virgin Islands and to the estate and gift tax treatment of certain citizen residents of possessions. Except as noted below (and except for technical clarifying amendments), the text of Senate amendment No. 3 is the same as H.R. 5547, as passed by the House.

Both H.R. 5547 and the Senate amendment, with two exceptions, provide that tax liability incurred to the Virgin Islands pursuant to the income tax provisions equivalent to those of the United States, as made applicable in the Virgin Islands by the Naval Appropriations Act, approved July 12, 1921, or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, is not to be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands.

The first exception relates to United States and Virgin Islands corporations and, in general, provides that subsidies can be paid to these corporations under much the same conditions as those under which income tax exemptions are presently available in the case of U.S. corporations carrying on a trade or business in most other U.S. possessions (sec. 931 of the code). The second exception relates to citizens of the United States (both those who are citizens by reason of the special act of Congress relating to the possession, and those who are citizens by reason of birth in the continental United States, naturalization, etc.) who are bona fide residents of the Virgin Islands and permits the granting of subsidies in much the same manner as bona fide residents of Puerto Rico may claim an exemption from U.S. income tax with respect to their income derived from sources within Puerto Rico (sec. 933 of the code). With respect to this second exception, the Senate amendment contains a provision (not in the House bill) under which gain or loss from the sale or exchange of any security (as defined in section 165(g)(2) of the code) shall not be treated as derived from sources within the Virgin Islands.

Both H.R. 5547 and the Senate amendment provide (in effect) that U.S. citizens who are residents of a possession, and whose citizenship is derived from citizenship of that possession, are to be subject to the estate and gift tax imposed by the United States, in general, to the same extent as in the case of nonresidents not citizens of the United States.

The effect of this, in the case of the estate tax, is to impose the U.S. estate tax with respect to the portion of the gross estate of these citizens of U.S. possessions who are residents of the possessions at the time of their death, only with respect to that part of their gross estate which at the time of their death is situated in the United States. The effect, in the case of the gift tax, is that one of these citizens and residents of a U.S. possession at the time he makes a gift will be subject to the gift tax if, but only if, the property transferred is situated within the United States. For this purpose stock issued by a corporation is considered property situated within the United States only in the case of domestic corporations, but the making of a gift of stock of a domestic corporation, or any other intangible property with a situs within the United States is subject to the gift tax only if the donor resident of the possession is engaged in business in the United States at any time during the year in which the gift of the stock is made.

The House recedes with a clerical amendment.

MODIFICATION OF FILING REQUIREMENTS FOR DECLARATIONS OF ESTIMATED TAX BY INDIVIDUALS

Amendment No. 4: Senate amendment No. 4 adds a new section to the bill, relating to requirement of declaration of estimated tax by individuals.

Present law (sec. 6015 of the code) provides that, for an individual with no more than $100 of gross income from sources other than wages or salaries, a declaration is required if his gross income is expected to be more than $5,000; however, no declaration is required by a married person if the gross income of the married person and his spouse is expected to be not more than $10,000 (nor from a head of a household or a surviving spouse if his gross income is expected to be not more than $10,000). For an individual with more than $100 of income not subject to withholding, a declaration is required if his gross income from all sources is expected to be more than $600 per exemption plus $400.

Under Senate amendment No. 4, section 6015(a) is amended so as to (1) provide that no declaration is to be required if the estimated tax can reasonably be expected to be less than $40, (2) eliminate the gross income test of $400 plus $600 times the number of exemptions, and (3) increase from $100 to $200 the minimum gross income which can reasonably be expected to be received from sources other than wages without becoming liable to file a declaration.

The House recedes with a clerical amendment.

EXPENDITURES BY FARMERS FOR FERTILIZER

Amendment No. 5: This amendment adds a new section to the bill as passed by the House which adds a new section 180 to the Internal Revenue Code of 1954. Under the new section 180 a taxpayer engaged in the business of farming may elect to treat as expenses which are not chargeable to capital account expenditures (otherwise chargeable to capital account) which are paid or incurred by him during the taxable year for the purchase or acquisition of fertilizer, lime, ground limestone, marl, or other materials to enrich, neutralize, or condition land used in farming, or for the application of such materials to such land. The expenditures so treated are to be allowed as a deduction. For this purpose, "land used in farming" means land used (before or simultaneously with the expenditures described in the preceding sentence) by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.

The House recedes with clerical amendments and with a technical amendment clarifying the definition of the term "and used in farming."

CHARITABLE CONTRIBUTIONS FOR CERTAIN STUDENTS MAINTAINED IN TAXPAYER'S HOME

Amendment No. 6: This amendment adds a new section to the bill as passed by the House amending section 170 of the Internal Revenue Code of 1954 (relating to charitable contributions and gifts). Subsection (a)(1) of the new section of the bill amends section 170(c) of the 1954 Code so as to include within the definition of "charitable contribution" amounts treated as paid under the new subsection (d) (described below) for the use of organizations described in section 170(c) (2), (3), or (4), i.e., religious, charitable, scientific, literary, educational, veterans, fraternal, etc., organizations.

Subsection (a)(2) of the new section of the bill inserts a new subsection (d) in section 170 of the 1954 Code and redesignates the present subsections (d) and (e) as (e) and (f), respectively. Under paragraph (1) of the new subsection (d), amounts paid by a taxpayer to maintain an individual (other than a dependent or a relative) as a member of his household during the period that the individual is a full-time student in the 12th or any lower grade at an educational institution located in the United States and is a member of the taxpayer's household under a written agreement between the taxpayer and an organization described in paragraph (2), (3), or (4) of section 170(c) of the 1954 Code to implement a program of the organization to provide educational opportunities for students in private homes, are to be treated as amounts paid for the use of the organization (and thus will be treated as charitable contributions).

Paragraph (2) of the new subsection (d) contains two limitations on the amounts paid within the taxable year to which paragraph (1) applies. First, the amounts to which paragraph (1) applies are limited, for each taxable year, to an amount equal to $50 times the number of calendar months during the taxable year which fall within the period in which the student is a member of the taxpayer's household under the agreement described above. Second, paragraph (1) does not apply to any amount paid by the taxpayer within the taxable year if the taxpayer receives any money or other property as compensation or reimbursement for maintaining the student in his household during such period.

Under the Senate amendment these new provisions apply with respect to taxable years beginning after December 31, 1959.

The House recedes with a clerical amendment.

CAPITAL CONTRIBUTIONS TO FEDERAL NATIONAL MORTGAGE ASSOCIATION

Amendment No. 7: This amendment inserts in section 162 of the Internal Revenue Code of 1954 (relating to trade or business expenses) a new subsection (d), relating to capital contributions to the Federal National Mortgage Association. The new subsection provides that, for purposes of subtitle A of the 1954 Code, whenever the amount of capital contributions evidenced by a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act exceeds the fair market value of the stock as of the issue date of such stock, the initial holder of the stock is to treat the excess as ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business.

Amendment No. 7 also amends the 1954 Code to insert a new section 1054 in the provisions of such code relating to special rules as to the basis of property. The new section 1054 provides that, in the case of any share of stock described above, the basis of such share in the hands of the initial holder is to be an amount equal to the capital contributions evidenced by such share, reduced by the amount (if any) required by the new section 162(d) to be treated (with respect to such share) as ordinary and necessary expenses paid or incurred in carrying on a trade or business.

These amendments are to apply with respect to taxable years beginning after December 31, 1959.

The substance of this amendment is the same as the substance of H.R. 7885, which passed the House of Representatives on June 27, 1960.

The House recedes with a clerical amendment.

MECHANICAL LIGHTERS FOR CIGARETTES, CIGARS, AND PIPES

Amendment No. 8: Section 4201 of the Internal Revenue Code of 1954 (relating to tax on pens and mechanical pencils and lighters) imposes, upon the sale by the manufacturer, producer, or importer of mechanical lighters for cigarettes, cigars, and pipes, a tax equal to 10 percent of the price for which so sold.

This amendment provides that the tax on the sale by the manufacturer, producer, or importer of the mechanical lighters described above is to be 10 cents for each lighter but not more than 10 percent of the price for which so sold.

This change in tax is to apply only with respect to articles sold by the manufacturer, producer, or importer thereof 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.

The House recedes with a clerical amendment.

REAL ESTATE INVESTMENT TRUSTS

Amendment No. 9: This amendment amends the Internal Revenue Code of 1954 to provide substantially the same tax treatment for real estate investment trusts as present law provides for regulated investment companies. Real estate trusts are organizations specializing in investments in real estate and real estate mortgages, while the regulated investment companies specialize in investments in stock and securities.

Under present law, regulated investment companies which distribute 90 percent or more of their ordinary income are taxed only on their retained earnings. Thus, the distributed earnings are taxed only to the shareholders. This same general type of tax treatment is accorded by amendment No. 9 to real estate investment trusts, effective with respect to taxable years of real estate investment trusts beginning after December 31, 1960.

The substance of this amendment is the same as the substance of H.R. 12559, which passed the House of Representatives on June 29, 1960.

The House recedes with a clerical amendment.

PENSION FUND, PLUMBERS' LOCAL UNION NUMBERED 775

Amendment No. 10: This amendment adds a new section to the bill as passed by the House which provides that the pension fund, Plumbers' Local Union No. 775, shall be held and considered to have been a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to have been exempt from taxation under section 501(a) of such code, for the period beginning May 1, 1957, and ending May 11, 1959.

The House recedes with an amendment. Under the conference agreement, the trust is to be deemed to constitute a qualified trust (and to be exempt from tax) for the period specified, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
NOAH M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.

[H.R. 10087] [22]

OVERALL LIMITATION ON FOREIGN TAX CREDIT

[House of Representatives Report No. 1358, Eighty-Sixth Congress, Second Session]

[March 8, 1960]

MR. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 10087.

The Committee on Ways and Means, to whom was referred the bill (H.R. 10087) to amend the Internal Revenue Code of 1954 to permit taxpayers to elect an overall limitation on the foreign tax credit, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The committee amendment strikes out all after the enacting clause and substitutes therefor a new text which appears in the reported bill in italic type.

I. SUMMARY OF THE BILL

Under present law income taxes paid to a foreign country may be taken as a credit against income taxes otherwise due the United States. However, the taxes of each foreign country which may be taken as a credit are limited to the same proportion of the U.S. tax (before this credit) which the income from that foreign country is of the taxpayer's total taxable income. This is known as the "per country" limitation. This bill provides an alternative limitation known as the "overall" limitation which a taxpayer may elect. This limitation applies to taxes of all foreign countries taken together and allows as a credit the same proportion of the U.S. tax (before this credit) which the income from *all* foreign countries is of total taxable income. This has the effect of permitting taxpayers to treat the taxes of the various foreign countries collectively, rather than separately for each country.

Under the bill taxpayers may choose to apply either the per country or overall limitation, but once they have elected the overall limitation they must continue to apply this limitation for 5 years (unless they receive permission of the Treasury Department to change after a shorter interval). Also after having applied the overall limitation for a period and subsequently having shifted to the per country limitation, the taxpayer then must also continue to apply this per country limitation for a 5-year period (unless the Treasury consents to a change after a shorter interval.)

The election under the bill to apply the overall limitation is to be available for the calendar year 1961 and subsequent years.

It is estimated that provision for this election will result in an annual revenue loss of between $20 and $40 million.

This bill has been reported unanimously by your committee.

II. REASONS FOR THE BILL

Present law, in general, provides that foreign income, war profits, or excess profits taxes paid to any foreign country or to a possession of the United States may be credited against the U.S. tax otherwise due (or alternatively may be treated as a deduction in arriving at the income subject to the U.S. tax). However, present law provides a limitation on the extent to which these foreign, etc., taxes may be credited against U.S. tax in order to prevent the foreign tax from offsetting U.S. tax on domestic income. Thus the limitation restricts the extent to which the foreign taxes may be credited to what the U.S. tax otherwise would be on the foreign source income. For example, if $200 of taxable income is derived from domestic sources and $100 from foreign sources, the extent to which the foreign taxes may offset U.S. taxes is limited to what the U.S. tax would be on the $100 of foreign source income. Thus, the maximum amount of foreign taxes which may be credited against the U.S. tax of $156 (assuming a flat 52-percent rate) on the $300 of taxable income is $52; namely, the amount of tax the United States would impose on the $100 of foreign source income.

The limitation in present law has been called a "per country" limitation be-

[22] Public Law 86-780, page 720, this Bulletin.

cause the limitation is applied separately with respect to the tax of each foreign country (and each possession of the United States). Thus, present law provides that the amount of tax paid (or accrued) to each foreign country which can be claimed as a credit is to be the same proportion of the total tentative U.S. tax which the taxpayer's taxable income from sources within the foreign country in question is of his total taxable income.

Prior to the adoption of the 1954 Code, two limitations were imposed on the extent to which foreign taxes could be taken as a credit against U.S. taxes. One limitation was the "per country" limitation referred to above and the other was a so-called overall limitation. The "overall" limitation was computed in the same manner as the per country limitation, except that this limitation applied to the aggregate taxes paid all foreign countries and possessions of the United States. Thus, this limitation (expressed in terms of current definitions of income) restricted the amount of the foreign taxes which could be claimed as credits against U.S. taxes to the same proportion of the taxpayer's tentative U.S. tax which his taxable income from all foreign countries [23] was of his total taxable income.

Congress in 1954 concluded that it was inappropriate for both of these limitations to be applied in determining the foreign taxes allowable as a credit and at that time repealed the so-called overall limitation. The report of your committee at that time stated as the reason for this action:

> As a practical matter * * * the overall limitation is operative only when a taxpayer earns income in one foreign country and incurs a loss in another. The effect of the limitation is unfortunate because it discourages a company operating profitably in one foreign country from going into another country where it may expect to operate at a loss for a few years. Consequently, your committee has removed the overall limitation.

While the per country limitation may be preferable to taxpayers where they are operating at a profit in one foreign country and at a loss in another, more frequently taxpayers find themselves in situations where averaging out the high and low taxes of different foreign countries in which they operate would be more advantageous. Thus, if $100 of a taxpayer's income is taxed at a 42 percent rate in foreign country A and another $100 of his income is taxed at a rate of 62 percent in foreign country B, such a taxpayer under the per country limitation will not be able to claim credits for all of his foreign taxes unless he is able to carry the noncredited taxes back or forward and use them in other years. This occurs under the per country limitation because while the full $42 paid in country A may be claimed as a credit, only $52 of the $62 paid in country B may be so claimed. Thus in this case in the current year the total foreign taxes claimed as a credit against U.S. tax may not exceed $94.

On the other hand, under the overall limitation the income and taxes with respect to countries A and B are added together before applying the limitation and since on $200 of foreign income the U.S. tax (again assuming a flat 52 percent rate) would be $104, the full $42 paid country A and the full $62 paid country B may be credited.

These two limitations represent basically different concepts of the relationship between domestic and foreign income. The overall limitation in effect treats the taxpayer's income as being divisible into two parts, domestic and foreign. Thus, under this limitation a foreign tax credit is allowed for any foreign income taxes so long as these taxes do not represent more than the U.S. tax rate applied to the taxpayer's total foreign income. The per country limitation, on the other hand, treats the taxpayer's income as being divisible into many parts, his domestic income and his income from each foreign country, and applies the limitation separately to each.

In most cases American firms operating abroad think of their foreign business as a single operation and in fact it is understood that many of them set up their organizations on this basis. It appears appropriate in such cases to permit the taxpayer to treat his domestic business as one operation and all of his foreign business as another and to average together the high and low taxes of the various countries in which he may be operating by using the overall limitation.

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[23] Technically this is income from sources without the United States.

In addition, making the overall limitation generally available for foreign operations only provides treatment which is already available in the case of the so-called foreign base corporation, or foreign subsidiary serving as a holding company for its subsidiaries carrying on active business enterprises. In the case of a foreign base corporation the Treasury regulations provide that the taxes paid by its subsidiaries are to be treated as if they were paid to the foreign country where the foreign base company is incorporated, and thus aggregated for purposes of applying the limitation.

On the other hand it is recognized that in some cases taxpayers may think of their businesses in various foreign countries as separate ventures. This, of course, is especially likely when a company begins in a different foreign country a business which is risky and which is likely to result in losses at least for an initial period of years. In such cases the company is more likely to think of such a business as being separate and apart from its other more stable operations in other foreign countries. It seems appropriate in such cases to permit taxpayers to use the per country limitation, thus for tax purposes treating each as a separate operation.

Your committee does not, however, believe the taxpayer should be in a position to shift back and forth between the overall and per country limitations merely because one results in a larger credit in one year and the other in the next. Instead it believes that the taxpayer should in general adopt either a unitary concept of his foreign operations or one which treats the business in each foreign country separately and retain the same concept for future years. Because the basic nature of a business can change over a period of time, however, the bill permits a taxpayer (in addition to an initial change at any time from the per country to the overall limitation) to change from one type of limitation to the other only once every 5 years (unless consent of the Treasury is received for a change within this interval).

III. GENERAL EXPLANATION

The bill amends section 904 of the code to provide two alternative limitations on the foreign tax credit, the "per country" limitation (already applicable under present law) and an "overall" limitation. The per country limitation restricts the portion of foreign income, war profits, and excess profits taxes which may be credited against U.S. tax to the same portion of the total tentative U.S. tax (i.e., the tax computed without this credit) which the taxable income from the foreign country (or U.S. possession) is of the taxpayer's total taxable income. The overall limitation is computed in the same manner except that instead of computing this limitation separately with respect to the tax paid each country it is computed on an aggregate basis. Thus, under this limitation the aggregate amount of foreign taxes which may be claimed as a credit against U.S. tax is limited to the same proportion of the taxpayer's total tentative U.S. tax which his taxable income from *all* foreign countries [24] is of his total taxable income.

These two alternative limitations can be illustrated by the same example used in the prior section, namely, the case of a taxpayer operating abroad through a branch who has $200 of foreign income, $100 of which is subject to a $42 tax in country A and $100 of which is subject to a $62 tax in country B. In addition, assume he has $100 of domestic income. The tentative U.S. tax on the $300 of income would be 156 (assuming a flat 52 percent rate). The formula for the per country limitation is as follows:

$$\text{Tentative U.S. tax} \times \frac{\text{Taxable income from country in question}}{\text{Total taxable income}}$$

Applying this formula in the case of the tax paid to country A gives the following result:

$$\$156 \times \frac{\$100}{\$300} = \$52.$$

In this case the actual tax paid is less than the $52 which may be credited under the limitation, with the result that the full $42 of tax paid may be credited. However, in country B, although the formula will provide the same $52 limitation, in this case the limitation is applicable and reduces from $62 to $52 the

[24] Technically this is income from sources without the United States.

amount of taxes which may be credited. Thus, the total taxes in this case which may be taken currently as a credit under the per country limitation are $42 plus $52 or $94.

Under the overall limitation, on the other hand, the formula is as follows:

$$\text{Tentative U.S. tax} \times \frac{\text{Taxable income from all foreign countries}}{\text{Total taxable income}}$$

Applying this formula in the illustration used here gives the following result:

$$\$156 \times \frac{\$200}{\$300} = \$104.$$

Thus, in this case, since the foreign taxes paid ($42 plus $62) do not exceed the $104 limitation, the entire amount may be claimed as a credit.

Under the bill the per country limitation is to be applied unless the taxpayer elects the overall limitation. This in effect means that the present limitation is to apply unless the taxpayer desires to change to the overall limitation. This overall limitation may be elected for the first time for taxable years beginning on or after January 1, 1961. However, once this overall limitation is elected, it will continue to apply for a 5-year period, unless the taxpayer receives the consent of the Secretary or his delegate to change back to the per country limitation at an earlier date. As noted previously, this is intended to prevent the taxpayer from shifting back and forth from year to year solely because the change results in a higher credit. It is anticipated that the Secretary or his delegate, in exercising his consent under this provision to shift from the overall limitation back to the per country limitation, will permit such shifts where the basic nature of a taxpayer's business changes. Thus, for example, it would appear reasonable to permit the taxpayer to shift back to the per country limitation if he were about to enter new operations in a different foreign country and anticipated that the operation in that country would prove quite risky, with the possibility of it resulting in a loss for a number of years.

Once a taxpayer has changed back from the overall limitation to the per country limitation he again must wait 5 years before electing the overall limitation, unless he receives the consent of the Secretary to change after a shorter interval. Again, it is intended that the Secretary or his delegate exercise this consent, for example, in those cases where the basic nature of the business changes.

Under present law foreign taxes which, because of the per country limitation, cannot be credited against U.S. tax in the current year, may be carried back 2 years and credited in those years to the extent that the per country limitations with respect to those years permit, and then any foreign taxes still remaining may be carried forward to the 5 years immediately succeeding the year in which the taxes arose and successively applied in those years to the extent that the applicable per country limitations permit.

Your committee's bill continues this carryback and carryforward where the limitation in the year to which the taxes are carried is of the same type as that applicable in the year when the taxes were paid or accrued. Thus, if the taxpayer has elected the per country limitation for the current year, he may carry any foreign taxes which cannot be credited in that year back to the 2 prior years, if a per country limitation also was applicable in such years, and then, to the extent of any remaining taxes, may carry them forward to the 5 succeeding years again if the per country limitation applies. Similarly, taxes may be carried back or forward from a year in which the overall limitation has been elected if the years to which the taxes are carried are also years in which the overall limitation applies.

In addition, the bill permits taxes to be carried back or forward from a year in which the per country limitation applies to a year in which the overall limitation applies. However, in order to prevent complications in the administration of this provision, and also in the interest of simplifying taxpayer compliance, the bill does not permit taxes to be carried from a year in which the overall limitation applies to a year in which the per country limitation applies. This will make it unnecessary to provide a special country-by-country allocation rule for the taxes paid or accrued in a year in which the overall limitation applied and which then (if no restrictions were imposed under the carryback or carryover rules) could be carried to a year in which the per country limitation applies. In such a year it would be necessary to know the "uncredited" taxes on a country-by-country basis since the limitation in that year applies separately to each country. Since there is no problem in carrying taxes which cannot be

credited in a per country year to years in which the overall limitation applies, this is permitted under your committee's bill.

It has been necessary to allocate taxes to separate foreign countries, however, where they are being carried back from a per country year to an overall year and partially credited, and then any balance subsequently being carried forward to a per country year. In such a case the taxes considered as being credited in the overall year are allocated on the basis of the percentage the taxes of each foreign country not credited in the year they are paid or accrued are of the total foreign taxes not credited in that year. To illustrate this point, assume that in a year when the per country limitation was applicable $10 of taxes paid to country A cannot be credited in the year they were paid or accrued and $15 of taxes paid or accrued to country B cannot be credited in that year. Assume that this $25 of taxes is carried back to a prior year in which the overall limitation applied and in which $5 of this $25 may be credited. In this case $20 remains available as a carryforward to subsequent years when perhaps the per country limitation applies. In this case the question is how much of the $20 in taxes should be attributed to country A and how much to country B. The formula referred to above indicates that since two-fifths of the taxes which were not used in the year paid or accrued are attributable to taxes paid to country A and three-fifths to country B, the same ratio is to be applied to the $20. Thus, two-fifths of $20 or $8 will be attributed to taxes paid country A and three-fifths or $12 to taxes paid in country B.

Under the bill a provision is added to provide that the statute of limitations for a year to which foreign taxes are carried back as a result of the unused credit is not to close for purposes of the foreign taxes credited in that year until 1 year after the statute runs for the year from which the taxes are carried (or that is, generally, the year in which the taxes were paid or accrued). The purpose of this is to prevent taxpayers from claiming a double benefit with respect to an amount where the statute has run with respect to one year and not the other. Thus, for example, if the per country limitation were applicable in 1961, taxes which could not be credited in that year could be carried back and credited in 1959 if in both cases the per country limitation applied. However, if after the statute of limitations has run for the year 1959 the taxpayer changes his election with respect to 1961 and elects the overall limitation, then no carryback to a per country limitation year would be available and taxes not credited would be available in full as a carryforward to years in which the overall limitation applied. This would be true despite the fact that this same amount which is being carried forward has been claimed as a credit in the prior year with respect to which the statute of limitations has run. The extending of the statute of limitations with respect to the credits in the earlier year until 1 year after the statute of limitations has run for the year in which he taxes arose will prevent this double benefit and give the Internal Revenue Service time to review the application of the foreign tax carryback in the earlier year. This double benefit is prevented not only in the case of changes from the per country to the overall limitation but also in cases of the change from a credit to a deduction.

The bill also provides that the choice to take the foreign tax credit in lieu of the deduction, and the choice to take the overall limitation in lieu of the per country limitation, must in general be made or changed within the 3-year statute of limitations (or the statute which applies to the tax itself) and not within the special 10-year statute provided by section 6511(d)(3). The bill provides that for periods to which the 1954 Code is applicable (generally the calendar year 1954 and subsequent years) this 10-year statute is to be available only for purposes of determining the size of the credit, and not for purposes of making a choice between per country or overall limitation or a choice between a deduction or credit.

Although generally the bill is to be available only with respect to taxable years beginning on or after January 1, 1961, the provision described above, preventing a double benefit as a result of the running of the statute of limitations, is made applicable to taxable years beginning on or after January 1, 1958. The calendar year 1958 is the earliest taxable year to which unused foreign taxes may be carried. In any case this year will be open at least until 1962. Also as indicated above, the bill provides that generally the 3-year statute, but in no case the 10-year statute, is to be available for choices between the selection of the deduction or credit, or overall or per country limitation for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

IV. TECHNICAL EXPLANATION OF THE BILL

First Section of the Bill

The first section of the bill makes amendments to section 904 of the Internal Revenue Code of 1954 (relating to limitation on foreign tax credit). Subsection (a) strikes out subsection (a) of section 904 and inserts in lieu thereof new subsections (a) and (b).

Alternative limitations.—The new section 904(a)(1) contains the existing provisions of section 904(a) but prefaced with a clause to the effect that such provisions (referred to in the heading as the per country limitation) shall apply in the case of a taxpayer who does not elect the overall limitation provided by a new paragraph (2) of section 904(a). Under the per country limitation, the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States may not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

In the case of a taxpayer who elects the overall limitation provided by the new paragraph (2), the total amount of the credit with respect to taxes paid or accrued to all foreign countries and U.S. possessions may not exceed the same proportion of the tax against which such credit is taken as the taxpayer's taxable income from sources without the United States (but not to exceed total taxable income) bears to the taxpayer's entire taxable income for the same taxable year.

In computing the per country limitation, only income from sources within the country in question is taken into account in the numerator of the ratio. In computing the overall limitation, on the other hand, all income from sources without the United States is to be taken into account. Thus income which is from sources without the United States but not from sources within any foreign country or possession of the United States (for example, high seas income) is not taken into account under the per country limitation but is taken into account under the overall limitation.

Election of overall limitation.—Section 904(b)(1) provides that a taxpayer may elect the overall limitation for any taxable year beginning after December 31, 1960, and that the election remains in effect for all subsequent years up to (but not including) a taxable year for which the election is revoked. It may be revoked with the consent of the Secretary of the Treasury or his delegate for any taxable year, or without such consent only for a taxable year following the fifth taxable year to which the election applies. For such purpose, all the taxable years count whether or not the taxpayer chooses the foreign tax credit for each taxable year. Thus, if A, a taxpayer, chooses the foreign credit and elects the overall limitation for taxable year 1961, A may revoke his election of the overall limitation without the consent of the Secretary or his delegate beginning with taxable year 1966, even though he chooses a deduction for foreign taxes for one or more of the intervening years.

Section 904(b)(2) provides that, after a revocation of an election of the overall limitation, a taxpayer may not reelect such overall limitation before the fifth taxable year which begins after the taxable year for which the revocation was made unless the Secretary or his delegate consents to an earlier reelection. For such purpose, all the taxable years count whether or not the taxpayer chooses the foreign tax credit for each taxable year. Thus, if in the illustration in the preceding paragraph, A revokes the election for 1966, A cannot again elect (without consent) the overall limitation for any taxable year earlier than 1971.

Section 904(b)(3) provides that either the election of the overall limitation or the revocation of such an election may be made only in such manner as the Secretary or his delegate by regulations prescribes. Such election or revocation for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of U.S. income tax imposed for such taxable year.

Conforming amendments.—Subsections (b) and (c) of the first section of the bill redesignate subsections (b) and (c) of existing section 904 as subsections (c) and (d), respectively, and insert "the applicable limitation under subsection (a)" in lieu of "the limitation under subsection (a)" in such subsections.

Carrybacks and carryovers where overall limitation is elected.—Subsection

(d) of the first section of the bill amends section 904 by adding a new subsection (e), relating to the carryback and carryover of taxes where the overall limitation is elected.

The new section 904(e) provides special rules for carrybacks and carryovers of foreign taxes where the overall limitation is elected. Section 904(e)(1) provides that, for the purpose of determining the carryover or carryback under the first sentence of section 904(d), the foreign taxes for a taxable year to which the overall limitation applies shall be aggregated on an overall basis rather than taken into account on a per country basis.

Section 904(e)(2) provides that no amount of foreign taxes paid or accrued for any taxable year to which the overall limitation applies, however, shall be deemed paid or accrued under section 904(d) in any taxable year to which the per country limitation applies. Such per country limitation years shall be taken into account with respect to a carryover or carryback from the overall limitation year only to determine the number of preceding or succeeding taxable years that have elapsed.

To illustrate paragraphs (1) and (2) of section 904(e), assume that A elects the overall limitation for taxable years 1961, 1962, 1963, 1964, and 1965, revokes the election for taxable year 1966, and re-elects the overall limitation for taxable year 1971. The excess of the aggregate of taxes paid or accrued to foreign countries in 1961 over the overall limitation (as provided in sec. 904(a)(2)) for such year may not be carried back to 1959 or 1960 since 1959 and 1960 are per country limitation years. Such excess, however, may be carried over to 1962, 1963, 1964, and 1965, since such years are overall limitation years, but may not be carried over to 1966 since 1966 is a per country limitation year. If there were an excess of the aggregate taxes over the overall limitation for 1965, such excess could be carried back to 1963 and 1964; however, such excess could not be carried over to 1966 through 1970.

Section 904(e) does not prevent the carrying of foreign taxes from a per country limitation year to an overall limitation year. Thus, if in the previous illustration there were an excess of taxes paid or accrued to each of countries X and Y for 1967 over the per country limitations for such year under section 904(a)(1), such excess amounts would be aggregated and carried back to 1965 (an overall-limitation year), and to the extent not used in 1965, would be carried on a per country basis to 1966 (a per country limitation year), but with the adjustments required by section 904(e)(3).

To determine the aggregate of the excess amounts of foreign taxes paid or accrued for a per country limitation year for purposes of carrying such aggregate to or through an overall limitation year, first determine the excess of such taxes over the limitation under section 904(a)(1) for each country or possession. The sum of such excess amounts is the aggregate. For example, assume that the taxpayer elected the overall limitation for 1961 and revoked such election for 1966. Assume further that his income for 1966 (a per country limitation year) consists of the amounts derived from the sources indicated as follows:

Taxable income from sources within country A	$480
Taxable income taxed by country A although from sources on the high seas	120
Taxable income from sources within country B	500
Taxable income from sources within the United States	100
Total taxable income	1,200

The taxpayer has paid or accrued income taxes of $300 to country A, and $290 to country B. The U.S. income tax before the credit under section 901 is assumed to be $600. The excess of tax paid or accrued to country A over the section 904(a)(1) limitation is $60 determined as follows:

Total tax paid or accrued to country A	$300
Per country limitation under sec. 904(a)(1) $\left(\frac{\$480}{\$1,200} \times \$600\right)$	240
Excess over the per country limitation under sec. 904(a)(1)	60

It is to be noted that the numerator of the fraction is $480 rather than $600. The $120 of high seas income taxed by country A is not taken into account as being income from sources within A.

The excess of tax paid or accrued to country B over the section 904(a)(1) limitation is $40 determined as follows:

Total tax paid or accrued to country B	$290
The limitation determined under sec. 904(a)(1) $\left(\frac{\$500}{\$1,200}\times\$600\right)$	250
Excess over the per country limitation under sec. 904(a)(1)	40

The aggregate of the excess amounts of foreign taxes for 1966 is $100 ($60+$40), which may be carried back to 1964 (an overall limitation year), and to the extent not absorbed in 1964 may be carried back to 1965 (another overall limitation year). To the extent such aggregate excess is not absorbed in 1965, it can be carried over on a country-by-country basis (adjusted as provided by sec. 904(e)(3) for the intervening years 1964 and 1965) to 1967, and to the extent that the excess is not absorbed in 1967, may be carried to 1968, etc., through taxable years 1971.

Where an amount paid or accrued to any foreign country or possession of the United States for a taxable year to which the per country limitation applies is carried through 1 or more taxable years to which the overall limitation applies, section 904(e)(3) provides that such amount shall be properly adjusted for such overall limitation years, under regulations prescribed by the Secretary of the Treasury or his delegate, on the basis of the ratio which the excess taxes paid or accrued (over the per country limitation) to a foreign country or possession for the taxable year from which carried bears to the aggregate of the excess taxes for all foreign countries and possessions for the taxable year from which carried.

The application of subsection (e)(3) may be illustrated by the following example:

Assume that a corporation elects the overall limitation for taxable years 1961, 1962, 1963, 1964, and 1965. It revokes its election with respect to 1966. Also assume that the amount of tax paid or accrued for 1966 to foreign countries A and B exceeds the respective per country limitation for such year as follows: Country A, $60; country B, $40.

The aggregate of such excess amounts ($100) is carried back to 1964. Assume that (without taking the 1966 carryback into account) the foreign taxes paid or accrued for 1964 (plus excess amounts which are carried to 1964 under sec. 904(d) from years prior to 1966) is $150 and that the overall limitation for such year is $160. Thus $6 of the country A carryback to 1964 is absorbed in 1964 $\left(\frac{\$60}{\$100}\times 10=\$6\right)$. Similarly, $4 of the country B carryback to 1964 is absorbed in 1964 $\left(\frac{\$40}{\$100}\times 10=\$4\right)$. Thus, the country A carryback from 1966 to 1965 is $54 ($60−$6) and the country B carryback from 1966 to 1965 is $36 ($40−$4).

Assume further that the foreign taxes paid or accrued to all countries and possessions during 1965 (plus excess amounts which are carried to 1965 under sec. 904(d) from years prior to 1966) totals $200 and that the overall limitation for such year is $230. Under these facts $\left(\frac{\$60}{\$100}\times\$30\right)$ or $18 of country A carryback to 1965 is used up and $\left(\frac{\$40}{\$100}\times\$30\right)$ or $12 of country B carryback to 1965 is used up. Thus, the country A 1966 carryover to 1967 (a year to which the per country limitation applies) is $36 ($60−($6+$18)). The country B 1966 carryover to 1967 is $24 ($40−($4+$12)).

Section 2 of the Bill

References in section 901 to limitation of section 904.—Subsection (a) of section 2 of the bill amends subsections (a) and (b) of section 901 to make it clear that the reference in each such subsection to the "limitation of section 904" is to be read as a reference either to the per country limitation of section 904(a)(1) or to the overall limitation of section 904(a)(2), whichever is applicable.

Time for choosing between credit and deduction.—Subsection (b) of section 2 of the bill amends the second sentence of section 901(a) of the 1954 Code to make it clear that the choice as to whether to take a foreign tax credit for any taxable year, or to take the foreign taxes as a deduction for such year, must be made or changed before the expiration of the period prescribed for making a

claim for credit or refund of the tax imposed for such taxable year by chapter 1 of the 1954 Code. This period will usually expire at the time prescribed by section 6511(a) (generally, 3 years from the time the return was filed). If, however, the time for filing such a claim for credit or refund is extended by agreement (as provided under sec. 6511(c)), then the time for making the choice as to claiming a credit or a deduction for foreign taxes will extend to the expiration of the time agreed upon.

It is to be noted that the period prescribed by the second sentence of section 901(a) is not extended by section 6511(d)(3). Section 6511(d)(3) provides, in effect, a 10-year period of limitation for claims for credit or refund of overpayments attributable to foreign taxes. However, for this 10-year period to be applicable, the choice to take the foreign tax credit (in lieu of the deduction) must have been timely made (that is, made within the time prescribed by the second sentence of sec. 901(a)).

In applying the second sentence of section 901(a) in a case where a carryback or carryover of taxes under section 904 is involved, the taxable year which is determinative of the period for making the choice between a credit and a deduction is the taxable year from which the excess taxes may be carried (and not the taxable years to which they may be carried). In addition, the excess taxes for such taxable year may not be used as a credit in another taxable year to which carried unless the taxpayer chose to take a credit (rather than a deduction) for such other taxable year within the period prescribed by the second sentence of section 901(a) for making the choice for such other taxable year.

For example, assume that foreign taxes in excess of the per country limitation of section 904(a)(1) are paid or accrued for 1961. Even though, under section 904(d), such excess may be carried back to 1959 and 1960, and may be carried over to 1962, 1963, 1964, 1965, and 1966, the determinative year for the period for making the choice of taking a credit or deduction with respect to these taxes is 1961 (in the normal case this period will expire March 15, 1965, in the case of a corporation, and April 15, 1965, in the case of any other taxpayer). Assuming a timely election for 1961, no amount may be used as a credit for any taxable year to which the 1961 taxes may be carried unless, for that other year also, the choice of the foreign tax credit route (in lieu to the deduction route) was also made within the time prescribed for such other taxable year.

Deficiencies attributable to foreign tax carrybacks.—Subsection (c) of section 2 of the bill adds a new subsection (i) to section 6501 of the code. This new subsection, which is similar to the existing section 6501(h), relating to net operating loss carrybacks, provides in effect that in the case of a deficiency attributable to the application to the taxpayer of a carryback of taxes paid or accrued to foreign countries or possessions of the United States in excess of the applicable limitation under section 904(a) of the code (the per country or the overall limitation, as the case may be), such deficiency may be assessed at any time before the expiration of 1 year after the expiration of the period within which a deficiency may be assessed for the taxable year from which such excess may be carried.

For example, assume that taxpayer T chooses to have the benefits of the foreign tax credit for taxable years 1959, 1960, and 1961. Assume further that by reason of the application of the per country limitation for 1961 there is a carryback to 1959 of $60 taxes paid to country X and $50 taxes paid to country Y. Assume also that all of the taxes so carried back may be used for 1959. On the basis of these carrybacks, T obtains a refund of his 1959 U.S. tax in the amount of $110.

On December 1, 1964, T elects for 1961 the overall limitation provided by the new section 904(a)(2). Since under the new section 904(e)(2) the excess (if any) for an overall limitation year may not be carried to 1959, a per country limitation year, the election results in a deficiency for 1959 of $110. Disregarding the new section 6501(i), and assuming no special circumstances, the period for assessing the deficiency for 1959 would have expired. Under the new section 6501(i), however, the deficiency attributable to the election to take the overall limitation in lieu of the per country limitation could be assessed.

The new section 6501(i) applies, under section 3 of the bill, to taxable years beginning after 1957. Thus, for example, it would apply to a case where the taxpayer has received the benefit of a per country limitation carryback from 1960 to 1958 and, after the expiration of the general period for assessing deficiencies for 1958, the taxpayer changes his choice as to claiming the foreign tax credit for 1960 and instead claims a deduction for foreign taxes for 1960.

SECTION 3 OF THE BILL

Section 3 of the bill provides the effective date for the amendments made by the first two sections of the bill.

The first sentence of section 3 provides that the amendments made by the first section of the bill, and the amendments made by subsection (a) of section 2 of the bill, are to apply with respect to taxable years beginning after December 31, 1960.

The second sentence of section 3 provides that the amendment made by subsection (b) of section 2 of the bill (relating to time for choosing between the foreign tax credit and the deduction for foreign taxes) is to apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. (This is the same effective date as was provided, in general, for the 1954 Code.)

As explained above, section 2(c) of the bill inserts a new subsection (i) in section 6501 of the 1954 Code, relating to the period for assessing deficiencies attributable to the carryback of excess foreign taxes. Under the third sentence of section 3 of the bill, the new section 6501(i) will apply to the assessment of deficiencies for taxable years beginning after December 31, 1957.

[H.R. 10087] [25]

OVERALL LIMITATION ON FOREIGN TAX CREDIT

[Senate Report No. 1393, Eighty-Sixth Congress, Second Session, Calendar No. 1456]

[May 19, 1960]

MR. BYRD of Virginia, from the Committee on Finance, submitted the following report together with Minority Views to accompany H.R. 10087.

The Committee on Finance, to whom was referred the bill (H.R. 10087) to amend the Internal Revenue Code of 1954 to permit taxpayers to elect an overall limitation on the foreign tax credit, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY OF THE BILL

A. IN GENERAL

Under present law income taxes paid to a foreign country may be taken as a credit against income taxes otherwise due the United States. However, the taxes of each foreign country which may be taken as a credit are limited to the same proportion of the U.S. tax (before this credit) which the income from that foreign country is of the taxpayer's total taxable income. This is known as the "per country" limitation. This bill provides an alternative limitation known as the "overall limitation which a taxpayer may elect. This limitation applies to taxes of all foreign countries taken together and allows as a credit the same proportion of the U.S. tax (before this credit) which the income from *all* foreign countries is of total taxable income. This has the effect of permitting taxpayers to treat the taxes of the various foreign countries collectively, rather than separately for each country.

B. COMMITTEE AMENDMENTS

Under the House bill taxpayers could make their initial shift from the per country limitation to the overall limitation at any time. Once under the overall limitation they could of their own volition shift back to the per country limitation after an interval of 5 years (or after a shorter period if they had the permission of the Treasury Department). After having shifted back to the per country limitation they could of their own volition again return to the overall limitation after a 5-year interval (or lesser time with the consent of the Treasury Department). Your committee's amendments provide that taxpayers may not of their own volition shift back and forth between these limitations after 5-year intervals. Under the bill as amended by your committee taxpayers may at their

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[25] Public Law 86–780, page 720, this Bulletin.

own election make an initial shift from the per country to the overall limitation but thereafter they can change from the overall limitation to the per country limitation, or vice versa, only with the consent of the Treasury Department. It is expected that this consent will be given where there are basic changes in a taxpayer's business as, for example, where he engages in substantial operations in a new foreign country or where existing investments are lost due to nationalization, expropriation, or war.

Under the House bill foreign income taxes, which may not be credited against U.S. taxes in the current year, may be carried back or forward from a year in which the per country limitation is used to either a year in which the per country or overall limitation is used. However, under the House bill foreign taxes may not be carried from an overall-limitation year to a per-country-limitation year. Under your committee's amendments taxes may not be carried either from a per-country-limitation year to an overall-limitation year or from an overall-limitation year to a per-country-limitation year. They may, however, be carried from a year in which the per-country limitation applies to another year in which the per-country limitation applies, or from a year in which the overall limitation applies to another year in which the same limitation applies.

Your committee has also amended the bill to provide that to the extent foreign taxes are above those imposed by the United States because of the special 14 point tax differential provided by the United States for Western Hemisphere trade corporations, they cannot be used to offset U.S. taxes at a 52 percent rate on income earned in countries where the foreign taxes involved are less than those imposed by the United States. This amendment has application only where consolidated returns are filed.

Under both the House and your committee's version of the bill, the overall limitation is to be available for the calendar year 1961 and subsequent years.

Your committee has also added to the bill an amendment relating to another problem. It has provided that where individuals have received reimbursements from certain types of nonprofit corporations for moving expenses, these amounts are not to be included in gross income of the individuals. This rule is to apply only to the extent the amounts received did not exceed the actual moving expenses and only if the individuals were not advised by an agent of the employer that the amount was properly includible in gross income. The amendment is further limited to expenses paid by nonprofit corporations formed exclusively to operate scientific laboratories for the Atomic Energy Commission and operating on funds provided by the Commission.

C. Revenue Effect

It is estimated that this bill will result in an annual revenue loss of between $15 and $20 million.

D. Treasury Views

The Treasury Department has indicated that it has no objections to the bill as amended by your committee.

II. REASONS FOR THE OVERALL LIMITATION ON THE FOREIGN TAX CREDIT

A. In General

Present law, in general, provides that foreign income, war profits, or excess profits taxes paid to any foreign country or to a possession of the United States may be credited against the U.S. tax otherwise due (or alternatively may be treated as a deduction in arriving at the income subject to the U.S. tax). However, present law provides a limitation on the extent to which these foreign, etc., taxes may be credited against U.S. tax in order to prevent the foreign tax from offsetting U.S. tax on domestic income. Thus the limitation restricts the extent to which the foreign taxes may be credited to what the U.S. tax otherwise would be on the foreign source income. For example, if $200 of taxable income is derived from domestic sources and $100 from foreign sources, the extent to which the foreign taxes may offset U.S. taxes is limited to what the U.S. tax would be on the $100 of foreign source income. Thus, the maximum amount of foreign taxes which may be credited against the U.S. tax of $156 (assuming a flat 52-percent rate) on the $300 of taxable income is $52; namely, the amount of tax the United States would impose on the $100 of foreign source income.

The limitation in present law has been called a "per country" limitation because the limitation is applied separately with respect to the tax of each foreign country (and each possession of the United States). Thus, present law provides that the amount of tax paid (or accrued) to each foreign country which can be claimed as a credit is to be the same proportion of the total tentative U.S. tax which the taxpayer's taxable income from sources within the foreign country in question is of his total taxable income.

Prior to the adoption of the 1954 Code, two limitations were imposed on the extent to which foreign taxes could be taken as a credit against U.S. taxes. One limitation was the "per country" limitation referred to above and the other was a so-called overall limitation. The "overall" limitation was computed in the same manner as the per country limitation, except that this limitation applied to the aggregate taxes paid all foreign countries and possessions of the United States. Thus, this limitation (expressed in terms of current definitions of income) restricted the amount of the foreign taxes which could be claimed as credits against U.S. taxes to the same proportion of the taxpayer's tentative U.S. tax which his taxable income from all foreign countries [26] was of this total taxable income.

Congress in 1954 concluded that it was inappropriate for both of these limitations to be applied in determining the foreign taxes allowable as a credit and at that time repealed the so-called overall limitation. The report of your committee at that time stated as the reason for this action:

> The effect of the (overall) limitation is unfortunate because it discourages a company operating profitably in one foreign country from going into another country where it may expect to operate at a loss for a few years. Consequently, your committee has removed the overall limitation. (Parenthesis added.)

While the per country limitation may be preferable to taxpayers where they are operating at a profit in one foreign country and at a loss in another, more frequently taxpayers find themselves in situations where averaging out the high and low taxes of different foreign countries in which they operate would be more advantageous. Thus, if $100 of a taxpayer's income is taxed at a 42 percent rate in foreign country A and another $100 of his income is taxed at a rate of 62 percent in foreign country B, such a taxpayer under the per country limitation will not be able to claim credits for all of his foreign taxes unless he is able to carry the noncredited taxes back or forward and use them in other years. This occurs under the per country limitation because while the full $42 paid in country A may be claimed as a credit, only $52 of the $62 paid in country B may be so claimed. Thus in this case in the current year the total foreign taxes claimed as a credit against U.S. tax may not exceed $94.

On the other hand, under the overall limitation the income and taxes with respect to countries A and B are added together before applying the limitation and since on $200 of foreign income the U.S. tax (again assuming a flat 52 percent rate) would be $104, the full $42 paid country A and the full $62 paid country B may be credited.

These two limitations represent basically different concepts of the relationship between domestic and foreign income. The overall limitation in effect treats the taxpayer's income as being divisible into two parts, domestic and foreign. Thus, under this limitation a foreign tax credit is allowed for any foreign income taxes so long as these taxes do not represent more than the U.S. tax rate applied to the taxpayer's total foreign income. The per country limitation, on the other hand, treats the taxpayer's income as being divisible into many parts, his domestic income and his income from each foreign country, and applies the limitation separately to each.

In most cases American firms operating abroad think of their foreign business as a single operation and in fact it is understood that many of them set up their organizations on this basis. It appears appropriate in such cases to permit the taxpayer to treat his domestic business as one operation and all of his foreign business as another and to average together the high and low taxes of the various countries in which he may be operating by using the overall limitation.

In addition, making the overall limitation generally available for foreign operations only provides treatment which is already available in the case of the so-called foreign base corporation, or foreign subsidiary serving as a holding

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[26] Technically this is income from sources without the United States.

company for its subsidiaries carrying on active business enterprises. In the case of a foreign base corporation the Treasury regulations provide that the taxes paid by its subsidiaries are to be treated as if they were paid to the foreign country where the foreign base company is incorporated, and thus aggregated for purposes of applying the limitation.

On the other hand it is recognized that in some cases taxpayers may think of their businesses in various foreign countries as separate ventures. This, of course, is especially likely when a company begins in a different foreign country a business which is risky and which is likely to result in losses at lease for an initial period of years. In such cases the company is more likely to think of such a business as being separate and apart from its other more stable operations in other foreign countries. It seems appropriate in such cases to permit taxpayers to use the per country limitation, thus for tax purposes treating each as a separate operation.

B. Committee Amendments

1. No automatic elections every 5 years

Your committee agrees with the basic concept expressed in the House committee report, namely, that taxpayers should either adopt a unitary concept of foreign operations or one which treats the business in each foreign country separately. However, it sees no reason to permit taxpayers of their own volition to shift back and forth between the two types of limitations over 5-year intervals as the House bill would do. Where the basic nature of the business changes, or where conditions in the foreign country change, under the bill as amended by your committee it will still be possible to change from one type of limitation to the other by obtaining the consent of the Treasury Department. Your committee has been assured that the Secretary of the Treasury will be reasonable in exercising this authority and will permit, for example, taxpayers to shift back to the per country limitation where they are about to enter substantial operations in a new foreign country and anticipate that the operations in that country will prove quite risky with the possibility of their resulting in a loss for a number of years. Also, it is understood that he will permit taxpayers to shift back to the per country limitation where substantial losses are realized with respect to existing investments because of nationalization, expropriation, or war. Similarly, it is expected that the Secretary or his delegate will develop appropriate rules allowing a taxpayer, upon a proper showing, to shift back to the overall limitation where he previously had the consent of the Secretary to use the per country limitation.

2. No carrybacks or carryforwards from per-country to overall-limitation years

Like the House bill, the bill as amended by your committee does not permit foreign taxes to be carried from an overall-limitation year to a per-country-limitation year. In addition, however, your committee's bill does not permit foreign taxes to be carried from a per-country-limitation year to an overall-limitation year. This restriction was added because otherwise there would be a windfall gain to those taxpayers who have accumulated unused carryovers, which they could not use when the per-country-limitation was applicable, and which they might now be able to use if they shift over to the overall limitation. In many cases the greater averaging obtainable under the overall limitation would enable taxpayers to use these accumulated unused foreign taxes as credits when they otherwise could not do so. The Treasury Department has estimated that this aspect of the bill alone would have resulted in an immediate revenue loss for the first year after enactment of approximately $30 million. Your committee's amendments foreclose this windfall and possible revenue loss by permitting unused foreign taxes to be carried only from a year in which the per-country-limitation applies to another year in which this same limitation applies or from a year in which the overall limitation applies to another year in which this same limitation applies.

3. Application of overall limitation to Western Hemisphere trade corporations

Your committee has also amended the House bill in its application of the overall limitation to Western Hemisphere trade corporations filing a consolidated return with other domestic corporations. Under present law these corporations are given a 14-percentage-point tax differential or, in general, are taxed at 38 percent rather than 52 percent.

Under the House bill where a consolidated return is filed, foreign taxes which cannot be credited against U.S. tax, because this lower rate is in effect, can be used to offset U.S. taxes at 52 percent on other foreign-source income where the foreign tax rates involved are not this high. For example, assume that the income of a Western Hemisphere trade corporation is $100 before the imposition of foreign taxes of $45. Assume another domestic corporation also earns $100 in another foreign country and is subject to the same $45 foreign tax, but that this company is not a Western Hemisphere trade corporation. The Western Hemisphere trade corporation in this case would generally be subject to a U.S. tax (before foreign tax credit) of about $38 (ignoring the surtax exemption). Therefore, in this case only $38 of the $45 of foreign taxes could be credited against U.S. tax, leaving $7 of foreign taxes which cannot be credited. In the case of the other corporation, the U.S. tax before foreign tax credit would be $52 (again ignoring the surtax exemption). Against this could be credited the full $45 tax paid the foreign country, leaving a net U.S. tax of $7. If the income of the two corporations in this example were included in a consolidated return, it would be possible in effect to credit the $7 of foreign tax not be credited in the case of the Western Hemisphere trade corporation against the $7 of U.S. tax otherwise due in the case of the corporation subject to the 52 percent tax. To prevent this result, the amendments made by your committee provide that foreign taxes which cannot be credited against U.S. taxes in the case of Western Hemisphere trade corporations as a result of the special 14-point-tax differential provided for these corporations may not be used to offset U.S. tax on other foreign-source income either in the current year or in years to which the unused credits may be carried. This is applied only where a consolidated return is filed and only where the overall limitation is used.

The foreign taxes which may not be taken into account for this purpose are only those which cannot be credited because of the 14-point-tax differential which Western Hemisphere trade corporations have. Thus, if the foreign taxes on $100 of income of a Western Hemisphere trade corporation were $62, the amount in excess of $52 (ignoring the surtax exemption), or $10, would be allowed as a credit against any U.S. tax on other foreign-source income.

If more than one Western Hemisphere trade corporation is involved, the taxes of this group of corporations are averaged before determining any foreign taxes which may not be taken into account. This can be illustrated by an example of a Western Hemisphere trade corporation having $100 of income on which the foreign taxes are $20, and another Western Hemisphere trade corporation, included in the same consolidated group, also with income of $100 but foreign taxes of $45. In this case the U.S. tax on this $200 of income before credit would be at an effective rate of about 38 percent, or amount to about $76. The combined foreign taxes on this income would be $65 ($20+$45). All of these taxes could be credited even though in the case of one of the companies the taxes were in excess of a 38-percent tax. This is because the *average* tax on the combined income of the two Western Hemisphere trade corporations is not in excess of a 38-percent effective rate.

III. GENERAL EXPLANATION OF THE OVERALL LIMITATION ON THE FOREIGN TAX CREDIT

A. In General

The bill amends section 904 of the Internal Revenue Code to provide two alternative limitations on the foreign tax credit, the "per country" limitation (already applicable under present law) and an "overall" limitation. The per-country limitation restricts the portion of foreign income, war profits, and excess profits taxes which may be credited against U.S. tax to the same portion of the total tentative U.S. tax (i.e., the tax computed without this credit) which the taxable income from the foreign country (or U.S. possession) is of the taxpayer's total taxable income. The overall limitation is computed in the same manner except that instead of computing this limitation separately with respect to the tax paid each country it is computed on an aggregate basis. Thus, under this limitation the aggregate amount of foreign taxes which may be claimed as a credit against U.S. tax is limited to the same proportion of the taxpayer's total tentative U.S. tax which his taxable income from *all* foreign countries [27] is of his total taxable income.

[27] Technically this is income from sources without the United States.

These two alternative limitations can be illustrated by the same example used in the prior section, namely, the case of a taxpayer operating abroad through branches who has $200 of foreign income, $100 of which is subject to a $42 tax in country A and $100 of which is subject to a $62 tax in country B. In addition, assume he has $100 of domestic income. The tentative U.S. tax on the $300 of income would be $156 (assuming a flat 52-percent rate). The formula for the per country limitation is as follows:

$$\text{Tentative U.S. tax} \times \frac{\text{Taxable income from country in question}}{\text{Total taxable income}}$$

Applying this formula in the case of the tax paid to country A gives the following result:

$$\$156 \times \frac{\$100}{\$300} = \$52.$$

In this case the actual tax paid is less than the $52 which may be credited under the limitation, with the result that the full $42 of tax paid may be credited. However, in country B, although the formula will provide the same $52 limitation, in this case the limitation is applicable and reduces from $62 to $52 the amount of taxes which may be credited. Thus, the total taxes in this case which may be taken currently as a credit under the per-country limitation are $42 plus $52 or $94.

Under the overall limitation, on the other hand, the formula is as follows:

$$\text{Tentative U.S. tax} \times \frac{\text{Taxable income from all foreign countries}}{\text{Total taxable income}}$$

Applying this forumla in the illustration used here gives the following result:

$$\$156 \times \frac{\$200}{\$300} = \$104.$$

Thus, in this case, since the foreign taxes paid ($42 plus $62) do not exceed the $104 limitation, the entire amount may be claimed as a credit.

Under the bill the per-country limitation is to be applied unless the taxpayer elects the overall limitation. This in effect means that the present limitation is to apply unless the taxpayer desires to change to the overall limitation. This overall limitation may be elected for the first time for taxable years beginning on or after January 1, 1961. Once this overall limitation is elected, under the House bill it would continue to apply for a 5-year period unless the taxpayer received the consent of the Secretary of the Treasury or his delegate to change back to the per-country limitation at an earlier date. Under the amendments made by your committee, however, once this overall limitation is elected, the taxpayer may change back to the per-country limitation only with the consent of the Secretary or his delegate. Once a taxpayer has changed back from the overall limitation to the per-country limitation under the House bill he can, after waiting 5 years, of his own volition again elect the overall limitation (or at a shorter interval if he receives the consent of the Secretary or his delegate to make such a change). Under your committee's amendments, however, once having been permitted to go back to the per-country limitation by the Secretary or his delegate, he must again receive this consent in order to shift back to the overall limitation.

Under present law foreign taxes which, because of the per-country limitation, cannot be credited against U.S. tax in the current year, may be carried back 2 years and then any foreign taxes still remaining may be carried forward to the 5 immediately succeeding years. The House bill would provide that foreign taxes may not be carried from a year in which the overall limitation applies to another year in which the per-country limitation applies.

The amendments made by your committee similarly do not permit unused foreign taxes to be carried from a year in which the overall limitation applies to a year in which the per-country limitation applies. However, in addition, the amendments made by your committee do not permit unused foreign taxes to be carried from a year in which the per country limitation applies to a year in which the overall limitation applies.

The House bill provides no special restriction as to the application of the overall limitation in the case of Western Hemisphere trade corporations. Your committee's bill provides that where one or more Western Hemisphere trade corporations files a consolidated return with other corporations and the overall

limitation applies, the amount of foreign taxes paid by the Western Hemisphere trade corporation in excess of the amount of U.S. tax on the consolidated return attributable to them is not to be taken into account for purposes of the foreign tax credit. Thus, assume that a Western Hemisphere trade corporation has paid foreign taxes of $45 on $100 of income (the income being that on the consolidated return attributable to the Western Hemisphere trade corporation) and that the U.S. tax on the consolidated income attributable to the corporation is $38 (this ignores the effect of the surtax exemption and possibly other items). In this case the excess of the $45 foreign tax over the $38 U.S. tax, or $7, is not to be taken into account for purposes of the foreign tax credit. If two or more Western Hemisphere trade corporations are involved in a consolidated return, the income and taxes of the two are averaged together in applying this restriction.

The bill also provides that the foreign taxes not to be taken into account in general are only those imposed at rates between 38 percent and 52 percent. This result is accomplished by providing that the restriction referred to above is not to apply to the extent that the foreign taxes paid by the Western Hemisphere trade corporation (or corporations) is in excess of the tax it would have to pay the United States (before any foreign tax credit and without regard to the 2-percent penalty tax on consolidated returns) if the corporation were not a Western Hemisphere trade corporation.

B. Statute of Limitations

Both the House and your committee's version of the bill provide that the statute of limitations for a year to which foreign taxes are carried back as a result of the unused credit is not to close for purposes of the foreign taxes credited in that year until 1 year after the statute runs for the year from which the taxes are carried (or that is, generally, the year in which the taxes were paid or accrued). The purpose of this is to prevent taxpayers from claiming a double benefit with respect to an amount where the statute has run with respect to 1 year and not the other. Thus, for example, if the per country limitation were applicable in 1961, taxes which could not be credited in that year could be carried back and credited in 1959 if in both cases the per country limitation applied. However, if after the statute of limitations has run for the year 1959 the taxpayer changes his election with respect to 1961 and elects the overall limitation, then no carryback to a per country limitation year would be available and taxes not credited would be available in full as a carryforward to years in which the overall limitation applied. This would be true despite the fact that this same amount which is being carried forward has been claimed as a credit in the prior year with respect to which the statute of limitations has run. The extending of the statute of limitations with respect to the credits in the earlier year until 1 year after the statute of limitations has run for the year in which the taxes arose will prevent this double benefit and give the Internal Revenue Service time to review the application of the foreign tax carryback in the earlier year. This double benefit is prevented not only in the case of changes from the per country to the overall limitation but also in cases of the change from a credit to a deduction.

Both versions of the bill also provide that the choice to take the foreign tax credit in lieu of the deduction, and the choice to take the overall limitation in lieu of the per country limitation, must in general be made or changed within the 3-year statute of limitations (or the statute which applies to the tax itself) and not within the special 10-year statute provided by section 6511(d)(3). The bill provides that for the periods to which the 1954 Code is applicable (generally the calendar year 1954 and subsequent years) this 10-year statute is to be available only for purposes of determining the size of the credit, and not for purposes of making a choice between per country or overall limitations or a choice between a deduction or credit.

C. Effective Dates

Although generally, under both the House and your committee's versions, the bill is to be available only with respect to taxable years beginning on or after January 1, 1961, the provision described above, preventing a double benefit as a result of the running of the statute of limitations, is made applicable to taxable years beginning on or after January 1, 1958. The calendar year 1958 is the earliest taxable year to which unused foreign taxes may be carried. In any case this year will be open at least until 1962. Also as indicated above, the bill pro-

vides that generally the 3-year statute, but in no case the 10-year statute, is to be available for choices between the selection of the deduction or credit, or overall or per country limitation for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

IV. REIMBURSEMENT FOR MOVING EXPENSES RECEIVED BY EMPLOYEES OF CERTAIN CORPORATIONS FORMED EXCLUSIVELY TO OPERATE LABORATORIES FOR THE ATOMIC ENERGY COMMISSION

A situation has been called to the attention of your committee involving moving expenses received by employees of a corporation formed to perform research, development and production tasks for the Atomic Energy Commission on the ordnance aspect of atomic weapons. The corporation concerned engages only in activities assigned to it by the Atomic Energy Commission, and it operates under a contract which specifically provides that all costs and expenses of operation will be reimbursed by the Atomic Energy Commission from appropriations by Congress. Also, under the contract the services of the corporation involved are to be rendered without profit of any kind.

In hiring the professional and skilled employees required for the type of work in which the corporation is involved, the corporation paid the traveling and moving expenses incurred by the new employees in moving to accept employment. Until Revenue Ruling 55–140 (C.B. 1955–1, 317) was issued in March of 1955, the officials of the corporation had assumed that such expense reimbursement was not taxable income. This was based on the fact that an Internal Revenue Service ruling issued in 1949 to a laboratory, which was an Atomic Energy Commission installation, and which initially had held that reimbursed travel expense to a new employee from a person under contract to the Atomic Energy Commission was taxable income, was modified by the Commissioner in 1951. In the 1951 ruling it was held that reimbursement for travel expense on transfers between different nonprofit contractors in the Atomic Energy Commission complex was not considered to be taxable income.

In view of all of the circumstances involved in this case, your committee believes that it would be unfortunate to impose income tax with respect to the reimbursement of moving expenses for the employees of this corporation. It has, therefore, added a new section to the bill relating to amounts received by an individual, after December 31, 1949, and before the date of enactment of this bill from a corporation meeting certain qualifications, as reimbursement for moving himself and his immediate family, household goods, and personal effects to a new place of residence in order to accept employment with the qualifying corporation. This section provides that moving expenses of the type referred to above are to be excluded from the gross income of the individual to the extent that the reimbursement did not exceed the actual expenses paid or incurred for these purposes.

This provision is not, however, to apply in any case where the individual involved was advised at the time of his employment by an authorized official of the corporation that the amount of the reimbursement would be includible in gross income. In the case in question it is understood that new employees on or about September 1, 1955, were advised specifically that the amounts reimbursed to them for moving and travel expenses were taxable income and thus many, if not all, of the new employees hired after that date will not receive the treatment accorded by this provision.

The conditions which must be met by a corporation to qualify under this provision are (1) it must be formed exclusively for the purpose of, and be exclusively engaged in, operating without profit a scientific laboratory for the Atomic Energy Commission, and (2) it must be operated solely on funds appropriated to the Atomic Energy Commission by Congress.

This amendment was added by your committee as a section in the Technical Amendments Act of 1958 but was deleted in the conference on that bill on the understanding that the Treasury Department objected to this provision. The Treasury Department has now indicated that it does not object to the enactment of this provision.

V. TECHNICAL EXPLANATION OF THE BILL

First Section of the Bill

The first section of the bill makes amendments to section 904 of the Internal Revenue Code of 1954 (relating to limitation on foreign tax credit). Subsection

(a) strikes out subsection (a) of section 904 and inserts in lieu thereof new subsections (a) and (b).

Alternative limitations.—The new section 904(a)(1) contains the existing provisions of section 904(a) but prefaced with a clause to the effect that such provisions (referred to in the heading as the per-country limitation) shall apply in the case of a taxpayer who does not elect the overall limitation provided by a new paragraph (2) of section 904(a). Under the per-country limitation, the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States may not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

In the case of a taxpayer who elects the overall limitation provided by the new paragraph (2), the total amount of the credit with respect to taxes paid or accrued to all foreign countries and U.S. possessions may not exceed the same proportion of the tax against which such credit is taken as the taxpayer's taxable income from sources without the United States (but not to exceed total taxable income) bears to the taxpayer's entire taxable income for the same taxable year.

In computing the per-country limitation, only income from sources within the country in question is taken into account in the numerator of the ratio. In computing the overall limitation, on the other hand, all income from sources without the United States is to be taken into account. Thus income which is from sources without the United States but not from sources within any foreign country or possession of the United States (for example, high seas income) is not taken into account under the per-country limitation but is taken into account under the overall limitation.

Election of overall limitation.—Section 904(b)(1) provides that a taxpayer may elect the overall limitation for any taxable year beginning after December 31, 1960, and that the election remains in effect for all subsequent years up to (but not including) a taxable year for which the election is revoked. It may be revoked with the consent of the Secretary of the Treasury or his delegate for any taxable year.

Section 904(b)(2) provides that if a taxpayer has made an election of the overall limitation which, with the consent of the Secretary or his delegate, has been revoked, he may not make a new election of the overall limitation unless the Secretary or his delegate consents to such new election.

Section 904(b)(3) provides that either the election of the overall limitation or the revocation of such an election may be made only in such manner as the Secretary or his delegate by regulations prescribes. Such election or revocation for any taxable year may be made or changed at any time before the expiration of the period prescribed by section 6511(a) (generally, 3 years from the time the return was filed) for making a claim for credit or refund of U.S. income tax imposed for such taxable year. Since the initial election of the overall limitation does not require consent of the Secretary or his delegate, the initial election made for a taxable year (whether or not the first taxable year beginning after December 31, 1960) may be revoked without the consent of the Secretary or his delegate before the expiration of the period prescribed for making a claim for credit or refund of U.S. income tax imposed for the taxable year in which the initial election was made. After such a timely revocation the taxpayer could make his initial election of the overall limitation for a later taxable year without the consent of the Secretary or his delegate. If, however, a taxpayer has made his initial election of the overall limitation, and the period prescribed for making a claim for credit or refund of U.S. income tax imposed for the taxable year to which the initial election first applied has expired, the taxpayer may not revoke such election for any taxable year without the consent of the Secretary or his delegate. Moreover, if the taxpayer revokes such election for any taxable year with the consent of the Secretary or his delegate, he may not make a new election without the consent of the Secretary or his delegate even though the period prescribed for making a claim for credit or refund of U.S. income tax imposed for such taxable year has not expired. In such case the taxpayer may make an election of the overall limitation for any subsequent taxable year only with the consent of the Secretary or his delegate.

Conforming amendments.—Subsections (b) and (c) of the first section of the bill redesignate subsections (b) and (c) of existing section 904 as subsections

(c) and (d), respectively, and insert "the applicable limitation under subsection (a)" in lieu of "the limitation under subsection (a)" in such subsections.

Carrybacks and carryovers where overall limitation is elected.—Subsection (d) of the first section of the bill amends section 904 by adding a new subsection (e), relating to the carryback and carryover of taxes where the overall limitation is elected, and a new subsection (f), a cross-reference.

The new section 904(e) provides special rules for carrybacks and carryovers of foreign taxes where the overall limitation is elected. Section 904(e)(1) provides that, for the purpose of determining the carryover or carryback under the first sentence of section 904(d), the foreign taxes for a taxable year to which the overall limitation applies shall be aggregated on an overall basis rather than taken into account on a per-country basis.

Section 904(e)(2) provides that no amount of foreign taxes paid or accrued for a taxable year to which the per-country limitation applies shall be deemed paid or accrued under subsection (d) in any taxable year to which the overall limitation applies, and that no foreign tax paid or accrued for a taxable year to which the overall limitation applies shall be deemed paid or accrued under subsection (d) in any taxable year to which the per-country limitation applies. The taxable years in which such taxes are not deemed paid or accrued under the preceding sentence shall, however, be taken into account to determine the number of preceding or succeeding taxable years that have elapsed for purposes of subsection (d).

To illustrate paragraphs (1) and (2) of section 904(e) assume that A elects the overall limitation for taxable years 1961, 1962, 1963, 1964, and 1965, revokes the election for taxable year 1966, and reelects the overall limitation for taxable year 1969. The excess of the aggregate of taxes paid or accrued to foreign countries in 1961 over the overall limitation (as provided in sec. 904(a)(2)) for such year may not be carried back to 1959 or 1960 since 1959 and 1960 are per-country limitation years. Such excess, however, may be carried over to 1962, 1963, 1964, and 1965, since such years are overall limitation years, but may not be carried over to 1966 since 1966 is a per-country limitation year. If there were an excess of the aggregate taxes over the overall limitation for 1965, such excess could be carried back to 1963 and 1964; such excess could not be carried over to 1966 through 1968 but could be carried over to 1969 and 1970, overall limitation years; it could not be carried to 1971 and later years because 5 succeeding taxable years would have elapsed with respect to the carryover from 1965. If there were an excess of any foreign or U.S. possession taxes over the per-country limitation for 1967 such excess could not be carried back to 1965, nor over to 1969, 1970, 1971, or 1972. Such excess could be carried, however, back to 1966 and over to 1968 since such years are per-country limitation years.

Cross reference.—Section 904(f) is a cross reference to section 1503(d) added by section 2 of the bill relating to a special rule for application of the foreign tax credit in the case of an affiliated group which includes Western Hemisphere trade corporations for years in which the overall limitation applies.

Section 2 of the Bill

Special rule for application of overall limitation on foreign tax credit.—Section 2 of the bill amends section 1503 of the Internal Revenue Code of 1954 (relating to computation and payment of tax in case of consolidated returns) by adding a new subsection (d). The new subsection (d) provides that, if an affiliated group includes any Western Hemisphere trade corporations for a taxable year to which the overall limitation on the foreign tax credit applies, the amount of taxes paid or accrued to foreign countries and possessions of the United States by such Western Hemisphere trade corporations which is in excess of a specified amount shall not be taken into account for the purpose of section 901 (relating to the allowance of the foreign tax credit). Such specified amount is the tax which would be computed under section 1503(a) (without regard to the foreign tax credit) on the aggregate consolidated taxable income attributable to the Western Hemisphere trade corporations. The rule stated in the second sentence of this paragraph does not apply, however, to the extent that the amount of taxes paid or accrued to foreign countries and U.S. possessions by the Western Hemisphere trade corporations exceeds the amount of tax which would be computed under section 1503(a) (but without the 2-percent surtax) on the aggregate consolidated

taxable income which would be attributable to such corporations if they were not Western Hemisphere trade corporations.

Example.—Assume that an affiliated group of corporations makes a consolidated return for taxable year 1962, chooses the foreign tax credit under section 901, and elects the limitation under section 904(a)(2). Assume also that, of the four corporations in the group, two are Western Hemisphere trade corporations. To simplify this illustration, the surtax exemption is disregarded. With that qualification the foreign tax credit is computed as follows:

Consolidated taxable income attributable to the Western Hemisphere trade corporations before the section 922 deduction	$100
Section 922 deduction $\left(\frac{14}{52}\times\$100\right)$	27
Consolidated taxable income attributable to Western Hemisphere trade corporations after the section 922 deduction ($100 minus $27)	73
U.S. tax computed on consolidated taxable income attributable to Western Hemisphere trade corporations ($73×0.52)	38
U.S. tax which would be computed on the consolidated taxable income attributable to such corporations if they were not Western Hemisphere trade corporations but without the 2 percent surtax under section 1503(a) ($100×0.52)	$52
Income, war-profits, and excess profits taxes paid or accrued by such corporations to foreign countries or U.S. possessions	60
The amount of such foreign taxes taken into account under sec. 901 ($38+($60−$52))	46
Consolidated taxable income not attributable to Western Hemisphere trade corporations (½ of which is assumed to be from sources outside the United States)	100
Consolidated taxable income ($100+$73)	173
U.S. income tax before the foreign tax credit (0.52×$173) plus ($100×0.02)	92
Income, war-profits, excess profits taxes paid or accrued to foreign countries or U.S. possessions by other than the Western Hemisphere trade corporations	20
Foreign taxes taken into account and allowed as a credit subject to the overall limitation ($46+$20)	66
Consolidated taxable income from sources outside U.S. ($73+$50)	123
The foreign tax credit for 1962 as limited by the overall limitation $\left(\frac{123}{173}\times\$92\right)$	65
The excess foreign taxes over such limitation available to be carried to another taxable year ($66−$65)	1

SECTION 3 OF THE BILL

References in section 901 to limitation of section 904.—Subsection (a) of section 3 of the bill amends subsection (a) and (b) of section 901 to make it clear that the reference in each such subsection to the "limitation of section 904" is to be read as a reference either to the per-country limitation of section 904(a)(1) or to the overall limitation of section 904(a)(2), whichever is applicable.

Time for choosing between credit and deduction.—Subsection (b) of section 3 of the bill amends the second sentence of section 901(a) of the 1954 Code to make it clear that the choice as to whether to take a foreign tax credit for any taxable year, or to take the foreign taxes as a deduction for such year, must be made or changed before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed for such taxable year by chapter 1 of the 1954 Code. This period will usually expire at the time prescribed by section 6511(a) (generally, 3 years from the time the return was filed). If, however, the time for filing such a claim for credit or refunds is extended by agreement (as provided under sec. 6511(c)), then the time for making the choice as to claiming a credit or a deduction for foreign taxes will extend to the expiration of the time agreed upon.

It is to be noted that the period prescribed by the second sentence of section 901(a) is not extended by section 6511(d)(3). Section 6511(d)(3) provides, in effect, a 10-year period of limitation for claims for credit or refund of over-

payment attributable to foreign taxes. However, for this 10-year period to be applicable, the choice to take the foreign tax credit (in lieu of the deduction) must have been timely made (that is, made within the time prescribed by the second sentence of sec. 901(a)).

In applying the second sentence of section 901(a) in a case where a carryback or carryover of taxes under section 904 is involved, the taxable year which is determinative of the period for making the choice between a credit and a deduction is the taxable year from which the excess taxes may be carried (and not the taxable years to which they may be carried). In addition, the excess taxes for such taxable year may not be used as a credit in another taxable year to which carried unless the taxpayer chose to take a credit (rather than a deduction) for such other taxable year within the period prescribed by the second sentence of section 901(a) for making the choice for such other taxable year.

For example, assume that foreign taxes in excess of the per-country limitation of section 904(a)(1) are paid or accrued for 1961. Even though, under section 904(d), such excess may be carried back to 1959 and 1960, and may be carried over to 1962, 1963, 1964, 1965, and 1966, the determinative year for the period for making the choice of taking a credit or deduction with respect to these taxes is 1961 (in the normal case this period will expire March 15, 1965, in the case of a corporation, and April 15, 1965, in the case of any other taxpayer). Assuming a timely choice for taking a credit for 1961, no amount may be used as a credit for any taxable year to which the 1961 taxes may be carried unless, for that other year also, the choice of the foreign tax credit route (in lieu of the deduction route) was also made within the time prescribed for such other taxable year.

Deficiencies attributable to foreign tax carrybacks.—Subsection (c) of section 3 of the bill adds a new subsection (i) to section 6501 of the code. This new subsection, which is similar to the existing section 6501(h), relating to net operating loss carrybacks, provides in effect that in the case of a deficiency attributable to the application to the taxpayer of a carryback of taxes paid or accrued to foreign countries or possessions of the United States in excess of the applicable limitation under section 904(a) of the code (the per-country or the overall limitation, as the case may be), such deficiency may be assessed at any time before the expiration of 1 year after the expiration of the period within which a deficiency may be assessed for the taxable year from which such excess may be carried.

For example, assume that the taxpayer T chooses to have the benefits of the foreign tax credit for taxable years 1959, 1960, and 1961. Assume further that by reason of the application of the per-country limitation for 1961 there is a carryback to 1959 of $60 taxes paid to country X and $50 taxes paid to country Y. Assume also that all of the taxes so carried back may be used for 1959. On the basis of these carrybacks, T obtains a refund of his 1959 U.S. tax in the amount of $110.

On December 1, 1964, T elects for 1961 the overall limitation provided by the new section 904(a)(2). Since under the new section 904(e)(2) the excess (if any) for an overall limitation year may not be carried to 1959, a per-country limitation year, the election results in a deficiency for 1959 of $110. Disregarding the new section 6501(i), and assuming no special circumstances, the period for assessing the deficiency for 1959 would have expired. Under the new section 6501(i), however, the deficiency attributable to the election to take the overall limitation in lieu of the per-country limitation could be assessed.

The new section 6501(i) applies, under section 4 of the bill, to taxable years beginning after 1957. Thus, for example, it would apply to a case where the taxpayer has received the benefit of a per-country limitation carryback from 1960 to 1958 and, after the expiration of the general period for assessing deficiencies for 1958, the taxpayer changes his choice as to claiming the foreign tax credit for 1960 and instead claims a deduction for foreign taxes for 1960.

Section 4 of the Bill

Section 4 of the bill provides the effective date for the amendments made by the first three sections of the bill.

The first sentence of section 4 provides that the amendments made by the first section and section 2 of the bill, and the amendments made by subsection (a) of section 3 of the bill, are to apply with respect to taxable years beginning after December 31, 1960.

The second sentence of section 4 provides that the amendment made by subsection (b) of section 3 of the bill (relating to time for choosing between the foreign tax credit and the deduction for foreign taxes) is to apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. (This is the same effective date as was provided, in general, for the 1954 Code.)

As explained above, section 3(c) of the bill inserts a new subsection (i) in section 6501 of the 1954 Code, relating to the period for assessing deficiencies attributable to the carryback of excess foreign taxes. Under the third sentence of section 4 of the bill, the new section 6501(i) will apply to the assessment of deficiencies for taxable years beginning after December 31, 1957.

SECTION 5 OF THE BILL

This section, for which there is no corresponding provision in the House bill, provides an exclusion from gross income of amounts received as reimbursement for moving expenses of new employees of certain corporations, to the extent that such amounts do not exceed the actual expenses paid or incurred by the employee for such purposes. Under existing law, payments or reimbursements to a new employee of moving or relocation expenses come within the statutory description of gross income, and the expenses incurred by a new employee in moving his family and household goods are not expenditures for which deductions may be taken in computing income taxes. *U.S.* v. *Sherrill O. and Doris M. Woodall, U.S.* v. *Glenn S. and Margaret H. Mills* (255 F. 2d 370 (C.A. 10th 1958)) (cert. denied 358 U.S. 824, Rev Rul. 55–140, C.B. 1955–1, 317, amplified in Rev. Rul. 59–236, C.B. 1959–2, 234).

Section 5 of the bill as added by your committee provides that, notwithstanding any other law or rule of law, a reimbursement of moving expenses under the circumstances described below shall be treated as an amount which was not includible in the gross income of the individual, to the extent that such reimbursement did not exceed the actual moving expenses paid or incurred by the individual.

The applicability of section 5 is limited to reimbursements received from a corporation which was (1) formed exclusively for the purpose of, and was engaged exclusively in, operating without profit a scientific laboratory for the Atomic Energy Commission and (2) operated solely on funds appropriated to the Atomic Energy Commission.

This section further provides that the general rule, and not the exception provided in section 5, will apply where the individual was advised, at the time of his employment, by an authorized officer, employee, or agent of such corporation that the amount of such reimbursement would be includible in gross income.

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MINORITY VIEWS OF H.R. 10087

As is so often the case, the subject bill, H.R. 10087, cannot be considered in isolation nor can it be taken at face value. Under the guise of assisting the economic advancement of the underdeveloped countries, this bill would provide a privileged minority of American taxpayers with tax concessions not available to all. It is part and parcel of the larger problem of the proper method of taxing the income earned abroad by U.S. corporations. At the present time, certain foreign taxes are allowed as credits against the U.S. income tax, and, furthermore, the incidence of the U.S. tax varies, both as to rate and as to time levied, with the organization of the foreign operating arm of the U.S. corporation.

Specifically, this bill would allow a U.S. corporation, in taking credit for foreign income, war profits, and excess profit taxes against U.S. income taxes, to apply either the per-country limitation, now in effect, or the overall limitation at the option of the corporation. This bill was originally section 5 of the bill, H.R. 5, the so-called Boggs bill which is still pending in the House of Representatives. For some reason this part of H.R. is now singled out for special treatment. The Treasury opposed the provisions of this bill when such provisions were embodied in section 5 of the Boggs bill, in hearings before the Ways and Means Committee.

The foreign tax credit, considered as a tax package, constitutes one of the glaring loopholes in our tax laws.

Allowing any item of expense or expenditure as a credit against taxes violates all principles of taxation. All such items, if considered at all, should be treated

as deductions in arriving at the net income subject to applicable tax rates. The foreign tax credit should be abolished, it being basically unsound in principle and discriminatory in practice. Failing this, many changes should be made to tighten existing laws and procedures governing this method of handling the income tax on income earned abroad. The bill now under consideration does not do this. On the contrary, it nibbles away a bit more around the periphery of the foreign tax credit loophole for the benefit of a few taxpayers of whom not one has demonstrated an inequity under present law.

The Congress of the United States, since our present income tax laws first became effective in 1913, has always maintained the right to tax the income of U.S. citizens or corporations on a worldwide basis. The Congress has never surrendered the right to tax, or to legislate concerning the taxation of, income of U.S. corporations earned anywhere in the world.

This principle is seldom openly attacked. Instead, those who would profit from a broadening of the foreign tax credit loophole seek to do so on grounds varying from expediency to economic foreign policy. Most of the arguments, however, boil down to excuses for requesting tax benefits to which the corporations concerned are not entitled.

The proper handling of multijurisdictional taxation, foreign or domestic, has long presented a problem. Prior to 1918 all foreign taxes, including income taxes, were treated as deductible expenses just as were taxes levied by State or local governments within the United States. As a matter of expediency or accommodation, and on the grounds that American corporations operating abroad were allegedly at a competitive disadvantage with foreign corporations, foreign income taxes in 1918 were placed in a separate category from taxes imposed by domestic jurisdictions and it was provided by law that foreign income taxes could be either credited against American income taxes or allowed as deductions from taxable income at the option of the taxpayer. Taxes levied by domestic jurisdictions, States and local governments, continued to be treated as deductions. This operates a discrimination against business within the United States in competition with business in foreign countries.

This approach to the handling of foreign income taxes has remained the basic law, although a great many changes have been made from time to time to broaden this favor. At the present time, then, our tax laws provide a haven for foreign income, war profits, and excess profits taxes which is not available to other kinds of taxes. Because of this, many U.S. corporations have established foreign branches or subsidiaries to compete in the U.S. market.

Allowing credit for these foreign taxes rather than treating them as deductions has given rise to many abuses. Companies such as the Arabian American Oil Co., for example, have been able to persuade the governments of the host countries in which their principal operations are conducted to classify royalties, subsidies and other charges as income taxes, thus denying the U.S. Government many millions of dollars in taxes. Some such large corporations pay very little, if any, taxes to the U.S. Government. Many abuses connected with subsidiaries, including the use of third country tax havens have been made possible.

Many arguments have been advanced for continuing and broadening the foreign tax credit loophole. Generally speaking, they can be grouped under three general headings:

(1) The foreign tax credit is necessary to prevent double taxation. This argument assumes that double taxation, that is, the taxation of the same income by more than one government, is wrong per se. Our tax laws recognize no such principle. There is essentially no difference, so far as a taxpayer is concerned, between a State income tax and an income tax levied by a foreign government. So-called double taxation is not avoided in the case of State taxes by allowing such taxes to be deducted as an item of business expense. What is accomplished is an accommodation which works satisfactorily. The foreign tax credit represents an accommodation, just as does the allowance of the State income tax as a deduction. Either is a compromise. The tax credit, however, is wrong in principle.

(2) It is said that a dollar earned anywhere should be subject to the same tax. This objective, if it is a proper objective, is not achieved by the foreign tax credit. A dollar earned through a subsidiary operating abroad does not bear the same tax burden as does a dollar earned in New York or New Orleans.

(3) It is said that the foreign tax credit encourages private investment abroad. This is the argument which is most often advanced today to justify tax preferences to companies operating abroad. It is true that a desirable ingredient of

our foreign economic policy is an increased private investment abroad. Achieving this increased investment by means of tax incentives is not, however, the most appropriate method. Such incentives do not necessarily direct investment into the most desirable channels or into the most desirable areas of the world. There is a great deal of difference, insofar as the furtherance of our national objectives is concerned, between encouraging a manufacturer to begin assembling automobiles in Germany and encouraging a food processor to open a plant in India. The foreign tax credit may, as I have shown, promote undesirable development. There are better, more direct and more manageable means of promoting desirable foreign investment and development.

Several arguments can be made against the foreign tax credit. I would like to call attention to three which I consider pertinent.

(1) The foreign tax credit allows the foreign government to determine the effective U.S. tax rate, operating frequently as a preemption. It has been alleged that many foreign governments have tended to adjust their tax rates to the U.S. rate. Be this as it may, we have given the foreign government, through the mechanism of the foreign tax credit, the power to decide whether the United States can collect taxes on income of U.S. corporations earned abroad at the rate of 52 percent, 20 percent, 10 percent, or 0 percent.

(2) The benefits of foreign tax credits accrue to a relatively few companies. According to a study of this problem made in 1955, it was then estimated that 40 percent of all foreign investment is accounted for by 10 U.S. corporations and 71 percent by 62 corporations. Any concessions made in the form of tax reductions would necessarily accrue very largely to these few corporations. It was estimated that 25 to 50 corporations would receive half the benefits from any tax reductions, and nearly all the benefits from such reductions would be received by 150 corporations.

(3) Benefits accruing to corporations as a result of the foreign tax credit do not necessarily further national objectives. It was formerly felt that most of the benefits derived from the foreign tax credit accrued to the export operations and thus benefited the entire American economy. This does not now appear to be the case. On the contrary, the foreign tax credit now encourages the establishment of manufacturing concerns in foreign countries where goods are produced which are in direct competition with American exports or become competitive as imports into the United States. It would also appear that, except for those corporations engaged in the extractive industries, the foreign investment which is encouraged by the foreign tax credit takes place largely in Europe in countries which are already highly developed. The export of capital to such areas may not further national objectives at all, but instead may add to the competition which already exists for American exports and, furthermore, directly complicates our critical balance-of-payments problem. The foreign tax credit may equally promote the desirable or undesirable.

In amplification of the above reference to national objectives, it is pertinent to cite a few facts.

Many who wish to increase private American investment abroad in the underdeveloped areas feel that such private investment can replace foreign aid. This is not possible. Private investment, with or without tax incentives, goes where it can produce a good return. In most of the underdeveloped countries the public sector must first be built up. Only then will there be a base on which private investment can build.

During recent years new U.S. direct investment in the underdeveloped countries of Asia, the Middle East, and Africa has amounted to only about $100 million per year, and a great deal of even this small amount has gone into petroleum in a few countries.

Tax forgiveness, which assists only those enterprises making substantial profits, will not accomplish our desired economic foreign policy objectives. Even if it did, the results may be contradictory. Tax forgiveness, applied across the board, will pull American investment into the already industrialized countries. It will not lend effective encouragement to reluctant investors to go into the underdeveloped countries where markets must be created.

Net return, regardless of the tax structure, is a governing factor in sending capital abroad. As an illustration of the inefficacy of the tax incentive, I might cite the fact that U.S. investment in Western Europe increased 135 percent from 1950 to 1959, while at the same time investment in Latin America increased only 92 percent, and the Western Hemisphere Trade Act gives Latin American investments a tremendous tax advantage.

As I have pointed out, there are serious objections to the foreign tax credit in principle. Aside from the principles involved, however, there are further serious defects in our laws relating to foreign tax credits. The most serious of these are:

(1) No tax is levied on the income of subsidiaries until such income is remitted in the form of dividends to the parent company in the United States.

(2) Because of the way in which foreign taxes paid by subsidiaries are credited, it is often possible, particularly if a third country tax haven is employed, to reduce the effective 52 percent U.S. tax rate to an effective rate of slightly more than 40 percent.

(3) The Western Hemisphere trade corporation is a historical accident and should be abolished.

To return to the subject bill, H.R. 10087, more specifically, the main reason which has been advanced for its adoption is that some companies regard their foreign operations as one operation and they, therefore, should be allowed to adopt the overall limitation. Other companies, it is said, regard operations in each foreign country as a separate operation and these companies should, therefore, if they so desire, be allowed to use the per-country limitation. It is certainly a strange concept of tax law which allows a company to choose any method of computing its tax which it desires merely because such a method comports with the concept which that company holds as to its own operations. This is about as logical as allowing an individual to regard himself as a corporation for tax purposes in any year his income puts him in a bracket higher than 52 percent, and pay his income tax accordingly.

In 1954 the per-country limitation was decided on. Insofar as we may wish, and are able, to use tax policy to further national economic policy, this limitation is more appropriate than is the overall limitation. When a corporation opens up a new plant or undertakes a new operation in a new country, it is quite likely to undergo a loss for a few years in that country. In such a case the company is generally better off under the per-country limitation than under the overall limitation. Existing law, to that extent, does encourage U.S. corporations to begin new operations in new, and it may be hoped underdeveloped, countries.

The amendments adopted by the Senate Finance Committee are excellent and do much to make this bill more nearly acceptable. Despite these improvements in the bill, however, it still represents an effort to enlarge an existing loophole in the tax laws without justification. This bill will result in a loss of revenue to the U.S. Government of between $20 and $40 million. In effect, a gift of this amount will be made to corporations which have shown neither need nor deserts to such largess. This is another example of a special bill to give tax relief to "somebody" (usually a few) when the crying need is for more equitable tax laws for all.

ALBERT GORE.

[H.R. 10087] [28]

OVERALL LIMITATION ON FOREIGN TAX CREDIT

[Conference Report No. 2199, Eighty-Sixth Congress, Second Session]

[August 29, 1960]

MR. MILLS, from the committee of conference, submitted the following conference report to accompany H.R. 10087.

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 10087) to amend the Internal Revenue Code of 1954 to permit taxpayers to elect an overall limitation on the foreign tax credit, having met after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendments of the Senate numbered 1, 2, 3, 4, 5, 6, 7, 8, 9, 11, 12, 13, 14, 15, and 16, and agree to the same.

Amendment numbered 10:

That the House recede from its disagreement to the amendment of the Senate numbered 10, and agree to the same with an amendment as follows:

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[28] Public Law 86-780, page 720, this Bulletin.

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

Sec. 2. Section 1503 of the Internal Revenue Code of 1954 (relating to computation and payment of tax in case of consolidated returns) is amended by adding at the end thereof the following new subsection:

"(d) Special Rule for Application of Foreign Tax Credit When Overall Limitation Applies.—

"(1) In general.—If the affiliated group includes one or more Western Hemisphere trade corporations (as defined in section 921), and if for the taxable year an election under section 904(b)(1) (relating to election of overall limitation on foreign tax credit) is in effect, then the amount of taxes paid or accrued to foreign countries and possessions of the United States by such Western Hemisphere trade corporations which may be taken into account for purposes of section 901 shall be reduced by the amount (if any) by which—

"(A) the amount of such taxes (or, if smaller, the amount of the tax which would be computed under subsection (a), if such corporations were not Western Hemisphere trade corporations, with respect to the portion of the consolidated taxable income attributable to such corporations), exceeds

"(B) the amount of the tax computed under subsection (a) with respect to the portion of the consolidated taxable income attributable to such corporations.

"(2) Adjustment in case of certain public utilities.—So much of any reduction under paragraph (1) as is attributable to taxes paid or accrued to foreign countries and possessions of the United States by one or more corporations which are both Western Hemisphere trade corporations and regulated public utilities shall be decreased by the excess of—

"(A) the amount of the tax computed under subsection (a) with respect to the portion of the consolidated taxable income attributable to income derived, by the corporations in the affiliated group which are not Western Hemisphere trade corporations, from sources within the foreign countries referred to in paragraph (3)(B), over

"(B) the amount of taxes paid or accrued to such foreign countries by the corporations referred to in subparagraph (A).

This paragraph shall apply only if the corporations described in subparagraph (A) derive 80 percent or more, of the gross income (computed without regard to capital gains and losses) which they derive from sources within the foreign countries described in paragraph (3)(B), from regulated public utilities and from operations as regulated public utilities.

"(3) Special rules.—

"(A) For purposes of paragraph (2), a corporation is a regulated public utility only if it is a regulated public utility within the meaning of subparagraph (A) (other than clauses (ii) and (iii) thereof) or (D) of subsection (c)(1). For purposes of the preceding sentence, subsection (c)(2) shall be applied as if subsection (c)(1) were limited to subparagraphs (A)(i) and (D) thereof.

"(B) For purposes of paragraph (2), the foreign countries referred to in this subparagraph include only any country from which any public utility referred to in the first sentence of paragraph (2) devices the principal part of its income.

"(C) For the purposes of paragraph (1)(A), the amount of tax which would be computed with respect to the portion of the consolidated taxable income attributable to any corporation or corporations shall be determined without regard to the increase of 2 percent provided in subsection (a)."

And the Senate agree to the same.

Amendment numbered 17:

That the House recede from its disagreement to the amendment of the Senate numbered 17, and agree to the same with the following amendments:

On page 4 of the Senate engrossed amendments, strike out line 5 and "any" on line 6 and insert *Sec. 5. Any*

On page 4 of the Senate engrossed amendments, line 7, strike out "the date of the enactment of this Act" and insert the following: *October 1, 1955,*

On page 4 of the Senate engrossed amendments, line 22, strike out "unless" and insert *if*

On page 5 of the Senate engrossed amendments, line 1, strike out "would be" and insert *would not be*

And the Senate agree to the same.

Amendment numbered 18:

That the House recede from its disagreement to the amendment of the Senate numbered 18, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

Sec. 6. (a) Subpart A of part III of subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to information concerning persons subject to special provisions) is amended by renumbering section 6038 as 6039, and by inserting after section 6037 the following new section:

"SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

"(a) Requirement.—

"(1) In general.—A domestic corporation shall furnish, with respect to any foreign corporation which it controls (within the meaning of subsection (c)(1)) and with respect to any foreign subsidiary of any such foreign corporation (within the meaning of subsection (c)(2)), such information as the Secretary or his delegate may prescribe by regulations relating to—

"(A) the name, the principal place of business, and the nature of business of such foreign corporation or foreign subsidiary, and the country under whose laws incorporated;

"(B) the accumulated profits (as defined in section 902(c)) of such foreign corporation or foreign subsidiary, including the items of income (whether or not included in gross income under chapter 1), deductions (whether or not allowed in computing taxable income under chapter 1), and any other items taken into account in computing such accumulated profits;

"(C) a balance sheet for such foreign corporation or foreign subsidiary, listing assets, liabilities, and capital;

"(D) transactions between such foreign corporation or foreign subsidiary and—

"(i) any foreign corporation controlled by the domestic corporation,

"(ii) any foreign subsidiary of a foreign corporation controlled by the domestic corporation, and

"(iii) the domestic corporation or any shareholder of the domestic corporation owning at the time the transaction takes place 10 percent or more of the value of any class of stock outstanding of the domestic corporation; and

"(E) a description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each citizen or resident of the United States and each domestic corporation who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation or foreign subsidiary.

"(2) Period for which information is to be furnished, etc.—The information required under paragraph (1) shall be furnished—

"(A) in the case of a foreign corporation, for its annual accounting period ending with or within the domestic corporation's taxable year, and

"(B) in the case of any foreign subsidiary of such foreign corporation, for such subsidiary's annual accounting period ending with or within such foreign corporation's annual accounting period described in subparagraph (A).

The information required under this subsection shall be furnished at such time and in such manner as the Secretary or his delegate shall by regulations prescribe.

"(3) Limitation.—No information shall be required to be furnished under this subsection with respect to any foreign corporation or foreign subsidiary for any annual accounting period unless such information was required to be furnished under regulations in effect on the first day of such annual accounting period.

"(b) Effect of Failure to Furnish Information.—If a domestic corporation fails to furnish, within the time prescribed under paragraph (2) of subsection (a),

any information with respect to any foreign corporation or foreign subsidiary required under paragraph (1) of subsection (a), then, in applying section 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) to such domestic corporation (or to any person who acquires from any person any portion of the interest of such domestic corporation in any such foreign corporation or foreign subsidiary, but only to the extent of such portion) for any taxable year, the amount of taxes paid or deemed paid by such foreign corporation and foreign subsidiary with respect to which the domestic corporation is required to furnish information during the annual accounting period or periods with respect to which such information is required under such paragraph (2) of subsection (a) shall be reduced by 10 percent. If such failure continues 90 days or more after notice by the Secretary or his delegate to the domestic corporation, then the amount of the reduction under this subsection shall be 10 percent plus an additional 5 percent for each 3 month period, or fraction thereof, during which such failure to furnish information continues after the expiration of such 90-day period. No taxes shall be reduced under this subsection more than once for the same failure. For purposes of this subsection, the time prescribed under paragraph (2) of subsection (a) to furnish information (and the beginning of the 90-day period after notice by the Secretary) shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary or his delegate) reasonable cause existed for failure to furnish such information.

"(c) Control, Etc.—For purposes of this section—

"(1) If at any time during its taxable year a domestic corporation owns more than 50 percent of the voting stock of a foreign corporation, it shall be deemed to be in control of such foreign corporation.

"(2) If at any time during its annual accounting period a foreign corporation owns more than 50 percent of the voting stock of another foreign corporation, such other corporation shall be considered a foreign subsidiary of the corporation owning such stock.

"(d) Annual Accounting Period.—For purposes of this section, the annual accounting period of a foreign corporation or of a foreign subsidiary is the annual period on the basis of which such foreign corporation or such foreign subsidiary regularly computes its income in keeping its books.

"(e) Cross Reference.—

"For provisions relating to penalties for violations of this section, see section 7203."

(b) (1) The table of sections for such subpart is amended by striking out the last item and inserting in lieu thereof the following:

"Sec. 6038. Information with respect to certain foreign corporations.
"Sec. 6039. Cross references."

(2) Section 902 of the Internal Revenue Code of 1954 (relating to credit for corporate stockholder in foreign corporation) is amended by adding at the end thereof the following new subsection:

"(e) Cross Reference.—

"For reduction of credit with respect to dividends paid out of accumulated profits for years for which certain information is not furnished, see section 6038."

(c) The amendments made by subsections (a) and (b) shall apply to taxable years of domestic corporations beginning after December 31, 1960, with respect to information relating to a foreign corporation or a foreign subsidiary described in section 6038(a) of the Internal Revenue Code of 1954 (as added by subsection (a)) for its annual accounting periods beginning after December 31, 1960.

And the Senate agree to the same.

Amendment numbered 19:

That the House recede from its disagreement to the amendment of the Senate numbered 19, and agree to the same with the following amendments:

On page 8 of the Senate engrossed amendments, strike out lines 5 and 6 and in lieu thereof insert the following:

Sec. 7. (a) Section 6046 of the Internal Revenue Code of 1954 (relating to information returns as to formation or reorganization of foreign corporations) is amended to read as follows:

On page 10 of the Senate engrossed amendments, line 2, strike out the closing quotation marks, and after line 2 insert the following:

"(d) Cross Reference.—

"For provisions relating to penalties for violations of this section, see section 7203."

(b) *The table of sections for subpart B of part III of chapter 61 of the Internal Revenue Code of 1954 is amended by striking out the last item and inserting in lieu thereof the following:*

"*Sec. 6046. Returns as to creation or organization, or reorganization, of foreign corporations.*"

And the Senate agree to the same.

Amendment numbered 20:

That the House recede from its disagreement to the amendment of the Senate numbered 20, and agree to the same with an amendment as follows:

On page 10 of the Senate engrossed amendments, line 4, strike out "amendment" and insert *amendments;* and the Senate agree to the same.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
N. M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.
H. F. BYRD,
ROBERT KERR,
By H. F. BYRD,
CLINTON P. ANDERSON,
JOHN WILLIAMS,
FRANK CARLSON,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 10087) to amend the Internal Revenue Code of 1954 to permit taxpayers to elect an overall limitation on the foreign tax credit, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendments Nos. 1, 2, 3, and 4: Under present law (subpt. A of pt. III of subch. N. of ch. 1 of the Internal Revenue Code of 1954) income taxes paid to a foreign country or a possession of the United States may be taken as a credit against income taxes otherwise due the United States. However, under section 904 of such code, the taxes of each foreign country which may be taken as a credit are limited to the same proportion of the U.S. income tax (before the credit) which the taxable income from that foreign country is of the taxpayer's total taxable income. This is known as the "per-country" limitation.

The bill as passed by both the House and the Senate provides an alternative limitation, to be applied at the election of the taxpayer. This alternative limitation, known as the "overall limitation," applies to the amount of taxes paid to all foreign countries taken together, and allows as a credit against the U.S. income tax the same proportion of the U.S. tax (before the credit) which the taxable income from sources without the United States is of the total taxable income.

Under the bill as passed by the House, taxpayers could make their initial shift from the per-country limitation to the overall limitation at any time. Once under the overall limitation they could of their own volition shift back to the per-country limitation after an interval of 5 years (or after a shorter period if they had the permission of the Treasury Department). After having shifted back to the per-country limitation they could of their own volition again return to the overall limitation after a 5-year interval (or lesser time with the consent of the Treasury Department). Senate amendments Nos. 1, 2, 3, and 4 provide that taxpayers may at their own volition elect to make an initial shift from the per-country to the overall limitation at any time, but thereafter they can change from the overall limitation of the per-country limitation or vice versa, only with the consent of the Treasury Department.

The House recedes.

Amendments Nos. 5 and 6: These are clerical amendments.

The House recedes.

Amendments Nos. 7 and 8: Under the bill as it passed the House, the amount of income taxes paid to foreign countries which was in excess of the amount

which could be credited against the U.S. income tax for the current year could be carried back or forward from a year in which the per-country limitation was used to a year in which either the per-country limitation or the overall limitation was used, but could not be carried from an overall limitation year to a per-country limitation year. Under Senate amendments Nos. 7 and 8, such excess cannot be carried either from a per-country limitation year to an overall limitation year, or from an overall limitation year to a per-country limitation year (but may, as under the bill as passed by the House, be carried from one per-country limitation year to another per-country limitation year, or from one overall limitation year to another overall limitation year).

The House recedes.

Amendment No. 9: This is a technical amendment. The House recedes.

Amendment No. 10: Senate amendment No. 10 adds a new subsection (d) to section 1503 of the Internal Revenue Code of 1954, relating to computation and payment of tax in case of consolidated returns. This new subsection provides that in the case of a consolidated return by an affiliated group of corporations which includes one or more Western Hemisphere trade corporations in a year in which the new overall limitation applies, the amount of taxes paid to foreign countries or United States possessions with respect to the income of Western Hemisphere trade corporations (which are taxed at a 38 percent rate instead of the regular corporate 52 percent rate) in excess of a 38 percent rate, but not in excess of a 52 percent rate, should not be taken into account in computing the foreign tax credit of the affiliated group. The bill as passed the House contained no comparable provision.

The House recedes with an amendment. The conference agreement retains the substance of the Senate amendment as a general rule which appears in paragraph (1) of the new subsection (d). As under the Senate amendment, the rule provided in this paragraph denies, where the overall limitation is used, the right to credit certain foreign taxes [29] paid by the Western Hemisphere trade corporations against the U.S. taxes on income attributable to corporations in the same affiliated group which are not Western Hemisphere trade corporations. The taxes which may not be credited are those in excess of what the U.S. taxes are for these Western Hemisphere trade corporations (generally resulting in an effective tax rate slightly under 38 percent), but only to the extent these foreign taxes do not exceed the U.S. taxes which would be imposed on these corporations if they were not Western Hemisphere trade corporations (generally resulting in an effective tax rate slightly under 52 percent).[30] Thus if all the Western Hemisphere trade corporations in a consolidated group in the aggregate pay foreign taxes which, in terms of U.S. methods of computing income, result in a tax at the effective rate of, say, 32 percent then paragraph (1) would not come into operation. However, if the effective rate of the tax exceeds 38 percent,[31] then paragraph (1) denies the use of such excess foreign taxes as credits against the U.S. taxes on other foreign income in the consolidated group. However, once this effective rate reaches 52 percent,[32] to the extent of any taxes over this effective rate, the taxes are eligible for crediting. The omission in this paragraph of any reference to the computation of the U.S. taxes involved as being before allowance of the foreign tax credit does not have any substantive effect but merely conforms with the general references in the code to income taxes as those before the allowance of credits.

Under the conference agreement, the reduction in the taxes of Western Hemisphere trade corporations which may be credited in the case of taxes on other income, i.e., the general rule provided by paragraph (1), may itself be reduced where the Western Hemisphere trade corporations are also regulated public utilities. An adjustment is provided for in a new paragraph (2) of the subsection (d). This paragraph (2) makes the reduction provided by paragraph (1) inapplicable in the case of excess foreign taxes of Western Hemisphere trade corporations which are also public utilities (the excess referred to is the taxes which, under par. (1) of the new subsec. (d), may not be credited against U.S. taxes on the income of corporations other than Western Hemisphere trade corporations) but only to the extent of the excess of U.S. taxes over the foreign taxes paid by corporations in the same affiliated group which are other

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[29] All references to foreign taxes are intended to also include taxes of U.S. possessions.
[30] This is determined without regard to the additional 2 percent tax on consolidated returns.
[31] This is an approximation since it does not take into account the surtax exemption.
[32] This is an approximation since it does not take into account the surtax exemption.

than Western Hemisphere trade corporations, with respect to income derived from these same foreign countries.

The adjustment provided by paragraph (2) is to be available only when the corporations involved, which are not Western Hemisphere trade corporations, receive 80 percent or more of the gross income (from the foreign countries specified in the conference agreement) from regulated public utilities and from their own operations (where they are regulated public utilities). Income *from* regulated public utilities for this purpose is intended to include dividend and interest income received from regulated public utilities as well as commissions, fees, etc., received from such utilities as payments for the rendition of technical and management services. Capital gains and losses are not taken into account for the purposes of this computation. Moreover, it is not intended, in the computation of gross income for this purpose, that any amount be taken into account more than once.

A new paragraph (3) in subsection (d) specifies in subparagraph (A) that the regulated public utility referred to is one which is described in section 1503(c)(1)(A) (other than clauses (ii) and (iii) thereof) or (D). Thus, it must be a corporation engaged in the furnishing or sale of electric energy, gas, water, or sewerage disposal services or telephone or telegraph services and 80 percent or more of its income must be derived from some combination of these sources. The rates must be established or approved by the agencies specified in the law or the requirements of the last sentence of section 1503(c)(2) (relating to treatment of unregulated rates) must be satisfied.

Subparagraph (B) of paragraph (3) provides that the foreign countries referred to in paragraph (2) are those from which the public utility referred to in the first sentence of paragraph (2) derives the principal part of its income. Where more than two countries are involved, this means the country from which the utility derives more income than it derives from any other country.

Subparagraph (C) of paragraph (3) provides that, for purposes of the computation of U.S. tax required by paragraph (1)(A), the 2 percent additional tax provided by section 1503(a) is to be omitted.

The adjustment provided in paragraph (2) can be illustrated by the following example: Assume that four Western Hemisphere trade corporations, which are regulated public utilities, operate in four different Latin American countries and have an aggregate consolidated taxable income of $100,000 on which they paid foreign taxes of $45,000. The U.S. tax in such a case (ignoring the surtax exemption) would be $38,000. Assuming the overall limitation is used, only $38,000 of the $45,000 could be claimed as a foreign tax credit as the result of the application of subsection (d)(1). However, assume also that the other two corporations in the same consolidated group (which are not Western Hemisphere trade corporations and which meet the 80 percent gross income test of the new sec. 1503(d)(2)) receive $50,000 of consolidated taxable income from the same four countries on which they pay taxes to those countries of $22,000. The U.S. tax in this case (again ignoring the surtax exemption but including the additional 2 percent tax on certain consolidated income) would be $27,000. Paragraph (2) provides in such a case that $7,000 of excess foreign taxes paid by the four Western Hemisphere trade corporations ($45,000 less $38,000) is available to be claimed as a credit to the extent the U.S. taxes on the other income in the consolidated group from the same foreign countries ($27,000) exceeds the taxes paid these foreign countries with respect to this income ($22,000). Thus $5,000 of $7,000 in this case could be claimed as a credit.

Amendments Nos. 11, 12, 13, 14, 15, and 16: These are clerical amendments. The House recedes.

Amendment No. 17: Senate amendment No. 17 added a new section to the bill as it passed the House. Under this new section, any amount received after 1949 and before the enactment of the bill from a corporation (1) formed exclusively for the purpose of, and engaged exclusively in, operating without profit a scientific laboratory for the Atomic Energy Commission, and (2) operated solely on funds appropriated to the Commission, by an individual as reimbursement for moving himself and his immediate family, his household goods, and his personal effects to a new place of residence in order to accept employment with such corporation, is to be treated (for Federal income tax purposes) as an amount not includible in gross income to the extent such amount did not exceed the expenses actually paid or incurred for such purposes. This provision was to apply unless the individual was advised at the time of his employment by an authorized officer, employee, or agent of the corporation that the amount of reimbursement would be includible in gross income. In any case in which a re-

fund or credit of an overpayment resulting from the application of this provision is prevented by the operation of any law or rule of law (other than ch. 74 of the Internal Revenue Code of 1954, relating to closing agreements and compromises, and the corresponding provisions of prior law), such refund or credit may be made or allowed if claim is filed within six months from the enactment of the bill, but no interest is payable or allowable on any refund or credit payable by reason of the application of this waiver.

The House recedes with amendments. Under the conference agreement, the new section added by the Senate amendment No. 17 is retained but applies only to amounts received before October 1, 1955 (rather than before the date of the enactment of the bill). In addition, this provision applies only to cases where the individual involved was advised (either expressly or by clear implication) at the time of his employment by an authorized official of the corporation that the amount of the reimbursement would not be includible in gross income.

It is the understanding of the conferees that prior to about September 1, 1955, the officials of a corporation engaged exclusively in operating without profit a scientific laboratory for the Atomic Energy Commission had assumed that such expense reimbursement was not taxable income. It is further understood that professional and skilled employees who were hired by the corporation before that date were either expressly told or given the clear impression that their reimbursed traveling or moving expenses were not taxable income to them. For example, the conferees have been advised that in many cases new employees were told all of their expenses of moving would be paid by the corporation, with no mention made as to the taxable nature of such reimbursed expenses. Under such circumstances it is the view of the conferees that prior to September 1955, corporate officials of the corporation were, in effect, advising newly hired employees that they would not be taxable with respect to such expense reimbursement.

Amendment No. 18: Senate amendment No. 18 adds a new section to the bill as it passed the House redesignating section 6038 of the Internal Revenue Code of 1954 as section 6039 and inserting a new section 6038. Under the Senate amendment, the new section 6038 provides that, if a domestic corporation controls any foreign corporation, it must furnish such information with respect to such foreign corporation (and with respect to any foreign subsidiary of such foreign corporation) as the Secretary of the Treasury or his delegate prescribes by forms and regulation as necessary to carry out the provisions of the income tax laws. If such information is not furnished at the time required by the Secretary or his delegate, no credit is allowable to any person under section 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) for taxes paid by such foreign corporation or its subsidiaries for their taxable years for which the domestic corporation failed to furnish information.

The House recedes with an amendment substantially revising the new section 6038. Under the conference agreement section 6038 specifies the information required to be furnished by the domestic corporation, concerning any foreign corporation it controls and any of such foreign corporation's subsidiaries, as such information as the Secretary or his delegate prescribes by regulations relating to specific listed items. In general, these include corporation name; country of incorporation; nature and place of business; profits, deductions, foreign taxes, and any other items taken into account to determine accumulated profits; a balance sheet showing assets, liabilities, and capital; transactions with certain related persons; and certain shareholders who are citizens or residents of the United States or who are domestic corporations.

Such information must be furnished as to the foreign corporation for its annual accounting period ending with or within the domestic corporation's taxable year and as to the subsidiary for its annual accounting period ending with or within the foreign corporation's annual accounting period. The information must be furnished at such time and in such manner as the Secretary or his delegate prescribes by regulations, but only such information shall be required for any annual accounting period as is required to be furnished under regulations in effect on the first day of the period.

Subsection (b) provides that, if the domestic corporation fails, by the time prescribed by regulations for a taxable year, to furnish any information concerning any one or more of the foreign corporations or subsidiaries, then in applying section 902 (relating to foreign tax credit for corporate shareholder in foreign corporation) to such domestic corporation (or to any person who acquires

from any person any portion of the interest of such domestic corporation in any such foreign corporation or subsidiary, but only to the extent of such portion) for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation and subsidiary during the accounting period or periods for which the domestic corporation was required to furnish information for the taxable year of the failure shall be reduced by 10 percent. If the failure continues 90 days or more after notice by the Secretary of his delegate, the reduction is 10 percent plus 5 percent for each 3 month period or part thereof during which the failure continues after the 90-day period. No taxes, however, shall be reduced more than once for the same failure. For purposes of the new section 6038(b), the time to furnish information, and the beginning of the 90-day period is treated as delayed, however, until the last day (as shown to the satisfaction of the Secretary or his delegate) that reasonable cause exists for the failure.

Under subsection (c) the domestic corporation is deemed to control a foreign corporation 50 percent of whose voting stock it owns, and the foreign corporation is deemed to have as a subsidiary another foreign corporation 50 percent of whose voting stock it owns.

Subsection (d), adapting the definition contained in section 441 of the Internal Revenue Code of 1954, defines "annual accounting period" of a foreign corporation or its foreign subsidiary as the annual period on the basis of which such corporation keeps its books. The term may refer to an accounting period of less than 1 year, however, where for example the foreign income, war profits, and excess profits taxes are determined on the basis of an accounting period of less than 1 year as described in section 902(c)(2).

The new section 6038 applies to taxable years of a domestic corporation beginning after December 31, 1960, with respect to information as to a foreign corporation or foreign subsidiary for annual accounting periods beginning after December 31, 1960.

Amendment Nos. 19 and 20: Senate amendment No. 19 adds a new section to the bill as it passed the House. The amendment would modify section 6046 of the Internal Revenue Code of 1954. Present section 6046 requires every attorney, accountant, fiduciary, bank, trust company, financial institution, or other person, who advises as to the formation or reorganization of a foreign corporation, to file a return in accordance with regulations prescribed by the Secretary of the Treasury or his delegate. The regulations under this section provide that an attorney need not furnish any information which he has obtained by virtue of the attorney-client relationship. As a result, existing section 6046 has had little practical effect. Attorneys are not free to furnish information which is the subject of privileged communications, and in most cases those not entitled to invoke the privilege contend that they have merely given general advice or performed clerical services and therefore possess no substantive information.

In order to obtain more comprehensive information concerning a greater number of foreign corporate organizations and reorganizations than is available under the present section 6046, the section is amended to require returns relating to the creation, organization, or reorganization of foreign corporations to be made by every citizen or resident of the United States who was an officer or director of the corporation at any time within 60 days after its creation, organization, or reorganization, and by every U.S. shareholder of the corporation owning at least 5 percent of its outstanding stock at any time within such 60 days. This amendment eliminates from the section the problem resulting from privileged communications and places the responsibility for making returns on those persons who are most likely to have within their possession the information desired.

Senate amendment No. 20 adds a new section to the bill providing that the amendment to section 6046 is to apply only with respect to foreign corporations created or organized, or reorganized, after the date of the enactment of the bill.

Under the conference agreement, the House recedes on Senate amendments Nos. 19 and 20 with technical amendments.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
N. M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.

[H.R. 12536] [33]

EXCLUSION OF LOCAL ADVERTISING CHARGES FROM MANUFACTURERS SALES PRICE

[House of Representatives Report No. 2103, Eighty-sixth Congress, Second Session]

[August 15, 1960]

MR. MILLS, from the Committee on Ways and Means, submitted the following report to accompany H.R. 12536.

The Committee on Ways and Means, to whom was referred the bill (H.R. 12536) relating to the treatment of charges for local advertising for purposes of determining the manufacturers sale price, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

This bill provides that where a manufacturer (or producer or importer) of articles subject to manufacturers' excise tax makes a separate charge for local advertising of the article, or reimburses the retailer (or other distributor) for part or all of his expenses for local advertising of the articles (subject to certain limitations) this charge is to be excluded from the manufacturers' sales price, or this price is to be readjusted for this charge. Excluding this amount from the sales price, or readjusting this price for this amount, reduces the manufacturers' excise taxes which are payable since this price is the base for these taxes. The price exclusion, or readjustment, is limited to radio, television, and newspaper advertising and to not more than 5 percent of the sales price (excluding local advertising charges). This amendment is to apply with respect to articles sold on or after the first day of the first calendar quarter beginning more than 20 days after the date of enactment of this bill.

The Treasury Department has indicated that it does not object to the enactment of this bill and the bill has been reported unanimously by your committee.

II. GENERAL STATEMENT

This bill is concerned with the manner of determining the manufacturers' (or producers' or importers') sales price, which is the base on which various manufacturers' tax rates are applied. The problem is concerned with the treatment of certain local advertising expenses incurred by the retailer (or other distributor) of the taxed article where reimbursement is to be provided by the manufacturer (or producer or importer) for part or all of these expenses.

In 1932 the Internal Revenue Service ruled that specific additional charges billed by a manufacturer to a distributor for advertising were to be excluded from the sales price for purposes of the manufacturers' excise tax if it could be established that the value of the advertising equals or exceeds the amount collected from a customer. In addition, this had to be shown separately on the invoices in order to be excluded in computing the tax and was limited to local advertising.[34] From 1932 to 1956 the Internal Revenue Service also issued numerous private rulings permitting readjustments of sales price for local advertising expenses incurred by the retailer (or other distributor).

Then in 1956 the Forand Subcommittee on Excise Tax Technical and Administrative Problems, in one of its reports to the House Committee on Ways and Means, indicated that it had been informed that the Internal Revenue Service was planning to issue a ruling with respect to cooperative advertising providing that, where a manufacturer makes a separate charge to his distributor for advertising and the proceeds are kept in a separate account earmarked for advertising, the separate advertising charge is not to be considered a part of the tax base. It was further stated that the separation of the advertising charge (and, therefore, its exclusion from the tax base) could be supported by establishing that the charge was either listed separately on the sales invoice or billed separately; the contributions from the distributor were set aside in a fund to be used for advertising for the benefit of the contributors; and the funds were so

[33] Public Law 86-781, page 726, this Bulletin.
[34] S.T. 523, C.B. XI-2, 477. See also, S.T. 430, C.B. II-2, 300 (1923).

used, or the unexpended portion was held in trust or refunded to the contributor upon his withdrawal from the program.[35] In addition, the Internal Revenue Service had indicated that, although direct contributions by manufacturers to an advertising account were not to be deductible in computing the taxable sales price, subsequent allowances, against these contributions, to distributors for advertising expenditures by them were to be treated as adjustments in sales price.

The Commissioner of Internal Revenue in December of 1956 indicated, however, that the Service did not feel it was in a position to go forward with the publication of the ruling previously discussed.[36] Subsequently in 1958, the Treasury Department in a regulation denied taxpayers an exclusion from, or readjustment of, the sales price for advertising charges or expenditures.[37]

A number of taxpayers who had entered into cooperative advertising arrangements with their distributors instead of securing specific rulings applying to their own cases had relied upon information generally available to the effect that these cooperative advertising charges were excludible from the base on which the manufacturers' excise tax rates were applied, or that price adjustments attributable to such charges would result in refunds of tax.

A recent court case on this problem, *General Motors Corp.* v. *United States*, was decided by the Court of Claims on May 4, 1960 (No. 236–56). The court held in this case that the taxpayer properly could readjust its sales price for articles sold to the extent of the amount it paid dealers of its products for the cost of many different types of local advertising under a cooperative advertising plan.

Your committee concluded that due to the confusion as to the status of advertising charges, in determining manufacturers' sales prices, there was need for statutory clarification, as well as some limitations as to the extent to which such exclusions or adjustments should be allowed. Your committee concluded that it is appropriate to exclude from the manufacturers' sales price a reasonable amount of local advertising where the advertising is under the control of the distributor. Such advertising appears to be an expense traditionally incurred by the distributor rather than by the manufacturer and, therefore, more appropriately reflected in the retail distributor's price rather than in the manufacturer's price. This, of course, distinguishes such advertising charges from national advertising which customarily is a part of the manufacturers' own costs. Excluding such reasonable local advertising charges from the base of the various manufacturers' excise taxes in your committee's view also is desirable in that it provides greater uniformity in the application of manufacturers' excise taxes.

III. GENERAL EXPLANATION OF BILL

The bill provides that there is to be excluded from the sales price, for purposes of computing various manufacturers' excise taxes (sec. 4216), any charge for local advertising where certain conditions are met.

First, the charge may be excluded only to the extent it is not in excess of 5 percent of the manufacturers' price for the article (determined by excluding any local advertising charge). Second, a separate charge must be made for the advertising at the time the article is sold, and, third, it must be intended that the advertising charge be refunded to the purchaser from the manufacturer (or any subsequent purchaser) in reimbursement for local advertising. Unless the reimbursement occurs before May 1 of the next year the charge previously excluded is to be subject to tax. In addition, the excludable local advertising charge is limited to radio, television, or newspaper advertising, and to advertising which states the name of the article and the retail sales location at which the article involved may be purchased. No other charges for advertising are to serve as the basis for an exclusion from, or readjustment of, the sales price of an article. Also, the advertising must be initiated, or obtained, by the

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[35] Subcommittee on Excise Tax Technical and Administrative Problems, report to the House Committee on Ways and Means, 84th Cong., 2d sess., Apr. 20, 1956, pp. 22–23. A Treasury Department representative previously had made a similar statement in hearings before the subcommittee in January of 1956; see hearings before a subcommittee on the Committee on Ways and Means, U.S. House of Representatives, "Excise Tax Technical and Administrative Problems," 84th Cong., 2d sess., pt. II, pp. 15 and 57–59.

[36] Hearings before a subcommittee of the Committee on Ways and Means, U.S. House of Representatives, "Excise Taxes," 84th Cong., 2d sess., November and December 1956, pp. 922–923.

[37] T.D. 6340 [C.B. 1959–1, 694], 23 F.R. 9692–9693. The proposed regulation was issued on Mar. 22, 1958, and the final regulation on Dec. 16, 1958.

immediate purchaser of the article (or any subsequent purchaser) rather than by the manufacturer, producer, or importer.

The bill also amends the code (sec. 6416(b)) to provide that taxes paid with respect to charges for local advertising (as above defined) are to constitute overpayments and where the applicable conditions are met that credit or refund of tax attributable to these charges is to be available.

The 5-percent ceiling in the case of local advertising is computed at the end of each calendar quarter on a cumulative basis. However, any advertising charges which may not be deducted in the calendar quarter or quarters which have elapsed to date may be carried over to a subsequent calendar quarter in the same year and, to the extent such charges, together with any similar charges attributable to this subsequent calendar quarter, do not exceed the 5-percent limitation for such quarter, they may be deducted at that time. This 5-percent ceiling takes into account not only amounts initially excluded from the sales price but also readjustments in the sales price (under sec. 6416(b)) as well.

The exclusions, or readjustments, in price with respect to local advertising allowed by this bill are, from the effective date of the bill, to be the only exclusions or readjustments for advertising allowed in computing the price of articles subject to excise tax.

The amendments made by this bill are to apply with respect to articles sold on or after the first day of the first calendar quarter beginning more than 20 days after the date of enactment of this bill.

IV. TECHNICAL EXPLANATION OF BILL

The first section of the bill amends section 4216 of the Internal Revenue Code of 1954 by adding a new subsection (f). Section 4216 defines sale price for purposes of those manufacturers excise taxes which are based on sale price. Paragraph (1) of the new subsection (f) provides an exclusion from the sale price of any article for certain charges made by the manufacturer for "local advertising," as defined in paragraph (4) of the new subsection (f). "Local advertising," as so defined, means advertising which—

(1) Is initiated or obtained by the person who made a direct purchase from the manufacturer of the article in respect of which the charge was made, or any other person in the chain of distribution of the article.

(2) Names the article so purchased and states the location at which it may be purchased at retail. The location need not be stated specifically in terms of street address and number, provided it is described sufficiently to enable consumers to identify the particular place at which they may purchase the article.

(3) Is broadcast over a radio station or a television station, or appears in a newspaper.

The exclusion from sale price of a taxable article, as provided in paragraph (1) of the new subsection (f) of section 4216 of the code, will apply to the extent that—

(1) The charge for local advertising of the article is separately stated when the article is sold.

(2) The charge does not exceed an amount computed by applying 5 percent against the sale price of the article, as determined under section 4216 exclusive of any charge for local advertising, whatever the amount of such charge may be. Any excess of such charge over the amount so computed will not qualify for the exclusion.

(3) The charge is intended to be refunded by the manufacturer to the person who purchased the article from him, or to any subsequent purchaser in the chain of distribution, in reimbursement of costs incurred for local advertising.

To the extent that a charge for local advertising meets all of these conditions, the charge is not includible in the taxable sale price of the article in respect of which the charge was made. However, the exclusion from sale price will cease to apply in respect of any part of such charge which the manufacturer, producer, or importer fails to refund, before May 1 of the year following the calendar year in which the article was sold, to the person who purchased the article from him or to any subsequent purchaser in the chain of distribution. If, on such May 1, any part of the charge has not been so refunded, the manufacturer, producer, or importer becomes liable for the tax at that time in respect of such part.

The exclusion provided in paragraph (1) of the new subsection (f) in respect of charges for local advertising, and the credits or refunds which may be claimed under section 6416(b)(1) of the code as amended by section 2 of the bill, in respect of certain payments by the manufacturer, producer, or importer for local advertising, are subject to an overall limitation as provided in paragraph (2) of the new subsection (f). The limitation is to be applied as of the close of each calendar quarter in relation to all articles taxable under a particular section of the code. For example, a manufacturer selling articles taxable under section 4061 of the code (relating to motor vehicles) and also selling articles taxable under section 4111 of the code (relating to refrigeration equipment) who makes local advertising charges or expenditures in respect of any one or more articles in each of the groups must apply the limitation separately in relation to the articles taxable under section 4061 and in relation to the articles taxable under section 4111. However, in such case, no breakdown of the separate articles taxable under section 4061 or section 4111 is required.

The limitation in relation to articles taxable under a particular section of the code is determined by applying 5 percent against the total of the taxable sale prices (determined under sec. 4216 exclusive of all charges for local advertising) of such articles sold in the calendar quarter. This limitation should be compared with the total of the price exclusions for local advertising taken by the manufacturer, producer, or importer in such quarter in respect of such articles. To the extent that the limitation exceeds the total of such price exclusions, credit or refund may be claimed by the manufacturer, producer, or importer in respect of tax paid on amounts (previously included in taxable sale price of such articles) which are paid by him in the calendar quarter, to persons who purchased such articles directly from him, in respect of costs for local advertising. If such quarter is not the first calendar quarter in the calendar year in respect of which price exclusions may be taken or credit or refund may be claimed in respect of local advertising of the articles, the maximum amount of the credit or refund allowable in respect of such advertising should be computed by taking into account the price exclusions attributable to such articles sold in the earlier quarter or quarters of the calendar year and the total sale prices (determined as previously indicated) of such articles sold in such earlier quarter or quarters. In such case, however, the maximum amount of the credit or refund so computed must be reduced by the amount of any credit or refund previously claimed by the manufacturer, producer, or importer in respect of amounts (included in taxable sale price) paid to his purchaser in such year for local advertising of such articles. The sale prices of articles sold tax free by the manufacturer may not, in any event, be included in the computation. However, no adjustment of such sale prices is required, for purposes of the computation, in respect of credits or refunds attributable to articles sold by a distributor, dealer, etc., for an exempt purpose, or in respect of price readjustments for quantity buying, prompt payment, etc.

The operation of this ceiling may be illustrated as follows: Assume that a manufacturer during the first calendar quarter of 1961 sold refrigerators at a total price of $105,000, of which $5,000 was a separate charge for local advertising as defined in the bill and that this $5,000 was subsequently paid to the vendees as reimbursement for their local advertising charges. Subsequently, during the same quarter, assume that the manufacturer refunded an additional $10,000 to the vendees for additional local advertising as defined in the bill. Under the new section 4216(f)(1) of the Code, added by the bill, the manufacturer's excise tax base is reduced by $5,000 (5 percent of the aggregate price of the refrigerators, exclusive of the separate charge for local advertising). Since this reduction amounts to 5 percent of the price (determined by excluding all charges for local advertising) at which the refrigerators were sold, no credit or refund in tax can be made at the close of the first quarter of 1961 with respect to the additional $10,000. Assume that the same manufacturer in the second quarter of 1961 also sold refrigerators the total price of which was $52,500 of which $2,500 of this price was a separate charge for local advertising as defined in the bill. For this second calendar quarter the manufacturer would reduce his tax base by $2,500. If in the third calendar quarter the manufacturer sold no refrigerators, then for this third quarter he would be entitled to no credit for local advertising expenses even though there remained an excess of local advertising expenses from the first calendar quarter of 1961. In the fourth calendar quarter of 1961 assume this manufacturer sold refrigerators the total price of which was $200,000, no part of which was a separate charge for local advertising. The operation of

the 5-percent ceiling of the new section 4216(f)(2) of the Code would entitle him in this fourth quarter to a readjustment in the manufacturers' sale price in the amount of $10,000 for the local advertising payments made to his vendees in the first quarter of 1961 which in that quarter exceeded the 5-percent ceiling.

If this manufacturer by April 30, 1962, had reimbursed his vendees for local advertising only for $1,500 of the $2,500 excluded from price during the second quarter of 1961, then this manufacturer would become liable on May 1, 1962, for a tax of 5 percent (the tax on the sale by the manufacturer, etc., of refrigerators under sec. 4111) on the $1,000 not reimbursed to his vendees, as though a sale in that amount had been made on May 1, 1962.

Paragraph (3) of the new subsection (f) of section 4216 of the code provides that no charge or expenditure for advertising shall serve as the basis for an exclusion from sale price under section 4216, or as a readjustment of sale price under section 6416(b)(1), except to the extent provided in paragraphs (1) and (2) of the new subsection (f).

Section 2 of the bill amends section 6416(b)(1) of the code to specify that tax-paid amounts which are paid by a manufacturer, producer, or importer, to a person who has purchased the article directly from him in respect of costs for local advertising are readjustments of sales price under such section. However, any such readjustment is subject to the limitations provided in paragraphs (2) and (3) of the new subsection (f) of section 4216 of the code.

Section 3 of the bill provides that the amendments made by the bill shall apply with respect to articles sold on or after the first day of the first calendar quarter beginning more than 20 days after the date of enactment of the bill.

[H.R. 12536][38]

EXCLUSION OF LOCAL ADVERTISING CHARGES FROM MANUFACTURERS SALES PRICE

[Conference Report No. 2213, Eighty-sixth Congress, Second Session]

[August 30, 1960]

MR. MILLS, from the committee of conference, submitted the following conference report to accompany H.R. 12536.

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12536) relating to the treatment of charges for local advertising for purposes of determining the manufacturers sale price, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendments of the Senate numbered 1 and 3 agree to the same.

Amendment numbered 2:

That the House recede from its diasagreement to the amendment of the Senate numbered 2, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 5. (*a*) *The Iron Workers' Mid-American Pension Fund, which was established by an indenture executed on January 30, 1957, as a result of an agreement between various locals affiliated with the International Association of Bridge, Structural, and Ornamental Iron Workers and three employer associations, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, for years ending on or after December 17, 1958, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning on January 30, 1957, and ending on December 16, 1958, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.*

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[38] Public Law 86–781, page 726, this Bulletin.

(b) The Pattern Makers' Pension Trust Fund of Chicago, which was established by an agreement and declaration executed on April 28, 1958, between the Pattern Makers' League of North America, Chicago Association, and the Pattern Manufacturers' Association of Chicago and Vicinity, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, for years ending on or after February 25, 1959, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such action 501(a), for the period beginning on April 28, 1958, and ending on February 24, 1959, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(c) The Pipe and Refrigeration Fitters Local 537 Pension Fund of Boston, Massachusetts, which was created on September 1, 1955, as a result of an agreement between Local 537 of the United Association of Pipe Fitters and Refrigeration Fitters and the Heating, Piping, and Air Conditioning Contractors, Boston Association (now known as Mechanical Contractors Association of Boston), and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, for years ending on or after November 10, 1959, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning on March 1, 1956, and ending on November 9, 1959, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(d) The Annuity Plan of the Electrical Switchboard and Panelboard Manufacturing Industry of New York City, which was created May 16, 1956, as a result of an agreement between Local Union Numbered 3, International Brotherhood of Electrical Workers, American Federation of Labor and Congress of Industrial Organizations, and the Electrical Manufacturers of New York, Incorporated, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a), for the period beginning May 16, 1956, and ending May 22, 1957, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(e) The District Council No. 19 Welfare Fund, now known as Painters District Council No. 19 Welfare and Pension Fund, which was first created as of May 1, 1947, as a result of an agreement between Painters District Council No. 19, Brotherhood of Painters, Decorators and Paperhangers of America, of the State of New Jersey and painting contractors signatory to the union agreement, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a) and under section 165(a) of the Internal Revenue Code of 1939, for the period beginning January 1, 1954, and ending August 6, 1956, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

(f) The Local Union Numbered 377 Pension Fund, which was created October 13, 1952, as a result of an agreement between Local Union Numbered 377, Brotherhood of Painters, Decorators and Paperhangers of America, of the State of New Jersey and Painting and Decorating Contractors of America, Hudson County Employers Chapter, and which has been held by the Internal Revenue Service to constitute a qualified trust under section 401(a) of the Internal Revenue Code of 1954, and to be exempt from taxation under section 501(a) of such Code, shall be held and considered to have been a qualified trust under such section 401(a), and to have been exempt from taxation under such section 501(a) and under section 165(a) of the Internal Revenue Code of 1939, for the period beginning October 13, 1952, and ending April 1, 1958, but only if it is shown to the satisfaction

of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

And the Senate agree to the same.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
NOAH M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.
HARRY F. BYRD,
ROBT. S. KERR,
J. ALLEN FREAR, Jr.,
RUSSELL B. LONG,
By HARRY F. BYRD,
JOHN J. WILLIAMS,
FRANK CARLSON,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 12536) relating to the treatment of charges for local advertising for purposes of determining the manufacturers sale price, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

ELECTION AS TO BASE FOR DETERMINING PERCENTAGE DEPLETION DEDUCTION IN THE CASE OF MINERALS USED IN MAKING CEMENT

Amendment No. 1: To determine the percentage depletion allowance under present law, it is necessary to multiply the percentage rate applicable to the particular mineral by the value of the mineral at the point at which the mining process ends. This point is referred to as the "cutoff point." In the case of many mineral industries, this cutoff point has been the subject of uncertainty and litigation. Included in this group is the cement industry.

In order to resolve the cutoff question for 1961 and future years, Congress in the Public Debt and Tax Rate Extension Act of 1960 [P.L. 86–564, page 681, this Bulletin] modified section 613(c) of the Internal Revenue Code of 1954. As amended, this statutory provision established specific cutoff points for numerous minerals, including those used in the manufacture of cement. This cutoff point for cement-producing minerals (except for preheating of the kiln feed) occurs just prior to the introduction of the kiln feed into the kiln. This cutoff point is derived from a ruling published by the Treasury Department in 1953.

Although the recent legislation determines the cutoff point for the cement industry for future years, it does not settle this question for any open years prior to 1961. Senate amendment No. 1 permits taxpayers mining minerals used in making cement to elect to apply, for the years prior to 1961, the cutoff provisions adopted in the Public Debt and Tax Rate Extension Act of 1960. If a taxpayer fails to make the election, the cutoff point in his case for these years would be determined under existing law.

Under the amendment, if the taxpayer makes the election, it will apply to all of his mineral properties used in making cement and, in general, to all of his taxable years beginning before 1961 which are open on the date of the enactment of the bill. However, the making of the election resolves only the point at which the cutoff occurs and does not deal with any other matters which may be in issue, such as the method of computing the gross income at that point. The election must be made by the taxpayer on or before the date which is 60 days after the date of the publication of final regulations on this provision. Once made, the election is irrevocable.

The House recedes.

INCOME TAX EXEMPTION AND DEDUCTIONS FOR CERTAIN PENSION PLANS

Amendment No. 2: Under present law, a pension trust is qualified for income tax exemption only if it meets certain requirements relating to coverage of

employees and nondiscrimination of contributions or benefits. Where the pension trust is properly qualified, not only is it exempt from Federal taxation with respect to its income, but contributions paid to it by an employer on behalf of his employees are deductible for Federal income tax purposes. Senate amendment No. 2 provides that certain pension trusts shall be deemed to constitute qualified trusts, and to be exempt from tax, under the Federal income tax laws for the period of time specified in the amendment with respect to each such trust. The trusts are as follows:

(1) The Iron Workers' Mid-America Pension Fund.

(2) The Pattern Makers' Pension Trust Fund of Chicago.

(3) The Pipe and Refrigeration Fitters Local 537 Pension Fund of Boston, Mass.

(4) The Annuity Plan of the Electrical Switchboard and Panelboard Manufacturing Industry of New York City.

(5) The District Council No. 19 Welfare Fund, now known as Painters District Council No. 19 Welfare and Pension Fund.

(6) The Local Union No. 377 Pension Fund.

Under the conference agreement, the House recedes with an amendment under which each trust specified in the Senate amendment is to be deemed to constitute a qualified trust (and be exempt from tax) for the period specified in the Senate amendment, but only if it is shown to the satisfaction of the Secretary of the Treasury or his delegate that the trust has not in this period been operated in a manner which would jeopardize the interests of its beneficiaries.

LIMITATION ON ACCELERATION OF ACCRUAL OF TAXES

Amendment No. 3: This amendment adds a new subsection (d) to section 461 of the Internal Revenue Code of 1954 (relating to general rule for taxable year of deduction). Paragraph (1) of the new subsection (d) provides the general rule that, in the case of a taxpayer whose taxable income is computed under an accrual method of accounting, to the extent that the time for accruing taxes is earlier than it would be but for any action of any taxing jurisdiction taken after December 31, 1960, then, under regulations prescribed by the Secretary of the Treasury or his delegate, such taxes are to be treated as accruing at the time they would have accrued but for such action by such taxing jurisdiction.

Paragraph (2) of the new subsection (d) provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, paragraph (1) is to be inapplicable to the extent that its application would (but for such par. (2)) prevent all persons (including successors in interest) from ever taking such item into account.

Amendment No. 3 also provides that the new section 461(d) is to apply to taxable years ending after December 31, 1960. In this respect it is to be noted that the rule of law that a tax liability is accruable on a certain date such as the assessment or lien date has developed over a long period of years through court decisions and is a basic concept which the Internal Revenue Service has recognized in numerous rulings. Several States in recent years have changed this accrual date from January 1 to December 31 in order to provide an extra accrual date for State taxes. This amendment, which would be effective for years after 1960 and thus put the States and taxpayers on proper notice, would change the law to provide for only one accrual for State taxes in any one taxable year where the State legislature has changed the accrual date, and would thus eliminate the additional deduction available under existing law. This legislation is prospective so that taxpayers who have acted in good faith in taking such deductions in the past under existing law will be treated uniformly and not be subjected to retroactive action on the part of the Treasury Department.

The House recedes.

W. D. MILLS,
AIME J. FORAND,
CECIL R. KING,
NOAH M. MASON,
JOHN W. BYRNES,
Managers on the Part of the House.

DOUBLE TAX CONVENTIONS [39]

[Senate Executive Report No. 1, Eighty-fifth Congress, Second Session]

[Monday, July 7, 1958]

MR. GREEN, from the Committee on Foreign Relations, submitted the following report [To accompany Ex. N, 85th Cong., 1st sess.; Ex. B, 85th Cong., 2d sess.; and Ex. C, 85th Cong., 2d sess.]

The Committee on Foreign Relations has had under consideration the conventions listed below and recommends that the Senate give its advice and consent to their ratifications:

1. Taxation convention with Pakistan, signed at Washington July 1, 1957 (Ex. N, 85th Cong., 1st sess.), with a reservation.

2. Notification by the Government of Great Britain and Northern Ireland with a view to extending to certain British overseas territories the application of the convention on taxes on income, as modified, signed on April 16, 1945 (notification received August 19, 1957, Ex. C, 85th Cong., 2d sess.), with a reservation.

3. Convention with Belgium supplementing the convention of October 28, 1948, relating to double taxation, signed at Washington August 22, 1957 (Ex. B, 85th Cong., 2d sess.), without a reservation. In connection with this convention, the committee also recommends that the Senate give its advice and consent to acceptance by the United States of a notification given April 2, 1954, by the Belgian Government with a view to extending to the Belgian Congo and the Trust Territory of Ruanda-Urundi the operation of the 1948 convention with Belgium, as modified.

1. MAIN PURPOSE OF THE CONVENTIONS

The taxation convention with Pakistan is designed to avoid double taxation and to prevent fiscal evasion with respect to income taxes. As modified by the committee reservation, it follows the general pattern of other double tax conventions of this type.

The notification by the British Government, when accepted by the United States, will extend the coverage of the 1945 convention to 20 British overseas territories. The committee reservation, which is of a technical nature, deletes a reference to a protocol which would supplement the 1945 convention but which has not been ratified.

The supplementary convention with Belgium makes certain changes which are necessary in the 1948 convention to facilitate the extension of that convention to the Belgian Congo and Ruanda-Urundi. The extension can then be accomplished by United States acceptance (for which the advice and consent of the Senate is necessary) of a notification of such extension given this Government by the Belgian Government in 1954.

2. COMMITTEE ACTION

The convention with Pakistan was signed July 1, 1957, and sent to the Senate July 12. It was the subject of committee hearings July 30 and August 9, 1957. The convention was considered in executive session August 13, after which further information was sought from the Departments of State and the Treasury.

The notification from the United Kingdom and the supplementary convention with Belgium were received by the Senate January 30, 1958. These matters were the subject of hearings before the committee July 1, after which the committee considered them in executive session and voted to report them favorably to the Senate. At the same session, the committee further considered the Pakistan convention and likewise approved it with a reservation.

3. THE CONVENTION WITH PAKISTAN

As noted above, the Pakistan convention, as modified by the committee reservations, follows generally the pattern established by earlier tax conventions which are now in force with Australia, Belgium, Canada, Denmark, Fin-

[39] The conventions with Pakistan, United Kingdom, and Belgium to which this report relates appear on pages 646, 653, and 625.

land, France, Germany, Greece, Honduras, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, South Africa, and the United Kingdom.

The convention eliminates double taxation by granting tax exemption in one country to income which would otherwise be subject to tax in both countries. It is reciprocal in nature, and covers income from businesses, investments, personal services, and pensions and annuities. Remittances or grants to students or trainees are also exempt, as is interest received by the State Bank of Pakistan from sources in the United States or by the Federal Reserve banks of the United States from sources in Pakistan.

The convention also provides for administrative cooperation, including the exchange of information, between the tax authorities of the two countries in order to give effect to its provisions and to prevent tax evasion. All of these provisions have become standard in tax conventions and have been approved by the Senate many times.

Committee consideration of the Pakistan convention hinged around the tax-sparing provisions of article XV (1), and it is to this section that the reservation applies.

The paragraph provides, in effect, that the United States will allow as a foreign tax credit Pakistani taxes which are waived. Under Pakistan law at the time the treaty was negotiated, earnings up to 5 percent on certain types of invested capital were tax exempt for the first 5 years after the investment was made. Without a provision such as that in article XV (1), United States tax laws would have effectively nullified this concession on the part of Pakistan in an effort to attract foreign investment. This would have been so, because the United States tax would have been increased to the extent that the Pakistan tax was reduced.

Tax sparing, as incorporated in article XV(1), is a new principle in United States tax treaties. Its application requires careful consideration on a country-by-country basis. During the period when the Pakistan convention was pending in the committee and before the committee came to any conclusion regarding the tax-sparing article, the Pakistan law providing a waiver of taxes expired. The question of tax sparing in this case, therefore, becomes moot. The committee accordingly recommends a reservation excepting the second sentence of the first paragraph of article XV from the resolution of advice and consent. This is the sentence which provides the United States credit for taxes waived by Pakistan. Because Pakistan has terminated its tax waiver, this provision would be inoperative for the present and future even without a reservation. If approved, it would operate to the retroactive benefit of two United States corporations. The principal argument for tax sparing is that it is a means of encouraging foreign investment and this argument loses validity when made retroactively.

In recommending a reservation to article XV(1), the committee wants to make it perfectly clear that this is without prejudice to future consideration of the matter in the event the Pakistan tax-waiver law is reenacted and the question again comes before the committee. There is no occasion for the Senate at this time to decide the question. The committee reserves complete freedom of decision for the future.

4. Extension of United Kingdom Tax Convention

The 1945 double tax convention with the United Kingdom, as modified, provides that the convention may be extended to the overseas territories of either party by notification to the other party and acceptance by that party of the notification. On August 19, 1957, in a note to the Secretary of State, the British Ambassador gave notification of the desire of his Government to extend the convention to certain British overseas territories. The Senate is now called upon to give its advice and consent to the President to accept the notification, and the committee recommends that this be done.

The territories in question are Aden, Antigua, Barbados, British Honduras, Cyprus, Dominica, Falkland Islands, Gambia, Grenada, Jamaica, Montserrat, Nigeria, Rhodesia and Nyasaland, St. Christopher, Nevis and Anguilla, St. Lucia, St. Vincent, Seychelles, Sierra Leone, Trinidad and Tobago, and Virgin Islands.

When action to give effect to the notification has been completed, the extension will be effective from the 1st of the following January in the United States and in all the territories except Aden, Nigeria, Rhodesia, and Nyasaland, and Sierra Leone where it will be effective from the 1st of the following April.

For the territories other than Rhodesia and Nyasaland, the extension will not apply to taxation of interest on bonds, securities, notes, debentures, or other forms of indebtedness. For Rhodesia and Nyasaland the extension will not apply to United States taxes on gains from the sale or exchange of capital assets or on accumulated or undistributed earnings, profits, income, or surplus.

The convention will apply to the income tax in all of the territories. In addition, it will apply to the surtax in British Honduras, Grenada, and Jamaica; to the supertax and undistributed-profits tax in Rhodesia and Nyasaland; and to the duty on profits, the diamond-industry-profits tax, and the iron-ore-concessions tax in Sierra Leone.

The notification from the British Government expresses the desire of that Government to extend the 1945 convention as modified by the supplementary protocols of 1946, 1954, and 1957. The protocols of 1946 and 1954 have been ratified and are in effect as a part of the basic convention. The 1957 protocol, which deals with the taxation of royalties, is still pending. The committee feels it should not be further considered until final action is taken on H. R. 4952, a bill dealing with the same subject matter which is now pending before the Finance Committee. Consequently, the extension of the 1945 convention with the United Kingdom should include only the 1946 and 1954 protocols and should exclude the 1957 protocol. This would be accomplished by the reservation proposed by the committee.

5. Supplementary Convention With Belgium

This convention is designed to remove certain difficulties in the way of extension of the 1948 convention with Belgium to the Belgian Congo and to the Trust Territory of Ruanda-Urundi.

The 1948 convention with Belgium, like the 1945 convention with the United Kingdom, discussed above, provides that it may be extended to the overseas territories of either party by notification to the other party and acceptance by the other party of that notification. The Belgian Government gave such notification in 1954. The pending convention has been negotiated since that time in order to modify the 1948 convention in ways to make it acceptable as applied to the Congo and Ruanda-Urundi.

The following changes are made in the 1948 convention:

The definition of "Belgian enterprise" is extended to include—

any corporation organized or created under the laws of Belgium or of the Belgian Congo and subject to tax under the Belgian fiscal law of June 21, 1927.

In the 1948 convention, the definition is limited to—

an industrial or commercial enterprise or undertaking carried on in Belgium by a citizen or resident of Belgium or by a corporation or other juridical person created or organized in Belgium or under the laws of Belgium.

The 1948 convention provides, in article XXII(2), that extensions to overseas territories will be effective on the 1st of January following acceptance of the notification of extension. This is changed, in article III of the pending supplementary convention, to the 1st of January immediately preceding acceptance of the notification so far as the Congo and Ruanda-Urundi are concerned.

It is further provided, in article IV of the pending supplementary convention, that for the purposes of the 1948 convention, the term "overseas territories" applies to any such territory for the foreign relations of which either contracting state is responsible. This interpretation is necessary to make it possible to extend the 1948 convention to Ruanda-Urundi, which Belgium administers under a United Nations trusteeship agreement and which is not, strictly speaking, a Belgian territory.

Finally, article II of the pending convention, when taken in conjunction with the existing convention, will provide a 15-percent tax in the Congo and Ruanda-Urundi on the one hand, and in the United States on the other hand, on dividends from sources within one area paid to a resident of the other. In the case of the Congo and Ruanda-Urundi the present tax rate is 15 percent and will be frozen at that level. In the case of the United States the present rate of 30 percent will be reduced to 15 percent.

In order to extend the 1948 convention to the Congo and Ruanda-Urundi, it is necessary for the Senate to approve not only the supplementary convention but also acceptance by the President of the Belgian notification of 1954 informing the United States of Belgium's desire to extend the convention.

6. Conclusion and Recommendation

The three international tax matters covered in this report are a part of the continuing effort of the United States to encourage private foreign investment and thereby promote economic development and world trade. Among the many ways in which this goal can be pursued, the elimination of double taxation is among the more important.

Tax treaties not only provide relief for American investment overseas; they also provide to foreign governments and territories an earnest of American good faith in our frequently expressed desire to encourage foreign investment.

The instant treaties and modifications follow well-established practice. The committee recommends that the Senate give its advice and consent to ratification.

* * * * * * *

[Report of the Secretary of State on the Pakistan Convention]

Department of State,
Washington, July 8, 1957.

The President,
The White House:

The undersigned, the Secretary of State, has the honor to submit to the President, with a view to its transmission to the Senate to receive the advice and consent of that body to ratification, if the President approve thereof, a convention between the United States of America and Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on July 1, 1957.

The convention was formulated as a result of technical discussions between representatives of this Government and representatives of the Pakistan Government, in the course of which an effort was made to determine the bases upon which agreement might be reached for the purpose of avoiding double taxation, and establishing certain procedures for mutual administrative assistance, in regard to income taxation. Elimination of such double taxation is an important step toward removing one of the impediments to international trade and investment.

The convention with Pakistan follows in general the pattern of income-tax conventions presently in force between the United States and a number of foreign countries, namely, Australia, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Honduras, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the Union of South Africa, and the United Kingdom.

As in the cases of similar conventions, the one with Pakistan is designed to eliminate the obstacles to the international flow of trade and investment. It contains provisions relating to business income, investment income, personal service (including professional) income, official salaries, pensions and annuities, remuneration received by teachers, remittances or grants to students and apprentices, and interest received by the State Bank of Pakistan and the Federal Reserve banks of the United States from sources in the other country. The convention also contains, as is customary, provisions regarding administrative procedures, including exchange of information, for giving effect to the convention.

The convention contains certain provisions, unlike those in income-tax conventions with other countries, under which the United States would take an important step toward avoiding nullification of the efforts of a foreign country to encourage industrial development through its tax law. Pakistan tax law, in order to attract capital and encourage investment for the development of Pakistan's economy and natural resources, offers an incentive for establishment of approved new enterprises. Pakistan accords certain tax exemptions as to profits of such enterprises and also as to dividends paid out of such profits. More specifically, under the income-tax law of Pakistan a business qualifying as a new enterprise may obtain tax exemption for a 5-year period on profits up to 5 percent of invested capital, and dividends paid from such profits may be tax-exempt. At present an American corporation qualifying for such treatment under Pakistan law may find that United States taxes will be increased and thus offset the effects of the Pakistan tax law. The concession by Pakistan, therefore, is no special attraction to the United States investor.

Under article XV(1) of the proposed convention this situation would be remedied within limits and on certain conditions by treating, as though paid for foreign-tax-credit purposes, the amount of income tax and supertax by which the American taxpayer's Pakistan tax is reduced.

It is understood that the Department of the Treasury is prepared to make such further explanations as may be found desirable regarding the technical aspects and application of the proposed convention.

The convention applies, so far as United States taxes are concerned, only to the Federal income taxes, including surtaxes. It does not apply to the imposition or collection of taxes by the several States, the District of Columbia, or the Territories or possessions of the United States, although it contains a broad national-treatment provision similar to a provision customarily found in treaties of friendship, commerce, and navigation. In Pakistan the convention would be applicable to the income tax, supertax, and business-profits tax.

It is believed that the convention with Pakistan, if brought into force, would be beneficial to both countries and to their respective citizens and enterprises. It has the approval of the Department of State and the Department of the Treasury.

Article XIX provides for ratification and for exchange of instruments of ratification. It prescribes that, upon such exchange, the convention shall have effect in the United States for taxable years beginning on or after January 1 of the year in which the exchange takes place and shall have effect in Pakistan for "previous years" or "chargeable accounting periods," as defined in Pakistan law, beginning on or after January 1 of the year in which the exchange takes place.

It is provided in article XX that the convention shall continue in effect indefinitely, but may be terminated at the end of a period of 3 years or thereafter by the giving of a notice by one of the parties to the other party on or before June 30 of any year, in which event the convention would cease to be effective (*a*) in the United States, for the taxable years beginning on or after January 1 next following the notice of termination, and (*b*) in Pakistan, in respect of the "previous years" or the "chargeable accounting periods," as defined in Pakistan law, beginning on or after January 1 next following the notice of termination.

JOHN FOSTER DULLES.

* * * * * * *

[Report of the Secretary of State on Belgium Supplementary Convention]

DEPARTMENT OF STATE,
Washington, January 16, 1958.

The PRESIDENT,
The White House:

The undersigned, the Secretary of State, has the honor to submit herewith, for transmission to the Senate to receive the advice and consent of that body to ratification, if the President approve thereof, a convention between the United States of America and Belgium, signed at Washington on August 22, 1957, supplementing the convention of October 28, 1948, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, as modified by the supplementary convention of September 9, 1952.

It is desired also that, in conjunction with the consideration of the supplementary convention submitted herewith, the Senate consider and approve the acceptance by the United States Government of a notification given by the Belgian Government with a view to extending to the Belgian Congo and the Trust Territory of Ruanda-Urundi the operation of the 1948 convention (S. Ex. I, 81st Cong., 1st sess.; 4 U.S.T. 1647), as modified (S. Ex. A, 83d Cong., 1st sess.; 4 U.S.T. 1647). That notification is embodied in a note dated April 2, 1954, addressed by the Ambassador of Belgium to the Secretary of State. An English translation of that note, prepared in the Department of State, is enclosed for transmission to the Senate.

The purpose of the new supplementary convention is to facilitate the extension of the 1948 convention, as modified, to the Belgian Congo and the Trust Territory of Ruanda-Urundi and thereby to facilitate investment in those areas. Upon entry into force of this convention, and after Senate approval of the proposed extension as mentioned above, it would be possible to complete the

procedure prescribed in the 1948 convention for extending its operation to those areas.

In a letter relating to this matter, addressed by the Secretary of the Treasury to the Secretary of State prior to the signing of the supplementary convention, it was stated:

The Belgian Government first notified the United States Government of its desire to have the treaty extended in a note to the State Department on April 2, 1954. Following such notification, it became clear that certain modifications in the basic treaty would be necessary before the United States could give its acceptance to the notification as required by the convention. The proposed supplementary convention is an outcome of discussions held with officials of the Belgian Government since that time.

The new supplementary convention contains 5 articles, 4 of which would effect the modifications considered desirable to lay an adequate basis for the proposed extension.

Article I would amend the definition of "Belgian enterprise" in article II(1)(d) of the 1948 convention so as to cover any corporation organized or created under the laws of Belgium or of the Belgian Congo and subject to tax under the Belgian fiscal law of June 21, 1927. For purposes of the proposed extension, the definition will mean an industrial or commercial enterprise or undertaking carried on in the Congo by a citizen or resident of the Congo or by a corporation or other juridical entity created or organized under the laws of the Congo. An individual resident of the Congo, regardless of nationality, would be entitled to the benefits accorded by the convention to a Congo enterprise, provided he carries on business in the Congo, but a corporation created or organized under the laws of a country other than the Congo would not be entitled to benefits.

Article II of the supplementary convention is related to article VIII of the 1948 convention and would preclude the Belgian Congo and the Trust Territory of Ruanda-Urundi from imposing the "tax mobilière" at a rate in excess of 15 percent on dividends from sources within either of those areas paid to a resident of the United States who, or a corporation or other entity of the United States which, does not have a permanent establishment in such area. The effect of article VIII of the 1948 convention as modified by the 1952 convention and the convention submitted herewith, taken together with article XXII(4) of the 1948 convention, is to leave the Congo tax on dividends unchanged, but frozen at a maximum of 15 percent. The effect is also to reduce from 30 percent to 15 percent the United States tax on dividends going from the United States to aliens residing in the Congo or the Trust Territory of Ruanda-Urundi. The effect is, therefore, reciprocal.

Article III, by substituting the words "immediately preceding" for the word "following" in article XXII(2) of the 1948 convention, would make the extension to the Congo and the Trust Territory of Ruanda-Urundi effective on and after January 1 immediately preceding the date on which the United States formally accepts the Belgian Government's notification for such extension.

Article IV clarifies the term "overseas territories" in accordance with the original intent as applying to any overseas territory for the foreign relations of which either the United States or Belgium is responsible.

Article V provides for ratification and for exchange of instruments of ratification, the supplementary convention to become effective with respect to taxable years beginning on or after January 1 of the year in which such exchange takes place. The supplementary protocol would continue in effect as an integral part of the 1948 convention, as modified, subject to the same provisions in regard to termination.

The only Congo taxes that will be subject to the convention, if and when the proposed extension is accepted by the United States Government, are the income taxes, additions to those taxes, and similar taxes that may be imposed in the future. No national crisis tax or personal complementary tax, applicable in Belgium (see art. I of the 1948 convention) has been enacted for the Congo.

Article XXII of the 1948 convention contains provisions in paragraph (1) whereby either party may, with a written notification to the other party through diplomatic channels—

declare its desire that the operation of the present Convention, either in whole or as to such provisions thereof as may be deemed to have special application, shall extend to any of its colonies or overseas territories which imposes taxes

substantially similar in character to those which are the subject of the present Convention.

Article XXII(2) provides that, in the event a notification is given by one of the parties in accordance with that procedure—

the present Convention, or such provisions thereof as may be specified in the notification, shall apply to any territory named in such notification on and after the first day of January following the date of a written communication through diplomatic channels addressed to such Contracting State by the other Contracting State, after such action by the latter State as may be necessary in accordance with its own procedures, stating that such notification is accepted in respect of such territory. In the absence of such acceptance, none of the provisions of the present Convention shall apply to such territory.

As indicated hereinabove, the Belgian Government gave, by a note dated April 2, 1954, a written notification in accordance with article XXII of the 1948 convention, expressing the desire of that Government that the application of the provisions of that convention and of the supplementary convention of 1952 be extended to the Belgian Congo and the Trust Territory of Ruanda-Urundi.

In accordance with established policy (see S. Ex. Rept. No. 11, 80th Cong., 2d sess.), any proposal for extension, before being accepted by the United States Government, is to be submitted to the Senate for approval. Accordingly, it is desired that the Senate not only give advice and consent to ratification of the new supplementary convention in order to effect the necessary modifications in the 1948 convention, as modified, but also approve the acceptance by the United States Government of the proposed extension to the Belgian Congo and the Trust Territory of Ruanda-Urundi.

Both the supplementary convention and the proposed extension have the approval of the Department of State and the Department of the Treasury.

Respectfully submitted.

JOHN FOSTER DULLES

* * * * * * *

[Report of Acting Secretary of State on extension agreement with the United Kingdom.]

DEPARTMENT OF STATE,
Washington, January 23, 1958.

The PRESIDENT,
The White House:

The undersigned, the Acting Secretary of State, has the honor to submit herewith, for transmission to the Senate to receive the approval of that body, a notification given by the Government of the United Kingdom of Great Britain and Northern Ireland with a view to extending to certain British overseas territories the application of the convention of April 16, 1945, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, as modified by supplementary protocols of June 6, 1946, May 25, 1954, and August 19, 1957.

The notification is embodied in a note dated August 19, 1957, from the British Ambassador in Washington to the Secretary of State, a copy of which is enclosed, together with a copy of the annex thereto.

Article XXII of the 1945 convention, as amended by the supplementary protocol of 1954, contains provisions in paragraph (1) whereby either party may, by a written notification to the other party through diplomatic channels—

declare its desire that the operation of the present Convention, either in whole or in part or with such modifications as may be found necessary for special application in a particular case, shall extend to all or any of its territories for whose international relations it is responsible, which impose taxes substantially similar in character to those which are the subject of the present Convention * * *.

It is provided further in the same paragraph that the proposed extension shall become effective when the party to which the notification is given accepts it. The provision reads:

* * * When the other Contracting Party has, by a written communication through the diplomatic channel, signified to the first Contracting Party that such notification is accepted in respect of such territory or territories, the present Convention, in whole or in part or with such modifications as may be found

necessary for special application in a particular case, as specified in the notification, shall apply to the territory or territories named in the notification on and after the date or dates specified therein. None of the provisions of the present Convention shall apply to any such territory in the absence of such acceptance in respect of that territory.

The notification by the Government of the United Kingdom proposing that the operation of the convention, as modified, be extended to the territories specified in the notification, was given in accordance with the procedure prescribed in article XXII, as amended. Before the proposal can be accepted by the Government of the United States it is necessary that the matter be submitted to the Senate for approval. When the 1945 convention was under consideration in the Senate Committee on Foreign Relations, the Acting Secretary of State sent to the chairman of that committee a letter dated June 27, 1945 (S. Ex. Rept. No. 6, 79th Cong., 1st sess., p. 2), in which, after referring to discussions before a subcommittee of that committee, it was stated:

During those discussions a question was presented respecting the procedure to be followed by this Government in accepting or giving a notification of extension of the convention, under the provisions of article XXII thereof, to colonies, overseas territories, or other areas over which one of the contracting parties exercises authority. I am glad to inform you that in connection with any such notification of extension of the convention, the Department of State will recommend to the President that the matter be submitted to the Senate for its advice and consent before any notification of extension is accepted or given on behalf of the United States.

British authorities indicated informally as long ago as 1949 that there was a desire to give this Government a notification for extending the operation of the convention to certain named British overseas areas. Recognizing that this would entail a great deal of technical study by the tax authorities of this Government, including a study of the tax laws applicable in the various named territories, in order to determine the extent to which it would be feasible to extend the operation of the convention to such territories, the British authorities delayed the sending of the formal notification until the United States tax authorities had completed the necessary studies and had indicated that such a notification, when received, would be acceptable so far as technical and administrative aspects thereof are concerned. A draft of the note, with annex, which the British Government planned to send to this Government was formulated as a result of discussions between the interested authorities of the two Governments. The formal notification which has been received from the British Government is based upon that draft. The Secretary of the Treasury has informed the Secretary of State that the text thereof has the approval of the Department of the Treasury.

It will be observed that the British Ambassador's note expresses the desire of the British Government—

that the application of the Convention should be extended to the territories named in the Annex to this note, subject to the modifications and with effect from the dates specified therein.

The annex to the note is divided into three parts. Paragraph I is a table listing the British territories to which the convention, as modified, would be extended, subject to the conditions set out in paragraphs II and III. It also specifies the taxes imposed in the respective territories to which the convention, as modified, shall apply and the date on which, as to each territory, the provisions shall be effective. Paragraph II of the annex indicates the extent to which the convention, as modified, shall be extended with respect to each of the territories mentioned in paragraph I. Paragraph III of the annex indicates certain necessary modifications in the convention, as modified, for the purpose of the proposed extension.

The territories specified in paragraph I of the annex are Aden; Antigua; Barbados; British Honduras; Cyprus; Dominica; Falkland Islands; Gambia; Grenada; Jamaica; Montserrat; Federation of Nigeria; Federation of Rhodesia and Nyasaland; St. Christopher, Nevis, and Anguilla; St. Lucia; St. Vincent; Seychelles; Sierra Leone; Trinidad and Tobago; and Virgin Islands.

The dates set forth in column (3) of the tabulation refer to the respective dates of commencement of the year of assessment in each of the named territories.

It is stipulated in subparagraph (b) of paragraph II of the annex that when—

the last of those measures shall have been taken in the United States of America and in any territory named in the above Table necessary to give the present extension the force of law in the United States of America and in such territory, respectively—

the extension shall have effect (1) in the United States, with respect to United States tax, on and after January 1 next following the date on which the last of those measures have been taken, and (2) in each of the territories, with respect to its tax, for the year of assessment beginning on the date specified opposite its name next following the date on which the last of those measures have been taken, and for subsequent years of assessment. The United States Government would inform the British Government when the last of the measures necessary have been taken in the United States. The British Government would inform the United States Government when the last of the measures necessary in the several named territories have been taken in the several named territories.

Pursuant to paragraph III of the annex, if and when the proposed extension becomes effective, the convention of 1945, as modified by the supplementary protocols of 1946, 1954, and 1957, would apply with certain exceptions, namely, (1) for the purposes of the extension to the Federation of Rhodesia and Nyasaland articles XIV (United States tax on gains from the sale or exchange of capital assets) and XVI (United States tax on accumulated or undistributed earnings, profits, income, or surplus) shall be deemed to be deleted; and (2) for the purposes of the extension to the other territories named in the tabulation articles VII (taxation of interest on bonds, securities, notes, debentures, or any other form of indebtedness), XIV, and XVI shall be deemed to be deleted.

The Secretary of the Treasury, in his communication to the Secretary of State indicating approval of the text of the proposed British notification, has called attention to the widespread interest in the extension of the operation of the 1945 convention, as modified, to the British territories. It is understood that the Department of the Treasury is prepared to make such further explanations as may be found desirable regarding the technical aspects and application of the proposed extension.

Respectfully submitted

CHRISTIAN A. HERTER,
Acting Secretary.

PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

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PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

TREASURY DEPARTMENT ORDER 150-52

Internal Revenue Service—Establishment of new offices

There shall be in the National Office of the Internal Revenue Service the office of Assistant Commissioner of Internal Revenue (Administration) and the office of Assistant to the Commissioner.

The office of Administrative Assistant to the Commissioner established by Treasury Department Order No. 150-44 [C.B. 1956-2, 1368], dated November 16, 1956, is abolished.

This order shall be effective September 6, 1960.

Dated September 1, 1960.

[SEAL] FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 9, 1960, 8:49 a.m., and published in the issue of the Federal Register for September 10, 1960, 25 F.R. 8759)

DELEGATION ORDER NO. 5 (Rev. 2)

(Effective October 24, 1960)

Emergency order of succession and delegation of authority

1. By virtue of the authority vested in me by Treasury Department Order No. 129, Revision No. 2, dated April 22, 1955, the officials in the positions listed below and on a document filed at the Internal Revenue Service emergency relocation site are hereby authorized, in the event of an enemy attack on the United States, and the disability of the Commissioner, his absence from the emergency relocation site, or if there is a vacancy in the office, to succeed to the position of Acting Commissioner in the order listed, and are authorized to perform the functions of Commissioner to insure the continuity of the functions of that office:

Deputy Commissioner
Assistant Commissioner (Operations)
Assistant Commissioner (Technical)
Assistant Commissioner (Inspection)
Assistant Commissioner (Planning and Research)
Assistant Commissioner (Administration)

If none of these officials are available, the first available Regional Commissioner, in the order listed in the document on file at the emergency relocation site, will become Acting Commissioner.

Immediately in the event of an attack on the United States, each Regional Commissioner shall communicate as quickly as possible with the emergency National Office at the relocation site and advise the official in charge of his availability to assume the position of Acting Commissioner. After the lapse of a reasonable time for receipt of communications from the Regional Commissioners, the official in charge of the emergency National Office will advise the available Regional Commissioner highest in the order of succession to report to the emergency National Office at the relocation site to become Acting Commissioner.

If no Regional Commissioner is available, a District Director will become Acting Commissioner in the order indicated in the above-mentioned document on file at the emergency relocation site. District Directors need not contact the emergency National Office.

2. There is hereby delegated to Regional Commissioners and District Directors, or the officials acting in their stead, upon the event of an enemy attack on the United States, all authority vested in the Commissioner of Internal Revenue by law or transfer from the Secretary of the Treasury as is necessary to insure the continuous performance of Internal Revenue Service functions by those officials in their areas of jurisdiction. This delegation of authority will remain in effect until notice is received that it has been terminated.

3. This Order supersedes Delegation Order No. 5 (Revised), dated July 27, 1959 [C.B. 1959–2, 907].

DANA LATHAM,
Commissioner.

(Filed by the Division of the Federal Register on November 4, 1960, 8:47 a.m., and published in the issue of the Federal Register for November 5, 1960, 25 F.R. 10604)

DELEGATION ORDER NO. 6 (REVISED) (REVOCATION NOTICE)

(Effective June 23, 1960)

Authority to grant authorizations of agents

Delegation Order No. 6 (Revised), dated August 22, 1957 [C.B. 1957–2, 1088], delegated to District Directors of Internal Revenue authority to grant authorizations of agents to perform all acts required of employers under chapters 21, 22, 24, and 25, subtitle C of the Internal Revenue Code of 1954. This authority is now contained in section 31.3504–1(a) of the Employment Tax Regulations (26 CFR 31.3504–1(a); T.D. 6354, C.B. 1959–1, 263).

Accordingly, Delegation Order No. 6 (Revised), dated August 22, 1957, published at 22 F.R. 7082, is hereby revoked.

CHARLES I. FOX,
Acting Commissioner.

(Filed by the Division of the Federal Register on July 8, 1960, 8:51 a.m., and published in the issue of the Federal Register for July 9, 1960, 25 F.R. 6486)

DELEGATION ORDER NO. 11 (REVISED)

(Effective July 1, 1960)

Delegation of authority to accept certain offers in compromise

Pursuant to authority vested in me by Treasury Department Order No. 150–25, dated June 1, 1953 [18 F.R. 3238], it is hereby ordered:

1. Subject to the limitations contained in applicable regulations and procedures, District Directors are delegated authority, under section 7122 of the Internal Revenue Code, to accept offers in compromise in cases in which the liability sought to be compromised (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $25,000, and in cases involving specific penalties.

2. This authority may not be redelegated.

3. This Order supersedes Delegation Order No. 11, issued December 2, 1955 [C.B. 1956–1, 1010].

DANA LATHAM,
Commissioner.

(Filed by the Division of the Federal Register on April 28, 1960, 8:49 a.m., and published in the issue of the Federal Register for April 29, 1960, 25 F.R. 3766)

DELEGATION ORDER NO. 23 (Rev. 2)

(Effective October 11, 1960)

Settlement of tort claims

1. Pursuant to Treasury Department Order No. 145 (Revision No. 2), dated October 28, 1959, there is hereby delegated to the Assistant Commissioner (Administration) and the Director, Operating Facilities Division:

(a) The authority, under 28 U.S.C. 2672, to consider, ascertain, adjust, determine, settle and pay claims for money damages of $2,500 or less, for injury, loss, or death caused by the negligent or wrongful act or omission of any employee of the Internal Revenue Service; and

(b) The authority to consider, ascertain, adjust and determine claims under the Act of December 28, 1922, 42 Stat. 1066.

2. This authority may not be redelegated.

3. The authority delegated herein to the Director, Operating Facilities Division, shall be subject to the direction and supervision of the Assistant Commissioner (Administration), who shall have authority to revise or modify all or any part of the authority delegated to the Director, Operating Facilities Division.

4. This Order supersedes Delegation Order No. 23 (Revised), dated December 21, 1959 [C.B. 1960–1, 861].

DANA LATHAM,
Commissioner.

(Filed by the Division of the Federal Register on October 21, 1960, 8:52 a.m., and published in the issue of the Federal Register for October 22, 1960, 25 F.R. 10106)

DELEGATION ORDER NO. 36 (Rev. 1)

(Effective November 23, 1960)

Authority of Director of International Operations Extended to Panama Canal Zone, Puerto Rico and the Virgin Islands.

Pursuant to the authority vested in me by Commissioner Delegation Order No. 33 [C.B. 1956–2, 1375], dated June 6, 1956, it is hereby ordered:

1. Subject to the limitations contained in paragraph 2, there are delegated to the Director of International Operations the functions of administering the United States internal revenue laws in the Panama Canal Zone, Puerto Rico, and the Virgin Islands of the United States, and in all other areas of the world outside the United States, to the extent of the authority delegated by Commissioner Delegation Order No. 32 [C.B. 1956–1, 1016], dated May 1, 1956.

2. Nothing in this order shall be deemed to affect the procedures for administrative appeal existing immediately prior to August 1, 1956, or any function of the Assistant Regional Commissioner (Alcohol and Tobacco Tax), New York City Region.

This Order supersedes Delegation Order No. 36 [C.B. 1956–2, 1376], which was effective August 1, 1956, and is issued for the sole purpose of eliminating from the latter Order the words "and the territories of Alaska and Hawaii".

WILLIAM H. LOEB,
Assistant Commissioner (Operations).

(Filed by the Division of the Federal Register on December 6, 1960, 8:49 a.m., and published in the issue of the Federal Register for December 7, 1960, 25 F.R. 12526)

DELEGATION ORDER NO. 57 (Rev. 1)

(Effective August 21, 1960)

Notice of additional inspection of taxpayers' books of account under Section 7605(b), Internal Revenue Code 1954.

Pursuant to the authority vested in me by Delegation Order No. 33 dated June 6, 1956 [C.B. 1956–2, 1375], I hereby delegate authority, subject to the provisions of Subsection 4011 of the Internal Revenue Manual where applicable, to the Director of International Operations to sign in his name, after investigation, the notice to a taxpayer, required by Section 7605(b) of the Internal Revenue Code of 1954, that an additional inspection of such taxpayers' books of account is necessary.

This authority may not be redelegated.

This order supersedes Delegation Order No. 57, effective March 5, 1958 [C.B. 1958–1, 680].

WILLIAM H. LOEB,
Assistant Commissioner (Operations).

(Filed by the Division of the Federal Register on November 17, 1960, 8:50 a.m., and published in the issue of the Federal Register for November 18, 1960, 25 F.R. 11015)

DELEGATION ORDER NO. 75 AMENDMENT NO. 1

(Effective July 1, 1960)

Authority of Regional Appellate Division in Offers in Compromise

Paragraph numbered 2 of Delegation Order No. 75, dated February 18, 1960, [C.B. 1960–1, 861] is amended by striking out "$5,000" and inserting in lieu thereof "$25,000."

DANA LATHAM,
Commissioner.

(Filed by the Division of the Federal Register on July 8, 1960, 8:51 a.m., and published in the issue of the Federal Register for July 9, 1960, 25 F.R. 6486)

PROCLAMATION 3358

DETERMINING ETHYL 1-(3-CYANO-3,3-DIPHENYLPROPYL)-4-PHENYL-4-PIPERIDINECARBOXYLATE TO BE AN OPIATE

By the President of the United States of America—A Proclamation

WHEREAS section 4731(g) of the Internal Revenue Code of 1954 provides in part as follows:

OPIATE.—The word "opiate", as used in this part shall mean any drug (as defined in the Federal Food, Drug, and Cosmetic Act; 52 Stat. 1041, section 201(g); 21 U.S.C. 321) found by the Secretary or his delegate, after due notice and opportunity for public hearing, to have an addiction-forming or addiction-sustaining liability similar to morphine or cocaine, and proclaimed by the President to have been so found by the Secretary or his delegate. * * *;

AND WHEREAS the Secretary of the Treasury, after due notice and opportunity for public hearing, has found that the following-named drug has an addiction-forming or addiction-sustaining liability similar to morphine, and that in the public interest this finding should be effective immediately:

Ethyl 1-(3-cyano-3,3-diphenylpropyl)-4-phenyl-4-piperidinecarboxylate.

NOW, THEREFORE, I, DWIGHT D. EISENHOWER, President of the United States of America, do hereby proclaim that the Secretary of the Treasury has found that the aforementioned drug has an addiction-forming or addiction-sustaining liability similar to morphine and that in the public interest this finding should be effective immediately.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the Seal of the United States to be affixed.

DONE at the City of Washington this eighteenth day of July in the year of our Lord nineteen hundred and sixty, and of the
[SEAL] Independence of the United States of America the one hundred and eighty-fifth.

DWIGHT D. EISENHOWER.

By the President:
CHRISTIAN A. HERTER,
Secretary of State.

(Filed by the Division of the Federal Register on July 20, 1960, 2:40 p.m., and published in the issue of the Federal Register for July 22, 1960, 25 F.R. 6945)

PROCLAMATION 3362

DETERMINING CERTAIN DRUGS TO BE OPIATES

By the President of the United States of America—A Proclamation

WHEREAS section 4731(g) of the Internal Revenue Code of 1954 provides in part as follows:

OPIATE.—The word "opiate", as used in this part shall mean any drug (as defined in the Federal Food, Drug, and Cosmetic Act; 52 Stat. 1041, section 201(g); 21 U.S.C. 321) found by the Secretary or his delegate, after due notice and opportunity for public hearing, to have an addiction-forming or addiction-sustaining liability similar to morphine or cocaine, and proclaimed by the President to have been so found by the Secretary or his delegate. * * *;

AND WHEREAS the Secretary of the Treasury, after due notice and opportunity for public hearing, has found that each of the following-named drugs has an addiction-forming or addiction-sustaining liability similar to morphine, and that in the public interest this finding should be effective immediately:

1. Benzethidine (Ethyl 1-(2-benzyloxyethyl)-4-phenyl-4-piperidine carboxylate).
2. Furethidine (Ethyl 1-(2-tetrahydrofurfuryloxyethyl)-4-phenyl-4-piperidine carboxylate).
3. 2-(p-Cholorobenzyl)-1-diethylaminoethyl-5-nitrobenzimidazole.
4. 2-(p-Ethoxybenzyl)-1-diethylaminoethyl-5-nitrobenzimidazole.

NOW, THEREFORE, I, DWIGHT D. EISENHOWER, President of the United States of America, do hereby proclaim that the Secretary of the Treasury has found that each of the aforementioned drugs has an addiction-forming or addiction-sustaining liability similar to morphine and that in the public interest this finding should be effective immediately.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the Seal of the United States to be affixed.

DONE at the City of Washington this twenty-ninth day of July in the year of our Lord nineteen hundred and sixty, and of [SEAL] the Independence of the United States of America the one hundred and eighty-fifth.

DWIGHT D. EISENHOWER.

By the President:

CHRISTIAN A. HERTER,
Secretary of State.

(Filed by the Division of the Federal Register on August 3, 1960, 4:52 p.m., and published in the issue of the Federal Register for August 5, 1960, 25 F.R. 7351)

PROCLAMATION 3377

DETERMINING CERTAIN DRUGS TO BE OPIATES

By the President of the United States of America—A Proclamation

WHEREAS section 4731(g) of the Internal Revenue Code of 1954 provides in part as follows:

OPIATE.—The word "opiate", as used in this part shall mean any drug (as defined in the Federal Food, Drug, and Cosmetic Act; 52 Stat. 1041, section 201(g); 21 U.S.C. 321) found by the Secretary or his delegate, after due notice

and opportunity for public hearing, to have an addiction-forming or addiction-sustaining liability similar to morphine or cocaine, and proclaimed by the President to have been so found by the Secretary or his delegate. * * *;

AND WHEREAS the Secretary of the Treasury, after due notice and opportunity for public hearing, has found that each of the following-named drugs has an addiction-forming or addiction-sustaining liability similar to morphine, and that in the public interest this finding should be effective immediately:

(1) Diampromide (N-[2-([Methyl]-phenethylamino)-propyl]-propionanilide).
(2) Phenampromide (N-(1-Methyl-2-piperidinoethyl)-propionanilide).

NOW, THEREFORE, I, DWIGHT D. EISENHOWER, President of the United States of America, do hereby proclaim that the Secretary of the Treasury has found that each of the aforementioned drugs has an addiction-forming or addiction-sustaining liability similar to morphine, and that in the public interest this finding should be effective immediately.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the Seal of the United States to be affixed.

DONE at the City of Washington this twenty-seventh day of October in the year of our Lord nineteen hundred and sixty, and of [SEAL] the Independence of the United States of America the one hundred and eighty-fifth.

DWIGHT D. EISENHOWER.

By the President:

CHRISTIAN A. HERTER,
Secretary of State.

(Filed by the Division of the Federal Register on October 28, 1960, 10:37 a.m., and published in the issue of the Federal Register for October 29, 1960, 25 F.R. 10387)

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26 CFR 302.1: Statutory provisions and Executive order; section 212 of the International Claims Settlement Act, and Executive Order 10644.

T.D. 6479 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I. SUBCHAPTER F. PART 302.—TAXES UNDER THE INTERNATIONAL CLAIMS SETTLEMENT ACT, AS AMENDED AUGUST 9, 1955

Regulations relating to the application of the internal revenue laws to property subject to the International Claims Settlement Act, as amended.

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

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

On April 2, 1960, notice of proposed rulemaking regarding the regulations relating to the application of the internal revenue laws pursuant to section 212 of the International Claims Settlement Act of 1949, as added by the Act of August 9, 1955 (Public Law 285,

[1] 25 F.R. 6469.

84th Cong., 69 Stat. 562 [C.B. 1955–2, 756]), was published in the Federal Register (25 F.R. 2800). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

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302.1–4 Computation of taxes.
302.1–5 Payment of taxes.
302.1–6 Interest and penalties.
302.1–7 Claims for credit or refund.

AUTHORITY: §§ 302.1 to 302.7, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805, and sec. 212 of the International Claims Settlement Act of 1949, as added by the Act of Aug. 9, 1955, Pub. Law 285, 84th Cong., 69 Stat. 562.

§ 302.1 STATUTORY PROVISIONS AND EXECUTIVE ORDERS; SECTION 212 OF THE INTERNATIONAL CLAIMS SETTLEMENT ACT, AND EXECUTIVE ORDER 10644.

SEC. 212. (a) The vesting in any officer or agency designated by the President under this title of any property or the receipt by such designee of any earnings, increment, or proceeds thereof shall not render inapplicable any Federal, State, Territorial, or local tax for any period before or after such vesting.

(b) The officer or agency designated by the President under this title shall, notwithstanding the filing of any claim or the institution of any suit under this title, pay any tax incident to any such property, or the earnings, increment, or proceeds thereof, at the earliest time appearing to him to be not contrary to the interest of the United States. The former owner shall not be liable for any such tax accruing while such property, earnings, increment, or proceeds are held by such designee, unless they are returned pursuant to this title without payment of such tax by the designee. Every such tax shall be paid by the designee to the same extent, as nearly as may be deemed practicable, as though the property had not been vested, and shall be paid only out of the property, or earnings, increment, or proceeds thereof, to which they are incident or out of other property acquired from the same former owner, or earnings, increment, or proceeds thereof. No tax liability may be enforced from any property or the earnings, increment, or proceeds thereof while held by the designee except with his consent. Where any property is transferred, otherwise than pursuant to section 207(a) or 207(b) hereof, the designee may transfer the property free and clear of any tax, except to the extent of any lien for a tax existing and perfected at the date of vesting, and the proceeds of such transfer shall, for tax purposes, replace the property in the hands of the designee.

(c) Subject to the provisions of subsection (b) of this section, the manner of computing any Federal taxes, including without limitation by reason of this enumeration, the applicability in such computation of credits, deductions, and exemptions to which the former owner is or would be entitled, and the time and manner of any payment of such taxes and the extent of any compliance by the designee with provisions of Federal law and regulations applicable with respect to Federal taxes, shall be in accordance with regulations prescribed by the Secretary of the Treasury to effectuate this section. Statutes of limitations on assessments, collection, refund, or credit of Federal taxes shall be suspended with respect to any vested property or the earnings, increment, or proceeds thereof, while vested and for six months thereafter;

but no interest shall be paid upon any refund with respect to any period during which the statute of limitations is so suspended.

(d) The word "tax" as used in this section shall include, without limitation by reason of this enumeration, any property, income, excess-profits, war-profits, excise, estate, and employment tax, import duty, and special assessment; and also any interest, penalty, additional amount, or addition thereto not arising from any act, omission, neglect, failure, or delay on the part of the designee.

[Section 212, International Claims Settlement Act of 1949, as added by the Act of August 9, 1955 (Pub. Law 285, 84th Cong., 69 Stat. 562)]

EXECUTIVE ORDER 10644,

APPROVED NOVEMBER 7, 1955 (20 F.R. 8363)

By virtue of the authority vested in me by Title II of the International Claims Settlement Act of 1949, as added by Public Law 285, 84th Congress, approved August 9, 1955 (69 Stat. 562), and by section 301 of title 3 of the United States Code, and as President of the United States, it is ordered as follows:

SECTION 1. The Attorney General, and, as designated by the Attorney General for this purpose, any Assistant Attorney General are hereby designated and empowered to perform the functions conferred by the said Title II of the International Claims Settlement Act of 1949 upon the President, and the functions conferred by that title upon any designee of the President.

SEC. 2. The Attorney General is hereby designated as the officer in whom property shall vest under the said Title II.

SEC. 3. As used in this order, the term "functions" includes duties, powers, responsibilities, authority, and discretion, and the term "perform" may be construed to include "exercise".

§ 302.1–1 DEFINITIONS.—(a) (*General.*)—When used in the regulations in this part, the terms defined in this section shall have the meaning so assigned to them. A term not defined herein shall have the meaning, if compatible with the context, imputed thereto under the internal revenue laws.

(b) *Attorney General.*—The term "Attorney General" includes the officer in whom property is vested pursuant to Title II of the International Claims Settlement Act of 1949, as amended. The term also includes the officer, including any Assistant Attorney General designated by the Attorney General for this purpose, designated and empowered pursuant to Executive Order No. 10644 to perform the functions conferred by Title II upon the President of the United States and the functions conferred by such Title upon the designee of the President.

(c) *Commissioner.*—The term "Commissioner" means the Commissioner of Internal Revenue.

(d) *Person.*—The term "person" includes a natural person, partnership, association, other unincorporated body, corporation, or body politic, having or claiming an interest in vested property or liable or charged with liability for internal revenue tax in connection with such property.

(e) *Former owner.*—The term "former owner" means the owner immediately prior to vesting and any successor in interest by inheritance, devise, bequest, or operation of law, of such owner.

(f) *Property.*—The term "property" means any property, right, or interest, including earnings, increment, or proceeds thereof.

(g) *Act.*—The term "Act" means the International Claims Settlement Act of 1949, as amended by the Act of August 9, 1955 (Public Law 285, 84th Cong., 69 Stat. 562).

(h) *Tax.*—The term "tax" includes, but is not limited to, any property, income, excess-profits, war-profits, excise, estate, and employment tax, import duty, and special assessment; and also any interest, penalty, additional amount, or addition thereto not arising from any act, omission, neglect, failure, or delay on the part of the Attorney General.

§ 302.1–2 Application of Regulation.—(a) *Property covered.*—The regulations in this part are applicable in connection with property vested in the Attorney General pursuant to section 202(a) of the Act and in connection with the net proceeds of any property described under section 202(b) of such Act which was vested in the Attorney General after December 17, 1941, pursuant to the Trading With the Enemy Act, as amended (40 Stat. 411).

(b) *Taxes covered.*—The regulations in this part are applicable to any internal revenue tax with respect to (1) property vested in the Attorney General or any action or transaction incidental to such property, or (2) any person whose property is so vested or any action or transaction of such person, whether the tax is applicable in respect of the period of vesting or any other period.

§ 302.1–3 Protection of Internal Revenue Prior to Tax Determination.—(a) *Suits and claims for return of vested property.*—(1) *General.*—The provisions of this paragraph apply in cases where there has been neither a final nor a tentative determination of internal revenue tax liability. See paragraphs (e) and (f) of § 302.1–4. In such cases vested property (including property vested pursuant to section 202(a) of the Act which is subject to divestment by reason of its ownership by a natural person) shall not be returned or divested except in accordance with this paragraph.

(2) *Notice to Commissioner.*—(i) *Suits for recovery.*—Where suit for the return of vested property has been instituted pursuant to section 207(a) of the Act, the Attorney General shall within a reasonable time after answer has been filed or after beginning of the trial of the case notify the Commissioner in writing of the property involved and the name, address, citizenship, residence, and business organization of the claimant, and any other pertinent information.

(ii) *Return without suit.*—Where the Attorney General has determined that pursuant to section 207(b) of the Act vested property is to be returned to the claimant, the Attorney General shall notify the Commissioner in writing in the manner prescribed in subdivision (i) of this subparagraph at least 90 days prior to any return of such property.

(3) *Return of property.*—(i) *By divestment.*—Where the Attorney General has determined that property vested pursuant to section 202(a) of the Act was directly owned by a natural person, the Attorney General shall not divest himself of such property and restore it to its blocked status prior to vesting unless there has been a determination of tax liability pursuant to § 302.1–4 and a payment of such tax pursuant to § 302.1–5.

(ii) *Without security.*—Where vested property is the subject of a suit or proceeding pursuant to the Act, it may be returned without security prior to determination of applicable internal revenue taxes and prior to the judgment of the court or to the publication of the order of the Attorney General directing such return to the following described claimants under conditions hereinafter stated:

(*a*) *Residents and domestic enterprises.*—In the case of claimants who at the time of return are (*1*) individuals permanently resident in the United States since December 7, 1941, or (*2*) corporations or other business enterprises organized under the laws of the United States, or any State, Territory, or possession thereof, or the District of Columbia, or doing business in the United States, the Attorney General may without notice to the Commissioner return the property at any time.

(*b*) *Non-residents, etc.*—In the case of claimants who at the time of return are (*1*) individuals not permanently resident in the United States since December 7, 1941, or (*2*) nondomestic corporations or other nondomestic enterprises not doing business within the United States, the property may be returned not less than 90 days after notice by the Attorney General to the Commissioner in a case within subparagraph (2) (i) of this paragraph, or not less than 60 days after notice in a case within subparagraph (2) (ii) of this paragraph, unless within such time the Attorney General is advised otherwise by the Commissioner.

(iii) *When security required.*—Except as provided in subdivisions (i) and (ii) of this subparagraph, vested property shall not be released prior to determination of tax liability without security satisfactory to the Commissioner, but determination of tax liability will be expedited in order that the release of the property or of the security shall not be unnecessarily delayed.

(4) *Security.*—When security is required under subparagraph (3) (iii) of this paragraph, it shall be such of the following as the Commissioner considers necessary:

(i) *Bond.*—A bond of the claimant conditioned upon payment of the full amount of internal revenue taxes determined to be due, filed with the district director in such amount, and with such sureties, as the Commissioner deems necessary. Only surety companies holding a certificate of authority from the Secretary of the Treasury may be used.

(ii) *Collateral security.*—Collateral authorized by law deposited by the claimant in lieu of surety conditioned upon the payment of the full amount of internal revenue taxes determined to be due.

(iii) *Reservation of assets.*—Monies, or if the monies are insufficient, so much of the other property involved, to be reserved by the Attorney General, as will be sufficient in the judgment of the Attorney General to cover any internal revenue tax liability determined by the Commissioner.

(b) *Vested property subject to debt claims.*—(1) *Notice to Commissioner.*—With respect to vested property available for the payment of debt claims pursuant to section 208 of the Act, and with respect to which debt claims have been filed, prior to the allowance of any such claims the Attorney General shall in writing notify the Commissioner of the property involved, the citizenship, residence, business organiza-

tion and other necessary information concerning the debtor and the aggregate of debt claims filed in respect thereof.

(2) *Action by Commissioner.*—Upon receipt of the notice provided in subparagraph (1) of this paragraph the Commissioner shall, as soon as practicable and not later than 120 days after receipt of notice, unless the time is extended by the Commissioner after notice to the Attorney General, (i) determine the taxes payable by the Attorney General in respect to the debtor, or (ii) advise the Attorney General of the provision, if any, to be made by him for payment to taxes with respect of the debtor.

§ 302.1–4 COMPUTATION OF TAXES.—(a) *Detail of employees of the Internal Revenue Service.*—The Commissioner will detail for the assistance of the Attorney General such employees of the Internal Revenue Service as may be necessary to make the computations under the regulations in this part promptly and accurately.

(b) *Relationship of Attorney General and former owner.*—In the computation of tax liability under the regulations in this part, except as otherwise provided herein, the vesting of property shall not be considered as affecting the ownership thereof; and any act of the Attorney General in respect of such property (including the collection or operation thereof and any investment, sale, or other disposition and any payment or other expenditure) shall be considered as the act of the owner. Nevertheless, except as otherwise provided in the Act or the regulations in this part, insofar as taxes are incident to the vested property during the period of vesting, they shall be payable b ythe Attorney General, except that to the extent of the value of any of the property returned to the former owner the latter shall be liable for such tax not paid by the Attorney General. While tax incident to nonvested property is collectible out of both vested and nonvested property, the nonvested property will be regarded as the primary source of collection of such tax. In determining the amount of liability to be paid out of property not vested by the Attorney General a computation shall be made covering the taxpayer's full period of liability, but without regard to the vested property, or the income received by, or the operations of, the Attorney General. The amount so computed shall be first asserted against and collected so far as practicable from the taxpayer or out of his property which is not vested. Such part of the total tax liability as is not paid by the taxpayer or collected out of property not vested shall be asserted against the vested property. See § 302.1–5, relating to payment of taxes, and § 302.1–7, relating to claims for credit or refund.

(c) *Laws applicable to computations.*—Except as otherwise specifically provided in the regulations in this part, the computation under the regulations in this part of any internal revenue tax liability shall be in accordance with the internal revenue laws and regulations applicable thereto, including all amendments of such laws or regulations enacted or promulgated prior to determination of the tax.

(d) *Periods for which computations made.*—The amount of income, declared value excess profits, excess profits, capital stock, employment, and excise taxes under the internal revenue laws will be computed for each taxable year or period during all or part of which property is vested prior to the return of the property. In the case

of a return of property prior to computation of tax, see § 302.1–3. Where vesting occurs during a taxable year or taxable period, any return filed or computation made covering vested or nonvested property should nevertheless be for the entire year or period. See paragraph (b) of this section. Unless facts are available indicating a liability for taxes for a taxable year or period occurring wholly prior or subsequent to the period of vesting of the property by the Attorney General, the computations under the regulations in this part, both tentative and final, will be made only in respect of years and periods during all or part of which the property is held by the Attorney General.

(e) *Tentative computation.*—In order that the return of property or other appropriate action may not be delayed until the amount of taxes payable is finally computed and paid, a tentative computation of such amount will be made in every case, unless there are circumstances appearing to make such action inappropriate. Such circumstances would include (1) return of the property in accordance with § 302.1–3, (2) notice to the Commissioner by the person to whom the property is returnable or by the Attorney General that such person or the Attorney General, as the case may be, prefers that the return of the property be postponed until the amount of such taxes can be finally computed or (3) belief on the part of the Commissioner that a final computation will not unduly delay the return of, or other appropriate action with respect to, the property. In making any such tentative computation of income, profits, or estate tax, the gross income or the gross estate, as the case may be, as shown by the records of the Attorney General (excluding therefrom items exempt from taxation) shall be considered as the taxable or net income or taxable or net estate, respectively, unless a tax return has been filed or facts are available upon which a more accurate computation can be made. In any case in which a duly authorized officer or employee of the Internal Revenue Service has otherwise computed the amount of taxes payable in respect of any period, such computation will be accepted as a tentative computation, unless the facts clearly indicate that a more accurate computation can be made.

(f) *Final computation.*—(1) *General.*—A final computation of the amount of taxes payable by the person to whom property is returnable, or out of property to be returned, will be made as soon as practicable in every case. In any case in which the amount shown by a tentative computation has been paid, refund or credit of any amount paid in excess of the amount properly due will be made in accordance with the final computation, even though a claim therefor has not been filed, if the period of limitation applicable to the filing of such claim has not expired. However, if it is desired to protect the right to any credit or refund determined to be due, a claim for credit or refund should be filed. The sufficiency of any such claim in respect of an amount paid in accordance with a tentative computation under the regulations in this part will not be questioned solely because facts upon which a more accurate computation could be made are not available or cannot be established at the time such claim is filed. Any such claim in respect of an amount paid in accordance with a final computation must, however, clearly set forth in detail under penalties of perjury all the facts relied upon in support of the claim

and must conform to the regulations applicable to an ordinary claim for refund or credit. See § 302.1–7 relating to claims for credit or refunds.

(2) *Information required.*—(i) *Income and profits taxes.*—The following information submitted under penalties of perjury by or for the taxpayer is necessary in each case for a final computation, for each taxable year for which the computation is to be made:

(*a*) All income (other than income received by the Attorney General) from sources within the United States, or if no such income has been received, then a statement to that effect, except that in the case of a citizen or resident of the United States, income from sources without as well as within the United States must be shown.

(*b*) If a return of such income has been made, then the following data in respect of such return:

(*1*) The taxable year for which the return was made and the tax (whether income, declared value excess profits, or excess profits tax) paid;

(*2*) The name of the taxpayer for whom the return was made;

(*3*) The name of the agent or other person (if any) by whom such return was made;

(*4*) The office of the district director in which such return was filed.

(*c*) Such other facts as may be required, from time to time, by the Commissioner.

(ii) *Other taxes.*—Except as otherwise provided in subdivision (i) of this subparagraph, in order to make a final computation of the amount of any internal revenue tax payable by return in any case, the usual return should be filed, together with the supporting documents required by the regulations pertaining to the tax.

(g) *Tax returns*—(1) *General.*—In many cases allowance of deductions and credits is contingent upon the making of a return in accordance with the applicable internal revenue law. The submission of evidence relative to income or profits tax in accordance with subdivisions (*a*) and (*c*) of paragraph (f) (2) (i) of this section will be considered as the making of the return required by any such law, only (i) for any taxable period, ending on or before December 31, 1946, during all or part of which all or part of the property of the taxpayer was held by the Attorney General, or (ii) for any taxable period ending within one year from the date of the first return to the taxpayer of any part of the property held by the Attorney General, whichever period ends later. In all other cases a return will be required in accordance with the applicable internal revenue law and regulations. In the case of returns where property is vested during a taxable year or period, see paragraph (d) of this section.

(2) *Estates and trusts.*—In the case of estates and trusts the fiduciaries shall file returns, including information returns as required by section 147 of the Internal Revenue Code of 1939 or section 6041 of the Internal Revenue Code of 1954.

(3) *Income tax forms to be used.*—(i) *General.*—In the case of taxpayers engaged in trade or business in the United States Forms 1040B and 1120, as may be appropriate, shall be used. Where the taxpayer is not engaged in trade or business in the United States, Form M797 may be used in lieu of Forms 1040NB, 1040NB–a, and 1120NB.

(ii) *Definition.*—When used in subdivision (i) of this subparagraph, the term "engaged in trade or business in the United States" includes the managing and renting of real estate in the United States by an agent of the Attorney General or of the former owner duly authorized to execute rental agreements and to pay all taxes and charges incident to the repair and maintenance of such property, but does not include the mere renting or leasing of property under agreement requiring the lessee or occupant to pay taxes and to make repairs or improvements.

§ 302.1–5 PAYMENT OF TAXES.—(a) *Pursuant to tentative computations.*—The amount of taxes shown by a tentative computation, shall be paid by the Attorney General or the taxpayer, as the case may be, to the district director as soon as practicable after the tentative computation has been made. It will not be necessary, however, for the payment by the Attorney General to be made prior to the return of property if an amount sufficient to cover all internal revenue taxes is retained from the property by the Attorney General.

(b) *Pursuant to final computations.*—Upon a final computation of internal revenue taxes properly payable, the amount thereof remaining unpaid shall be paid by the Attorney General to the district director as soon as practicable after the final computation has been made, or, in case the property has been returned to the former owner, by such owner. If the final computation shows that the full amount of internal revenue taxes properly payable is less than the amount previously paid, the difference shall be credited or refunded in accordance with the provisions of the regulations in this part and other applicable regulations. A final computation will not prohibit a subsequent recomputation if it is determined that the amount shown by the final computation is erroneous.

(c) *Deficiency procedure.*—The Attorney General shall pay internal revenue taxes without regard to the provisions of law relating to the sending of a deficiency notice by certified or registered mail or to notice and demand.

§ 302.1–6 INTEREST AND PENALTIES.—(a) *Liability for interest and civil penalties.*—Under subsection (d) of section 212 of the Act there is no liability for interest or penalty on account of any act or failure of the Attorney General. Such subsection is not applicable to interest or penalties payable in respect of any act or failure during the period prior to the vesting of the property by the Attorney General, or after the return of the property, or during the period which the property was vested by the Attorney General on account of an act or omission of any person other than the Attorney General.

(b) *Adjustment.*—In case of any assessment or collection, or credit or refund, of interest or a civil penalty contrary to section 212 (c) or (d) of the Act, proper adjustment shall be made.

§ 302.1–7 CLAIMS FOR CREDIT OR REFUND.—(a) *Time for filing claims.*—Claims for credit or refund must be filed within the period prescribed by section 322 of the Internal Revenue Code of 1939 or by section 6511 of the Internal Revenue Code of 1954, as modified by section 212(c) of the Act. Any such claim must contain a detailed statement under penalties of perjury of all the facts relied upon in support of the claim and should be filed with the district

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director of the district in which the tax was paid. See paragraph (f) (1) of § 302.1–4 relating to final computation.

(b) *Attorney General acting for taxpayer.*—Any act of the Attorney General for, or on behalf of, a taxpayer in respect of any claim under the regulations in this part will be considered as the act of such taxpayer, unless such taxpayer notifies the Commissioner in writing, by the filing of a claim for refund or credit or otherwise, that he does not ratify such act. See paragraph (b) of § 302.1–4 relating to relationship of Attorney General and former owner.

(c) *Refund payable to Attorney General.*—All refund of taxes paid by the Attorney General shall be made directly to that official.

CHARLES I. FOX,
Acting Commissioner of Internal Revenue.

Approved July 1, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 8, 1960, 8:48 a.m., and published in the issue of the Federal Register for July 9, 1960, 25 F.R. 6469)

T.D. 6483 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 17.—TEMPORARY RULES RELATING TO THE DEALER RESERVE INCOME ADJUSTMENT ACT OF 1960

Temporary rules relating to elections or other actions by taxpayers under the provisions of such Act.

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

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

The following rules, prescribed under the Dealer Reserve Income Adjustment Act of 1960 (74 Stat. 124) [P.L. 86–459, C.B. 1960–1, 795], relate to certain elections or other actions by taxpayers under the provisions of such Act.

The rules set forth herein are temporary rules designed to inform taxpayers as to how, when, and where to perform certain acts required or permitted under the Dealer Reserve Income Adjustment Act of 1960. More comprehensive rules with respect to the subject involved will be incorporated in subsequent regulations under the Act. The inclusion in this Treasury Decision of rules relating to certain acts is intended to assist taxpayers in the performance of such acts. Rules with respect to other acts required or permitted by other provisions of the Act will be covered in subsequent regulations.

In order to prescribe temporary rules relating to certain elections or other actions by taxpayers under the provisions of the Dealer Reserve Income Adjustment Act of 1960, the following rules are hereby adopted:

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[1] 25 F.R. 6879.

§ 17.1–1 Elections Under Dealer Reserve Income Adjustment Act of 1960.—(a) *In general.*—The Dealer Reserve Income Adjustment Act of 1960 (74 Stat. 124) contains transitional provisions relating to adjustments to income resulting from a change in the income tax treatment of "dealer reserve income". This Act applies to any person who, for his most recent taxable year ending on or before June 22, 1959, (1) computed, or was required to compute, taxable income under an accrual method of accounting, (2) treated any dealer reserve income, which should have been taken into account (under the accrual method of accounting) for such taxable year, as accruable for a subsequent taxable year, and (3) before September 1, 1960, makes an election under either section 3(a) or 4(a) of the Act. These elections relate to the manner of computing adjustments to income resulting from the change in the treatment of "dealer reserve income". Section 4(b) provides an election in certain cases for the payment in installments of the net increase in tax resulting from the exercise of the election under section 4(a). These elections are applicable only with respect to adjustments resulting from the change in the treatment of dealer reserve income and the increase or decrease in tax resulting therefrom. For a definition of "dealer reserve income", see section 5(a) of the Act.

(b) *Elections.*—(1) *Election to have section 481 apply.*—Section 3(a) provides that if the taxpayer makes an election under that section, the change in the treatment of dealer reserve income shall be treated as a change in method of accounting not initiated by the taxpayer to which section 481 of the Internal Revenue Code applies. The year in which the change is considered to have been made is the earliest of the years described in section 3(b) in which the treatment of dealer reserve income is changed to a method proper under the accrual method of accounting.

(2) *Election to have section 481 not apply.*—Section 4(a) provides that if the taxpayer makes an election under that section, the change in the treatment of dealer reserve income shall be treated as not a change in method of accounting to which section 481 of the Code applies. An election made under section 4(a) shall apply to all taxable years ending on or before June 22, 1959, for which the assessment of any deficiency, or for which refund or credit of any overpayment, was not, on June 21, 1959, prevented by the operation of any law or rule of law. If a valid election is made under section 4(a), whether or not an election under section 4(b) is also made, no interest shall be imposed on any underpayment and no interest shall be paid on any overpayment attributable to such election for the period beginning on the date of the election and ending on the date prescribed for payment of the tax for the taxable year in which the election was made.

(3) *Election to pay in installments.*—Section 4(b) provides that if an election is made under section 4(a), and if the "net increase in tax" as defined in paragraph (2) of section 4(b) exceeds $2,500, then the taxpayer may elect to pay any portion of such increase upaid on the date of election in 2 or more (but not to exceed 10) equal annual installments. In determining whether the net increase in tax resulting from the election exceeds $2,500, there shall be taken into account interest computed on any increase in tax from the due date for payment of the tax for the taxable year to which the increase relates to

the date of election. Similarly, there shall be taken into account interest computed on any decrease in tax from the date of overpayment to the date of election.

(c) *By whom election is to be made.*—(1) *In general.*—Generally, the taxpayer to whom the Act applies will exercise the elections provided therein. In the case of a partnership or a corporation electing under the provisions of subchapter S, chapter 1 of the Code, the elections shall be exercised by the persons specified in subparagraphs (2) and (3) of this paragraph, respectively.

(2) *Partnerships.*—In the case of a partnership, the election under section 3 or 4(a) shall be exercised by the partnership. If an election is made by the partnership under section 4(a), any election under section 4(b) to pay the net increase in tax in installments shall be made by each partner separately. The determination as to whether the net increase in tax resulting from the section 4(a) election exceeds $2,500 shall be made with reference to the increase or decrease in the tax of each partner attributable to the adjustment to his distributive share of the partnership income resulting from the election.

(3) *Subchapter S corporations.*—In the case of an electing small business corporation under subchapter S, chapter 1 of the Code, the election under section 3 or 4(a) shall be made by such corporation. An election under section 4(b) to pay the net increase in tax in installments shall, to the extent the net increase in tax resulting from the election is attributable to adjustments to income for taxable years for which the corporation was not an electing small business corporation, be made by the corporation. The determination as to whether the net increase in tax for such taxable years exceeds $2,500 shall be made with reference to the increase or decrease in tax of the corporation. Any election under section 4(b) to pay the net increase in tax in installments shall, to the extent the increase in tax is attributable to years for which the corporation was an electing small business corporation, be made by the shareholders separately. The determination in such a case as to whether the net increase in tax for such taxable years exceeds $2,500 shall be made with reference to the increases or decreases in the tax of each shareholder attributable to the adjustments to taxable income of the electing small business corporation resulting from the election.

(d) *Time and manner of making elections.*—(1) *In general.*—Any election made under the Act shall be made by the person described in paragraph (c) of this section before September 1, 1960, by filing a statement with the district director with whom such person's income tax return for the taxable year in which the election is made is required to be filed. Any election is irrevocable after August 31, 1960. A copy of the statement of election shall be attached to and filed with such person's income tax return for such taxable year.

(2) *Election to have section 481 apply.*—An election under section 3 of the Act shall be made in the form of a statement which shall include the following:

(i) A clear indication that an election is being made under section 3;

(ii) Information sufficient to establish eligibility to make the election; and

(iii) The year of change as defined in section 3(b).

An amended income tax return reflecting the increase or decrease in tax attributable to the election shall be filed for the year of change together with schedules showing how the tax was recomputed under section 481 of the Code. If income tax returns have been filed for any taxable years subsequent to the year of change, amended returns reflecting the proper treatment of dealer reserve income for such years shall also be filed. Any amended return shall be filed with the office of the district director with whom the taxpayer files his income tax return for the taxable year in which the election is made and, if practicable, on the same date the statement of election is filed, but amended returns shall be filed in no event later than November 30, 1960. Whenever the amended returns do not accompany the statement of election, a copy of the statement shall be submitted with the amended returns.

(3) *Election not to have section 481 apply.*—An election under section 4(a) of the Act shall be made in the form of a statement which shall include the following:

(i) A clear indication that an election is being made under section 4(a);

(ii) Information sufficient to establish eligibility to make the election; and

(iii) The taxable years to which the election applies.

Amended income tax returns reflecting the increase or decrease in tax attributable to the election shall be filed for the taxable years to which the election applies. If income tax returns have been filed for any subsequent taxable years, amended returns reflecting the proper treatment of dealer reserve income for such years shall also be filed. Any amended return shall be filed with the office of the district director with whom the taxpayer files his income tax return for the taxable year in which the election is made and, if practicable, on the same date the statement of election is filed, but amended returns shall be filed in no event later than November 30, 1960. Whenever the amended returns do not accompany the statement of election, a copy of the statement shall be submitted with the amended returns.

(4) *Election to pay tax in installments.*—(i) Except as otherwise provided in subdivision (ii) of this subparagraph, if the person making the election under section 4(a) of the Act also desires to make the election under section 4(b) to pay the increase in tax in installments, then the statement of election prescribed by subparagraph (3) of this paragraph shall include the following additional information:

(*a*) A clear indication that an election is also being made under section 4(b);

(*b*) A summary of the total increases and decreases in tax, together with interest thereon, in sufficient detail to establish eligibility to make the election; and

(*c*) The number of annual installments in which the taxpayer elects to pay the net increase in tax.

(ii) Where a partnership or electing small business corporation under subchapter S, chapter 1 of the Code, has made an election under section 4(a), and any partner or shareholder, as the case may be, desires to make an election under section 4(b), a statement of election shall be filed by such partner or shareholder containing the following information:

(*a*) A clear indication that an election is being made under section 4(b);

(*b*) A summary of the total increases and decreases in tax, together with interest thereon, of such partner or shareholder in sufficient detail to establish eligibility to make the election;

(*c*) The number of annual installments in which the partner or shareholder elects to pay the net increase in tax; and

(*d*) The office of the district director and the date on which the election under section 4(a) was filed by such partnership or corporation.

The statement of election under section 4(b) shall be accompanied by a copy of the statement of election under section 4(a) made by the partnership or by the electing small business corporation under subchapter S, chapter 1 of the Code, as the case may be.

Because this Treasury Decision merely provides temporary rules designed to inform taxpayers as to how, when, and where to perform certain acts required or permitted under the Dealer Reserve Income Adjustment Act of 1960, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in section 5(f) of the Dealer Reserve Income Adjustment Act of 1960 (74 Stat. 128) and section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DANA LATHAM,
Commissioner of Internal Revenue.

Approved July 14, 1960.

FRED C. SCRIBNER, JR.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 19, 1960, 8:49 a.m., and published in the issue of the Federal Register for July 20, 1960, 25 F.R. 6879)

(Also Part I, Section 819.) T.D. 6491 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Percentage to be used by foreign life insurance companies in determining the "minimum figure" under section 819(b) of the Internal Revenue Code of 1954, for purposes of computing declaration of estimated income tax for the taxable year 1960.

DEPARTMENT OF THE TREASURY,
Washington 25, D.C.

To Officers and Employees of the Treasury Department and Others Concerned:

Section 819(b) of the Internal Revnue Code of 1954, as added by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 136) [P.L. .86–69, C.B. 1959–2, 654], provides for the determination of a percentage to be used in determining a "minimum figure" for each foreign life insurance company described in section 819(a). Where

[1] 25 F.R. 8776.

this minimum figure exceeds the foreign life insurance company's surplus held in the United States, the amount of the "policy and other contract liability requirements" (determined under section 805 without regard to section 819(b)), and the amount of the "required interest" (determined under section 809(a) without regard to section 819(b)), must each be reduced by an amount determined by multiplying such excess by the "current earnings rate" (as defined in section 805(b)(2)). In view of the extensions granted to many domestic life insurance companies to file their 1959 returns, it will not be possible to compute the percentage required by section 819(b) prior to the expiration of the date for the filing of the declaration of estimated income tax for the taxable year 1960. Accordingly, it is hereby determined that for purposes of the declaration of estimated 1960 income tax and payments of installments thereof by foreign life insurance companies, a percentage of 12.5 (the percentage applicable for 1959) shall be used in determining the minimum figure under section 819(b). No additions to tax shall be made because of any underpayment of tax which results solely from the use of this percentage.

Because the public cannot effectively participate in the determination of the percentage announced in this Treasury Decision, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of such Act.

FRED C. SCRIBNER, Jr.,
Acting Secretary of the Treasury.

September 6, 1960.

(Filed by the Division of the Federal Register on September 12, 1960, 8:47 a.m., and published in the issue of the Federal Register for September 13, 1960. 25 F.R. 8776)

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26 CFR 601.602: Forms and instructions. Rev. Proc. 60–14
(Also Part I, Section 404; 1.404(a)–2.)

Copies of the information forms filed with the United States Department of Labor pursuant to the Welfare and Pension Plans Disclosure Act, Public Law 85–386, may be used in partial satisfaction of the requirements of section 1.404(a)–2 of the Income Tax Regulations which deals with the information to be furnished by an employer claiming deductions under section 404 of the Internal Revenue Code of 1954.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce that copies of the information forms filed with the United States Department of Labor pursuant to the Welfare and Pension Plans Disclosure Act, Public Law 85–836, 85th Congress, 29 U.S.C. 306, will partially satisfy the requirements of section 1.404(a)–2 of the Income Tax Regulations with regard to information to be furnished by employers claiming deductions under section 404 of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND.

.01 As stated in the Welfare and Pension Plans Disclosure Act, one of its purposes is to carry out the policy of the Congress to protect

the interests of participants in employee welfare and pension benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto. To carry out this policy, the Act requires the administrator of an employee welfare or pension benefit plan to (1) make available to participants or beneficiaries for examination in the principal office of the plan, copies of a description of the plan (including all amendments or modifications thereto upon their effective date) and the latest annual reports; (2) to deliver, upon written request, to a participant or beneficiary a copy of the description of the plan (including all amendments or modifications thereto upon their effective date) and a summary of the latest annual report, by mailing such documents to the last known address of the participant or beneficiary making such request; and (3) to file two copies of each description of the plan and annual report with the Secretary of Labor.

.02 The purpose of the information required by section 1.404(a)–2 of the regulations is to establish whether a pension, annuity, profit-sharing or stock bonus plan meets the requirements of section 401(a) or 404(a)(2) of the Code and that deductions claimed do not exceed the amount allowable under paragraphs (1), (2), (3), and (7) of section 404(a) of the Code. To some extent the information called for by the Welfare and Pension Plans Disclosure Act and by section 1.404(a)–2 of the regulations overlap. However, to a large extent, the information called for by the Act is not required for income tax purposes and most of the information required by the regulations is not called for by the Act. In addition to differences in subject matter, the annual report filed under the Act may be for a period other than the employer's taxable year, whereas much of the information called for by the regulations must be for a taxable year.

SEC. 3. USE OF UNITED STATES DEPARTMENT OF LABOR FORMS.

.01 Even to the extent that information filed with the United States Department of Labor satisfies part of the requirements of section 1.404(a)–2 of the regulations, filing with the United States Department of Labor will not satisfy the requirement of the regulations that information to support deductions claimed on a tax return be filed in the office of the District Director of Internal Revenue in which the employer files his tax returns. It would not be feasible for a revenue agent examining an employer's tax return to suspend the examination in order to obtain a copy of the information from the Department of Labor.

.02 In accordance with the Act, the United States Department of Labor has prepared Form D–1, Description Form, December 1958, and Form D–2, Annual Report, January 1959, and has made them available to administrators of welfare and pension benefit plans for use in carrying out the disclosure and reporting requirements of the Act.

.03 To the extent that a taxpayer may find it convenient to use a form prepared by the Department of Labor for the purpose of filing information required under the Income Tax Regulations, a completed copy of such form, filed with the tax return or identified for association with it, will be acceptable for the purposes of the part of the information called for by section 1.404(a)–2 of the regulations which the form covers. For example, a completed copy of Exhibit B–1,

Summary Statement of Assets and Liabilities, and of Exhibit B–2, Summary Statement of Receipts and Disbursements, of Form D–2, will satisfy the information requirement specified in subparagraph (6) of section 1.404(a)–2(a) of the regulations for a detailed balance sheet and a detailed statement of receipts and disbursements in the case of a trusteed plan. Similarly, items 6 and 10 of Form D–2 provide some of the information required by such subparagraph (6) for nontrusteed annuity plans. As a further example, in the case of a pension or annuity plan, item 12 of Form D–2 for a trusteed plan, or Exhibit A–2 of Form D–2 for an insured plan, will, if completed, satisfy at least part of the information requirement specified in subparagraph (7) of section 1.404(a)–2(a) of the regulations for the years in which such information must be furnished.

.04 Rather than extract certain schedules from Form D–2 for submission with income tax returns, employers may find it more convenient to submit to the office of the District Director an entire copy of Form D–2 as filed with the Department of Labor. However, even if this is done, it will not satisfy the requirements of the Income Tax Regulations with respect to information not contained in such Form D–2. For example, little or none of the information specified in subparagraphs (3), (4), (5), (8), and (9) of section 1.404(a)–2(a) of the regulations is provided for in either Form D-1 or Form D–2. These items of information must be submitted for the years in which they are required by section 1.404(a)–2 of the regulations, in addition to any information furnished on Department of Labor forms.

SEC. 4. EFFECTIVE DATE.

This Revenue Procedure will be effective July 11, 1960.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III-A, Section 5213; 201.371.) — Rev. Proc. 60–15

An applicant bottler may omit package serial numbers on Form 179, Withdrawal of Spirits Taxpaid (Revised 1960), provided such applicant bottler submits a statement that the serial numbers will be supplied by the bonded warehouseman upon filling drums of beverage spirits.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedure relating to the placing of serial numbers of packages on Form 179, Withdrawal of Spirits Taxpaid (Revised 1960), which is to be used on and after July 1, 1960.

SEC. 2. BACKGROUND.

Section 201.371 of the Distilled Spirits Plant Regulations provides, in part, that where spirits are to be withdrawn by the proprietor of the bottling premises for rectification or bottling he shall make application for such withdrawal on Form 179. The instructions on Form 179 require that the proprietor of the bottling premises making application for withdrawal shall enter on such form the serial numbers of the packages he wishes to withdraw pursuant to the appropriate withdrawal bond.

SEC. 3. CONCLUSION.

The Internal Revenue Service will not object to the applicant bottler omitting the package serial numbers on submission of a statement that such numbers will be supplied by the bonded warehouseman upon the filling of the drums. However, this permission will extend only to those bonded warehouse premises where it is a customary trade practice to fill drums of beverage spirits upon receiving orders from customers and just prior to shipment. There must also be compliance with all other pertinent provisions of the regulations, and this permission may be withdrawn if administrative difficulties or any jeopardy to the revenue ensues. As an alternative measure, the proprietor of the bottling premises may give a power of attorney to the proprietor of the bonded premises to enable him to complete Form 179 with respect to such serial numbers.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. — Rev. Proc. 60–16

Establishment of a full-time Conference Coordinator position in each internal revenue district to be responsible for the direction and execution of the informal conference function.
Revenue Procedure 56–34, C.B. 1956–2, 1396, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce certain improvements that are currently being made in the informal conference procedures in the Audit Divisions of the District Directors' of Internal Revenue offices. The objective of these improvements is to encourage more taxpayers in unagreed cases to avail themselves of informal conferences than have done so under prior procedures.

SEC. 2. BACKGROUND.

.01 Revenue Procedure 56–34, C.B. 1956–2, 1396, announced the establishment of the position of Conference Coordinator in the larger district offices and modified prior informal conference procedures. Those changes were designed to provide effective direction and control of the informal conference function at the district office level.

.02 Experience gained in the use of the procedures prescribed in Revenue Procedure 56–34 and results of further studies made in this area disclose the need for expanding the Conference Coordinator position to all districts and adding further refinements to prior procedures in order to encourage taxpayers now by-passing informal conferences to avail themselves of this opportunity to resolve unagreed issues.

SEC. 3. SCOPE.

In general, the revised informal conference procedures apply both in field audit and office audit cases. The new procedure encompasses

not only income tax cases, but also estate, gift, excise and employment tax cases.

SEC. 4. RESPONSIBILITY FOR THE INFORMAL CONFERENCE FUNCTION.

A full-time Conference Coordinator position has been established in each district which did not previously have such a position. In all district offices the Conference Coordinator is responsible for the direction and execution of the informal conference function under the supervision of the Chief, Audit Division. One or more full-time conferees will be assigned to the Conference Coordinator's Staff in every district that has a sufficient volume of work to warrant such assignments. From time to time, as need arises, other qualified technicians in the Audit Division may be temporarily assigned to the Conference Coordinator's Staff to hold informal conferences.

SEC. 5. REVISIONS IN PROCEDURE.

.01 In unagreed cases, the examining officer will, at the conclusion of the examination, prepare a statement of proposed adjustments. This statement will be mailed to the taxpayer, together with an appropriate informal conference invitation letter.

.02 The Conference Coordinator in each district will be responsible for the assignment of conferees to handle all informal conferences. These assignments will be made generally on the following basis:

(1) The Conference Coordinator will handle, or will assign a full-time member of his staff or another qualified technician in the Audit Division to handle informal conferences in all complex cases, in all cases in which the taxpayer requests that the conference be handled by a conferee who functions independently of the examining officer's group supervisor, and in all cases in which the examining officer's group supervisor disqualified himself as conferee due to his prior active participation in the case.

(2) The examining officer's group supervisor will normally be assigned to handle informal conferences in all other cases unless the best interests and rights of the Service and the taxpayer would not be served thereby. However, in this type of case, the taxpayer will be informed that if he prefers he may instead request a conference with a conferee who will function independently of the examining officer's group supervisor. All such taxpayer requests will be honored by the Conference Coordinator.

.03 In complex informal conference cases, taxpayers will be requested to submit a brief informal written statement setting forth the facts, rulings, or other data on which they rely. Although not required, such a statement would expedite the conference and assist the conferee in resolving the issues.

.04 If a taxpayer fails to avail himself of an informal conference at the time one is initially offered and subsequently files a formal protest upon receipt of the examination report and a 30-day preliminary notice, his case will be referred to the Conference Coordinator for review. If the Conference Coordinator believes the unagreed issues in the case are susceptible to being resolved at the Audit Division level, he will schedule an informal conference for the taxpayer with a member of his staff and invite the taxpayer to attend. Such invitation may be by local telephone call or by letter.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 56–34, C.B. 1956–2, 1396, is hereby superseded.

SEC. 7. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Operations) for the attention of O:A:P.

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26 CFR 601.104: Collection functions. Rev. Proc. 60–17
(Also Part I, Sections 6601, 6611; 301.6601–1, 301.6611–1.)
(Also Part II, Sections 292, 294, 3771; Regulations 118, Section 39.294–1.)

Guides and instructions to be followed with respect to the computation of restricted interest under the Internal Revenue Codes of 1954 and 1939.

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SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the provisions of the Internal Revenue Codes of 1939 and 1954 relating to restricted interest on internal revenue taxes and to set forth the procedure to be followed in the computation of restricted interest.

SEC. 2. AUTHORITY FOR AND GENERAL NATURE OF RESTRICTED INTEREST.

.01 *General provisions.*—The payment of interest is mandatory on underpayments and overpayments of any internal revenue tax unless specifically prohibited by law or by mutual agreement. See section 6601 and 6611 of the Internal Revenue Code of 1954; and sections 292, 294 and 3771 of the Internal Revenue Code of 1939.

(1) Under the general rule, interest is paid on a tax overpayment for the time the government has the use of the taxpayer's money. Interest is collected, similarly, for the time the taxpayer has the use of the government's money. The underlying objective is to determine in a given situation whose money it is and for how long the other party had the use of it.

(2) There are special provisions in law which limit or prohibit interest under certain conditions which the law stipulates. These give rise to the term "restricted interest."

.02 *Code provisions restricting and prohibiting interest.*—The 1939 and 1954 Codes define, in some instances generally and in others in specific terms, the conditions under which interest is either restricted or prohibited on internal revenue taxes. The table below lists the sections of the 1954 Code and certain other provisions having the effect of law, which govern adjustments to income resulting in deficiencies or overassessments on which interest is restricted. It also lists an identifying title of the item of income and the related provision which governs the computation of interest.

(1) Income Tax—1954 Code

Adjustments Code Section	*Subject*	*Interest restricted on—* *Underpayments*	*Overpayments*
172(b)	Net Operating Loss Carryback.	----------	6611(f)
6411(b)	Tentative Carryback Allowance.	6601(e)	6611(f)
1332	War Loss Recoveries----------	1335	1335
901	Foreign Tax Credit----------	905(c)	Not restricted
904(c)	Carryback and Carryover of Foreign Tax Credit.	----------	6611(g)
905(b)	Foreign Tax Credit for United Kingdom Income Tax on Royalties, etc.	----------	Sec. 103(c) P.L. 85–866, C.B. 1958–3, 254.
547(a)	Deficiency Dividend Deduction Personal Holding Co. Tax.	547(b)(1)	547(b)(2)
1481(a)	Renegotiation of Government Contracts.	----------	1481(b)(3) and 1481(c).
1341(b)(2)	Computation of Tax Where Taxpayer Restores Substantial Amount Held Under Claim of Right.	----------	Sec. 60(c) P.L. 85–866, C.B. 1958–3, 254.
7508	Time for Performing Certain Acts Postponed by Reason of War.	7508(a)	7508(a)
Sec. 511 Merchant Marine Act of 1936	Construction Reserve Fund----	Sec. 511(j) M.M. Act of 1936	Sec. 511(j) M.M. Act of 1936
166(a) 832(c)(6) 165(g)	Bad Debts and Worthless Securities.	----------	1954 Code Tax Not Restricted (Sec. 3771(d) 1939 Code)
802(a) as amended by P.L. 86–89	Special Provisions Relating to Life Iusurance Companies.	----------	Sec. 3(i) P.L. 86–69, C.B. 1959–2, 654

(2) Estate Tax—1954 Code

Adjustments Code Section	*Subject*	*Interest restricted on—* *Underpayments*	*Overpayments*
2011(a)	Credit for State Death Taxes--	----------	2011(c)
2014(a)	Credit for Foreign Death Taxes.	----------	2014(e)
2016	Recovery of Taxes Claimed as Credit.	2016	----------
2038(c)	Revocable Transfers—Effect of Disability in Certain Cases.	----------	Sec. 2 P.L. 86–141, C.B. 1959–2, 685

(3) Excise Taxes—1954 Code

Adjustments Code Section	*Subject*	*Interest restricted on—* *Underpayments*	*Overpayments*
6416(b)	Certain Taxes on Sales and Services.	----------	6416(b)
6416(c)	Credit for Tax Paid on Tires, Inner Tubes, Radio or Television Receiving Sets.	----------	6416(c)
6416(d)	Mechanical Pencils Taxable as Jewelry.	----------	6416(d)
Sec. 163(e) P.L. 85–859	Certain Radio Receiving Sets and Radio and Television Components.	----------	163(e) P.L. 85–859, C.B. 1958–3, 92
4243(c)	Club Dues----------	----------	Sec. 132(d) P.L. 85–859, C.B. 1958–3, 92
4226	"1956" Floor Stocks Taxes----	----------	6416(b)
6412(a)(1)	Floor Stocks Refunds Passenger Automobiles.	----------	6412(a)(1)
6412(a)(2)	Floor Stocks Refunds Trucks and Buses, Tires Tread Rubber and Gasoline.	----------	6412(a)(2)
6412(a)(3)	Floor Stocks Refunds Gasoline Held on July 1, 1961.	----------	6412(a)(3)
6412(d)	Floor Stocks Refunds Sugar and Articles in Chief Value of Sugar.	----------	6412(d)
6420(a)	Gasoline Used on Farms or for	----------	6420(a)
6421 (a) and (b)	Nonhighway Purposes, or by Local Transit Systems.		6421 (a) and (b)
4001, 4011	Prepayments of Retailers Excise	----------	Rev. Rul.
4021, 4031	Tax.		56–261, C.B. 1956–1,556
6417(a)	Coconut and Palm Oil Sold to States and Political Subdivisions thereof; and	----------	Rebate (not an overpayment)
6417(b)	Coconut and Palm Oil Exported.	----------	Rebate (not an overpayment)
6418(a)	Manufactured Sugar Used as Livestock Feed or for Distillation of Alcohol; and	----------	Rebate (not an overpayment)
6418(b)	Export of Manufactured Sugar or Articles Made Therefrom.	----------	Rebate (not an overpayment)
6419(b)	Excise Tax on Laid-Off Wager_	----------	6419(b)
6805	Stamps—Redemption of Unused Stamps.	----------	Rebate (not an overpayment)

(4) Employment Taxes—1954 Code

Adjustments Code Section	*Subject*	*Interest restricted on—* *Underpayments*	*Overpayments*
3101, 3111	Federal Insurance Contributions Act.	6205(a)	6413(a)
3201, 3221	Railroad Retirement Tax Act--	6205(a)	6413(a)
3402	Income Tax Collected at Source_	6205(a)	6413(a)
3121(1)	Foreign Subsidiaries of Domestic Corporations.	----------	3121(1)(7)(A)
3121(k)(1)	Nonprofit Organizations Waivers Certificates.	3121(k)(1)	----------

Adjustments Code Section	Subject	Interest restricted on— Underpayments	Overpayments
1402(a)(8)	Self-Employment Income (Ministers in a Foreign Country)	P.L. 880 Sec. 201(m)(2)(F) C.B. 1956–2, 1188	
1402(e)(2)	Self-Employment Income Extension of Time Within Which Ministers May Elect Social Security Coverage	P.L. 85–239 Sec. 1(c) C.B. 1957–2, 1061	
1402(c)(5)	Self-Employment Income (Lawyers, Dentists, etc.)	P.L. 880 Sec. 201(m)(2)(F) C.B. 1956–2, 1188	
1402(a)(1)	Self-Employment Income (Share-Farming Arrangements)	P.L. 880 Sec. 201(m)(2)(F) C.B. 1956–2, 1188	
1402(f)	Self-Employment Income Partner's Taxable Year Ending Before Partnership's Year Ending.	P.L. 85–840 Sec. 403 C.B. 1958–3, 85	
3302(a)	Federal Unemployment Tax	----------	6413(d)
3302(b)	Credit Against Tax Imposed by Sec. 3301.		

(5) Alcohol and Tobacco Taxes—1954 Code

Adjustments Code Section	Subject	Interest restricted on— Underpayments	Overpayments
5008(b)(2)	Distilled Spirits Withdrawn for Rectification or Bottling	----------	5008(b)(2)
5008(c)(1)	Loss of Distilled Spirits Withdrawn From Bond for Rectification or Bottling	----------	5008(c)(1)
5008(d)(1)	Distilled Spirits Returned to Bonded Premises	----------	5008(d)(1)
5008(e)	Samples for use by the United States	----------	5008(e)
5044(a)	Refund of Tax on Unmerchantable Wine	----------	5044(a)(1)
5056 (a) and (b)	Beer Removed From Market or Lost by Fire, etc.	----------	5056(a) and (b)
5063(a)	Floor Stocks Refunds on Distilled Spirits, Wines, Cordials, and Beer	----------	5063(a)
5064(a)	Losses Caused by Disaster	----------	5064(a)
Sec. 207 P.L. 85–859	Beer Lost by Reason of Floods of 1951 or Hurricanes of 1954 (1939 Code Taxes)	----------	Sec. 207 P.L. 85–859, C.B. 1958–3, 92
Sec. 208 P.L. 85–859	Losses of Alcoholic Liquors Caused by Disaster Occurring After December 31, 1954, and Before September 2, 1958.	----------	Sec. 208 P.L. 85–859, C.B. 1958–3, 92
5705(a)	Refund of Tobacco Tax Upon Withdrawal From Market, Loss, or Destruction.	----------	5705(a)
5707(a)	Floor Stocks Refund on Cigarettes.	----------	5707(a)

Adjustments Code Section	Subject	Interest restricted on— Underpayments	Overpayments
Sec. 209 P.L. 85–859	Losses of Tobacco Products Caused by Disaster Occurring After December 31, 1954, and Before September 2, 1958.	----------	Sec. 209 P.L. 85–859, C.B. 1958–3, 92
5708(a)	Losses of Tobacco Products Caused by Disaster Occurring After September 2, 1958.	----------	5708(a)
Sec. 3 P.L. 86–75 C.B. 1959–2, 679	Articles From Foreign Trade Zones.	----------	Sec. 497 Revenue Act of 1951

(6) Special Interest Provisions—1939 Code Taxes

Adjustments 1939 Code Section	Subject	Interest restricted on— Underpayments	Overpayments
P.L. 285	Claims Against Foreign Governments.	P.L. 285	P.L. 285, C.B. 1955–2, 756
Sec. 345 Rev. Act of 1951	Credit or Refund of Tax on Certain Trusts for Members of the Armed Forces.	----------	P.L. 310, C.B. 1955–2, 759
117(c)(1)(A)	Alternative Taxes—Credits Against Income Capital Gains and Losses.	----------	Sec. 2 P.L. 399, C.B. 1956–1, 853
120	Unlimited Deductions for Charitable Contributions.	----------	P.L. 408, C.B. 1956–1, 854
115(n)	Corporate Distributions Taxable as Dividends.	----------	Sec. 3(b) P.L. 629, C.B. 1956–2, 1165
502(f) and Sec. 223 Rev. Act of 1950	Exclusion in Computing Personal Holding Company Income.	----------	P.L. 370, C.B. 1955–2, 770 P.L. 85–319, C.B. 1958–1, 628
127(c)	War Loss Recoveries----------	----------	T.D. 6163, C.B. 1956–1, 635
Sec. 22(p)	Income Taxes Paid Under Contract.	----------	Sec. 92 of P.L. 85–866, C.B. 1958–3, 254
Sec. 99 of P.L. 85–866	Amounts Received by Certain Motor Carriers in Settlement of Claims Against the United States.	Sec. 99 of P.L. 85–866, C.B. 1958–3, 254	
Sec. 814	Credit for Tax on Certain Prior Transfers.	----------	P.L. 417, C.B. 1956–1, 857
P.L. 901	Reversionary Interest in Property Transferred.	----------	P.L. 901, C.B. 1956–2, 1205
812(e)(1)(D)	Bequests to a Surviving Spouse (Interest of spouse conditional on survival for limited period).	----------	P.L. 85–318 C.B. 1958–1, 627
812(e)(1)(F)	Bequests to a Surviving Spouse (Trust with power of appointment in surviving spouse).	----------	Sec. 93 of P.L. 85–866, C.B. 1958–3, 254
1954 Code Sec. 613(d)	Application of Percentage Depletion Rates to 1939 Code Tax Years Ending in 1954.	----------	Sec. 36(b) P.L. 85–866, C.B. 1958–3, 254

.03 *Application of and periods covered by 1954 and 1939 codes.*—The taxable periods to which the interest provisions of each Code apply are summarized by tax category and taxable period in the following table:

Tax category	1954 Code any taxable period		1939 Code any taxable period	
	Beginning	Ending	Beginning	Ending
(1) Income	after Dec. 31, 1953	after Aug. 16, 1954	before Jan. 1, 1954; or	either before or after Aug. 16, 1954
			on or after Jan. 1, 1954	on or before Aug. 16, 1954
(2) Estate	date of death after Aug. 16, 1954		date of death on or before Aug. 16, 1954	
(3) Gift, Employment, Excise, and Alcohol & Tobacco.	after Dec. 31, 1954		before Dec. 31, 1954	

SEC. 3. HOW TO APPLY AND COMPUTE RESTRICTED INTEREST.

.01 *General.*—(1) The income of a taxpayer for any taxable period may be adjusted under the provisions of a single section of law, resulting in a deficiency or overassessment in tax attributable to that adjustment on which interest is restricted or prohibited. However, it more often happens that an audit determination involves income adjustments under more than one section of law, resulting in a deficiency or overassessment attributable to each. This is referred to as a combination of adjustments. These deficiencies and overassessments are offset against each other resulting in (a) no change, (b) a net deficiency to be assessed or, (c) a net overassessment to be allowed. Interest is computed separately on each of the deficiencies or overassessments resulting from these adjustments and will be restricted on some adjustments but not on others.

(2) *Interest on unscheduled overpayments.*—a. In some instances when a net deficiency is to be assessed for a given taxable period, the interest computed on overpayments for the same taxable period which are not to be scheduled is less than interest computed on the deficiencies. In these instances the interest due the taxpayer is deducted from interest due the government and the deficiency is assessed together with the *net* amount of interest.

b. On the other hand, if interest on the overpayments which are not to be scheduled is greater than interest computed on deficiencies, the entire amount of deficiency interest is assessed, and the allowable interest is formally scheduled for credit to the deficiency and interest assessed.

c. Interest is never allowable on interest computed on an overpayment.

.02 *Technical Amendments Act of 1958 Sec. 83, P.L. 85-866, C.B. 1958-3, 254.*—(1) Under the previous law, situations arose when even though underpayments and overpayments offset each other, the Service collected more interest than it paid or the taxpayer received more interest than he paid.

(2) Section 83 of P.L. 85-866 eliminates these differences by amending 1954 Code sections 6601 and 6611(b), and 1939 Code sections 3794 and 3771(b). These amendments are applicable to credits made after December 31, 1957. The charts under paragraphs (3) and (4) will be used as a guide in determining interest.

(3) *Interest on underpayments satisfied by credit.—General rule.*—If any portion of a tax is satisfied by credit of an overpayment, then no interest shall be imposed on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable. The table on the following pages shows the dates to be used in computing interest:

If the amount satisfied by credit is	Assess and collect interest	
	From	To
a. Unpaid tax on which the due date is		
(a) later than the date of the overpayment	no period	
(b) earlier than the date of the overpayment	due date of tax or restricted date fixed by law	date of the overpayment.
b. Unpaid penalty, additions to the tax, or unpaid *interest on 1939 Code taxes*, when the overpayment is for a different year or different type of tax.	date of notice and demand	date of the overpayment.
c. Unpaid tax—satisfied by credit of an overpayment attributable to a restricted interest adjustment.	due date of tax	the date from which interest is allowable on the overpayment.
d. Unpaid tax—When satisfied by credit of an overpayment on which the allowance of interest is prohibited by law.		
(a) If a waiver under 6213(d) of the 1954 Code has been filed	due date of tax	30th day after filing of waiver or date of assessment, if earlier.
	If a notice and demand was issued for the unpaid tax, compute additional interest to the date of the schedule.	
(b) If no waiver has been filed	due date of tax	date of the schedule (date of payment).
(c) If the deficiency was stipulated in a Tax Court Case.	due date of tax	30th day after entry of the Tax Court decision or date of assessment if earlier.
(d) If the deficiency was determined by a Tax Court Decision which has become final in a tried case.	due date of tax	date of schedule on which the overpayment was certified.
(e) Penalties, additions to the tax (and interest on 1939 Code taxes).	date of notice and demand	date of the schedule.
e. General adjustments deficiency *extinguished* by overassessment attributable to a net operating loss carryback (Sec. 83, P.L. 85-866 not applicable)	due date of tax	last day of loss year.

If the amount satisfied by credit is	Assess and collect interest	
	From	To
f. Deficiency attributable to an excessive tentative or erroneous carryback allowance		
1954 Code Tax (interest allowed)	first day of year following loss year.	date of the overpayment so applied.
1939 Code Tax (no interest allowed)	the approximate date the taxpayer received the check or the date of the schedule if the allowance was adjusted for credit to other outstanding taxes.	30th day after waiver or date assessed if earlier.
g. Unpaid amounts satisfied by credit of interest allowable on an overpayment		
(a) Tax	due date of tax	30th day after waiver or date assessed, if earlier.
(b) Penalties and additions to the tax	date of notice and demand	date of schedule on which overpayment was certified.

(4) *Interest on overpayments credited against underpayments.—General rule.*—In the case of a credit, interest shall be allowed on an overpayment from the date of overpayment to the due date of the amount against which the credit is taken. The table below shows the dates to be used in computing interest.

If the overpayment is applied as a credit to—	Compute and allow interest	
	From—	To—
a. Unpaid tax for another year or another type of tax for a		
(a) prior year	no period	
(b) subsequent year	date of the overpayment	to due date of the tax.
b. Unpaid interest, penalty or addition to the tax		
(a) due for another year or another type of tax	date of overpayment	date of assessment of amount to which credit is applied.
(b) due for same year and same type of tax	No interest is allowable. These amounts are considered to be a part of the liability. No overpayment exists until all liability is satisfied.	

(5) *Due dates and dates of overpayment.*—For the purpose of computing interest under the foregoing tables:

a. The due date of tax is the due date of the return without regard to any extension of time for filing. In interest restricted cases, the due date is the restricted date fixed by law.

b. The due date of interest, penalty, or addition to the tax, is the date of assessment.

c. The date of overpayment is the actual date of receipt of the remittance rather than the date the schedule was signed, as provided in 1954 Code sections 7422(d) and 6407. Taxes withheld at the source or paid as estimated tax are deemed to have been paid on the due date of the return.

d. The date of overpayment in a restricted interest case is the date from which interest is allowable on the overpayment. This same date is the terminating date for charging interest on a deficiency satisfied by credit of an overpayment, or extinguished by an overassessment, attributable to a restricted interest adjustment, except that when a 1954 Code overpayment is attributable to a carryback loss, the terminating date for interest on the deficiency is the last day of the loss year.

e. The date of overpayment of an amount satisfied by credit, when recredited to other taxes outstanding, or refunded, is:

(a) if no interest was allowable under the law when the credit was made, allow interest on the amount recredited from the date the schedule was signed on which the original overpayment was certified.

(b) if no interest was payable because there was no period, allow interest on the amount recredited from the date of overpayment of the original amount credited.

(c) if interest was allowed on the credit at the time it was made, allow interest from the date to which interest was previously allowed on the amount applied as credit.

f. *Different taxpayers.*—The rules are equally applicable whether credit is applied to an open account of the same or a different taxpayer.

SEC. 4. NET OPERATING LOSS CARRYBACK.

.01 *Years to which loss may be carried.*

Net operating loss for taxable periods	*May be carried back*
Any taxable period ending after December 31, 1957	To the three preceding taxable years
Beginning after December 31, 1953 and before January 1, 1958	To the two preceding taxable years
Beginning after December 31, 1949 and ending before December 31, 1953	To the first preceding taxable year only
Beginning after December 31, 1941 and before January 1, 1950	To the two preceding taxable years

If a net operating loss exceeds the income for the preceding years to which it may be applied, the excess may be carried forward to succeeding taxable years. The years to which the loss may be carried forward is not here involved. The carryback of a net operating loss requires special consideration with respect to interest. Interest is computed under the regular rules when the loss is carried forward. Any net operating loss carried back from any taxable year must be applied first to the income for the earliest preceding taxable year to which it may be applied. If the loss exceeds the income for that year, it must be applied to the next year to which it is applicable, immediately following the earliest year, until absorbed.

.02 *General rule for determining interest period.*—(1) *Interest on overpayments.*—If the taxes for any year to which a carryback loss is applied were imposed by the 1954 Code, the taxpayer's right to relief arises on the first day after the end of the loss year. Accordingly, interest on an overpayment attributable to the carryback loss begin on that date. This is true unless the overpayment was made later than the last day of the loss year. In that event, interest begins on the actual overpayment date. If a loss occurring in a 1954 Code tax year is carried back to a year in which the taxes were imposed by the 1939 Code the taxpayer's right to relief is considered to arise on the due date of the return for the loss year. However, no interest is allowable on an overpayment attributable to the carryback loss unless a claim, or a petition to the Tax Court of the United States was filed for the year to which the loss is applied. Interest is then allowable from the date the claim or petition was filed, or from the date of overpayment, if later.

(2) *Interest on deficiencies extinguished by overpayment due to carryback loss.*—Interest is terminated on any deficiency extinguished by an overassessment attributable to a net operating loss carryback on the last day of the loss year provided the deficiency is for a 1954 Code tax year. If the deficiency is for a 1939 Code tax year interest is terminated on the due date of the return for the loss year. This is true regardless of whether the loss year is governed by the 1939 or 1954 Code.

.03 *Specific rules for determining interest periods.*—(1) Table section 4.03(2) should be used for determining applicable interest periods when making a tentative carryback adjustment or when the carryback loss is the only adjustment involved. Use table section 4.03(3) when there are combination adjustments.

(2) *Rules for determining interest period in carryback loss cases when no other adjustments are involved.*

Description of amount on which interest is computed	Adjustment	Interest period		Remarks and collateral action
		From	To	
OVERASSESSMENT				ASSESS NONPAYMENT INTEREST
Whether allowed in a tentative adjustment or on the bais of an audit determination involving no other adjustments				1. On unpaid original tax *From*: The due date of the return, or unpaid installment of tax. *To*: The last day of the loss year.
if the decrease in the liability resulting from the application of the loss is sufficient to cover the unpaid tax, and				2. On unpaid additional tax *From*: The date of notice and demand 6601(e). *To*: The last day of the loss year 6611(f).
if all of the liability (before application of the loss) for the year to which the loss is carried *has not been paid.*	Abate that part of the decrease in the liability which *has not been paid.*	No interest is allowable		3. On deferred payments not extinguished by the loss Original Tax *From*: The due date of the return or unpaid installment of tax *To*: The date of notice and demand. If not paid within 10 days interest accrues to date of payment.

Description of amount on which interest is computed	Adjustment	Interest period		Remarks and collateral action	
		From	To		
				Additional Tax *From* Date of notice and demand Code Sec. 6164(c)	*To* To date of payment. If satisfied by credit, interest is terminated on the date of the overpayment. 6601(f)(4) and 6601(g).
OVERPAYMENT Whether allowed in a tentative adjustment or on the basis of an audit determination involving no other adjustments, if the decrease in the liability resulting from the application of the loss is greater than the unpaid tax, and if all of the liability existing before application of the loss *has been paid*	REFUND	1st day after close of loss year, or the date of overpayment, whichever is later 6611(f).	A date not earlier than 30 days before issuance of the refund check. 6611(b)(2).		
	CREDIT To interest assessed on unpaid tax abated for the same year to which the loss is applied.	No interest is allowable		No overpayment exists until all of the liability for tax, interest, penalty and additions to the tax are satisfied. Such items are accretions to the tax and thus a part of the liability. *Blair* vs. *Birkenstock* (1926) 271 U.S. 348, T.D. 3886, C.B. V–1, 142 (1926), and Code Section 6659.	

	To original or additional tax due for a year *prior* to the loss year.	No interest is allowable 6611(f)----------	6611(b)(1) as amended.	1954 Code section 6611(b)(1) as amended provides that interest shall be allowed on an overpayment credited to other taxes, from the date of overpayment to the due date of the amount to which credit is taken.
	To original or additional tax due for a year *subsequent* to the loss year.	First day after the close of the loss year (unless the date of overpayment is later 6611(f).	The due date of the return for the subsequent year 6611(b)(1) as amended.	For this purpose, the due date of tax is the due date of the return without regard to any extension of time for filing, and
	To unpaid interest, penalty, or additions to the tax for another year or type of tax.	From day after the close of the loss year (or date of overpayment if later).	The date of assessment of the interest, etc.	The due date of interest is the date of assessment.
DEFICIENCY				
Erroneous or excessive tentative carryback allowance—no other adjustments.	Assessment-----	First day after close of loss year.	30th day after filing of a waiver, date of assessment or date of payment, whichever is the earliest (if paid by credit, then to date of overpayment).	Since interest is allowed on a tentative carryback allowance, interest is due on an excessive allowance from the same date from which interest was allowed. Thus, interest erroneously allowed is recovered as well as interest to the date of repayment.

(3) *Rules for determining interest period—Combination adjustments.*—a. *Net deficiency.*—

Assess and collect interest on	From	To	Authority Code Section
Any part of a general adjustments deficiency which is extinguished by an overassessment attributable to a net operating loss carryback.	Due date of return.	Last day of applicable loss year.	6601(a) 6601(e)
Any part of a general adjustments deficiency *which is to be assessed.*	The due date of the return.	Date of payment* If satisfied by credit, to the date of the overpayment so applied.	6601(a) 6601(g)
Any part of an excessive tentative carryback allowance *which is to be assessed.*	The first day of the taxable year following the loss year.	Same as above	6601(e) 6601(a) 6601(g)
Any part of an excessive tentative carryback allowance which is extinguished by a carryback overassessment from the next loss year.	First day of the next loss year.	Last day of the next loss year.	6601(e)

*30th day after waiver, date of assessment, or date of payment; if not paid in 10 days additional interest on tax only to date of payment.

b. *Net overassessment.*—

Allow interest on	From	To
Any part of a general adjustments overpayment* *which is to be scheduled.*	Date of overpayment *If refunded *If credited to unpaid original or additional tax for other years or types. If credited to unpaid interest, penalty, or addition to the tax, for another year or type.	To a date not exceeding 30 days prior to the refund check. 6611(b)(2) To the due date of the tax to which credit is taken. 6611(b)(1) To the date of assessment of the interest, etc. 6611(b)(1)
Any part of a general adjustments overpayment which is extinguished by a deficiency due to an excessive tentative carryback allowance.	Date of overpayment	Last day of the applicable loss year 6611(f)
Any part of an overpayment attributable to a carryback loss which is extinguished by a general adjustments deficiency.	No interest allowable (In effect, interest is allowed, by terminating interest on the deficiency on the last day of the loss year)	
Any part of an overpayment attributable to a carryback loss which is extinguished by an excessive tentative allowance based on a loss carryback from the next year.	First day of the next loss year 6611(f)	The last day of the next loss year 6611(f)
Any part of an overpayment attributable to a carryback loss which is to be scheduled.	First day of taxable period following the loss year 6611(f)	A date determined under Sec. 6611(b).

.04 *Reduction of deficiency interest.*—(1) When a combination of general and carryback adjustments results in a net overassessment attributable in part to each, and a deficiency was assessed at any time before application of the carryback loss, interest assessed on that deficiency must be reduced in proportion to the reduction in tax liability attributable to those general adjustments.

(2) If deficiency interest was initially computed to a date beyond the last day of the loss year, it will be necessary to recompute interest to the last day of the loss year on that portion of the deficiency extinguished by the net operating loss carryback.

.05 *Penalties.*—(1) *Not reduced.*—Penalties for delinquency in filing, negligence in reporting income, and fraud will not be reduced to reflect the effect of carryback losses. In the case of an overassessment resulting from a carryback loss, when penalty has been assessed

*All liability existing before application of the loss must have been paid.

on original or additional tax, no portion of the penalty will be allowed.

(2) *Prorated.*—If part of the allowance is due to general adjustments, the ad valorem penalty, as well as deficiency interest, will be prorated and any portion of the penalty applicable to the general adjustment overassessment will be allowed in the notice of adjustment.

(3) *Due on general adjustments deficiency.*—When penalty is to be assessed in a case involving general and carryback adjustments, the penalty is computed on the general adjustments deficiency only. The amount of penalty to be assessed should be included in the agreement, Form 870.

(4) *No credit to delinquency interest and penalty.*—No part of an overpayment is applied as a credit to penalty and interest charges asserted for delinquency when an offer in compromise has been invited or is pending, since amounts paid cannot be compromised. Taxpayers may be required to waive refunds of tax for the same year for which delinquency penalty is compromised. Forms 656, Offer and Consent, and 656-C, Offer and Consent (Deferred Installment Payments), contain an agreement and waiver regarding retention of payments previously made. Accordingly, when assessed penalty has not been paid it will be necessary to ascertain whether an offer in compromise has been invited or is pending, before applying any portion of an overpayment as a credit to the amount.

.06 *Technical Amendments Act of 1958, Public Law 85-866, C.B. 1958-3, 254—Special carryback features.*—(1) *Net operating loss deduction.*—Sections 172 (f) and (g) of the 1954 Code are amended to provide a more liberal method for computing the net operating loss deduction for years beginning in 1953 and ending in 1954 and for short taxable years beginning in 1954 and ending before August 17, 1954. A claim may be filed for credit or refund of an overpayment resulting from this amendment at any time before March 3, 1959. *No interest* is allowable on the overpayment.

(2) *Limitations on assessment and collection.*—Section 6501 of the 1954 Code is amended to provide that a deficiency for any year attributable to the application of a net operating loss carryback, including deficiencies arising from excessive tentative carryback allowances, may be assessed at any time within the period of limitation on assessment applicable to the taxable year in which the loss occurred. The same provisions are now applicable to both 1939 and 1954 Code taxes.

(3) *Limitations on credit or refund.*—Section 6511(d)(2)(A) of the 1954 Code is amended to correlate the period of limitations for filing claims for credit or refund, relating to an overpayment attributable to a net operating loss carryback, with the due date of the returns of taxpayers other than corporations. The amendment provides for filing the claim within the period which expires with the 15th day of the 40th month (or 39th month, in the case of a corporation) following the end of the loss year.

(4) *Interest attributable to net operating loss carryback for certain taxable years ending in 1954.*—Section 83(e) of the Act provides that when, by reason of enactment of section 172(b)(1)(A), the reapplication of a net operating loss from a 1954 Code

tax year to the second preceding year created a deficiency in the first year preceding the loss year and an overpayment in the second preceding year, no interest is payable on the deficiency for any period during which no interest was allowable on the overpayment. Credit or refund of overpayments of such interest may be allowed within the period of limitation applicable to the filing of a claim for the taxable period involved.

.07 *Special carryback features—Public Law 86–280, C.B. 1959–2, 689.*—(1) *Net operating loss deduction resulting from renegotiation.*—Section 6511(d)(2)(A) of the 1954 Code was further amended by Public Law 86–280 to extend the time for filing a claim for credit or refund of an overpayment attributable to the creation of, or an increase in, a net operating loss carryback as a result of the elimination of excessive profits by a renegotiation. The period shall not expire before September 1, 1959, or before the end of the 12th month following the month in which the agreement or order for the elimination of such excessive profits becomes final, whichever is the later. Section 322(b)(6) of the 1939 Code is similarly amended, except that it applies only to claims resulting from renegotiations of excessive profits received or accrued for taxable years ending after December 31, 1952.

SEC. 5. WAR LOSS RECOVERIES.

.01 *Definition.*—Upon the recovery in a taxable year of any money or property considered under section 127(a) of the 1939 Code as destroyed or seized, the amount of the recovery is included in gross income to the extent provided in section 1332 of the 1954 Code unless the taxpayer elects to have the provisions of section 1333 of the 1954 Code apply. Section 1333 relates to tax adjustment measured by prior tax benefits.

.02 *Time and manner of making election.*—An election under section 1335, once made is irrevocable and is applicable to all taxable years beginning after December 31, 1941, in which a recovery is received, whether such year is before or after the date of making the election.

.03 *Period of limitation for making assessments.*—If the taxpayer elected section 1333 for any taxable year, the period of limitation for assessment and collection shall not expire until two years after the date he made the election, with respect to (a) the amount to be added to the tax for such taxable year resulting from the application of section 1333, and (b) any deficiency for such taxable year, or any other taxable year, to the extent attributable to the basis of the recovered property being determined under section 1336(b).

04. *Period of limitation for credit or refund.*—If the taxpayer elected section 1333 for any taxable year, and refund or credit of any overpayment attributable to such adjustment is prevented by statute on the date of making such election, or within one year thereof (except in a compromise case) the credit or refund of an overpayment may nevertheless be allowed if a claim therefor is filed within one year from such date. Thus, the amount which may be refunded or credited is not subject to the limitations contained in section 6511 or 6512(b).

.05 *Taxable years ended before date election made.*—(1) *When interest is restricted.*—In the case of any taxable year ended before the date of an election under section 1335, no interest shall be allowed on an overpayment specified in section 5.04 above, and no interest shall be assessed on any deficiency specified in section 5.03 above, for any period before the expiration of six months after the date of the election. Interest begins to accrue on such a deficiency or overpayment on the first day after the end of the six months' period.

(2) *When interest is not restricted.*—Interest is not restricted if the election under section 1335 was made prior to the end of the taxable year being adjusted.

(3) *Combination adjustments.*—a. If a general adjustments deficiency is partly or entirely extinguished by an overassessment attributable to the application of section 1333, interest is computed on that part of the deficiency from the due date of the tax to a date six months after the taxpayer's election under section 1335. No interest is allowable on the part of the overassessment so offset.

Explanation: If the adjustments were to be made separately, the taxpayer would be entitled to interest on the overpayment attributable to the war loss recovery, for the period from the first day after the end of the six months' period following the date the election was made to a current date, and interest would be computed on the deficiency from the due date of the tax to a current date. Thus a mutual interest period exists from the first day after the expiration of the six months' period to the current date. The net result is obtained by terminating interest on the part of the deficiency extinguished, at the same time interest begins to accrue on the overpayment.

b. The same interest rules apply when an overpayment attributable to general adjustments is partly or entirely offset by a deficiency arising from the application of section 1333.

.06 *Change in interest provisions relating to war loss recoveries under the 1939 Code.*—Treasury Decision 6163, C.B. 1956–1, 635, amends Regulations 118 and 111 by deleting the existing interest provisions contained in section 39.127(c)–1(d)(3) and (4) and by adding a new subparagraph 39.127(c)–1(d)(5) which provides that no interest shall be assessed on any deficiency (specified in section 5.03 above) or allowed on any overpayment (specified in section 5.04 above) for any period before the expiration of six months following the making of an election under section 127(c)(5). Prior to this amendment no interest was allowable for any period on an overpayment attributable to the application of the provisions of section 127 (c)(3) of the 1939 Code, but interest was charged on a deficiency from the first day after expiration of the six months' period to the current date. Thus, the interest provisions have now been equalized on deficiencies and overpayments of 1939 Code taxes arising from this adjustment.

SEC. 6. FOREIGN TAX CREDIT.

.01 *Allowance of credit.*—Section 901(a) of the 1954 Code provides for the allowance of a credit against the income tax liability of individuals, partnerships and corporations, for the taxes paid or accrued during the taxable year to any foreign country or possession of the United States, as provided in section 901(b). The application of the credit does not require special consideration with respect to

interest unless adjustments are made as set forth in the paragraphs immediately following.

.02 *Adjustments to the credit.*—If the accrued taxes, when paid to the foreign country or possession of the United States, differ from amounts claimed as credits by the taxpayer on his return, or if any part of the tax actually paid is refunded to the taxpayer by the foreign country, the taxpayer must report the adjustment to the Secretary of the Treasury or his delegate and the tax liability will be redetermined for the year for which the adjustment was made.

.03 *Special interest rules when credit adjusted.*—(1) *Reduction in credit allowable.*—If the adjustment results in a *reduction* of the credit previously allowed, income tax liability is increased. Interest is computed on the increase from the date the taxpayer received the refund of foreign taxes paid, to the date of payment of the increase in tax. If interest on the refund was paid to the taxpayer by the foreign country:

a. An amount is added equal to such interest received by the taxpayer to the interest computed on the increase; and

b. The increase in tax together with the sum of the two amounts of interest is assessed. Sec. 905(c) and G.C.M. 18801, C.B. 1937–2, 302.

(2) *Accrued foreign tax abated.*—If the credit claimed on the return was for accrued taxes which were abated by the foreign country or possession of the United States, interest is computed on the increase in tax resulting from the reduction in the credit allowable, from the date such adjustment was made by the foreign country to the date of payment of the tax.

(3) *Increase in credit allowable.*—If the adjustment results in an *increase* in the credit previously claimed and allowed, income tax liability is decreased. There are no special rules with respect to the allowance of interest on overpayments attributable to an increase in the credit allowable. Accordingly, interest will be allowed on any overpayment resulting from an increase in the amount of credit allowable from the date of overpayment of the tax to a date determined under the rules applicable to credits and refunds.

.04 *Time for filing claim for foreign taxes paid or accrued.*—If a claim for credit or refund relates to an overpayment attributable to an adjustment of taxes paid or accrued to a foreign country or possession of the United States, for which a credit has been allowed under section 901, the period for filing is 10 years from the due date of the return for the year with respect to which the claim is made. The amount of the credit or refund based on such a claim may exceed the part of the tax paid within the period prescribed in section 6511 (b) or (c) to the extent the overpayment is attributable to the allowance of a credit under section 901.

.05 *Carryback and carryover of foreign tax credit.*—(1) Section 904(c) was added to the 1954 Code, by the Technical Amendments Act of 1958, P.L. 85–866, C.B. 1958–3, 254. This section provides for the carryback and carryover of foreign tax credit. The credit may be carried back only to taxable years beginning on or after January 1, 1958.

(2) Section 6611(g) was also added to the 1954 Code by the 1958 Act. This section provides that for the purpose of allowing interest

on an overpayment resulting from a carryback of foreign tax credit under section 904(c), the overpayment shall be deemed not to have been paid or accrued prior to the close of the taxable year in which such taxes were in fact paid or accrued. Accordingly, interest on the overpayment will be allowed from the first day after the close of that year.

.06 *Foreign tax credit for United Kingdom income tax paid with respect to royalties, etc.*—Section 905(b) of the 1954 Code, relates to proof of credits with respect to income from sources without the United States. The Technical Amendments Act of 1958 amended section 905(b) to provide that the recipient of a patent or copyright royalty from the United Kingdom can take a foreign tax credit equal to the tax deducted from royalty payments received from the United Kingdom if he elects to include the amount of the United Kingdom tax in his income. A similar amendment is made to 1939 Code section 131(e). These amendments apply to all taxable years beginning after 1949. No interest is allowable on any overpayment resulting from these amendments.

SEC. 7. PERSONAL HOLDING COMPANY TAX.

.01 *Deficiency dividend deduction.*—Section 547(a) of the 1954 Code provides that if liability for personal holding company tax is established for any taxable year, the taxpayer shall be allowed a deduction for the amount of deficiency dividends (as defined in section 547(d)) for the purpose of determining the personal holding company tax for that year, but not for the purpose of determining interest, additional amounts, or assessable penalties with respect to the tax. Section 506(a) of the 1939 Code provides for a deficiency dividend credit against the tax established instead of a deduction for the amount of deficiency dividends for the purpose of determining the tax.

.02 *How liability is established.*—Under section 547(c) (or comparable section of prior law) liability for personal holding company tax may be established by

(1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;

(2) a closing agreement under section 7121 (Form 866, Agreement as to Final Determination of Tax Liability);

(3) an agreement (Form 2198, Determination of Liability for Personal Holding Company Tax)—(new provision under the 1954 Code)

.03 *How and when to claim deficiency dividend deduction.*—The Internal Revenue Service informs the taxpayer how he may secure the benefits of section 547 and furnishes him Form 976, Claim for Deficiency Dividends Deduction. To qualify for such benefits the taxpayer must

(1) have committed no fraud;

(2) distribute the dividend within 90 days after the deficiency was established; and

(3) file his claim (Form 976) after such distribution and within 120 days after the deficiency was established.

.04 *Processing in Collection Division.*—(1) *If established by agreement Form 2198 or closing agreement Form 866*

Conditions	Collection Division procedure	Compute interest	
		From	To
a. If a timely claim Form 976 is filed and the tax on the deficiency dividend deduction approved is identical with the PHC tax deficiency established.	*Do not assess any part of the tax,* but assess and collect interest computed on the full deficiency.	due date of the tax	date the claim Form 976, was filed.
b. If the PHC deficiency established *exceeds* the amount attributable to the deficiency dividend deduction approved.	Assess and collect *only the excess,* together with interest, and	due date of the tax if Form 2198	30th day after the waiver (870) became effective or, the date of assessment if earlier.
		if Form 866 if the tax (to be collected) is satisfied by credit	date of assessment. To the date of overpayment of the amount so applied.
	in addition to the above, assess and collect interest only, computed on that part of the established PHC deficiency equal to the tax attributable to the deficiency dividend deduction approved.	due date of the tax	date the claim Form 976 was filed.

(2) *If established by a Tax Court decision or judgment.*—

a. If the claim, Form 976, is *not filed* before the 55th day after the court decision became final.	On the 55th day or, the first working day thereafter, assess the full amount of the PHC deficiency so established, together with interest.	due date of the tax	date of assessment.
		Do not issue notice and demand until the 120 day period for filing the claim has expired, and then only if no claim is filed.	

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Conditions	Collection Division procedure	Compute Interest	
		From	To
b. If the claim *is filed* on or before the 55th day after the decision became final, and			
(A) the PHC deficiency established *is identical* with the tax on the deficiency dividend deduction approved.	*Do not assess any part of the tax*, but assess and collect interest computed on the full deficiency.	due date of the tax	date the claim Form 976 was filed.
(B) the PHC deficiency established *exceeds* the tax on the deficiency dividend deduction approved.	Assess and collect *only the* excess, together with interest. *This part of the tax must be assessed within 60 days after the decision became final.*	due date of the tax If the tax (to be collected) is satisfied by credit, then	date of assessment. to the date of overpayment of the amount so applied.
In addition to the above, assess and collect *interest only* on the part of the deficiency equal to the tax attributable to the deficiency dividend deduction approved.		due date of the tax	date the claim Form 976 was filed.
(C) If the claim Form 976 is filed between the 55th and 60th day after the decision became final.	*Abate* that part of the assessment of tax which equals the tax on the deficiency dividend deduction approved. *Collect* the excess tax, if any, together with the proportionate interest previously assessed.		
	Recompute and collect interest only, on the part of the tax equal to the amount attributable to the deficiency dividend deduction approved.	due date of the tax	date the claim Form 976 was filed.
(3) *If the PHC tax has been assessed and paid.—*			
If the PHC tax was prematurely paid and the allowance of a deficiency dividend deduction results in an overpayment.	The allowance must be made within 2 years after the overpayment was determined.	No interest is allowable on the overpayment.	

SEC. 8. RENEGOTIATION OF CONTRACTS.

.01 *Definition.*—Section 1481(a) of the 1954 Code provides in part that if any contract between the United States, or any agency thereof, and a taxpayer is renegotiated and an amount of excessive profits is eliminated, the taxpayer is required to pay or repay to the contracting agency of the Government the amount of the excessive profits.

.02 *Tax credit.*—If the excessive profits have been reported in income for a prior year, section 1481(b) provides that a credit shall be allowed, *by the contracting agency of the government*, against the repayment, in an amount equal to the tax applicable to the income so reported which was reduced by renegotiation. This credit is never scheduled by the District Director of Internal Revenue.

.03 *Renegotiation stamp on return.*—After the excessive profits have been repaid to the contracting agency, the Renegotiation Board (or the agency) will inform the District Director with respect to the amount of taxes assessed or paid which have been allowed in the renegotiation settlement. Upon receipt of this information, the original return will be properly stamped to indicate the necessary information.

.04 *No interest allowable when credit deducted from repayment.*—No interest is allowable on the tax credit when deducted by the contracting agency from the repayment of excessive profits. Section 1481(b)(3) provides that if interest has been charged (by the contracting agency) on an item of cost disallowed in a cost-plus-a-fixed-fee contract, the amount so charged is added (by the agency) to the amount of the credit deducted from the excessive profits. This adjustment for interest charged by the contracting agency is an audit adjustment, to be considered when the amount of credit allowable is determined and is not to be added to the tax credit.

.05 *Interest allowable when credit not deducted from repayment.*—If the amount allowable as a credit has not been deducted by the contracting agency, or if an insufficient amount has been deducted, the additional credit allowable shall be scheduled by the Internal Revenue Service as an overpayment for the purpose of allowing interest under section 6611. The tax is considered overpaid on the date repayments of the excessive profits to the contracting agency were completed. If a part of the tax liability, for the year affected by renegotiation, was paid after repayments of excessive profits to the contracting agency were completed, interest is allowable only from the date the tax was actually paid.

.06 *Subsequent overassessments.*—Credits under section 1481(b) are considered as having been allowed from the most recent payments of tax made before the date the contracting agency notifies the District Director that the credit has been allowed. If the tax paid prior to that date is not sufficient to absorb the full credit, the balance is considered as having been allowed from payments immediately following the date of notification. Any refund or credit subsequently allowed by the District Director must be made from payments of tax not previously allowed in the 1481(b) credit. This is important in determining the validity of a claim, depending for statute purposes on amounts paid within two years of filing.

.07 *Preparation of allowance documents.*—Allowance documents prepared for any year for which the return bears a renegotiation stamp will indicate the credit as an addition to the tax liability rather than as a previous allowance, as follows:

Assessed:	*Tax*		
Account No. ----------			$100,000
Total assessed			$100,000
Less: Credit, Sec. 1481(b)			
I.R.C. of 1954		$15,000	
Correct liability		50,000	65,000
Overassessment			$35,000

.08 *Federal tax benefit.*—If the Renegotiation Board determines that excessive profits repaid by a taxpayer should be restored to the taxpayer, the result is an increase in taxable income. The tax is not assessed as a defiiciency by the District Director but is deducted by the Board (or agency) from the rebate to the taxpayer in arriving at the net renegotiation rebate. The Board (or agency) will request the District Director to determine the tax attributable to the amount of the rebate. After the amount of tax has been determined and approved, the Board is informed as to the amount of the Federal tax benefit. The Board then notifies the District Director when the net renegotiation rebate has been certified for payment to the taxpayer. At that time, the amount of the Federal tax benefit is entered on the return. Since a Federal tax benefit is in the nature of an assessment, it must be shown as a deduction from the 1481(b) credit in any subsequent adjustment of the tax liability, as follows:

Assessed:	*Tax*		
Acct. No. (original)			$100,000
Acct. No. (additional)			25,000
Total assessed			$125,000
Less: Credit, Sec. 1481(b)			
I.R.C. of 1954	$30,000		
Federal Tax Benefit	10,000	$20,000	
Correct liability		65,000	$85,000
Overassessment			$40,000

.09 *Tax credit based on assessment rather than payment.*—The tax credit is generally computed on all taxes assessed. In most instances, payment has been made in full before the allowance of the credit by the renegotiating agency. However, when the Service has knowledge of an unpaid amount of assessed tax, payment of which is in doubt, the computation is made on the basis of taxes paid. Thus the credit allowed by the renegotiating agency is limited to the overpayment of tax. In some instances the credit is computed on the basis of taxes assessed which have not been paid in full, and the credit has been allowed by the renegotiating agency. If the tax is not later paid, the amount of the credit allowed in excess of the amount allowable based on taxes paid, will be assessed as a deficiency (Revenue

Ruling 55–474, C.B. 1955–2, 673). Interest will be charged on such deficiency from the date the excessive credit was allowed. The date will be furnished by the contracting agency. For example:

The taxpayer reported income of $500,000 and tax liability of	$300,000
The income was later reduced to $300,000 by renegotiation with a tax liability of	175,000
A credit was allowed in the amount of	$125,000
It was later determined that the total tax paid was	$100,000
Assessment will be made of with interest computed from the date the excessive credit was allowed.	$25,000

.10 *Concurrent determination.*—If an audit determination indicates a concurrent general adjustments deficiency and an overpayment of tax due to renegotiation (when the credit was not deducted by the contracting agency), interest is computed on the general adjustments deficiency from the due date of the tax to the date the excessive profits were repaid to the contracting agency and no interest is allowed on the overpayment. (The right to the overpayment which extinguished the deficiency arose on the date the excessive profits were repaid.) If the overpayment exceeds the deficiency, interest is allowed on the excess only from the date of the repayment of the excessive profits or the date of payment of the tax, whichever is later.

.11 *Termination of applicable provisions.*—The provisions of the Renegotiation Act of 1951 were extended by Public Law 86–89, C.B. 1959–2, 680, to continue its application to receipts and accruals attributable to performance under contracts or subcontracts, through June 30, 1962. The previous termination date was June 30, 1959.

.12 *Computation of tax where taxpayer restores substantial amount held under claim of right.*—The Technical Amendments Act of 1958, Public Law 85–866, C.B. 1958–3, 254, amends Section 1341(b)(2) of the 1954 Code. This section provides special rules applicable to the recomputation of tax when the taxpayer restores a substantial amount held under claim of right. The new provision relates to price redeterminations in connection with certain subcontracts subject to statutory renegotiation with the United States Government. The amendment is applicable to 1954 Code years with respect to subcontracts entered into before January 1, 1958. *No interest* is allowable on any overpayment resulting from the application of this amendment.

SEC. 9. TIME FOR PERFORMING CERTAIN ACTS POSTPONED BY REASON OF WAR.

.01 *Period of time to be disregarded.*—Section 7508(a) of the 1954 Code provides in part for disregarding a period of time when determining whether certain acts were performed within the time prescribed, or in determining the amount of any credit or refund, including interest. In the case of an individual serving in the Armed Forces, or in support of the Armed Forces, the period to be disregarded is that during which the individual serves in a combat zone during a period of combatant activities, or is hospitalized outside the United States as a result of such services, and the next 180 days thereafter. No

interest is charged on any deficiency or allowed on any overpayment during the period to be disregarded.

.02 *Period of combatant activities.*—The period of combatant activities is determined by Executive Order. June 27, 1950, is considered the date combatant activities began in the combat zone designated in Executive Order 10195, C.B. 1951–1, 6, relating to the conflict in Korea. The period of time which may be disregarded in determining the period of limitations for performing any of the acts designated under section 7508(a) of the 1954 Code, or 3804(f) of the 1939 Code, ended July 30, 1955. This is the 180th day after January 31, 1955, designated in Executive Order 10585 C.B. 1955–1, 17, as the date combatant activities in Korea ceased. Rev. Rul. 56–298, C.B. 1956–1, 597.

SEC. 10. CONSTRUCTION RESERVE FUND—MERCHANT MARINE ACT OF 1936.

.01 *Definition.*—Section 511 of the Merchant Marine Act of 1936 (as added by the Act of October 10, 1940 (54 Stat., 1106; 46 U.S.C. 1161), and as amended by the Act of June 17, 1943, P.L. 78, 78th Cong., provides that for the purposes of promoting the construction of vessels * * * certain taxpayers may, upon application, establish a construction reserve fund (with the Maritime Commission) for the construction or acquisition of new vessels. The fund contains deposits of proceeds from sales of vessels, indemnities on account of losses of vessels, earining from operation of vessels and receipts (interest or otherwise) from amounts previously deposited. Earnings may accumulate in the fund without regard to the provisions of section 102 of the 1939 Code (531 of the 1954 Code), and are included in taxable income only when withdrawn.

.02 *Withdrawals from the fund.*—Section 511(i) of the Act prescribes the circumstances under which earnings deposited in the fund must be reported in income for any taxable year. That is the date when funds are withdrawn for purposes other than those for which the fund was established, or when the taxpayer has failed to comply with certain requirements.

.03 *Period of limitations upon assessment.*—Any additional tax due on account of withdrawals from the fund, or failure to comply with the provisions of the statute or the regulations, is collectible as a deficiency and may be assessed, together with the interest thereon, or a proceeding in court for the collection thereof may be begun without assessment, at any time, without regard to any period of limitations. Treasury Decision 5330, C.B. 1944, 720.

.04 *Interest period.*—(1) *Begins with date of withdrawal.*—Section 511(j) of the Act provides that interest upon any deficiency resulting from the inclusion in gross income of any gain (previously deposited in the fund) shall not begin until the date of such gain is required to be reported in income.

(2) *Combination of adjustments.*—If an audit determination results in a combination of general and carryback adjustments together with a deficiency arising from withdrawals from the construction reserve fund, interest will be computed as follows:

Adjustment	Allow interest	
	From	*To*
1. On any general adjustments overpayment extinguished by a deficiency due to withdrawal.	date of overpayment.	date of withdrawal
2. On any overpayment attributable to a carryback loss extinguished by a deficiency arising from a withdrawal on a date after the end of the loss year.	First day of year following loss year.	date of withdrawal
3. On the part of a deficiency, arising from a withdrawal, which is extinguished by either a general or carryback overassessment.	Assess no interest	
On any remainder	date of withdrawal.	date of payment*

*If satisfied by credit then to the date of the overpayment.

SEC. 11. BAD DEBTS AND WORTHLESS SECURITIES.

.01 *Definition.*—Section 166(a) of the 1954 Code provides for allowance as a deduction of any debt which becomes worthless within the taxable year. Section 832(c)(6) provides for allowance as a deduction against the income of an insurance company, of certain debts which become worthless within the taxable year. Section 165(g) provides that if any security which is a capital asset becomes worthless during the taxable year, the resulting loss shall be treated as a loss from the sale or exchange of a capital asset.

.02 *Seven-year period of limitation.*—Section 6511(d)(1) provides that if a claim for credit or refund relates to an overpayment of income tax resulting from a deduction under one of the sections mentioned in the preceding paragraph, in lieu of the 3-year period of limitation prescribed in section 6511(a), the period shall be 7 years from the due date of the return for the year with respect to which the claim is made. If the claim relates to the effect a bad debt or worthless security deduction has on a carryback, the period shall be either

(1) 7 years from the due date of the return for the year of the loss, or

(2) the period ending with the 15th day of the 40th month (39th month if the taxpayer is a corporation) following the end of the loss year, or

(3) the period ending 6 months after the expiration of the period within which an assessment may be made under a consent, Form 872, Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax,

whichever of such periods expires last.

.03 *Interest restricted on 1939 Code taxes only.*—Section 3771(d) of the 1939 Code, relating to claims based on deduction for bad debts or worthless securities, provides that if credit or refund of an overpayment would be barred except for the special 7-year period provided in section 322(b)(5), or 322(d)(2) relating to Tax Court cases, no interest shall be allowed on any overpayment for any period beginning after the expiration of the period provided in section 322(b)(1) and ending at the expiration of six months after the date the claim was filed, or if no claim was filed and the overpayment was found by

the Tax Court, ending with the date the petition was filed. Interest will be allowed on such an overpayment if the year is still open under the regular statute. If the special statutory provision is required for allowance, then interest will be allowed on such an overpayment only from the day after the end of the six-month period following the date the claim was filed to the date of allowance. The 1954 Code contains no provisions restricting the allowance of interest in connection with bad debts and worthless securities.

SEC. 12. CREDIT FOR STATE AND FOREIGN DEATH TAXES.

.01 *Definition.*—(1) Section 2011(a) of the 1954 Code allows the estates of citizens or residents of the United States, dying after August 16, 1954, to claim as a credit against their Federal estate tax an amount equal to any State estate, inheritance, legacy or succession taxes owed and paid by the decedent.

(2) Section 2014(a) provides a similar credit for such taxes paid to a Foreign Country with respect to property situated therein. If the decedent was not a citizen of the United States, the credit is allowed only if the country of which he was a citizen allows a similar credit to citizens of the United States residing in that country.

.02 *Time for filing claim and making allowance.*—The credit shall include only those taxes for which the proof required has been established and for which a claim has been filed,

(1) In general, within 4 years after the estate tax return was filed, or

(2) If a petition to the Tax Court was filed, then within the 4-year period or within 60 days after the decision of the Tax Court becomes final, or

(3) If an extension of time was granted for paying the tax, then within the 4-year period or before extension period ends, or

(4) If the claim for credit was filed within the time prescribed in section 6511, then within the 4-year period or within 60 days after the mailing of a registered notice of disallowance of any part of the claim, or within 60 days after a court decision becomes final with respect to a timely suit based on the claim, whichever is later. This provision was added by the Technical Amendments Act of 1958, Public Law 85–866, C.B. 1958–3, 254. The 1939 Code was similarly amended.

.03 *No interest allowable on overpayments.*—Sections 2011(c) and 2014(e) provide that refunds of overpayments based on credits for State and foreign death taxes may be made (despite the provisions of sections 6511 and 6512) if the claim is filed within the period prescribed in the preceding paragraph. No interest is allowable on these refunds.

.04 *Recovery of taxes claimed as credit.*—Section 2016 provides that if any tax claimed as a credit under section 2011 or 2014 is recovered (from a state or foreign government) by the taxpayer, notice shall be given to the Secretary or his delegate. The estate tax will be redetermined; and, without regard to the statute of limitations provided in section 6501, the amount of any estate tax due upon redetermination shall be paid upon notice and demand.

.05 *Interest on deficiency due to recovery.*—(1) Interest is computed under the regular rules (section 6601) on a deficiency resulting from recovery of any part of a State tax claimed as a credit.

(2) Interest is computed on a deficiency resulting from recovery of any foreign tax claimed as a credit from the date the refund was received by the executor of the estate. To the interest so computed is added an amount equal to any interest paid on the refund by the foreign government.

.06 *Combination adjustments.*—

If the net result is	*Interest computation*	
	From	*To*
A general adjustments deficiency	Interest is computed under the regular rules as provided in section 6601.	
A deficiency resulting from recovery of an amount claimed and paid as foreign death taxes.,	The date the taxpayer received the refund from the foreign government.	The date of payment of the tax, or if the deficiency is satisfied by credit, to the date of the overpayment so applied.
	To the amount so computed an amount equal to the interest is added, if any, received from the foreign government on the refund. The sum of the two amounts assessed.	
A deficiency resulting from recovery of an amount claimed and paid as State death taxes.	Interest is computed under the regular rules. Interest is not restricted on this deficiency.	
An overpayment due to general adjustments.	Interest is allowed under the regular rules as provided in section 6611(b)(1) and (2) as amended by P.L. 85–866, C.B. 1958–3, 254.	
An overpayment in resulting from an increase in the amount of credit claimed.	No interest is allowable. (See section 12.03.)	

SEC. 13. EXCISE TAXES.

.01 *Taxes on sales and services.*—Section 6416(a) of the 1954 Code prescribes the conditions under which credit or refund of an overpayment of retailers or manufacturers excise taxes, or cabaret or certain admissions taxes may be allowed. Interest is allowable on any overpayment unless specifically prohibited. Section 6416(b) sets forth special cases in which tax payments may be considered overpayments to be allowed *without interest*, as follows:

(1) *Price readjustments.*—If the retailers or manufacturers excise tax has been paid and the price of the article is readjusted by reason of return or repossession of the article or a covering or container, or by a bona fide discount, rebate, or allowance, a proportionate part of the tax paid is an overpayment. *Exception:* When the tax was computed under section 4223(b)(2) the rule applies only when the article is returned or repossessed. This section contains an elective provision.

(2) *Specified uses and resales.*—All manufacturers and only those retailers' excise taxes paid under section 4041(a)(1) or 4041(b)(1), are deemed to be overpayments if the article was exported, used, sold or resold, for any of the purposes set forth in section 6416(b)(2) (A)

to (Q), inclusive. *Exception:* Section 6416(g) provides that section 6416(b)(2)(A) shall apply to the tax imposed by section 4061(a), 4111, 4121, and 4141, only if the article was sold for export after notice was received of intent to export or resell for export.

(3) *Tax-paid articles used for further manufacture, etc.*—If the manufacturers excise tax has been paid on the sale of an article and the article was sold to a second manufacturer or producer, section 6416(b)(3) (A) to (D) prescribes the circumstances under which the tax is an overpayment allowable to the second manufacturer or producer.

(4) *Tires, inner tubes, and automobile radio and television receiving sets.*—If the manufacturers excise tax has been paid on any of the subject articles and the article is sold or used by the manufacturer, producer, or importer, on or in connection with, or with the sale of, or as a component part of any other article, and the other article is (1) exported, (2) sold to a State or local government, or to a nonprofit educational organization for its exclusive use, (3) used or sold for use as supplies for vessels or aircraft, the tax paid on the first article is an overpayment.

(5) Return of certain installment accounts.—If the tax was paid under section 4053(b)(1) or 4216(e)(1) on the sale of any installment account by a retailer or manufacturer, and the account is later returned (by agreement) at an adjusted price, to the person who sold it, a proportionate part of the tax paid is an overpayment.

.02 *Credit for tax paid on tires, inner tubes, radio or television receiving sets.*—Section 6416(c) provides for a credit *without interest* against the tax imposed under chapter 32 upon the sale of an article in connection with which one of the subject articles, also taxed under Chapter 32, was sold. The credit is computed as prescribed in section 641(c) (1) or (2), and is allowable only upon the first sale of the article.

.03 *Mechanical pencils taxable as jewelry.*—Section 641(d) provides for a credit, *without interest*, to the retailer, in an amount equal to the tax paid under section 4201 on an article used by the retailer in the further manufacture of an article taxable as jewelry under section 4001.

.04 *Certain radio receiving sets and radio and television components.*—Section 163(e) of the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92, provides for allowance of an overpayment *without interest* to a manufacturer, producer, or importer under the following conditions:

(1) If a radio receiving set, an automobile radio receiving set, or a radio or television component was initially used as a component part of any other article, and

(2) Such other article was exported, or sold to a State or local government for their own exclusive use, the manufacturers excise tax paid on the set or component is an overpayment made by the manufacturer, producer, or importer of such other article. Proof is required that the amount of the tax was not included in the sale price of the other article, or that the tax has been repaid to the ultimate purchaser, or his written consent to the allowance obtained.

.05 *Club dues.*—(1) Section 4243(c) was added to the 1954 Code by the Excise Tax Technical Changes Act of 1958. This section exempts from tax, club dues or fees including assessments for construction paid on or after January 1, 1958, to a nonprofit organization operated primarily to provide swimming or skating facilities for the members.

(2) No interest is allowable on any overpayment with respect to dues or fees paid between January 1 and September 2, 1958, if the overpayment is allowable only by reason of section 4243(c). Sec. 132(d), P.L. 85–859.

.06 *Floor stocks taxes.*—(1) *1956 floor stocks taxes.*—Section 4226 imposes a "1956" dealers' floor stocks tax at certain prescribed rates on stocks held by a dealer for sale on July 1, 1956, as follows:

a. trucks, truck trailers, buses, etc., taxed under section 4061(a)(1);

b. tires of the type used on highway vehicles, taxed under section 4071(a)(1);

c. tread rubber, taxed under section 4071(a)(4);

d. gasoline, taxed under section 4081.

(2) *1959 tax on gasoline.*—Section 4226 as amended by Public Law 86–342, C.B. 1959–2, 697, imposes a floor stocks tax of 1 cent a gallon (on gasoline taxed under section 4081) applicable to gasoline held by a dealer on October 1, 1959, (in storage) for sale. The tax does not apply to retail stocks held at the place where intended to be sold at retail, nor to gasoline held for sale by a producer or importer of gasoline. The return is due to be filed and the tax paid on or before January 15, 1960. See Treasury Decision 6417, C.B. 1959–2, 313.

(3) *Overpayments without interest.*—Section 4226(b) provides that all of the provisions of section 6416 are applicable to overpayments. Section 6416(b) sets forth special cases for allowing overpayments without interest.

.07 *Floor stocks refunds.*—(1) *Passenger automobiles, etc.*—Section 6412(a)(1) provides that if an article subject to tax under section 4061(a)(2) has been sold by a manufacturer, producer, or importer, before July 1, 1960, and on such date is held by a dealer for sale, the manufacturer, producer, or importer is entitled to a credit or refund *without interest*, in an amount equal to the difference between the tax paid on the sale of the article and the tax made applicable thereto on and after July 1, 1960. A claim must be filed by the manufacturer, etc., on or before November 10, 1960, based upon a request submitted by the dealer before October 1, 1960. Reimbursement must have been made to the dealer on or before November 10, 1960, or written consent obtained from the dealer to the allowance of the credit or refund.

(2) *Trucks and buses, tires, tread rubber, and gasoline.*—Section 6412(a)(2) provides that if an article subject to tax under section 4061(a)(1), 4071(a)(1) or (4), or 4081, has been sold by a manufacturer, producer, or importer, before July 1, 1972, and on that date is held for sale by a dealer, the manufacturer, etc., is entitled to a credit or refund, *without interest* in an amount equal to the difference in the tax paid and the amount made applicable to such article after July 1, 1972. A claim must be filed by the manufacturer, etc., on or before

November 10, 1972, based upon a request submitted by the dealer before October 1, 1972. Reimbursement must have been made to the dealer on or before November 10, 1972, or his written consent obtained to the allowance of the credit or refund.

(3) *Sugar.*—Section 6412(d) provides that if the import tax imposed by section 4501(b) has been paid on any sugar or articles made chiefly of sugar, and on June 30, 1961, the same goods are still held by the importer for sale, there shall be refunded to him without interest, an amount equal to the tax paid, provided a claim is filed on or before September 30, 1961. Section 4501(c) terminates the tax on sugar imposed by sections 4501 (a) and (b) as of June 30, 1961.

(4) *Gasoline held on July 1, 1961.*—Public Law 86–342, 86th Cong., adds a new paragraph (3) to section 6412(a) which provides for a credit or refund *without interest* of an amount equal to the difference between the tax paid on gasoline (imposed by section 4081) and the amount made applicable on and after July 1, 1961. The credit will be made to the producer or importer and is applicable to gasoline sold before July 1, 1961, and on such date is held by a dealer intended for sale. A claim must be filed on or before November 10, 1961, based on a request submitted by the dealer to the producer or importer before October 1, 1961. The producer or importer must have reimbursed the dealer on or before November 10, 1961, or obtained his consent to the allowance of the credit or refund. The provisions are not applicable to retail stocks of gasoline being sold, but only to gasoline held in storage tanks by either the dealer or the producer or importer.

.08 *Gasoline used on farms or for nonhighway purposes or by local transit systems.*—(1) Section 6420(a) provides for a rebate *without interest* to the ultimate purchaser of gasoline used on a farm for farming purposes. The amount is determined by multiplying the number of gallons used by the rate in effect (under section 4081) at the time of purchase.

(2) Section 6421(a) provides for a rebate *without interest* to the ultimate purchaser of gasoline used for certain nonhighway purposes. The amount is 1 cent for each gallon so used on which tax was paid at the rate of 3 cents a gallon and 2 cents for each gallon on which tax was paid at the rate of 4 cents a gallon. Amendment made by Public Law 86–342.

(3) Section 6421(b) provides for a rebate *without interest* to the ultimate purchaser of gasoline used during any calendar quarter in a vehicle engaged in the transportation of persons, but only if 60 percent of the fare revenue was tax exempt. The amount is determined as provided in this section, as amended by P. L. 86–342.

(4) One claim only may be filed for any one-year period ending on June 30 of any year. No claim shall be allowed unless filed on or before September 30 of the year in which the one-year period ends. An exception to this rule is made if $1,000 or more is payable under this section for gasoline used during a calendar quarter by a local transit system.

.09 *Prepayments of retailers' excise tax.*—(1) *Definition.*—Revenue Ruling 56–261, C.B. 1956–1, 556, provides that a retailer of articles subject to tax under the provisions of 1954 Code sections.

4001, on jewelry, and related items
4011, on furs
4021, on toilet preparations, and
4031, on luggage, handbags, etc.,

may, upon approval of his local District Director, compute and prepay the tax at the time the taxable articles are purchased, rather than when they are sold.

(2) *Adjustments to the tax prepaid.*—a. *Additional tax.*—If after prepayment of the retailers excise tax, articles are sold at prices higher than those used as a basis for computing the tax the additional excise tax must be included in the quarterly return for the period in which the articles are sold.

b. *Excess prepayments.*—If an excess prepayment arises from the sale of articles at prices lower than the retail price upon which the prepayment was based, or from a reduction in the applicable tax rate, or from the loss, destruction, or return to suppliers, of articles upon which the tax has been prepaid, interest will not be allowed upon such excess prepayments.

.10 *Erroneous payments of excise tax.*—Revenue Ruling 55-272 C.B. 1955-1, 199, holds that amounts of manufacturers excise taxes erroneously or mistakenly paid by retail dealers will be regarded as overpayments of tax upon which interest is allowable under section 6611(a) of the 1954 Code or section 3771(a) of the 1939 Code. The earlier policy, that interest was not allowable on credits or refunds to dealers pursuant to claims filed to recover amounts paid by them as excise taxes properly due and payable by manufacturers, will no longer be followed.

.11 *Coconut and palm oil.*—(1) *Sales to States or political subdivisions.*—Section 6417(a) provides for the allowance of a credit or refund of the tax imposed by section 4511 and paid on the processing of coconut and palm oil, when the oil, or an article containing the oil in combination or mixture, has been sold to a State or its political subdivision for use in the exercise of an essential governmental function. *No interest is allowable* on such credit or refund.

(2) *Export.*—Section 6417(b) provides for the allowance of a refund of tax paid under section 4511 (on the processing of coconut and palm oil) when the oil is exported to any foreign country or possession of the United States. No interest is allowable on the refund.

.12 *Special rules in case of manufactured sugar.*—(1) *Use as livestock feed or for distillation of alcohol.*—Section 6418(a) provides that if manufactured sugar or anything in which it is used, is ultimately used as or to produce livestock feed, or for the distillation of alcohol, the user is entitled to a rebate of any tax paid under section 4501 (a) and (b) for its manufacture or import.

(2) *Export.*—Section 6418(b) provides that if tax-paid manufactured sugar is being exported, except to Puerto Rico, the Secretary or his delegate will pay to the consignor (or to the shipper or manufacturer if the consignor waives any claim thereto) the amount of the tax originally paid. If the sugar had been imported and a drawback of any import tax had been or was to be claimed under section 4504, the payment would not be made.

(3) *Time for filing claim.*—Section 6511(e) (1) and (2) provides that no payment shall be allowed under section 6418 (a) or (b) unless a claim is filed within 2 years after the right to such payment under either section has accrued. *Under section 3494(b) of the 1939 Code, the period for filing this claim is one year.*

(4) *No interest allowable.*—A payment made pursuant to section 6418 (a) or (b) does not constitute a payment of tax erroneously, illegally, or otherwise wrongfully collected, but is a payment dependent upon the performance of certain acts after the liability for the tax was legally incurred and paid by manufacturers of the sugar. Thus, there is no authority in the law for the allowance of interest on such a payment (Revenue Ruling 55–650, C.B. 1955–2, 497).

.13 *Excise tax on wagering.*—Section 6419(b) provides that a credit or refund shall be allowed, *without interest*, to any taxpayer who paid a tax on a wager and then lays off part or all of such wager with another person who is liable for a proportionate part of the tax.

SEC. 14. EMPLOYMENT TAXES.

.01 *General.*—If more or less than the correct amount of tax is paid with respect to employment taxes imposed by 1954 Code sections

3101	FICA tax on employees
3111	FICA tax on employers
3201	RRTA tax on employees
3221	RRTA tax on employers, and
3402	Income tax collected at source

proper adjustments of both the tax and the amount to be deducted will be made *without interest.* Overpayments are adjusted under section 6413(a); underpayments under section 6205(a).

.02 *Foreign subsidiaries of domestic corporations.*—(1) *Foreign subsidiary agreements.*—Domestic corporations employing U.S. citizens in their foreign subsidiaries may enter into agreements under section 3121(1) whereby Federal old age and survivors insurance is extended to those citizens. Under these agreements the corporations pay amounts equivalant to the FICA taxes imposed by sections 3101 and 3111. Whether the tax is over or underpaid, adjustments are without interest.

(2) *Special rule for overpayment not "adjusted".*—Any overpayment which cannot be adjusted will be refunded only if a claim is filed within 2 years from the time the tax was paid. (Generally, claims for overpayments of F.I.C.A. Taxes may be filed within the applicable period of limitations for making credits and refunds.) Any claim filed under section 3121(1) (7) (B) must be plainly marked "claim under section 3121(1)."

.03 *Nonprofit organizations—waiver certificates.*—(1) Religious, charitable and certain other organizations which are exempt from income taxes may file a certificate certifying that they desire to have the Social Security insurance system extended to their employees (1954 Code section 3121(k)(1)).

(2) The Social Security Amendments [Act] of 1958 (Public Law 85–840, C.B. 1958–3, 85) amended section 3121(k)(1) to provide

that an organization which filed a waiver certificate after 1955 but before August 28, 1958, covering only part of its employees, may file a request at any time before 1960 to have such certificate effective with respect to the service of additional individuals. The effective date would begin with the first day of any calendar quarter preceding the first calendar quarter for which it was effective and following the last calendar quarter of 1955. (Prior to this amendment, a supplemental list (of additional employees) could be filed only within 2 years following the first calendar quarter for which it was effective, or before January 1, 1959, whichever was later.)

a. If a request is filed under this provision—

(a) *for the purpose of computing interest* and additions to the tax for failure to file a return, *the due date for the return and payment of tax* for any calendar quarter resulting from the filing of such request shall be the last day of the calendar month following the calendar quarter in which the request is filed; and

(b) the statutory period for the assessment of such tax shall not expire before 3 years from such date.

b. If a certificate is effective for one or more calendar quarters prior to the quarter in which the certificate is filed, then—

(a) *for purposes of computing interest* and additions to the tax for failure to file a tax return, *the due date for the return and payment of the tax* for such prior calendar quarters resulting from the filing of such certificate shall be the last day of the calendar month following the calendar quarter in which the certificate is filed; and

(b) the statutory period for assessment of such tax shall not expire before 3 years from such due date.

.04 *Computation of interest.*—(1) *FICA tax*

	Compute interest	
	From	*To*
a. Underpayments		
(a) If correction is not "adjusted."	Due date of the tax	date of payment
(b) If correction is "adjusted" but the tax is not paid on the date prescribed for payment.	due date of return for tax-return period in which the error was ascertained (whether reported on a current return for that period or on a supplemental return).	or if satisfied by credit, to the date of the overpayment so applied.
b. Overpayments		
If an overpayment is not "adjusted"		
(a) a claim must be filed within the applicable period of limitations.	due date of the return on which the overpayment was reported, or the date of overpayment of the tax whichever is later.	date determined under Code section 6611(b).
(b) If overpayment was made under section 3121(1) the claim must be filed within 2 years after payment of the tax.		

(2) Income tax collected at source.—

	Compute interest	
	From	*To*
a. Underpayments		
(a) If the correction does not constitute an "adjustment."	date employer failed to withhold	following Apr. 15 or date of payment by employer, whichever is earlier.
(b) If reported as an "adjustment" but not paid on or before the due date of the return on which the adjustment is reported.	due date of the return on which the adjustment is reported.	or if satisfied by credit to date of the overpayment so applied.
b. Overpayments		
(a) If reported as an "adjustment."	no interest accrues	
(b) If not an "adjustment" but refunded or allowed as a credit on the return after authorization by the District Director.	due date of return on which the overpayment was reported or, from the date of payment whichever is later.	date determined under section 6611(b).

.05 *Self-employment income.*—(1) *Ministers—service in foreign country.*—The Social Security Amendments of 1956, P.L. 880, 84th Cong., C.B. 1956–2, 1188, amended 1954 Code section 1402(a)(8) permitting a minister in a foreign country who has a congregation of predominantly United States citizens to elect still further retroactive application of the benefits of section 1402(b)(8) in computing income for self-employment purposes. The election would cover years ended after 1954 and before 1957. Before this amendment the election could be made for taxable years ending after 1956 only. *No interest* may be assessed or collected on any underpayment arising from such election (Sec. 201(m)(2)(F), P.L. 880).

(2) *Extension of time within which ministers may elect Social Security coverage.*—a. *Definition.*—Section 1402(e)(2) of the 1954 Code as amended by Public Law 85–239, C.B. 1957–2, 1061, extends the time within which ministers, members of religious orders, and Christian Science practitioners may file a waiver certificate electing coverage under the old-age, survivors, and disability insurance program. The election is irrevocable.

b. *Retroactive coverage.*—

Waiver certificate	*Is effective*
If filed *after* August 30, 1957, but on or before the due date of the return for his 2nd taxable year ending after 1956 (including any extension).	For the first taxable year ending after 1955 and all succeeding taxable years.
If filed *on or before* August 30, 1957, effective only for the 3rd or 4th taxable year ending after 1954, and all succeeding taxable years.	For the first taxable year ending after 1955 and all succeeding taxable years (if he files a supplemental certificate after August 30, 1957, and on or before the due date of the return for his 2nd taxable year ending after 1956.
If filed after the due date of the return (including any extension) for his 2nd taxable year ending after 1956.	For the taxable year immediately preceding the taxable year with respect to which it was filed and all succeeding taxable years.

c. *Period for assessment, interest, and penalty.*—Section 1(c) of Public Law 85–239 provides that if a certificate after the due date of a return (including any extension) is effective for such taxable year or any preceding taxable year, then

(a) for purposes of computing interest, the due date for payment of the increase in tax for such year or years shall be the last day of the 6th month following the month in which the certificate is filed;

(b) the period for assessment of any deficiency shall not expire before the end of 3 years from such due date; and

(c) the addition to tax for failure to file a return (sec. 6651 of the 1954 Code) shall not include such increase in tax.

(3) *Trade or business.*—a. *Definition.*—Section 1402(c)(5) of the 1954 Code, relating to the definition of the term "trade or business" with respect to self-employment income, as amended by Public Law 880, C.B. 1956–2, 1188, extends coverage for social security purposes to lawyers, dentists, osteopaths, veterinarians, chiropractors, naturopaths, optometrists, architects, certified public accountants, other registered or practicing accountants, funeral directors, and professional engineers, all of whom were formerly excluded.

b. *Applicability.*—This provision is applicable to taxable years ending after 1955.

c. *Special interest provisions.*—Section 201(m)(2)(F) of Public Law 880, provides that any tax on self-employment income which is due solely by reason of this amendment, for any taxable year ended on or before August 1, 1956, shall be considered timely paid if payment was made in full on or before February 28, 1957. In no event shall any interest be imposed on any amount of tax due under section 1401(a) solely by reason of this amendment for any period before August 2, 1956.

(4) *Share-farming arrangements.*—a. *Definition.*—Section 1402(a)(1), relating to the definition of net earnings from self-employment, as amended by Public Law 880, provides that rentals from real estate and personal property leased with the real estate, derived by the owner or tenant of land under certain share-farming arrangements, which income was formerly excluded from net earnings from self-employment will be included in computing self-employment income or net earnings from self-employment.

b. *Applicability.*—This amendment relates to taxable years ending after 1955.

c. *Interest provisions.*—Section 201(m)(2)(F) of Public Law 880 provides that *no interest* shall be assessed or collected on the tax due on self-employment income by reason of enactment of this section for any taxable year ended on or before the date of enactment of this section (August 1, 1956).

The tax shall be considered timely paid if payment was made in full on or before February 28, 1957.

In no event shall interest be imposed on the amount of any such tax due for any period before the day after the date of enactment (August 1, 1956) of this Act.

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Accordingly, interest accrues from August 2, 1956, to the date of payment on any tax which would have been due before August 1, 1956, but not paid on or before February 28, 1957.

(5) *Death of a partner.*—1954 Code section 1402(f) contains special provisions for computing net earnings, from self-employment of a partner whose death occurs after August 28, 1958, because, as a result of his death, his taxable year ends before that of the partnership. (Subsection (f) was added by the Social Security Amendments Act of 1958, Public Law 85–840, C.B. 1958–3, 85.) This provision is also applicable to an individual who dies after 1955 and on or before August 28, 1958, (1) if there is filed before January 1, 1960, a self-employment tax return (or amended return) for the taxable year ending as a result of the individual's death, and (2) in the case of a return filed solely to obtain the benefit of this provision, it is accompanied by the amount of the tax attributable to the net earnings reported. *No interest or penalty* shall be assessed or collected on any tax due by reason of the application of this section.

.06 *Federal Unemployment Tax Act.*—(1) *Credit against tax imposed by section 3301.*—Section 3302(a) provides for the allowance of a credit against the tax imposed by section 3301 on employers of four or more individuals. The credit consists of the amount of contributions paid by the employer into a State unemployment fund in any taxable year. An additional credit is also allowable under section 3302(b).

(2) *Refund or credit of Federal Unemployment Tax.*—Section 6413(d) provides that any credit allowable under section 3302, to the extent not previously allowed, shall be considered an overpayment, but no interest shall be allowed or paid with respect to such overpayment.

SEC. 15. STAMP TAXES.

.01 *Authorization for allowance or redemption.*—Section 6805 of the 1954 Code provides that upon receipt of satisfactory evidence of the facts, the Secretary or his delegate may make allowance for, or redeem such of the stamps issued under authority of any internal revenue law, (a) as may have been spoiled, destroyed or rendered useless or unfit for the purpose intended, or (b) for which the owner may have no use, or (c) which through mistake may have been improperly or unnecessarily used.

.02 *Time for filing claims.*—Claims for redemption or allowance under section 6805(c) of the 1954 Code must be presented within 3 years after purchase of such stamps. (The period of limitations for filing a claim under 1939 Code section 3304 is 4 years, except for tobacco tax.)

.03 *Interest on overpayments.*—Interest is allowable on overpayments of stamp taxes (including excise tax value stamps) in accordance with the provisions of section 6611 of the 1954 Code. This is true irrespective of whether the tax was paid by stamp or through assessment. However, interest is allowable only when the stamps were used in payment of a tax (from the date the stamps were affixed and cancelled to the date of allowance). No interest is allowable on amounts paid in redemption of stamps, including unused excise tax value stamps.

SEC. 16. SPECIAL INTEREST PROVISIONS RELATING TO 1939 CODE TAXES.

Subject	Provision	Effect	Authority
.01 Claims against foreign governments.	This amendment provides that the Foreign Claims Settlement Commission of the U.S. may now handle certain claims brought by Americans against the Governments of Bulgaria, Hungary, Rumania, Italy and Russia. It provides for the vesting (taking title) of Bulgarian, Hungarian and Rumanian assets which were owned by those Governments on September 15, 1947 (the effective date of peace treaties with the United States) and which remain blocked on August 9, 1955. Assets are vested in Office of Alien Property in the Department of Justice. The property may be liquidated and Federal, State, Territorial, or local taxes paid.	The statutes of limitations on assessment collection, refunds or credits of Federal taxes are suspended while property is vested and for 6 months thereafter. No interest is allowable on any refund during the period of suspension.	P.L. 285, 84th Cong., approved Aug. 9, 1955, C.B. 1955–2, 756, adds title II to the International Claims Settlement Act of 1949.
.02 Credit or refund of tax on certain trusts for members of the Armed Forces.	The law provides for credit or refund of tax paid on trust income accumulated for a service man of the United States or of one of the other United Nations, if the service man died in active service between December 7, 1941, and January 1, 1948. The amendment corrects an oversight in a previous implied amendment by providing that if a credit or refund under that amendment was barred by statute (other than by closing agreement or compromise) allowance may be made if a claim is filed within one year after August 9, 1955.	If credit or refund would be barred except for this Act, no interest is allowable on the overpayment.	P.L. 310, 84th Cong., approved Aug. 9, 1955, C.B. 1955–2, 759, amended Sec. 345 of the Revenue Act of 1951 which implies amendment of section 162(a) of the 1939 Code.

Subject	Provision	Effect	Authority
.03 Unlimited Deductions for Charitable Contributions.	An unlimited charitable deduction will be allowed if in the current year, and in 8 out of 10 of the immediately preceding years the individual's contributions to charity, plus his income tax payments equal 90 percent or more of his taxable income. The deduction will be allowed only if an amount equal to any refund under this provision is paid to or set aside for charity.	No interest is allowable on any overpayment resulting from this amendment. Claim for refund may be filed at any time within *seven years* from the due date of the return. (Rev. Rul. 59–157, C.B. 1959–1, 647.) The amount allowable is not restricted by the provisions of section 322(b)(2) or (3) of the 1939 Code.	P.L. 408, 84th Cong., approved Feb. 15, 1956, C.B. 1956–1, 854, amended 1939 Code Section 120.
.04 Corporate Distributions Taxable as Dividends.	This amendment, in general, limits the amount of a distribution of property which is taxable as a dividend to the amount of the earnings and profits of the distributing corporation. This provision is applicable to any 1939 Code tax year. However, it does not apply to any taxable year of a shareholder (corporation) which filed a return for such year and reported dividends under a policy which had not been revoked at the time.	No interest is allowable on any overpayment resulting from this amendment.	Sec. 3(a) of P.L. 629 84th Cong., approved June 29, 1956, C.B. 1956–2, 1165, added subsection (n) to 1939 Code section 115. Sec. 3(b) prohibits allowance of interest.
.05 Exclusion in Computing Personal Holding Company Income.	These amendments provide that 1939 Code section 502(f) (relating to use of corporation property by a shareholder) shall not apply in computing gross income of a personal holding company with respect to rents received during the taxable years ending after December 31, 1945, to which the Internal Revenue Code of 1939 applies, if such rents were received for the use by the lessee (shareholder) of property of the taxpayer in the operation of	No interest is allowable on any overpayment resulting from these amendments.	P.L. 370, 84th Cong., approved August 11, 1955, C.B. 1955–2, 770, amended section 223 of the Revenue Act of 1950, applicable to years ending before January 1, 1954. P.L. 85–319, 85th Cong., C.B. 1958–1, 628, further amended section 502(f) 1939 Code making it ap-

		a bona fide commercial, industrial, or mining enterprise. (Previously applicable to rents received before January 1, 1950.)		plicable to all 1939 Code taxes.
.06	Income Taxes Paid Under Contract (Pyramided taxes).	This amendment provides that if two corporations entered into a contract (including a lease) before January 1, 1952, under which one is obligated to pay or reimburse the other for any part of the income tax imposed by the 1939 Code on the payee with respect to income under the contract, the gross income of the payee shall not include the remibursement other than to the extent of the income tax imposed on the payee, the tax to be determined without the inclusion in gross income of the reimbursement. A deduction is allowed to the payor for such payments but only to the extent provided. This amendment applies to taxable years beginning after December 31, 1951, to which the 1939 Code applies.	No interest is allowable on any overpayment resulting from this amendment. Overpayments which would be barred by statute from allowance at any time before March 3, 1959 (except in the case of a closing agreement or a compromise), may be allowed if a claim is filed before that date.	P.L. 85–866 Technical Amendments Act of 1958, C.B. 1958–3, 254, enacted Sept. 2, 1958, added subsection (p) to 1939 Code section 22.
.07	Amounts Received by Certain Motor Carriers in Settlement of Claims Against The United States.	This amendment provides that (notwithstanding the provisions of 1939 Code sec. 42) a motor carrier transportation system may elect to treat an amount received in settlement of a claim against the United States as having been received or accrued during the year in which the system was in the Government's possession or control. The election must be made before Sept. 3, 1959, and is irrevocable.	Any deficiency resulting from the application of this provision may be assessed at any time within one year after the date of the election. Interest begins on any such deficiency on March 15, 1953.	P.L. 85–866 Technical Amendments Act of 1958 enacted Sept. 2, 1958. Sec. 99.
.08	Credit for Tax on Certain Prior Transfers.	This section provides, in general, that if an executor of an estate so elects, the estate tax imposed by sections 810 and 835 with respect to decedents (citizen or resident of the United States at the time of death) dying after December 31, 1951, shall be credited with all or part of the Federal	No interest is allowable on any overpayment resulting from this amendment.	P.L. 417, 84th Cong., approved Feb. 20, 1956, C.B. 1956–1, 857 added section 814 to chapter 3 of the 1939 Code (Estate Tax).

Subject	Provision	Effect	Authority
	estate tax paid on the transfer of property to the decedent by a deceased spouse who died within 2 years before decedent's death. The credit will be determined under section 814 (b) and (c). Executors exercising this election should file a claim for refund (Form 843) and show the computation (used to determine the credit) in schedule R of Form 706.		
.09 Reversionary Interest in Property Transferred.	This amendment provides with respest to certain transfers of property (involving a retained life estate) by persons who died after February 10, 1939, that if credit or refund of any overpayment of estate tax in any case entitled to relief under the provision of P.L. 378 was barred by statute on Oct. 25, 1949 (except in the case of a closing agreement or compromise), the allowance may be made if a claim was filed before August 2, 1957.	No interest is allowable on any overpayment resulting from this amendment.	P.L. 901, 84th Cong. approved Aug. 1, 1956, C.B. 1956–2, 1205.
.10 Bequests to a Surviving Spouse (Trust with power of appointment in surviving spouse)	This amendment makes certain changes in the provisions for determining what part of the interest in property passing from a decedent shall be considered as passing to the surviving spouse. It applies to estates of decedents dying after April 1, 1948, and before August 17, 1954.	If refund or credit of any overpayment resulting from the application of this amendment is prevented by statute at any time before Sept. 3, 1959 (except in the case of a closing agreement or compromise), the allowance may be made if a claim is filed before September 3, 1959. No interest is allowable.	P.L. 85–866, enacted Sept. 2, 1958, C.B. 1958–3, 254, amends 1939 Code section 812(e)(1)(F).

.11	Bequests to a Surviving Spouse (Interest of spouse conditional on survival for limited period).	This amendment provides an additional exception whereby another type of terminal interest will be eligible for the marital deduction for estate tax purposes with respect to property passing to a surviving spouse. It applies to decedents dying after April 2, 1948.	No interest is allowable on any overpayment resulting from this amendment.	P.L. 85–318, 85th Cong., enacted February 11, 1958, C.B. 1958–1, 627, amends 1939 Code section 812(e)(1)(D).
.12	Application of Percentage Depletion Rates To Certain Taxable Years Ending in 1954.	Taxpayers may elect to apply 1954 Code percentage rates in the case of any mine, well, or other natural deposit listed in subsection 613(b), to a taxable year ending after December 31, 1953, to which the 1939 Code applies. The method of computation is given in section 613(d)(2).	If refund or credit of any overpayment resulting from this amendment is barred by statute on Sept. 2, 1958, or within 6 months thereafter (except in the case of a compromise or closing agreement), allowance may be made if a claim is filed before March 2, 1959. No interest is allowable on any overpayment arising from this amendment.	Section 36(a) of P.L. 85–866 added subsection (d) to 1954 Code sec. 613. Sec. 36(b) contains the statute and interest provisions relating to the adjustment.

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SEC. 17. ALCOHOL, TOBACCO, AND CERTAIN OTHER EXCISE TAXES.

.01 *General.*—Under the provisions of Chapters 51 and 52 of the 1954 Code, as amended, and regulations thereunder, taxes imposed on alcohol and tobacco are paid on the basis of a return or pursuant to assessment. Refunds under the following circumstances will be scheduled *without interest:*

(1) Distilled spirits voluntarily destroyed. Section 5008(b)(2).

(2) Losses of distilled spirits when lost after withdrawal from bond but before completion of bottling and casing or other packaging for removal from the bottling premises. Section 5008(c)(1).

(3) Distilled spirits withdrawn and later returned to the bonded premises. Section 5008(d)(1).

(4) Samples of distilled spirits removed from the bonded premises for analysis or testing by the United States. Section 5008(e).

(5) Wine produced in the United States and returned to bond as unmerchantable. Section 5044(a).

(6) Beer removed from the market and returned to the brewery or destroyed, or beer lost (other than by theft), or destroyed by fire, casualty, or act of God, before the transfer of title to any other person. Section 5056(a) and(b).

(7) Amounts allowed equal to the difference between the tax paid and the rate applicable after July 1, 1961, P.L. 86–564, page 681, this Bulletin, when the articles constituted floor stocks on that date. Section 5063(a).

(8) Amounts representing internal revenue taxes and customs duties paid on distilled spirits, wines, rectified products, and beer previously withdrawn and intended for sale, which were lost, rendered unmarketable, or condemned by a duly authorized official by reason of a major disaster occurring after June 30, 1959. Section 5064(a). Section 210(a)(3) of P.L. 85–859, C.B. 1958–3, 92, makes these provisions applicable to disasters occurring after September 2, 1958 but not later than June 30, 1959.

(9) Amounts equal to the tax imposed by section 3150(a) of the 1939 Code and paid on beer lost, rendered unmarketable, or condemned by a duly authorized official, by reason of the floods of 1951, or the hurricanes of 1954. Section 207 of P.L. 85–859.

(10) Amounts representing taxes or custom duties paid on distilled spirits, wines, rectified products, and beer, previously withdrawn, which were lost, rendered unmarketable, or condemned by a duly authorized official, by reason of a disaster occurring after December 31, 1954 but not later than September 2, 1958. Section 208, P.L. 85–859.

(11) Refunds of taxes imposed by section 5701 of the 1954 Code and paid on any tobacco products, cigarette papers and tubes withdrawn from the market, lost (other than by theft), or destroyed by fire, casualty, or act of God, while in possession or ownership of the claimant. Section 5705(a).

(12) Amounts allowable equal to the difference between the tax paid and the tax applicable on July 1, 1961, P.L. 86–75, with respect to floor stocks of cigarettes held for sale on that date. Section 5707(a).

(13) Amounts allowable equal to the tax or customs duties paid on tobacco products and cigarette papers and tubes removed, which

were lost, rendered unmarketable or condemned by a duly authorized official by reason of a major disaster occurring after December 31, 1954 but not later than September 2, 1958. Section 209, P.L. 85–859.

(14) Amounts equal to the taxes and customs duties paid on tobacco products and cigarette papers and tubes removed, which were lost, rendered unmarketable, or condemned by a duly authorized official, by reason of a major disaster occurring on or after September 2, 1958. Section 5708(a).

(15) Amounts allowable equal to the difference between the tax paid and the tax applicable on July 1, 1961, on articles from foreign trade zones:

a. *Articles taxed under 1939 Code sections*

2000(c)	cigarettes
2800(a)	distilled spirits generally
3030(a)	still wines
3150(a)	beer

b. *Articles taxed under 1954 Code sections*

5001(a)(1)	distilled spirits
5001(a)(3)	imported perfumes containing distilled spirits
5022	liqueurs containing wine
5041(b)	still wines
5051(a)	beer
5701(c)(1)	cigarettes

The same applies to previously taxpaid articles (including floor stocks tax) taxable under the above Code sections, which were taken into a foreign trade zone from customs territory of the United States and placed under the supervision of the collector of customs, and after July 1, 1961, were returned from a foreign trade zone to customs territory of the United States. P.L. 86–564.

SEC. 18. ESTATE TAX—REVOCABLE TRANSFERS—EFFECT OF DISABILITY IN CERTAIN CASES.

.01 *Definition.*—Section 2038 of the 1954 Code relates to the treatment of certain revocable transfers for purposes of the estate tax. Public Law 86–141, C.B. 1959–2, 685, adds a new subsection (c) which relates to the effect of disability in certain cases.

.02 *Applicability.*—This amendment applies to estates of decedents dying after August 16, 1954.

.03 *Interest.*—No interest is allowable on any overpayment resulting from the application of this amendment with respect to any payment made before August 7, 1959.

SEC. 19. SPECIAL PROVISIONS RELATING TO LIFE INSURANCE COMPANIES.

.01 *Limitations on assessment and collection.*—(1) Section 6501(c) of the 1954 Code, as amended by section 3(g) of the Life Insurance Company Income Tax Act of 1959, P.L. 86–69, C.B. 1959–2, 654, provides an additional exception to the general rule for limitations on assessment and collection, effective for taxable years beginning after December 31, 1957.

(2) A new paragraph (6) added by this law provides that in the case of any tax imposed under section 802(a)(1) by reason of section 802(b)(3)—

a. on account of a termination of the taxpayer as *an insurance company* such tax may be assessed within 3 years after the

return was filed (whether filed on or after the date prescribed) for the taxable year for which the taxpayer ceases to be *an insurance company;* or

b. on account of a termination of the taxpayer as *a life insurance company* to which section 815(d)(2)(A) applies, such tax may be assessed within 3 years after the *second* taxable year for which the taxpayer is not *a life insurance company;* or

c. on account of a distribution by the taxpayer to which section 815(d)(2)(B) applies, such tax may be assessed within 3 years after the taxable year in which the distribution is actually made.

.02 *Estimate tax for 1958.*—No addition to the tax shall be made under section 6655 for failure to pay estimated tax for any taxable year beginning in 1958, in the case of any taxpayer subject to tax under section 811 as it was prior to amendment by Public Law 86–69.

.03 *Income tax returns for 1958.*—(1) Every life insurance company subject to tax under section 802(a), as amended by Public Law 86–69, must file a return after June 25, 1959, and on or before September 15, 1959, for its taxable year beginning in 1958, with respect to the tax imposed by section 802, as amended. The return so filed will be *the return* for such taxable period and no return filed on or before June 25, 1959, with respect to tax imposed by section 802 as it was before amendment by Public Law 86–69 shall be considered for any purpose as a return for such taxable year.

(2) All payments made on or before June 25, 1959, with respect to tax imposed by section 802(a) before amendment (to the extent not credited or refunded) shall be considered payments made on September 15, 1959, of the tax imposed by section 802(a) as amended. The installment payment privilege under section 6152(a)(1) is not applicable to this tax for such taxable year.

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26 CFR 601.106: Appellate functions. Rev. Proc. 60–18[1]

Procedures to expedite the disposition of Tax Court cases in the offices of the Appellate Division and Regional Counsel.

In order to provide for prompt action and insure expeditious disposition of cases before the Tax Court of the United States which may be settled; to enable Regional Counsel to stipulate undisputed facts as required by the Tax Court in an orderly manner and make adequate preparations for trial and defense of the Commissioner's determination of tax liabilities; to avoid the rush and delay occasioned by last-minute settlement negotiations; and to facilitate all actions taken in compliance with Commissioner's Delegation Orders Nos. 60 and 66, Chief Counsel's Orders Nos. 1958–5 and 1958–11, the Appellate Division and Regional Counsel will operate under the following procedures:

(1) All docketed cases in which the deficiency notices were not issued by Appellate, except cases in which recommendations for criminal prosecution are pending, will be referred to Appellate by Counsel

[1] Also released as Technical Information Release 249, dated August 30, 1960.

as soon as they are at issue in the Tax Court. Cases in which the deficiency notices were issued by Appellate will be retained by Counsel for preparation for trial.

(2) Appellate will arrange a conference for settlement purposes promptly after receipt of the file. Except in unusual circumstances, Counsel will be represented at such conference and will actively participate in it.

(3) If a settlement is agreed upon by Appellate and Counsel as a result of such conference(s) with the taxpayer, the necessary computation, writeup and stipulation of settlement will be prepared as quickly as possible, so that the stipulation of settlement may be filed with the Tax Court without delay.

(4) If a settlement is not effected as a result of the conference(s) with the taxpayer, or if the taxpayer declines to discuss settlement, the file will be returned promptly to Counsel for preparation for trial and the taxpayer will be so advised by appropriate letter by Appellate.

(5) In the event of disagreement between Appellate and Counsel as to settlement of the case or any issue in the case or with respect to the amount of a counteroffer, if any, which should be made, efforts will be made to quickly resolve the matter if agreement cannot be reached the case will be referred promptly in writing to the Chief Counsel for decision.

(6) During the period between receipt of the Tax Court's "Trial Status Request" (usually issued from 60 to 90 days in advance of the issuance of the trial calendar) and the receipt of the trial calendar (usually issued about 90 days in advance of the opening date of the trial calendar) Appellate will conclude settlement negotiations on all cases not previously settled or referred to Counsel for preparation for trial.

(7) In order to enable Counsel adequately to prepare the cases for trial and stipulate the undisputed facts in all cases on the trial calendar which have not been settled, Appellate will, upon receipt of the trial calendar, return the files still in its possession in all cases on the calendar to Counsel, unless settlement has been agreed upon or Counsel agrees, in writing, that the files may be temporarily retained. Concurrently with any such return of the files, Appellate shall advise the taxpayer by letter that, since settlement negotiations have not been productive, the case is being referred to Counsel for preparation for trial.

(8) Upon receipt of the trial calendar, Counsel will address an appropriate letter to the taxpayer in each case on the calendar which has not been settled, or the files retained by Appellate under the provisions of paragraph (7), or in which the parties are not then negotiating a stipulation of facts. This letter will arrange or suggest a conference at an early date for the purpose of stipulating facts, as required by Rule 31(b) of the Tax Court, to clarify and, if possible, limit the issues.

(9) Any requests for conferences received after receipt of the trial calendar will be referred to Counsel.

(10) These procedures shall become effective with respect to all trial calendars issued by the Tax Court on and after November 1, 1960.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5382; 240.527.) Rev. Proc. 60–19

The experimental study for removing excess color from white wines, other than vermouth, established by Revenue Procedure 58–21, C.B. 1958–2, 1138, is to be continued through June 30, 1961.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to extend the experimental study for removing excess color from white wines, other than vermouth, established by Revenue Procedure 58–21, C.B. 1958–2, 1138, and previously extended by Revenue Procedure 59–29, C.B. 1959–2, 945.

SEC. 2. BACKGROUND.

In order to determine a practical application of section 240.527 of the Wine Regulations in regard to the removal of excess color from white wines with the use of activated carbon, Revenue Procedure 58–21 announced the start of an experimental study to expire June 30, 1959, and invited the participation of proprietors of bonded wineries and bonded wine cellars. Revenue Procedure 59–29 continued this study through June 30, 1960.

SEC. 3. CONTINUATION OF EXPERIMENTAL STUDY.

The experimental study respecting the removal of excess color from white wines is continued through June 30, 1961, under the procedure and conditions prescribed in Revenue Procedure 59–29.

SEC. 4. EVALUATION OF STUDY.

Before the expiration of this extension and after the evaluation of the experimental study, the Internal Revenue Service will include in the Wine Regulations, 26 CFR Part 240, procedures for removing excess color from wines. It appears, at present, that treatment of wine for this purpose, under the regulations, can be more limited than has been permitted under the experimental study, since no indication of need for the maximum permissible treatment has developed.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

The provisions of Revenue Procedure 57–35, C.B. 1957–2, 1108, continue to be inapplicable during the experimental period established by this Revenue Procedure.

SEC. 6. INQUIRIES.

Inquiries concerning this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5241; 201.407.) Rev. Proc. 60–20

Form 244, Tank Certificate, will continue to be used on bottling tanks on bottling premises and Form 2634, Denaturation of Spirits, should be prepared in triplicate by proprietors of distilled spirits plants in accordance with the instructions on the form.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the requirements of the Internal Revenue Service that (1) Form 244, Tank Certificate, will continue to be used on bottling tanks on bottling premises and (2) that Form 2634, Denaturation of Spirits, should be prepared in accordance with instructions on the form.

SEC. 2. FORM 244, TANK CERTIFICATE.

While no specific provision is made in the Distilled Spirits Plants Regulations for the use of Form 244 on bottling tanks on bottling premises, officers of the Internal Revenue Service will continue to verify the calibration of such tanks and to certify on Form 244 to their accuracy, before permitting the use of the tanks.

SEC. 3. FORM 2634, DENATURATION OF SPIRITS.

Form 2634 should be prepared in triplicate by proprietors of distilled spirits plants, in accordance with the instructions thereon, so that one copy may be furnished to the assigned Internal Revenue Officer as a notice of intent to denature, before the denaturation is commenced.

SEC. 4. INQUIRIES.

Inquiries concerning this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5207; 201.631.) — Rev. Proc. 60–21

Proprietors of distilled spirits plants must submit to the Internal Revenue Officer assigned to the plant copies of Form 1473, Notice of Shipment of Specially Denatured, Tax-Free, or Recovered Spirits, with Form 2636, Daily Report of Transactions.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the procedure to be followed in forwarding copies of Form 1473, Notice of Shipment of Specially Denatured, Tax-Free, or Recovered Spirits, to the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

SEC. 2. BACKGROUND.

.01 Instruction one on Form 2636, Daily Report of Transactions, states, "Each proprietor of bonded premises shall, for each day on which transactions occur, prepare a daily report on this form, in triplicate, showing his production, denaturing, warehousing, and bottling transactions. He shall attach to the original of each report the forms which are listed in column (c) as completed during the day, unless such forms were previously delivered to the assigned officer."

.02 The instructions on Form 1473 relating to distribution of the form state, "On shipment, the consignor will forward the original and one copy to the consignee (via the truck driver if shipment is by truck), forward one copy (two copies if interregion shipment other

than to U.S.) to his assistant regional commissioner, and retain a copy for his files."

SEC. 3. PROCEDURE.

Proprietors of distilled spirits plants must comply with the instructions on Forms 1473 and 2636 by submitting the Assistant Regional Commissioner's copies of Form 1473 with Form 2636 to the Internal Revenue officer assigned to duties at the plant, or, when so directed by the Assistant Regional Commissioner as provided in section 201.631 of the Distilled Spirits Plants Regulations, to another officer designated by the Assistant Regional Commissioner.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and should be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.203: Offers in compromise. Rev. Proc. 60–22
(Also Part I, Section 7122; 301.7122–1.)

Outline of the jurisdiction of District Directors of Internal Revenue and Regional Counsel with respect to the processing and disposition of certain offers to compromise liabilities under $25,000 and certain specific penalties.

Revenue Ruling 117, C.B. 1953–1, 498; Revenue Ruling 251, C.B. 1953–2,469; Revenue Ruling 252, C.B. 1953–2,469; Revenue Procedure 56–26, C.B. 1956–2,1383; and Revenue Procedure 57–30, C.B. 1957–2,1103, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the jurisdictional changes pertaining to the investigation and consideration of offers in compromise; to outline procedures established to implement Delegation Order No. 11 (Revised), page 919, this Bulletin; and also to supersede and restate in a current document the authorities of prior Revenue Rulings and Revenue Procedures applicable to comparable positions and organizational components.

SEC. 2. DECENTRALIZED AREAS OF RESPONSIBILITY.

.01 *District Directors.*—Certain functions of the Commissioner of Internal Revenue with respect to the compromise of civil cases involving liabilities under $25,000 and of specific penalties—incurred under the regulatory provisions of the Internal Revenue Codes of 1954 and 1939 and related statutes—have been delegated to District Directors of Internal Revenue under Delegation Order No. 11 (Revised). This is a "limited" delegation to the extent that the delegated authority must be exercised in accordance with the limitations prescribed by section 301.7122–1 of the Regulations on Procedure and Administration and with procedures established by the National Office. See section 3 herein with respect to offers excepted from the District Directors' delegated authority.

.02 *Regional Appellate Divisions.*—The District Director refers two types of compromise cases for consideration by the appropriate Regional Appellate Division. The first type relates to offers in compromise based in whole or in part on doubt as to liability, which

liability, irrespective of the amount involved, is pending before or was determined by the Regional Appellate Division or its predecessor organization. The second type involves consideration of a taxpayer's written appeal from a rejection or a proposed rejection by the District Director. (The procedure governing appeals is applicable only to those offers with respect to which the District Director has processing jurisdiction and which relate to a tax over which the Appellate Division has authority to function. See section 6.03 herein.) In considering either type of case referred to above, the Regional Appellate Division may call upon the District Director to conduct any investigation considered necessary for reaching a conclusion on the merits of the case and to prepare the prescribed documentation for acceptance or rejection of the offer. The entire file will thereupon be returned to the District Director for processing in accordance with the conclusion reached by the Regional Appellate Division.

.03 *Regional Counsel.*—The following legal functions with respect to offers in compromise are performed by Regional Counsel:

(1) Furnishing legal advice in the form of an advisory opinion when the District Director submits a specific request involving a doubtful question of law or regarding which, for any other reason in the judgment of the District Director, Counsel's opinion should be obtained.

(2) Reviewing acceptance cases prepared by the District Director which involve liabilities (including any interest, additional amounts, additions to the tax, or assessable penalties) of $500 or more, but less than $25,000, and those relating to specific penalties; and signing the legal opinion required under section 7122(b) of the Code.

(3) Processing offers in compromise in Chief Counsel cases and, subject to the exceptions provided in section 3 herein, preparing and signing the legal opinion as directed by the Chief Counsel and preparing the prescribed documentation for final closing of cases involving liabilities (including any interest, additional amounts, additions to the tax or assessable penalties) under $25,000. The Chief Counsel represents the Commissioner in the consideration of cases in which court proceedings are involved or criminal prosecution is pending. Specifically, Chief Counsel cases involve the compromise of tax liabilities in the following categories:

1 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;

2 Cases in which the taxpayer is in receivership or is involved in a proceeding under any provision of the Bankruptcy Act;

3 Cases in which the taxpayer is deceased;

4 Cases involving proposals to discharge property from the effect of tax liens;

5 Cases involving insolvent banks;

6 Cases involving assignments for the benefit of creditors;

7 Cases involving liquidation proceedings; and

8 Other cases in which court proceedings are pending, except cases pending before The Tax Court of the United States.

SEC. 3. LIMITATIONS ON DELEGATED AUTHORITY.

Regardless of the amount of liability involved, District Directors and Regional Counsel have not been delegated authority to accept offers in compromise in the following classes:

.01 All cases in which recommendations for prosecution are pending in the Intelligence Division of the District Director's office, 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 also related cases in which offers in compromise have been submitted. See section 2.03(3)1 above.

.02 All cases in which the acceptance of an offer by the Internal Revenue Service is dependent upon the acceptance of a related offer or upon a settlement under the jurisdiction of the Department of Justice.

.03 All cases arising under laws relating to alcohol, tobacco and firearms taxes.

.04 Certain narcotic cases. See Rev. Rul. 55–153, C.B. 1955–1, 199.

SEC. 4. FUNCTIONAL ALIGNMENT IN DISTRICT OFFICES.

.01 District Audit Divisions have jurisdiction over the following types of offers to compromise:

(1) Taxes of all classes, except alcohol, tobacco and firearms, including ad valorem penalties and interest;

(2) Ad valorem fraud and negligence penalties, including interest;

(3) Penalties relating to declarations of estimated tax;

(4) 100 percent penalties, as provided by sections 6671 and 6672 of the Internal Revenue Code of 1954, and corresponding sections of the 1939 Code; and

(5) Ad valorem delinquency penalties except those relating to employment taxes under Chapters 21 through 24 of Subtitle C of the Code.

District Audit Divisions also have investigative jurisdiction over all tax offers coming within the scope of this Revenue Procedure, including offers in Chief Counsel cases.

.02. District Collection Divisions have jurisdiction over:

(1) The filing, recording and payments relating to offers in compromise of all classes; and

(2) The processing, consideration, and disposition of (a) offers to compromise specific penalties, except those arising under laws relating to alcohol, tobacco, firearms, and certain narcotic offers; and (b) offers to compromise ad valorem delinquency penalties relating to employment taxes under Chapters 21 through 24 of Subtitle C of the Code.

SEC. 5. DISTRICT DIRECTOR AUTHORIZED TO REJECT AND PROCESS WITHDRAWN OFFERS.

Subject to the appeal procedure prescribed by Section 6 of this Revenue Procedure and the limitations set forth in this section, the

District Director, regardless of the liability amount involved, is authorized to reject and/or finally close—by written notification to the offeror—all compromise cases wherein the offers are not acceptable or have been withdrawn, except certain narcotic offers (See Rev. Rul. 55–153) and those arising under laws relating to alcohol, tobacco and firearms. With respect to Chief Counsel cases processed by Regional Counsel, the District Director's rejection authority is limited and consists of signing the rejection (or withdrawal) letter and memorandum prepared by Regional Counsel and the mailing of the letter to the proponent of the offer.

SEC. 6. CONFERENCE AND APPEAL PROCEDURE.

.01 *Conference in District Office.*—Upon oral or written request, either before or after rejection of an offer in compromise, and subject to the exceptions set forth in section 6.03 herein, the taxpayer or proponent—if he disagrees with the recommendation of the investigative agent—has the privilege of an informal conference in the District Audit Division. If the controversial issues cannot be resolved at the District level and if the offeror desires to appeal the rejection, he may, in writing, request the District Director to refer the case to the appropriate Regional Appellate Division for a hearing.

.02 *Regional Appellate procedure.*—Upon receipt of a protested rejection from the District office, the facts in the case are independently considered by the Regional Appellate Division, the taxpayer is granted a hearing, and, if necessary, a further investigative report is procured. After consideration on the merits, the Regional Appellate Division returns the case to the District Director for processing in accordance with the conclusions reached at the appeal level.

.03 *Appellate procedure not applicable.*—The procedure governing appeals to the Regional Appellate Division is not employed or available with respect to Chief Counsel cases processed by Regional Counsel or to offers involving specific penalties or certain delinquency penalties or to any excise tax, including interest and penalties, imposed by the following chapters of the Code (and the corresponding provisions of the 1939 Code): chapter 35 (relating to wagering); subchapter A of chapter 39 (relating to narcotic drugs and marihuana); subtitle E (relating to alcohol, tobacco, machine guns and certain other firearms); and subchapter D of chapter 78 (relating to certain import taxes) insofar as it relates to alcohol and tobacco.

SEC. 7. SCOPE OF DELEGATED ACCEPTANCE AUTHORITY.

.01 *Liabilities under $500.*—Except as provided in section 3 above, the District Director is delegated final authority to accept offers in cases under his processing jurisdiction wherein the unpaid amount of tax, including any interest, additional amount, additions to the tax or assessable penalty is less than $500. See also section 7.03 below. Under the provisions of section 7122(b) of the Code, no legal opinion is required in these cases.

.02 *Liabilities of $500 or more but less than $25,000 and specific penalties.*—Except as provided in section 3 above, the District Director with the approval of Regional Counsel is delegated authority to accept an offer which involves a liability (including any interest, additional amounts, additions to the tax or assessable penalties) of $500 or more,

but less than $25,000, or is in compromise of a specific penalty. The documentation for acceptance is prepared by the District Director and the case is forwarded to Regional Counsel for the legal opinion required under section 7122(b) of the Code. If the Regional Counsel considers the offer acceptable, he is authorized to sign the appropriate document which constitutes the legal opinion. The file is returned to the District Director for signature of the Abstract and Statement and issuance of the acceptance letter.

.03 *Chief Counsel cases—liabilities under $25,000.*—Subject to the exceptions provided in section 3 of this Revenue Procedure, when the Regional Counsel concludes that any offer in a Chief Counsel case (see section 2.03(3) above) should be accepted, and the case involves a liability (including any interest, additional amounts, additions to the tax or assessable penalties) under $25,000, he is authorized to prepare and sign the legal opinion as directed by the Chief Counsel. The acceptance case is then referred to the District Director for signature and disposition.

.04 *Liabilities $25,000 and over.*—When the District Director concludes that any offer should be accepted and such offer involves a liability (including any interest, additional amounts, additions to the tax, or assessable penalties) of $25,000 or over or is among the classes described in section 3 herein, he prepares the appropriate recommendation for acceptance and forwards the case to the Audit Division of the National Office for review. Also, when a Regional Counsel concludes that any offer in a Chief Counsel case should be accepted and such offer, under existing instructions, requires National Office approval, he prepares the appropriate documentation and forwards the case to the Chief Counsel for review. Compromise acceptance cases which are processed at District and Regional Counsel levels and which require National Office review are transmitted through channels for approval by the Commissioner of Internal Revenue.

SEC. 8. NATIONAL OFFICE COORDINATION.

In the National Office the management functions and the review of compromises requiring the Commissioner's approval are vested in the Operations Branch of the Audit Division—except that Chief Counsel cases (see section 2.03(3) above) and cases coming within the jurisdiction of the Alcohol and Tobacco Tax Division (those arising under the laws relating to alcohol, tobacco and firearms taxes) are channelled through the respective offices prior to Audit Division review and approval by the Commissioner.

SEC. 9. PUBLIC INSPECTION OF ACCEPTED OFFERS.

.01 *Authority.*—Public inspection of certain offers in compromise was authorized by Executive Order No. 10386, C.B. 1952–2, 299, and Treasury Decision 5927, C.B. 1952–2, 298. Pursuant to the Executive Order, such inspection is limited to accepted offers in compromise involving income, excess-profits, declared value excess-profits, capital stock, estate and gift tax cases (other than offers covering penalties and interest only).

.02 *Procedure.*—For a period of one year, a copy of the Abstract and Statement for each accepted offer which is subject to public inspection under Executive Order No. 10386 is made available for examination (1) in the Public Information Division of the National

Office when the offer covers a liability of $5,000 and over; and (2) in the office of the appropriate District Director when the offer covers a liability of less than $5,000. The place designated for public inspection in each district is listed on an inspection roster maintained by the Public Information Division of the National Office. No lists are prepared and no releases are distributed by the Internal Revenue Service in connection with these cases.

SEC. 10. EFFECT ON OTHER DOCUMENTS.

Revenue Ruling 117, C.B. 1953–1, 498; Revenue Ruling 251, C.B. 1953–2, 469; Revenue Ruling 252, C.B. 1953–2, 469; Revenue Procedure 56–26, C.B. 1956–2, 1383; and Revenue Procedure 57–30, C.B. 1957–2, 1103, are hereby superseded.

SEC. 11. EFFECTIVE DATE.

This Revenue Procedure is effective July 1, 1960.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. Rev. Proc. 60–23

(Also Part III–A, Section 5008; 201.482.)

In determining bottling losses, a proprietor should include as eligible spirits on the required Internal Revenue Service forms, any increase or decrease in proof gallons of imported spirits resulting from differences between the proof as determined by a Bureau of Customs gauger and the true proof as determined by a Customs chemist.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the method of the Internal Revenue Service for adjusting records of bottling gains or losses to reflect differences between the proof as determined by a Bureau of Customs gauger and the true proof as determined by a Customs chemist.

SEC. 2. CUSTOMS REPORTS.

The proprietor of a distilled spirits plant should make diligent efforts to obtain the Customs report of true proof promptly, preferably within ten days, so that the accounting for any lot of spirits may be accomplished within the month in which it was bottled. This is particularly true in connection with claims filed for the last period of the fiscal year.

SEC. 3. FORM 2611, STATEMENT OF LOSSES AT BOTTLING PREMISES.

Form 2611, Statement of Losses at Bottling Premises, should reflect the quantity of imported spirits withdrawn from Customs custody consistent with the most accurate information which the proprietor has available when the form is filed. Where the entry on Form 2611 is based on the gauge by a Customs gauger, and a determination of proof by a Customs chemist, under Revenue Ruling 58–258, C.B. 1958–1, 605, subsequently shows that the proof gallons released from Customs custody were either more or less than the proof gallons shown by the Customs gauger's gauge, an adjusting entry should be made on Form 2611, Form 122, Bottler's Dump and Batch Record, and Form 2733, Monthly Report of Bottling Premises Operations. This adjust-

ing entry need not be made on Form 122 provided Form 2733 reflects the adjusted gallonage. The adjusting entry on Form 2611 should be reflected in the claim covering the period in which the report of the Customs chemist is received. If upon final liquidation of the entry a discrepancy exists in the proof gallons as reflected by the Customs gauge and the Customs chemist's report, a corresponding adjusting entry should be made with respect to such entry. Adjustments on Form 2611 should be cross-referenced to the proper Form 2733. Form 2733 should also be cross-referenced to show the Form 2611 and Form 122 concerned.

SEC. 4. CLAIMS COVERING THE LAST PERIOD OF THE FISCAL YEAR.

Where a claim covering the last period of the fiscal year has been acted on and Customs reports covering any spirits bottled during such year on which losses are to be claimed are subsequently received, it will be necessary that such final claim be reopened and adjusted accordingly. Action on such a claim may be delayed for a reasonable time pending receipt of Customs final report. Reports for each year should be complete and no adjustments carried over from one year to another.

SEC. 5. CLAIMS WHICH INCLUDE LOSSES OF IMPORTED SPIRITS FOR WHICH THE ENTRY HAS NOT BEEN LIQUIDATED BY CUSTOMS.

On claims which include losses from spirits on which the Customs chemist's report has not been received or on which the entry has not been liquidated by Customs, the proprietor is required to state that fact on Form 2611, or in an accompanying statement, properly identify the spirits, and give the quantity involved. The claim must state that the quantity of imported spirits covered thereby is subject to adjustment pursuant to a Customs chemist's report or Customs' liquidation of the entry. The proprietor must make downward adjustments as well as those which react to his advantage.

SEC. 6. EFFECT.

The effect of this Revenue Procedure will enable the bottler, in most cases, to claim bottling losses on such additional taxable gallonage on a current basis and allow him to avoid the filing of amended claims.

SEC. 7. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. — Rev. Proc. 60–24

Establishment of full-time Conference Coordinator and conferee positions and announcement of revised informal conference procedures.

Revenue Procedure 60–16, page 940, this Bulletin, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to restate Revenue Procedure 60–16, page 940, this Bulletin, and add thereto the procedure

applicable when an agreement reached at an informal conference is upset upon review.

SEC. 2. BACKGROUND.

.01 Revenue Procedure 56–34, C.B. 1956–2, 1396, which was superseded by Revenue Procedure 60–16, page 940, this Bulletin, announced the establishment of the position of Conference Coordinator in the larger district offices and modified prior informal conference procedures. Those changes were designed to provide effective direction and control of the informal conference function at the district office level. Revenue Procedure 60–16 announced certain improvements which were made in the informal conference procedures in the Audit Divisions of the office of District Directors of Internal Revenue. The objective of these improvements is to encourage more taxpayers in unagreed cases to avail themselves of informal conferences than have done so under prior procedures.

.02 Experience gained in the use of the procedures prescribed in Revenue Procedure 56–34 and results of further studies made in this area disclosed the need for expanding the Conference Coordinator position to all districts and adding further refinements to prior procedures in order to encourage taxpayers now by-passing informal conferences to avail themselves of this opportunity to resolve unagreed issues.

SEC. 3. SCOPE.

In general, the revised informal conference procedures apply both in field audit and office audit cases. The new procedure encompasses not only income tax cases, but also estate, gift, excise and employment tax cases.

SEC. 4. RESPONSIBILITY FOR THE INFORMAL CONFERENCE FUNCTION.

A full-time Conference Coordinator position has been established in each district which did not previously have such a position. In all district offices the Conference Coordinator is responsible for the direction and execution of the informal conference function under the supervision of the Chief, Audit Division. One or more full-time conferees will be assigned to the Conference Coordinator's Staff in every district that has a sufficient volume of work to warrant such assignments. From time to time, as need arises, other qualified technicians in the Audit Division may be temporarily assigned to the Conference Coordinator's Staff to hold informal conferences.

SEC. 5. REVISIONS IN PROCEDURE.

.01 In unagreed cases, the examining officer will, at the conclusion of the examination, prepare a statement of proposed adjustments. This statement will be mailed to the taxpayer, together with an appropriate informal conference invitation letter.

.02 The Conference Coordinator in each district will be responsible for the assignment of conferees to handle all informal conferences. These assignments will be made generally on the following basis:

(1) The Conference Coordinator will handle, or will assign a full-time member of his staff or another qualified technician in the Audit Division to handle informal conferences in all complex cases, in all cases in which the taxpayer requests that the conference be handled by a conferee who functions independently

of the examining officer's group supervisor, and in all cases i which the examining officer's group supervisor disqualified hin self as conferee due to his prior active participation in the cas

(2) The examining officer's group supervisor will normally b assigned to handle informal conferences in all other cases unles the best interests and rights of the Internal Revenue Service an the taxpayer would not be served thereby. However, in this typ of case, the taxpayer will be informed that if he prefers he ma instead request a conference with a conferee who will functio independently of the examining officer's group supervisor. A such taxpayer requests will be honored by the Conferenc Coordinator.

.03 In complex informal conference cases, taxpayers will be re quested to submit a brief informal written statement setting forth th facts, rulings, or other data on which they rely. Although not re quired, such a statement would expedite the conference and assis the conferee in resolving the issues.

.04 Occasionally, in cases where an agreement is reached at an in formal conference, review of the case will disclose that the conferee' decision was based on a clearly defined error having a substantia effect on the tax liability. In such instances, if the change necessar to correct the error is adverse to the taxpayer, he will be offere another informal conference in the matter with the Conference Cc ordinator. This offer may be made by a local telephone call or b a letter. If the change is in the taxpayer's favor, the tax liabilit will, of course, be appropriately adjusted.

.05 If a taxpayer fails to avail himself of an informal conferenc at the time one is initially offered and subsequently files a forma protest upon receipt of the examination report and a 30-day pre liminary notice, his case will be referred to the Conference Coordinato for review. If the Conference Coordinator believes the unagree issues in the case are susceptible to being resolved at the Audit Div sion level, he will schedule an informal conference for the taxpaye with a member of his staff and invite the taxpayer to attend. Suc invitation may be by a local telephone call or by a letter.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 60–16, page 940, this Bulletin, is hereby supe seded.

SEC. 7. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addresse to the Assistant Commissioner (Operations) for the attention c O:A:P.

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26 CFR 601.301: Imposition of taxes qualification requirements, and regulations.
(Also Part III–A, Section 5362; 252.122, 252.125.)

Rev. Proc. 60–2

An exporter who is the proprietor of the bonded wine cellar from which the wine is to be withdrawn should, at the time of withdrawal of the wine, prepare a notice of such withdrawal

on Form 206, Withdrawal of Spirits, Specially Denatured Spirits or Wines for Exportation, in quadruplicate, and distribute the forms as provided in section 252.125 of the Exportation of Liquors Regulations and in instruction No. 2 on Form 206.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the correct disposition for Form 206, Withdrawal of Spirits, Specially Denatured Spirits or Wines for Exportation, in instances where the exporter is the proprietor of the bonded wine cellar.

SEC. 2. BACKGROUND.

Where the exporter is the proprietor of the bonded wine cellar from which the wine is to be withdrawn without payment of tax for exportation, use on vessels or aircraft, or transfer to foreign-trade zones, section 252.125 of the Exportation of Liquors Regulations and instruction No. 2 on Form 206 provide that, on removal of the wine, the proprietor shall forward one copy of Form 206 to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, retain one copy for his files, and deliver the original and remaining copy to the officer to whom the shipment is consigned, or in whose care it is shipped. On the other hand, section 252.122 of the regulations provides, in such instances, that all copies of Form 206 shall be filed with the Assistant Regional Commissioner.

SEC. 3. PROCEDURE.

.01 Where the exporter is the proprietor of the bonded wine cellar from which the wine is to be withdrawn without payment of tax for exportation, use on vessels or aircraft, or transfer to foreign-trade zones, he should, at the time of withdrawal of the wine, prepare a notice of such withdrawal on Form 206, in quadruplicate, and distribute the forms as provided in section 252.125 of the regulations and in instruction No. 2 on Form 206.

.02 Section 252.122 of the regulations will be amended to conform with related provisions of section 252.125 of the regulations.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

(Also Part III–A, Section 5205; 250.242, 251.68.) Rev. Proc. 60–26

An importer may, at the time of overprinting red strip stamps as required by section 250.242 of the Liquors and Articles from Puerto Rico and the Virgin Islands Regulations, and section 251.68 of the Importation of Distilled Spirits, Wines, and Beer Regulations, block out the denomination of standard size denominational red strip stamps.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to (1) outline the procedure to be followed in blocking out, at the time of overprinting, the denomination on standard size denominational red strip stamps, and

(2) to set forth the procedure to be used for reporting such stamps on Form 96, Strip Stamps Issued to and Used by Importers.

SEC. 2. BACKGROUND.

.01 Section 251.62 of the Importation of Distilled Spirits, Wines, and Beer Regulations provides, in part, that red strip stamps shall be affixed to imported containers of distilled spirits by the importer or owner under customs supervision. Section 251.63 of the regulations requires that red strip stamps be issued in a *standard size*, serially numbered, for bottles or containers of ½ pint capacity or more, and in a *small size* for bottles and containers of less than ½ pint capacity.

.02 Importers should, except as provided in section 3, continue to requisition stamps by denomination until further advised by the Alcohol and Tobacco Tax Division of the Internal Revenue Service and continue to use red strip stamps of a particular denomination as long as such denomination is furnished to them and until their stock is exhausted or until they are instructed to make other disposition of the strip stamps.

SEC. 3. PROCUREMENT AND OVERPRINTING OF STAMPS.

Section 250.242 of the Liquors and Articles from Puerto Rico and the Virgin Islands Regulations and section 251.68 of the Importation of Distilled Spirits, Wines, and Beer Regulations require red strip stamps to be overprinted with the name and address of the importer. In order to simplify operations involving denominational red strip stamps, importers may, at the time of overprinting the stamps as required by the regulations, block out the denomination on standard size denominational red strip stamps in their possession and use them in the same manner as the new nondenominational standard-size stamps. Importers who desire to so block out the denominations on such stamps should insert on the blank line in column (a) of Form 428, Requisition for Bottle Strip Stamps, the words "Any demonination" instead of specifying the denomination.

SEC. 4. REPORTING STAMPS ON FORM 96, STRIP STAMPS ISSUED TO AND USED BY IMPORTERS.

.01 Section 251.131 of the Importation of Distilled Spirits, Wine, and Beer Regulations provides that every importer shall prepare on Form 96, in triplicate, an annual report of all strip stamps procured, used, lost, mutilated, destroyed or otherwise disposed of during the fiscal year, a report of the balances on hand at the beginning and end of the fiscal year, and an accounting for any balances outstanding against each requisition at the end of the fiscal year.

.02 Importers are to consider denominational stamps, blocked out denominational stamps, and the new stamps not bearing denominations, as *standard size* stamps. These stamps should be reported in an unused column, preferably the "gallon" column, redesignated as "Standard Size." In addition to reporting at line 5 the total number of stamps used during the period, importers will also report at line 5, under the appropriate denominational heading, the number of bottles by sizes to which stamps were affixed.

SEC. 5. INQUIRIES.

Inquiries about this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6001, 6011, 6018, 6019; 1.6001–1, 1.6011–1, 20.6018–1, 25.6019–1.)

Rev. Proc. 60–27

Reproduced copies of certain Federal tax return forms and schedules may be used for filing purposes in lieu of the applicable official forms, subject, however, to prescribe conditions.

Revenue Procedure 59–37, C.B. 1959–2, 964, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to restate the requirements of the Internal Revenue Service relating to the preparation of acceptable reproductions of Federal tax return forms and schedules for filing purposes in lieu of the official forms and schedules.

SEC. 2. SPECIFICATIONS.

Subject to the conditions enumerated in section 3 below, the Service will accept, for filing purposes, reproduced copies of any of the following tax return forms and schedules:

Employee's Withholding Exemption Certificate, Form W–4.
U.S. Estate Tax Return, Form 706.
U.S. Gift Tax Return, Form 709.
Life Insurance Statement, Form 712.
Claim, Form 843.
U.S. Exempt Cooperative Association Income Tax Return, Form 990–C.
U.S. Return of Employees' Trust Described in Section 401(a) and Exempt Under Section 501(a) of the Internal Revenue Code of 1954, Form 990–P.
U.S. Individual Income Tax Return, Form 1040.
Profit (or Loss) From Business or Profession, Schedule C (Form 1040).
Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1040).
U.S. Departing Alien Income Tax Return, Form 1040C.
Declaration of Estimated Tax, Form 1040–ES.
U.S. Individual Income Tax Return (Optional Short Form), Form 1040W.
Schedule of Farm Income and Expenses, Schedule F (Form 1040).
U.S. Fiduciary Income Tax Return, Form 1041.
Allocation of Accumulation Distribution, Schedule J (Form 1041).
U.S. Partnership Return of Income, Form 1065.
Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1065).
Statement in Support of Credit Claimed by Domestic Corporation for Taxes Paid or Accrued to a Foreign Country or a Possession of the United States, Form 1118.
U.S. Corporation Income Tax Return, Form 1120.
Schedule of Gains and Losses From Sales or Exchanges of Property, Schedule D (Form 1120).
U.S. Small Business Corporation Return of Income, Form 1120–S.
Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1120–S).

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

Statement for the Purpose of Extending Time for Payment of Taxes by Corporations Expecting Carrybacks, Form 1138.

Application for Tentative Carryback Adjustment, Form 1139.

SEC. 3. CONDITIONS.

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

.02 Reproduction must be on paper of substantially the same weight and texture and of a quality at least as good as that used in the official form.

.03 Reproductions must substantially duplicate the colors of the paper and/or ink of the official form in order to be acceptable.

.04 Reproductions must have a high standard of legibility, both as to original form and as to filled-in matter. The Internal Revenue Service reserves the right to reject any reproductions with poor legibility, to withdraw the benefits of this Revenue Procedure from any firm or individual, and to reject any process which fails to meet these standards.

.05 Reproductions of page 3 of Schedule C and page 4 of Schedule F, Form 1040, which contain Schedule SE, U.S. Report of Self-Employment Income, must be on properly perforated paper of substantially the same weight and texture as that used in the official form.

.06 Reproductions can be the same size as that of the official form. However, the standard commercial size of 8½ x 11 (as noted in columns 2 and 3 of the table in section 5 below) will be accepted, but no tolerances will be permitted in the image size of printed material.

SEC. 4. ADDITIONAL INSTRUCTIONS.

.01 The Service ordinarily does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms and schedules satisfy the stated conditions.

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

.03 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 Service must be original signatures, affixed subsequent to the reproduction process.

.04 Reproductions of forms and schedules meeting the above conditions may be used without the prior approval of the Service. However, if specific approval of a reproduction of any such form or schedule is desired, or if the use of a reproduction of any form or schedule not listed herein or otherwise specifically authorized is desired, a sample of the proposed reproduction should be forwarded, by letter, to the Commissioner of Internal Revenue. Attention: O:C:S Washington 25, D.C., for consideration.

SEC. 5. PHYSICAL ASPECTS.

The conditions with respect to size, number of printed pages, and color of both paper and ink are as follows:

Form No.	Official IRS trim size [1]	Tolerances permitted in size [2]	Number of printed pages	Color of	
				Paper	Ink
(1)	(2)	(3)	(4)	(5)	(6)
W-4	7⅞ x 3⁷⁄₁₆	8 x 3½	2	White	Black
706	8 ⅜ x 11	8½ x 11	40	White	Black
709	8½ x 11		2	Buff	Black
712	8 x 10½	8½ x 11	1	White	Black
843	8 x 10½	8½ x 11	2	White	Black
990-C	8½ x 13⅜	8½ x 14	4	White	Black
990-P	8 x 10½	8½ x 11	3	White	Black
1040	8 x 11	8½ x 11	4	White	Black
1040W	8 x 11	8½ x 11	2	Buff	Black
Schedule C, 1040	7⅞ x 11	8½ x 11	4	White	Black
Schedule D, 1040	7⅞ x 11	8½ x 11	2	White	Black
1040C	7⅞ x 11	8½ x 11	4	White	Black
1961 1040-ES	8 x 10½	8½ x 11	2	White	Black
Schedule F, 1040	7⅞ x 11	8½ x 11	4	White	Black
1041	7⅞ x 11	8½ x 11	4	Pink	Black
Schedule J, 1041	7⅞ x 11	8½ x 11	2	Pink	Black
1065	8 x 11	8½ x 11	4	Yellow	Black
Schedule D, 1065	8 x 11	8½ x 11	2	Yellow	Black
1118	8½ x 11		2	White	Black
1120	8 x 11	8½ x 11	4	Blue	Black
Schedule D, 1120	8 x 11	8½ x 11	4	Blue	Black
1120S	8½ x 11		4	Green	Black
Schedule D, 1120S	8½ x 11		2	Green	Black
1122	8 x 10½	8½ x 11	1	Blue	Black
1138	8 x 10½	8½ x 11	2	White	Black
1139	8½ x 11		3	White	Black

[1] Sizes shown are for single forms furnished by Internal Revenue Service offices: forms supplied in Income Tax Packages are 8¾" x 11".
[2] Forms cannot exceed sizes shown, nor be less than size of official forms.

SEC. 6. BLACK AND WHITE PROOFS.

The Service, upon application, will furnish one set of black and white proofs to be used as the reproducible media in the printing of forms. These proofs, for which separate requests must be received annually, will be supplied free of charge to all concerns in the forms reproduction business. Reproduction proofs are available only for the following forms:

W-4
1040
1040W
Schedule C (1040)
Schedule D (1040)
1040-ES
Schedule F (1040)
1041
Schedule J (1041)
1065
Schedule D (1065)
1096
1099
1099L
1120
Schedule D (1120)
1120S
Schedule D (1120S)

Requests for reproduction proofs should be addressed to the Commissioner of Internal Revenue, Attention: A:O:P, Washington 25, D.C.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Procedure 59–37, C.B. 1959–2, 964.

(Also Part I, Section 6051; 31.6051–1.) Rev. Proc. 60–28

Substitutes for Form W–2, Withholding Tax Statement–1961, may be privately printed with slight variations in format and used without specific approval of the Internal Revenue Service, provided that they meet specified conditions with respect to physical characteristics, use of additional copies, and additional information, if any, to state and local taxing authorities.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the requirements of the Internal Revenue Service relating to the preparation of acceptable substitutes for Form W–2, Withholding Tax Statement—1961, for filing purposes in lieu of the official form printed by the Government Printing Office.

SEC. 2. SPECIFICATIONS.

.01 *Substitutes.*—Substitutes for Form W–2 may be privately printed with slight variations in format, and used without requesting approval of the Internal Revenue Service if the conditions enumerated in section 3 are met. For proposed substitutes which do not meet such conditions, specific approval must be requested as provided by section 5, below. In any rearrangement of the information, care should be taken to prevent disclosure of wage and tax information if a window envelope is used for mailing.

.02 *Design for mailing.*—The official form is designed for mailing in a standard window envelope. This feature will be found desirable in most of the privately printed substitutes.

.03 *Copy D.*—Copy D is included in the official assembly for the convenience of the employer. Although there is no requirement that privately printed substitute forms include Copy D, employers may find it desirable to make and retain such copy.

SEC. 3. CONDITIONS.

.01 *Color and quality of ink and paper.*—The substitute forms, except for authorized punch card substitutes, must be printed in blue ink on white paper, both of quality as good as that used by the Government. The paper must be of substantially the same weight and texture as that used in the official form, which is printed on substance 32-pound white-writing—basis 1,000 sheets 17×22.

.02 *Typography.*—Type may not be smaller than the corresponding type on the official form and as nearly as possible of the same font.

.03 *Format.*—The substitute forms must provide the same spaces as the official form for showing wages paid and tax withheld. In any rearrangement of such spaces, the block headed "INCOME TAX INFORMATION" is to be placed in a prominent position on the Form, preferably in the right-center position, the spaces for showing social security information to be either to the left or above such block.

.04 *Dimensions.*—The official form is eight inches wide by three and one-half inches deep, exclusive of a half inch snap-stub on the left side of the form. The substitute forms may vary in width from

seven inches to eight inches and in depth from three and one-sixth inches to three and two-thirds inches. The snap feature is not required on substitutes.

.05 *Carbonized forms or "spot carbons."*—Carbonized forms and "spot carbons" are not permissible. Interleaved carbon, if used, must be of good quality to preclude smudging and, preferably, black.

.06 *Special identification.*—Copy B must show the full-face dots, arranged vertically on the upper right side.

.07 *The Government Printing Office symbols.*—The Government Printing Office symbols must be omitted.

SEC. 4. ADDITIONAL INSTRUCTIONS.

.01 *Arrangement of assembly.*—Except as provided in paragraph .02 below, the parts of the assembly shall be arranged, from top to bottom, as follows: Copy A, "For District Director"; Copy B, "To Be Filed With Employee's Tax Return"; Copy C, "For Employee's Records"; Copy D, "For Employer." All references to the various parts shall be to "Copy A," "Copy B," "Copy C," or "Copy D."

.02 *Additional copies.*—Additional copies may be prepared for the use of employers in connection with taxes or deductions other than Federal income tax and Federal Insurance Contributions Act taxes. Such additional copies may not be placed ahead of Copy C in the assembly, except that if a copy or copies for a state or local taxing authority are prepared only one such copy may be placed ahead of Copy C in the assembly for better legibility. Forms for delivery to state or local taxing authorities should be clearly labeled to indicate the purpose for which they are intended and should not bear any part of the designation, "Form W–2—U.S. Treasury Department, Internal Revenue Service."

.03 *Excludable sick pay.*—If desired, a block may be shown on Form W–2 for excludable sick pay. However, if such a block is provided and no amount is entered, the word "None" or "0" should be shown.

.04 *Statement to support excludable sick pay.*—A statement from the employer to support sick pay excludable from gross income may be made a part of the assembly, provided it is not placed ahead of Copies A and B in the assembly and is printed on paper of distinctive color. Such statement should substantially conform with the statement set forth in Revenue Procedure 57–1, C.B. 1957–1, 721. It should be clearly indicated on such statement that it is to be attached to page 2 of the taxpayer's Federal income tax return, Form 1040 or Form 1040W.

.05 *Instructions.*—No deviation from the instructions on either the front or back of Copies A, B, or C will be permitted.

.06 *State or local taxing authorities.*—Additional wage or tax information for state or local taxing authorities may be shown on Copy C, but not on Copies A and B.

.07 *Other information.*—Payroll deductions other than those required to be reported on Form W–2 may not be shown on Copies A and B, except as provided in paragraph .08 below.

.08 *State agencies.*—The amounts of wages paid and employee contributions withheld under a State-Federal agreement, entered into pursuant to section 218 of the Social Security Act, may be shown in the spaces on Form W–2 for Federal Insurance Contributions Act

wages and employee tax, provided appropriate distinguishing cap tions are used to identify such amounts. The identification numbe assigned by the Social Security Administration to the state (prefi 69) should be shown in addition to the employer identification numbe assigned by the Internal Revenue Service for income tax withholdin purposes.

SEC. 5. SUBSTITUTES NOT MEETING ABOVE CONDITIONS.

Proposed substitute forms which do not meet the conditions state above and requests for submission of punched card Forms W–2 shoul be forwarded by letter to the Commissioner of Internal Revenue, At tention: O:C:S, Washington 25, D.C., for approval.

SEC. 6. REPRODUCTION PROOFS.

Reproduction proofs of the official From W–2 are available upo the request of any employer who desires to use reproductions of suc form. Requests for reproduction proofs should be addressed to th Commissioner of Internal Revenue, Attention; A:O:P, Washingto 25, D.C.

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26 CFR 601.103: Summary of general tax procedure. Rev. Proc. 60–29

(Also Part I, Section 7503; 1.7503–1.)

Section 7503 of the Internal Revenue Code of 1954 provides tha when the last day prescribed under the authority of the revenue law for performing any act falls on a Saturday, Sunday, or legal holiday the performance of such act shall be considered timely if it is per formed on the next succeeding day which is not a Saturday, Sunda or legal holiday. April 15, 1960, was Good Friday, a legal holida in several States. Residents of such States were not required t file returns until April 18, 1960, the next succeeding day that was no a Saturday, Sunday, or legal holiday. Limited to this specific in stance, the Commissioner of Internal Revenue granted to all taxpayer an extension of time until April 18, 1960, to file returns due on Apri 15, 1960. Thus, tax returns due on April 15, 1960, will be deeme timely if filed on April 18, 1960.

(EDITOR'S NOTE: Since the administrative position expressed in the new release was not published in the Internal Revenue Bulletin at the time o release, publication is now being made to make the position there expressed part of the Bulletin.)

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. Rev. Proc. 60–3

(Also Part III–A, Section 5552; 245.30.)

The 2BL Rotocycle Beer Meter and 3BL Rotocycle Beer Meter have been approved by the Internal Revenue Service for use by brewers in measuring beer.

SECTION 1. PURPOSE.

The purposes of this Revenue Procedure are (1) to announce th approval of a new type of beer meter for measuring the quantity o

[1] Based on news release dated April 13, 1960.

beer being packaged, or transferred to the brewery bottling house, and (2) to list the types of beer meters which have been previously approved.

SEC. 2. BACKGROUND AND APPROVAL OF NEW BEER METER.

After a series of tests and evaluations, the 2BL Rotocycle Beer Meter, rated capacity 20–100 gallons per minute, and the 3BL Rotocycle Beer Meter, rated capacity 50–200 gallons per minute, have been approved for measuring the quantity of beer being packaged, or transferred to the brewery bottling house. These meters are rotary positive displacement type and are manufactured by Rockwell Manufacturing Co., Pittsburgh, Pennsylvania. The movement of beer through the meter is accomplished by means of vanes incorporated in a rotating drum which seal off separate liquid segments of known volume of product. Adjustment is accomplished by means of a micro device acting on the counter drive mechanism which varies the amount indicated on the register by infinitely small increments rather than by varying the amount of liquid being displaced. The company has also developed a slow flow shut-off device for use with the new meters which will shut off all flow if the rate of flow drops below a predetermined figure. Installation of this device is optional with the brewer.

SEC. 3. METERS PREVIOUSLY APPROVED.

The following beer meters have previously been approved:

.01 For measuring beer being packaged, or transferred to the brewery bottling house:

1. Figure 486 Xacto Meter, and Figure 786 Xacto Meter, manufactured by Bowser, Inc., Ft. Wayne, Indiana; and
2. Pittsburgh Equitable Meter, manufactured by Rockwell Manufacturing Co., Pittsburgh, Pennsylvania; and

.02 For measuring beer being transferred to bottling tanks (but not directly to bottle fillers):

Potter Flow Meter, manufactured by the Potter Aeronautical Corporation, Union, New Jersey. See Rev. Proc. 58–22, C.B. 1958–2, 1140.

SEC. 4. INSTALLATION AND TEST OF METERS.

The Internal Revenue Service utilizes only master meters having two-inch flanged connections. Therefore, brewers must install all meters, including newly approved 3 BL Rotocycle Meters, so that they can be readily tested by means of these two-inch meters. Also, brewers must make provisions for testing meters at a lesser rate of flow, usually 90 to 100 gallons per minute, when their meters normally operate in excess of the master meter maximum rate of flow of approximately 100 gallons per minute.

SEC. 5. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III–A, Sections 5008, 5021; 201.424, 201.601.)

Rev. Proc. 60–3

The refund or credit of tax under the provisions of section 5008(e) of the Internal Revenue Code of 1954 will be computed without regard to the rectification tax imposed by section 5021 of the Code or to the quantities of drawback spirits, or to the quantities of wines when not in excess of two and one-half percent by volume.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth procedure for calculating the amount of tax to be refunded or credited on samples of distilled spirits taken for the use of the United States.

SEC. 2. BACKGROUND.

Section 5008(e) of the Internal Revenue Code of 1954 provides that, pursuant to regulations, the tax on any samples of distilled spirits removed from the premises of a distilled spirits plant for analysis or testing by the United States shall be refunded or credited to the proprietor.

SEC. 3. PROCEDURE.

.01 The tax to be refunded or credited on samples of rectified distilled spirits will be computed on a proof gallon basis at the rate imposed on the spirits by section 5001(a)(1) of the Code; no refund or credit will be made of the rectification tax imposed by section 5021 of the Code.

.02 The amount of tax to be credited or refunded, under the provisions of section 5008(e) of the Code, on samples of distilled spirits containing not in excess of two and one-half percent of wine by volume will be computed as if the alcoholic content of the sample consisted entirely of distilled spirits. The tax on samples that contain more than two and one-half percent of wine by volume will be credited or refunded only on the distilled spirits component of the sample.

.03 Section 201.424 of the Distilled Spirits Regulations limits the use in a rectified product of alcoholic materials on which drawback of tax has been or may be claimed to a quantity that will not represent on a proof gallon basis, more than two and one-half percent of the total proof gallons of spirits in the finished product. The amount of tax to be credited or refunded, under the provisions of section 5008(e) of the Code, on samples of such spirits will be computed without regard to the drawback spirits contained in the sample.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.311: Imposition of taxes; regulations.
(Also Part I, Section 5704; 290.205, 290.261.)

Rev. Proc. 60–32

When tax-exempt tobacco products are to be exported by truck to the United States Armed Forces in a contiguous foreign country, the Certificate of Exportation on the reverse of Form 2149, Notice of Removal of Tobacco, Tobacco Products, or Cigarette Papers or Tubes from Factory for Export, and on Form 2150, Notice of Removal of Tobacco Products or Cigarette Papers or Tubes from Warehouses for Export, must be modified so that the Inspector of Customs at the port of exit may certify to the exportation.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedures to be followed in the preparation and handling of Form 2149, Notice of Removal of Tobacco, Tobacco Products, or Cigarette Papers or Tubes From Factory For Export, or Form 2150, Notice of Removal of Tobacco Products or Cigarette Papers or Tubes from Warehouse For Export, when tax-exempt tobacco products are to be exported by truck to the United States Armed Forces in a contiguous foreign country.

SEC. 2. BACKGROUND.

Sections 290.205 and 290.261 of the Exportation of Tobacco Materials, Tobacco Products, and Cigarette Papers and Tubes, Without Payment of Tax, or With Drawback of Tax Regulations provide general procedures to be followed for the exportation of tobacco products (cigars in the case of a Customs warehouse) to a contiguous foreign country, including shipments to the United States Armed Forces in such a contiguous foreign country, and, as evidence of exportation, for the completion of the Certificate of Exportation on the Forms 2149 or 2150 by the Customs authorities at the port of exit. When tobacco products are exported by truck to the United States Armed Forces in a contiguous foreign country, where no shipper's export declaration is required, the Collector of Customs is unable to certify to the exportation of the products since he has no records in his office to serve as a basis for the certification. Therefore, the following procedure has been worked out with the Bureau of Customs for application in such instances.

SEC. 3. PROCEDURE FOR EXPORTATION BY TRUCK.

When tax-exempt tobacco products are to be exported by truck to the United States Armed Forces in a contiguous foreign country, the Certificate of Exportation on the reverse of the Form 2149 or 2150 will be modified so that the Inspector of Customs at the port of exit may certify to the exportation. To modify the Certificate of Exportation, manufacturers of tobacco products and proprietors of export warehouses and customs bonded cigar manufacturing warehouses should delete the words "records of this office show that the" and change the word "Collector" to "Inspector" in Item 20. Two copies of the modified Form 2149 or 2150 must accompany the shipment to the port of exit and be delivered to the Inspector of Customs. When the two copies of the modified Form 2149 or 2150 are delivered to him, the Inspector of Customs will check the shipment, execute the Cer-

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tificate of Exportation on both copies of the form, and forward th forms to his Collector. The Collector of Customs will retain on copy of the form for his file and mail the other copy to the manu facturer or warehouse proprietor making the shipment for filing wit his Assistant Regional Commissioner, Alcohol and Tobacco Tax.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to it number and be addressed to the office of the appropriate Assistar Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Sections 6166; 24.1–1.) Rev. Proc. 60–3

Procedures to be followed by the Audit Divisions of the District Directors' offices in processing the elections made by executors, administrators, etc., under section 6166 of the Internal Revenue Code of 1954, to pay estate taxes in installments.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth certain pr cedures established in the Audit Divisions of the District Director offices for processing the elections to pay estate taxes in installment made by executors, administrators, etc., under the provisions of sectio 6166 of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND.

.01 Section 6166 of the Code provides that under certain conditior where an interest in a closely held business is included in the gro estate of a decedent who was a citizen or resident of the United Stat at the time of his death, the executor may elect to pay in installmen part or all of the Federal estate tax imposed by section 2001 of th Code. Section 6166 contains the definition of an interest in a closel held business, the limitation placed on the amount which may b paid in installments, the number of installments in which the tax ma be paid, and the circumstances under which the privilege of paying th tax in installments will be terminated.

.02 Section 24.1–1 of the temporary regulations relating to exte sion of time for payment of estate tax as set forth in Treasury Dec sion 6321, C.B. 1958–2, 1102, provides that the election granted b section 6166 of the Code shall be exercised by filing notice of electic to pay the tax in installments with the district director. The regul tions also prescribe the form which the notice of election to pay th estate tax in installments may take.

SEC. 3. PROCEDURE.

.01 The District Director is responsible for determining wheth an election made by an estate meets the conditions specified in sectic 6166 of the Code. Where it appears after examination that an electic does not meet the requirements in section 6166 of the Code, the executc etc., of the estate will be given the opportunity of a hearing in th matter with an appropriate conferee in the District Audit Divisic

before a final decision is reached regarding the election. If it is determined that an election should be rejected, the District Director will communicate the decision to the executor, etc. Such decision to reject an election will be regarded as the Service's decision in the matter and will not be subject to appeal to, or review by, the Regional Appellate Division.

.02 When it is determined that an election is in accord with the requirements of section 6166 of the Code, no notice to that effect will be sent to the executor. An executor should assume that his election is acceptable if he has not been advised to the contrary. Elections submitted will be examined as soon as practicable after receipt.

SEC. 4. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Operations) for the attention of O : A : P.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III–A, Section 5207; 201.632, 201.633.)

Rev. Proc. 60–34

Proprietors of distilled spirits plants should report losses sustained in connection with the bottling of spirits or in packaging mingled or blended spirits on Form 2731, Monthly Report of Bonded Storage Operations, and report the quantity of spirits determined by gauge at the time of dumping for bottling in bond, at line 32 of Form 2636, Daily Report of Transactions.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedures for making certain entries on Form 2731, Monthly Report of Bonded Storage Operations, and Form 2636, Daily Report of Transactions.

SEC. 2. BACKGROUND.

.01 Form 2731 is a balanced report, but it does not include internal transactions. When bonded storage operations include internal transactions, such as bottling of spirits or mingling or blending of spirits, and losses are sustained in the bottling of spirits or in the packaging of mingled or blended spirits, such losses should be reported on Form 2731 in order that the report will balance.

.02 The quantity of spirits "used for bottling" is reported at line 32 on Form 2636. This quantity is derived from Form 1515, Distilled Spirits Bottled in Bond. The quantity of spirits determined by gauge and entered for bottling is entered in column (d), Section II, of Form 1515, and the quantity of spirits determined by gauge after reduction in proof for bottling is entered in column (e), Section III of Form 1515.

SEC. 3. PROCEDURE.

.01 Footnote six on Form 2731 states that line 20 covers only storage losses. Accordingly, where losses are sustained in bottling spirits or in packaging mingled or blended spirits, proprietors should enter and appropriately identify such losses in an unused line on Form 2731.

.02 The quantity of spirits reported at line 32 on Form 2636 should be the quantity determined by gauge at the time of dumping the spirits for bottling in bond and entered in column (d), Section II of Form 1515. This quantity would then represent the quantity of spirits used for bottling. The difference between the quantity used and the quantity bottled would represent the loss in bottling which would then be entered in Section IV of Form 1515 and on Form 2731 as provided in section 3.01, above.

.03 The quantity of spirits reported at line 33, used for blending, and at line 34, used for mingling, of Form 2636 should be the quantity determined by gauge at the time of dumping for blending or mingling and entered on Form 1685, Blending of Rums or Brandies in Bond, and Form 2323, Mingling of Distilled Spirits, respectively. Also, the loss in packaging such blended or mingled spirits and entered in item 14b of Form 1685 or in item 18G of Form 2323, as the case may be, should be entered on Form 2731 as provided in section 3.01, above.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.102: Classification of taxes collected by the Internal Revenue Service. (Also Part I, Section 6851; 1.6851–2.) — Rev. Proc. 60–35

In certain cases, groups of nonresident aliens having no taxable income from United States sources may file Form 2063, U.S. Departing Alien Income Tax Statement, and obtain a Certificate of Compliance without having to make a personal appearance in the office of a District Director of Internal Revenue.

An alien, other than a nonresident with no taxable income, may apply for and receive a Certificate of Compliance without having his taxable period terminated by supplying certain additional information with his Form 1040C, U.S. Departing Alien Income Tax Return, provided he intends to return to the United States and has filed all required returns for prior years and paid all tax due thereon and, further, there is no information indicating that jeopardy exists.

Rev. Rul. 55–468, C.B. 1955–2, 501, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide additional guidelines for simplifying procedures for obtaining Certificates of Compliance by certain aliens departing from the United States and its possessions.

SEC. 2. BACKGROUND.

Revenue Ruling 55–468, C.B. 1955–2, 501, as amplified by Revenue Ruling 58–7, C.B. 1958–1, 497, established uniform procedures for the clearance of aliens departing from the United States or its possessions and for the issuance of Certificates of Compliance with the Internal Revenue Laws.

SEC. 3. NONPERSONAL APPEARANCE IN CERTAIN CASES.

Each member of a group of nonresident aliens having no taxable income from United States sources will be permitted to file a Form

2063, U.S. Departing Alien Income Tax Statement, and obtain a Certificate of Compliance without personal appearance in the district office of the Internal Revenue Service. This may be accomplished by correspondence or by means of a messenger or other representative for the entire group. Generally, this procedure will be limited to those groups of nonresident aliens that are sponsored by governmental agencies, educational institutions, foundations, trade associations, and other similar organizations. Quantities of Form 2063 will be furnished for this purpose upon request of these organizations or other authorized representatives of the alien groups.

SEC. 4. CLEARANCE FOR ENTIRE TAXABLE YEAR.

.01 Certain information in addition to that required by Form 1040C, U.S. Departing Alien Income Tax Return, must be obtained in the case of a departing alien who wishes to establish that his departure will not result in jeopardy and, accordingly, his taxable period should not be terminated. Therefore, in appropriate cases the following information should be shown on page two of Form 1040C:

1. Are your wife and children (if any) remaining in the United States? ☐Yes ☐No
2. Show the approximate value and location in the United States of the property held by you.
   a. Real property------ $----------; ----------
      $----------; ----------
   b. Stocks and bonds--- $----------; ----------
   c. Cash---------- $----------; ----------
   d. Other (Specify)--- $----------; ----------
3. If you will not return before (a) the due date for filing a final United States income tax return for the current year, or (b) the due date for paying the tax for the preceding year, what arrangements have you made to have your final income tax return for the year filed and the tax paid?

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4. Is your employer willing to furnish a letter guaranteeing that the tax will be paid? ☐Yes ☐No
   If answer is "yes," please attach the letter.

Normally, the departing alien will be required personally to appear before a District Director for the purpose of executing the modified Form 1040C, as here indicated.

.02 This procedure is applicable to an alien (other than a nonresident alien with no taxable income) who intends to return to the United States and who has filed all required returns for prior years and paid all tax due thereon. In addition, where the period for filing the return for the preceding year has not expired, this return must also

be filed before departure, although payment of the tax shown thereon will not be required before the normal due date. In the absence of any information indicating jeopardy, the alien who has satisfied his prior years' tax obligations and indicates ties and connections such as business, employment, property or family in the United States or its possessions, will not have his taxable period terminated. The alien will be issued the Certificate of Compliance on the duplicate copy of Form 1040C completed with the deletion of the words "as of the intended date of departure" and the addition of the words "Annual" and "For Taxable Year Ended ----------." with the proper date inserted.

.03 When issued in accordance with the foregoing, this special Certificate of Compliance will be effective for all departures in the taxable year and the alien will not ordinarily be required to appear again before the District Director during the taxable year unless the District Director has reason to believe that the collection of the tax may be in jeopardy. An example of the application of this procedure would be a nonresident alien who at periodic intervals during the year comes to the United States for brief stays to attend meetings of a corporation board of directors for which he receives directors fees. Before the alien's first departure in the year, he would file Form 1040C. If the District Director determines that the alien's departure will not result in jeopardy, his taxable period need not be terminated. Thereupon, he will be issued a Certificate of Compliance applicable to all departures during the taxable year.

.04 Section 1.6851–2 of the Income Tax Regulations restricts the issuance of a Certificate of Compliance effective for all departures to the Certificate issued in conjunction with Form 1040C. Therefore the procedure prescribed herein is not applicable to nonresident aliens having no taxable income who must file Form 2063 on each departure from the United States in order to obtain a Certificate of Compliance applicable only to that particular departure.

.05 The Certificate of Compliance on Form 1040C issued to the departing alien whose taxable period is not terminated will be modified as indicated in section 4.02 above until Form 1040C is next reprinted. At that time the Certificate of Compliance on the form will be revised to provide for its use in both termination and nontermination cases. The Certificate will be used without modification in cases where the taxable year is terminated.

.06 The provisions of section 6 of Revenue Ruling 55–468, C.B. 1955–2, 501, at 503, are inconsistent with the provisions of section 4 of this Revenue Procedure and compliance with such requirements is no longer necessary.

SEC. 5. REFUND OF TAX BY EMPLOYERS.

.01 Revenue Procedure 57–13, C.B. 1957–1, 741, prescribes procedures for the refunding by employers, in certain cases, of tax withheld direct to the nonresident alien employee at the time of departure from the United States. Since that procedure is seldom used, this reference is made to acquaint those who are unaware of it in order that it will be used to the maximum extent in applicable cases. See section 5.02 below.

.02 The conditions under which the refund may be made to the nonresident alien are these: (1) his employer has not yet paid the with

held tax to the Government, (2) his employer agrees to make a refund of tax upon authorization from a District Director of Internal Revenue, and (3) he obtains authorization for such refund from that official. To obtain a refund before departure, the following steps should be followed:

1. The employer should prepare and sign an agreement as shown on Exhibit A of Revenue Procedure 57–13, *supra*, at 743.
2. Exhibit A should be taken to the District Director of Internal Revenue, who may then prepare Exhibit B of Revenue Procedure 57–13, *supra*, at 744.
3. Exhibit B, which states the amount of refund authorized, should be taken to the employer. The employer may now make the refund in the amount authorized.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Revenue Ruling 55–468, C.B. 1955–2, 501, is modified to the extent of the provisions in this Revenue Procedure.

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