Internal Revenue Bulletin

CUMULATIVE BULLETIN 1958-2

JULY-DECEMBER 1958

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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.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" represents 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, the Federal Firearms Act, 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 the Federal Firearms Act (Subpart B).

III. Part III contains rulings and decisions pertaining to the various alcohol taxes. This part is subdivided into three subparts according to matters issued under the Internal Revenue Code of 1954 (Subpart A), the Internal Revenue Code of 1939 (Subpart B), and the Federal Alcohol Administration Act (Subpart C).

IV. Part IV contains Tax Conventions and Treasury Decisions with respect thereto. (Public Laws pertaining to internal revenue matters enacted by the Second Session of the 85th Congress after June 30, 1958, together with their related Committee Reports and a digest of all tax legislation enacted during the Second Session, which normally would have been included in this Part of this Cumulative Bulletin, have been consolidated and are published in Internal Revenue Cumulative Bulletin 1958–3.)

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, 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. All Revenue Rulings published in the Bulletin have received the consideration and concurrence of the Chief Counsel.

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. 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. 337 for 1958 should be cited as "Rev. Rul. 58–337, C.B. 1958–2, 13." Similarly, Revenue Procedure No. 10 for 1958 should be cited as "Rev. Proc. 58–10, C.B. 1958–2, 1120." Revenue Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1958–2 contains all rulings, decisions, and procedures pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 1958–27 to 1958–52, inclusive, for the period July 1 to December 31, 1958. It includes an index to all matters published during the year in the weekly Internal Revenue 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 Inernal Revenue Bulletins in 1958.

Public Laws pertaining to Internal Revenue matters enacted by the Second Session of the 85th Congress after June 30, 1958, together with their related Committee Reports and a digest of all tax legislation enacted during the Second Session, have been consolidated and are published in Internal Revenue Cumulative Bulletin 1958–3.[1]

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.

[1] Copies of Cumulative Bulletin 1958–3 may be purchased at the price of $3.50 per copy from the Superintendent of Documents, Government Printing Office, Washington 25, D.C.

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, 1958, TO DECEMBER 31, 1958, INCLUSIVE

It is the policy of the Internal Revenue Service to announce in the INTERNAL REVENUE BULLETIN at the earliest practicable date the determination of the Commissioner to acquiesce or not to acquiesce in a decision of The Tax Court of the United States which disallows a deficiency in tax determined by the Commissioner to be due. Notice that the Commissioner has acquiesced or nonacquiesced in a decision of The Tax Court relates only to the issue or issues decided adversely to the Government. 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.

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Coastal Machine Works, Inc	32858	28	1034
	32859		
Coletto, Ralph, et ux	52557	28	845
Colony, Inc	53681	26	30
Continental Illinois National Bank & Trust Co., of Chicago, transferee and trustee of estate of Frederick M. Kasch [11]	59817	30	102
Coplan, Leonard, et ux.[7]	59283	28	1189
Cortese, Clara [14]	40633	22	293
Costa, Anthony, et ux	57390	29	1119
Cotton States Fertilizer Co	59879	28	1169
Crall, Irma Jean, a minor, Irma F. Morris, guardian	54016	29	864
Cristo, Joe [14]	40632	22	293
Culley, Lewis L., et ux	52840	29	1076
	57861		
	58991		
Cumberland Portland Cement Co	56829	29	1185
Cunningham, Eugene F., et ux.[15]	55091	28	670
Cunningham, Grace H.[15]	55090		
Damski, Paul	54929	29	1
Davis, John H., et ux.[13]	47447	24	1006

See footnotes at the end of tables.

ACQUIESCENCES—Continued

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Delsanter, Anthony	49167	28	845
Denise Coal Co	56762	29	528
Denzer, Alan R., executor of estate of Bernard E. Denzer [11]	62141	29	237
Denzer, Bernard E., estate of [11]			
de Vegvar, Edward A. Neuman	58742	28	1055
DeWitt, J. Roger, et ux	56109	30	1119
Duncan, Ralph E., et ux	64901	30	386
Dutton, Mary Creveling, estate of, and Tom W. Dutton, surviving husband	60549	29	833
Dutton, Tom W., et ux. (Constance)	60550		
Elek, Peter S	65092	30	731
Erburu, Michael P., et ux	51137	23	820
Evans, Gladys Cheesman	60640	30	798
Farah, John, et ux	52515	28	845
Farnsworth, Daniel W., et ux	64736	29	1131
Feigel Construction Corp	58803	30	346
Fink, Alex, et ux	57388	29	1119
Fink, Nathan, et ux	57387		
First National Bank of Chicago, transferee and trustee of estate of Frederick M. Kasch [11]	59818	30	102
Frieder, Alex [16]	63800	28	1256
Funk, Emilie Furnish (former wife of Richard D. Furnish)	51401	29	279
Furnish, Richard Douglas	51416		
	51417		
Garden City Bank and Trust Co., executor of estate of Myles C. Watson [11]	38341	20	386
Geometric Stamping Co.[17]	50645	26	301
Gersten, Albert	51226	28	756
Gersten, Albert, et ux	51227		
Gersten, Albert, transferee of Lawrence Land Co	51234		
Gersten, Albert, transferee of Rex Land Co	51231		
Gersten, Albert, transferee of J. Richard Co	51237		
Gersten, Albert, transferee of Whittier Development Co	51240		
Gersten, Milton, et ux	51229		
Gersten, Milton, et ux, transferees of Lawrence Land Co	51236		
Gersten, Milton, et ux., transferees of Whittier Development Co	51242		
Golconda Corp	59411	29	506
Gonzalez, Guillermo E., et al., executors of estate of Clotilde Santiago Rivera [11] [18]	36335	19	271
Goodrich, William H., et ux	51181	25	1235
Graham, Thornton G., et ux	54516	26	730
Guedel, John B., et ux	58667	29	88
Halsted, Harbeck [16]	57648	28	1069
Hampton, Becky Osborne	59759	30	708
Harris Corp., B. T	55088	30	635
Hartman, Morris	56790	29	244
Harvey, John W., III, a minor by J. W. Harvey, guardian	61511	28	910
Haynes, William C., et ux [2]	49797	23	1046
Hazelton, Franklin Lewis, estate of [16]	58284	29	637
Hazelton, Mary, administratrix of estate of Franklin Lewis Hazelton [16]			

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Taxpayer	Docket No.	Report	
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Herbert, Elizabeth	61138	30	26
Hickman, A. E., et ux	54014	29	864
Holcomb, Robert L., et ux	57590 59292	30	354
Holding, Maggie M., estate of [11]			
Holding, Willis A., Sr., et al., executors of estate of Maggie M. Holding [11]	65341	30	988
Holyoke Mutual Fire Insurance Co. [10]	51780	28	112
Huntoon, Josiah P., et ux	59045	28	1157
Hydraulic Press Manufacturing Co	26255 45261	27	278
Island Gas, Inc	61047	30	787
Johnson, Herbert C., et ux	60342	30	675
Jones, A. Raymond, et ux	47762 47763	25	1100
Jones, Hugh McK	57509	29	200
Jones, Thomas B	44126	29	601
Jones, Thomas B., et ux	44127		
Kasch, Frederick M., estate of [11]			
Kasch, Helen L., executor under the will of Frederick M. Kasch [11]	59815	30	102
Kasch, Helen L., transferee and beneficiary of estate of Frederick M. Kasch [11]	59816		
Kaufman's, Inc	57540	28	1179
Kavinoky, Edward H., et al., executors of estate of Lawrence M. Weil, and Lucille G. Weil, surviving wife	60161	29	366
Kilborn, Charles M., et ux	56499	29	102
King, Edward Travers B., et ux	59081	28	1157
Lawrence Land Co., a dissolved corporation	51233	28	756
Lee, Oliver, estate of [11]	57257	28	1259
Lentz, George J., et ux. [19]	59044	28	1157
Lockwood, Frederick M., et al., executors of estate of Oliver Lee [11]	57257	28	1259
Marco, Vincent A., et ux, ([20])	52943	25	544
Margiotti, Charles J., estate of			
Margiotti, Denise Z., executrix of estate of Charles J. Margiotti	56763	29	528
Martin, Lester B., et ux. [21]	52953	26	100
Marx, Julius H. (Groucho)	58663	29	88
McElroy, William R. [16]	54565	29	149
McInnis, Hugh J., et ux	57889	29	1076
McKeon, Daniel Manning, et al., executors of estate Of Robert Manning McKeon ([11])	44914	25	697
McKeon, Robert Manning, estate of [11]			
Merritt, Marjorie M. [16]	54563	29	149
Miller, Mary [14]	40631	22	293
Moke Epstein, Inc	59279	29	1005
Morris, B. Frank, et ux	54015	29	864
Morris, Irma F., guardian of Irma Jean Crall, a minor	54016		
Myers, Edward C.[22]	6037	6	258
Myers, Helen E	59752	30	714
National Bank of Commerce of Seattle [23]	56324	27	762
National Biscuit Company	54327	29	409
Newlin Machinery Corp	63750	28	837
O'Dwyer, William, et ux	54608 59475	28	698

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Oil Trading Co., Inc.[8]	11524	9	364
Orr Mills	50458	30	150
Pendleton, Lula Marion McElroy (formerly Lula Marion McElroy Parker)[16]	54564	29	149
Perry, Anthony, et ux	57389	29	1119
Peterson, B. Blaine, et ux	61437	28	910
Peterson, Earl G., et ux	61436		
Peterson, O. R., et ux	61485		
Philbrick, F. H., et ux	53780	27	346
Phillips, Pamphila H., estate of [11] [24]	a87519	36	1102
Phillips, Thomas W., Jr., executor of estate of Pamphila H. Phillips [11] [24]			
Pinkerton, Volney L., et ux	61435	28	910
Post, Rosalie W	54184	26	1055
Property Owners Mutual Insurance Co.[10]	51662	28	1007
Pulvermann, Curt E., beneficiary of estate of Eduard F. Pulvermann, deceased [11]	63087	30	231
Rand, Albert, a/k/a Albert E. Rand, Morris Fink, Kalman Rand, Henry Rozen, and Richard Freed, estate of [11]	58396	28	1002
Rand, Bessie, administratrix of estate of Albert Rand [11]			
Rex Land Co., a dissolved corporation	51230	28	756
Rivera, Clotilde Santiago, estate of [11] [18]	36335	19	271
Romer, Herman J	51607	28	1228
Romer, Herman J., et ux	51606		
Romer, Joyce M	51608		
Rondout Paper Mills, Inc	56791	29	244
Roschuni, Elliott J., et ux	58161	29	1193
Royal Cotton Mill Co	29689	29	761
Ruge, Arthur C., et ux	52103	26	138
Russell, Walter, et ux	59046	28	1157
Ryan Construction Corp	58802	30	346
Schmitt, Joe L., Jr., et ux	60267	30	322
Seaboard Commercial Corp., and subsidiary companies	32857	28	1034
Sesnon, Porter, et ux	56821	30	308
Sesnon, W. T., Jr., et ux	56819		
Shippen, Frank J	56996	30	716
Shoe Corporation of America	60544	29	297
Silverstein, Carl [9]	36442	21	123
	36443		
Silverstein, Cecily [9]	36444		
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Silverstein, Morris [9]	36447		
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	36449		
Smiling Jack Chesbro, Inc.[9]	36452		
Sorin, Arthur, et ux	56400	29	959
Southern Ford Tractor Corp	60547	29	833
Speicher, Franklin S., et ux	59449	28	938
Spencer, Craig L., estate of	61488	28	910
Spencer, Laura W., et al., executors of estate of Craig L. Spencer			

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Stanback, Fred J	51750	27	1
Stanback, Fred J., et ux	51751		
Stanback, T. M	51748		
Stanback, T. M., et ux	51749		
Standing, James J., et ux. [25]	57030	28	789
Suter, Frederick F., et al., administrators of estate of James F. Suter	56785	29	244
Suter, James F., estate of			
Suto, Juliette C. (formerly Juliette C. Margiotti)	56764	29	528
Tarver, Theodore Geddings, estate of [11]	57255	26	490
Theatre Concessions, Inc., a Florida corp	55331	29	754
Thomas, Joseph, executor of estate of Allen L. Weisberger [11]	57673	29	217
Thompson-Hayward Chemical Co., a corp	64268	30	96
Tivoli-Union Co	57616	28	1196
Tobin, Edward F., individually, and administrator of estate of Mary Catherine Tobin	52463	28	845
Tobin, Mary Catherine, estate of			
Tulane Hardwood Lumber Co., Inc. [17]	49860	24	1146
Valetti, Frank J., et ux. [26]	53007	28	692
	53008		
	62270		
Vichey, Lo Raine Good	57617	28	1196
WBSR, Inc	64637	30	747
Want, Estelle [11]	45463	29	1223
Want, Fannye M., executrix of estate of Samuel Want [11]	45461		
	45464		
	45465		
Want, Jacob A., estate of [11]	45462		
Want, Samuel, estate of [11]	45461		
Want, Samuel, estate of, and Estelle Want, trustees and beneficiaries of estate of Jacob A. Want [11]	45464		
Want, Samuel, estate of, and Estelle Want, trustees and transferees of estate of Jacob A. Want [11]	45465		
Want, Samuel, executor, and Estelle Want, executrix of estate of Jacob A. Want [11]	45462		
Washington Post Co. [27]	*a* 8085	10	1077
Watson, Myles C., estate of [11]	38341	20	386
Weidekamp, Alois Joseph [17]	58889	29	16
Weil, Lawrence M., estate of	60161	29	366
Weisberger, Allen L., estate of [11]	57673	29	217
Western Products Co	57615	28	1196
Western Wine & Liquor Co. [12]	23346	18	1090
Whittier Development Co., a dissolved corporation	51239	28	756
Williams, Jay A., et ux	61283	28	1000
Williamson, Paula R	54541	29	51
Williamson, Paula R., administratrix of estate of W. F. Williamson, and Paula R. Williamson	54540		
	54542		
Williamson, W. F., estate of	54540		
	54542		
Wolf, Charles B., estate of [11]	58662	29	441
Wolf, Charles S., et al., executors of estate of Charles B. Wolf [11]			
Wright, J. Marion, et ux	59143	30	392

See footnotes at the end of tables.

The Commissioner does NOT ACQUIESCE in the following decisions:

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Anchor Cleaning Service, Inc	44647	22	1029
Avco Manufacturing Corp.[28]	45633	25	975
Belridge Oil Co	54288	27	1044
Bradford, Eleanor A.[29]	36895	22	1057
Bradford, J. C.[29]	35990		
Campeau, Ray W., et ux	48329	24	370
Champion Spark Plug Co	64489	30	295
Consolidated Premium Iron Ores, Ltd.[30]	47893	28	127
Cunningham, Eugene F., et ux	55091	28	670
Cunningham, Grace H	55090		
Daley, William R., et ux.[30]	54352	28	127
Eaton, Cyrus S.[30]	54396		
Fenton, Leslie [31]	35203	21	15
Heintz, Ralph M	50167	25	132
Iowa Limestone Co. [32]	59519	28	881
Jack, William S	50168	25	132
Johnson, Frances Hamer [33]	33275	21	371
	37495		
Litvak, Anatole	31244	23	441
LoBue, Philip J	41595	28	1317
MacMurray, Fred [31]	35201	21	15
MacMurray, Lillian Wehmhoener, estate of [31]	35202		
Ogsbury, Florence N., executrix of estate of James S. Ogsbury, and as surviving wife	52837	28	93
Ogsbury, James S., estate of			
Roos, Bo C., executor of estate of Lillian Wehmhoener MacMurray [31]	35202	21	15
Rubinstein, Alex	44816	29	861
Smiling Jack Chesbro, Inc.[34]	36452	21	123
Smith, Luther Ely [35]	109631	3	696
Standing, James J., et ux.[36]	57030	28	789
Tully, Henry J., et ux	56340	28	265

a United States Board of Tax Appeals.

[1] Nonacquiescence published in C.B. 1954–2, 6, is withdrawn and acquiescence, as to result only, is substituted therefor. The Commissioner, while disagreeing with the treatment by the court of the issue involved, will not file an appeal in this case.

[2] Nonacquiescence published in C.B. 1956–2, 10, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58–302, C.B. 1958–1, 62.

[3] Acquiescence regarding the issue whether the deficiencies for 1940 through 1944 were due to fraud thereby permitting assessment of deficiencies and penalties otherwise barred by the statute of limitations.

[4] Nonacquiescence published in C.B. 1955–2, 10, with respect to the issue of whether amounts received by Eleanor A. Bradford under the Alabama Power Co. contract upon redemption of her preferred stock, were taxable as capital gain or ordinary income, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58–402, page 15, this Bulletin.

[5] Nonacquiescence published in C.B. XIII–1, 19 (1934), is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58–256, C.B. 1958–1, 215.

[6] Nonacquiescence published in C.B. 1948–1, 4, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58–402, page 15, this Bulletin.

[7] See Rev. Rul. 58–353, page 408, this Bulletin.

[8] Acquiescence regarding the issues whether the deduction for accrued officers' compensation in the fiscal year ended March 31, 1951, was unreasonable; and whether petitioner was entitled to alleged business expenses claimed to have accrued during the same period.

[9] Acquiescence deals with the issues with respect to petitioner's understatement of income and the allowability of certain unsubstantiated expenditures; the allowance of corporate loss involved in the demolition

of a building to comply with the requirements of the Fire Dep't; and whether the amount of bank deposits in the personal account of Cecily Silverstein constituted income to her.

[10] See Rev. Rul. 58-616, page 928, this Bulletin.

[11] Estate tax decision.

[12] See Rev. Rul. 58-40, C.B. 1958-1, 275.

[13] Nonacquiescence published in C.B. 1956-2, 10, is withdrawn and acquiescence is substituted therefor.

[14] Nonacquiescence published in C.B. 1955-1, 7, and 8, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58-94, C.B. 1958-1, 194.

[15] Nonacquiescence published in C.B. 1958-1, 7, is withdrawn and acquiescence is substituted therefor.

[16] Gift tax decision.

[17] Acquiescence as to result only. The Commissioner, while disagreeing with the treatment by the court of the issue involved, will not file an appeal in this case.

[18] Nonacquiescence published in C.B. 1953-2, 8, is withdrawn and acquiescence is substituted therefor.

[19] See Rev. Rul. 58-402, page 15, this Bulletin.

[20] Nonacquiescence published in C.B. 1956-2, 10, is withdrawn and acquiescence is substituted therefor.

[21] See Rev. Rul. 58-95, C.B. 1958-1, 197.

[22] Nonacquiescence published in C.B. 1950-1, 7, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 58-353, page 408, this Bulletin.

[23] See Rev. Rul. 58-42, C.B. 1958-1, 555.

[24] Nonacquiescence published in C.B. 1938-1, 52, is withdrawn and acquiescence is substituted therefor.

[25] Acquiescence with regard to the issue whether petitioners' business income and expenses should have been accounted for on the accrual basis.

[26] See Rev. Rul. 58-479, page 60, this Bulletin.

[27] Nonacquiescence published in C.B. X-1, 95 (1931), is withdrawn and acquiescence is substituted therefor.

[28] Nonacquiescence relates to the issue whether the liquidation of the Crosley Corporation constituted a tax-free transaction under section 112(b)(6) of the 1939 Code. Acquiescence in the other issues involving the amount of loss incurred upon the liquidation of corporate subsidiary; the status of certain stock distributions to shareholders; and the deductions claimed for accrued compensation payments to employees, and for certain tooling expenses, published in C.B. 1957-1, 3, remains unchanged.

[29] Acquiescence published in C.B. 1955-2, 4, relating to the issue of whether J. C. Bradford realized ordinary income as a result of the discount purchase of a promissory note made by his wife for petitioner's benefit, is withdrawn and nonacquiescence is substituted therefor. Acquiescence in the issue whether petitioner sustained a bad debt loss of the amounts paid to satisfy his liability as endorser on a promissory note, published in C.B. 1955-2, 4, remains unchanged.

[30] Nonacquiescence regarding the issues whether (1) the two individuals at all times acted as agents of the corporation, rather than in their individual capacities in connection with the bargain purchase of stock; (2) under the Canadian Tax Convention, the corporation had a permanent establishment, and engaged in trade or business within the United States and so incurred taxes on income, capital gains, etc., derived from sources therein. Acquiescence as to the delay in the timely filing of income and excess profits tax returns by the corporation as being due to reasonable cause and not wilful neglect, was published in C.B. 1957-2, 4.

[31] Acquiescence published in C.B. 1954-1, 4, and 5, insofar as it relates to the issue of whether the amount received from the producers-distributors of the movie, "Pardon My Past" constituted capital gain to the petitioners, is withdrawn and nonacquiescence is substituted therefor.

[32] Nonacquiescence deals with the issues whether any of petitioner's processes beyond the secondary crushing of limestone are "ordinary treatment processes"; also whether in a computation under Rule 50, the costs and proportionate profits attributable to certain processes should be eliminated from the sales price of the finished limestone product in determining gross income for percentage depletion purposes.

[33] Acquiescence published in C.B. 1954-1, 5, is withdrawn and nonacquiescence is substituted therefor.

[34] Nonacquiescence in the issue whether the adjustment, which increased corporate income, entitled the corporation to accrue and deduct the additional New York State franchise taxes based upon such increase.

[35] Acquiescence published in C.B. 1944-26, in the issue as to the deductibility of petitioner's contribution to the Missouri Institute for the Administration of Justice, is withdrawn and nonacquiescence is substituted therefor. Acquiescence in the issues as to the reporting of compensation received for the performance of legal services, and the deductibility of petitioner's contribution to the St. Louis League for Women Voters, remains unchanged. See Rev. Rul. 58-255, C.B. 1958-1, 91.

[36] Nonacquiescence in the issues whether legal and accounting fees incurred in the settlement of income tax deficiencies for prior years and the unpaid interest on such deficiencies constitute trade or business expenses and are deductible in determining taxpayer's adjusted gross income. Acquiescence with respect to taxpayer's accrual method of accounting for business income was published in C.B. 1958-1, 6.

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 A.—DETERMINATION OF TAX LIABILITY

PART IV.—CREDITS AGAINST TAX

SECTION 34.—DIVIDENDS RECEIVED BY INDIVIDUALS

26 CFR 1.34–2: Limitations on amount of credit. (Also Section 35; 1.35–1.) T. D. 6297 [1]

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

Income Tax Regulations relating to the credits for dividends and partially tax-exempt interest received by individuals subject to the alternative tax, 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:

In order to conform certain provisions of the Income Tax Regulations (26 CFR Part 1) relating to the credits for dividends received by individuals and partially tax-exempt interest received by individuals, issued as Treasury Decision 6161 (21 F. R. 788), approved January 31, 1956 [C. B. 1956–1, 7], to the decisions in *Springs* v. *United States* (D. C., W. D. S. C., 1957) 153 F. Supp. 514; *Schultz* v. *United States*, (D. C., S. D. Fla., 1957) 156 F. Supp. 811; and

[1] 23 F. R. 4456.

Cruickshank v. *Riddell*, (D. C., S. D. Calif. 1957) 58–1 U. S. T. C. 9169, such regulations are hereby amended as follows:

PARAGRAPH 1. Paragraph (a) of section 1.34–2 is amended by striking the last sentence and inserting in lieu thereof the following sentence:

Where the alternative tax on capital gains is imposed under section 1201(b), the taxable income for such taxable year is the taxable income as defined in section 63, which includes 50 percent of the excess of net long-term capital gain over net short-term capital loss.

PAR. 2. Paragraph (a) of section 1.35–1 is amended by striking the last sentence and inserting in lieu thereof the following sentence:

Where the alternative tax on capital gains is imposed under section 1201(b), the taxable income for such taxable year is the taxable income as defined in section 63, which includes 50 percent of the excess of net long-term capital gain over net short-term capital loss.

Because this Treasury Decision liberalizes the rules with respect to the limitation on the amount of the credits under sections 34 and 35 of the Internal Revenue Code of 1954, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

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

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved June 16, 1958.

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

(Filed by the Division of the Federal Register on June 19, 1958 at 8:49 a. m., and published in the issue of the Federal Register for June 20, 1958, 23 F. R. 4456.)

SECTION 35.—PARTIALLY TAX EXEMPT INTEREST RECEIVED BY INDIVIDUALS

26 CFR 1.35–1: Partially tax-exempt interest received by individuals.

Regulations under the Internal Revenue Code of 1954 are amended. See T.D. 6297, page 11.

SECTION 37.—RETIREMENT INCOME

26 CFR 1.37–4: Limitation on amount of retirement income.

Attribution of wife's insurance benefit and the old-age insurance benefit of her husband, where such benefits are received each month through one check made payable to them jointly for the total amount of their respective monthly benefits. See Rev. Rul. 58–419, page 57.

SUBCHAPTER B.—COMPUTATION OF TAXABLE INCOME

PART 1.—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, AND TAXABLE INCOME

SECTION 61.—GROSS INCOME DEFINED

26 CFR 1.61–1: Gross income. Rev. Rul. 58–337

A trust established by an instrument executed by a husband and wife for the benefit of their minor children is ineffective to relieve the grantors of tax upon the trust income, where under the trust instrument the husband and wife, as fee owners and lessors, transfer a lease as the corpus of the trust, limit the powers of the trustee and provide for the return of the lease after a stated period. The assignment of the lease is held to constitute an assignment of income. Rent payable under the lease is income to the grantors under the provisions of section 61 of the Internal Revenue Code of 1954.

Advice has been requested whether the transfer in trust of a lease, under the following described conditions, constitutes an assignment of income from the lease, in which event the income is taxable to the grantors under section 61 of the Internal Revenue Code of 1954.

The grantors, husband and wife, established a trust for the benefit of their minor children, designating their attorney as trustee. The trust corpus consists of an oil station lease, executed by the grantors in 1955, as lessors, and a corporation, as lessee. The lease is to continue for a period of ten years beginning in 1955 and ending in 1965. It provides for a stipulated rental and grants the lessee an option to make two successive renewals of the lease for a period of five years each. The lease further provides that in the event of a sale of the property the lessee is to be given a thirty-day option to purchase, or otherwise acquire the property.

The trust instrument authorizes the trustee to receive all rentals payable under the lease but gives him no authority to assign, or in any way transfer or encumber such lease. The trustee is bound by the terms of the lease and in such capacity assumes all liabilities thereunder. He is entitled, except as stated above, to exercise all of the rights of the lessor. In addition, the trustee is authorized to invest and reinvest the rentals received and any other income of the trust.

In 1965, the trustee is required to deliver to the grantors, as joint tenants, the lease (trust principal) including any extension, renewal, or substitution thereunder. Thereafter, the trustee is required to hold the accumulated income in trust until the dates fixed for the distribution of such income.

Prior to the creation of the trust in the instant case, the fee owners had carved out of their ownership two separate estates, a leasehold and a reversion. The leasehold was then made the subject of the trust here involved. When a fee owner/lessor assigns a lease without assigning the reversion, only the right to the rents passes to the assignee. Accordingly, the assignment of the lease in trust without an attendant assignment of the reversion constitutes an assignment of income for which the grantor remains taxable, since he may not escape the tax on his income by giving it away or assigning the right to receive it in advance of payment. *Helvering* v. *R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940–2, 206; *G. Richard Shafto* v. *U. S.*, 246 F.,

2d 338. In addition, although the grantors have purportedly conveyed all right, title and interest in the lease, any assignment or transfer thereof by the trustee is prohibited. This prohibition prevents the trustee from having full power and control over the assigned property. See *Commissioner* v. *Joseph Sunnen*, 333 U. S. 591, Ct. D. 1698, C. B. 1948–1, 7.

Therefore, it is held that the grantors are taxable under the provisions of section 61 of the Code for the income received under the lease. The instant case is not governed by subpart E of subchapter J of the Code since the codification of the rules determining taxability of trusts was not intended to and does not have any application in situations involving assignments of future income. See S. Rept. 1622, 83d Cong., 2d Session, p. 365; H. Rept. 1337, 83d Cong., 2d Session, p. A212.

Rev. Rul. 58–370

Certain laws enacted by the Federal Republic of Austria authorized claims to be filed by persons who, as former citizens of Austria, were persecuted for reasons of race, faith, or philosophy of life, by the National-Socialist (Nazi) regime and thereby suffered damage to life, body, health, liberty, or to professional or economic advancement. *Held*, the compensation paid by the Federal Republic of Austria to citizens or residents of the United States under the Law of Indemnification of Government Employees of July 18, 1952, B. G. Bl. No. 181/1952, or any indemnification laws enacted by the Federal Republic of Austria which are similar to those enacted by the Federal Republic of Germany, as referred to in Revenue Ruling 56–518, C. B. 1956–2, 25, and clarified in Revenue Ruling 57–505, I. R. B. 1957–44,9, is in the nature of reimbursement for the deprivation of civil or personal rights and does not constitute taxable income, for Federal income tax purposes, to the recipients.

Rev. Rul. 58–380

The distributive share received by an original, successor, or assignee mortgagor from the Federal Housing Administration, as a result of mortgage prepayment, constitutes gross income, for Federal income tax purposes, to the extent such distributive share exceeds the total of premiums paid by the distributee on Federal Housing Administration mortgage insurance with respect to that portion of the term of the mortgage beginning with the date when the distributee assumed the mortgage. However, if the distributee was entitled to deduct the premiums as a business expense, the full distribution is taxable to him.

Revenue Ruling 56–302, C. B. 1956–2, 19, amplified.

A question has arisen with respect to the applicability of Revenue Ruling 56–302, C. B. 1956–2, 19, in a situation in which the Federal Housing Administration makes a distribution from its "Participating Reserve Account" to a successor or assignee of the original mortgagor. The purpose of the present Revenue Ruling is to state the position of the Internal Revenue Service with respect to the treatment for Federal income tax purposes of such distributions to original, successor, or assignee mortgagors, as the case may be.

In accordance with the provisions of section 205(c) of the National Housing Act, 12 U. S. C. 1711, as amended, the Federal Housing Administration makes distributions of funds from its "Participating Reserve Account" to mortgagors upon the payment of mortgages insured by it and the consequent termination of its obligation thereunder. The maximum amount distributable to a mortgagor is the aggregate amount of the annual premiums paid on the insurance to the year of termination. Where the distributee is the original mortgagor, Revenue Ruling 56–302, *supra*, holds that such distributions to the extent that they do not exceed his premiums, are not subject to tax, except where the mortgagor was entitled to deduct the premiums as a business expense. However, in many cases, the distributee, although not entitled to deduct his premiums, is a successor or assignee of the original mortgagor. In such instances, the distributive share, while not exceeding the total premiums paid on the insurance, may exceed the premiums paid by such successor or assignee mortgagor during his period of ownership.

It is the position of the Service that the distributive share received by an original, successor, or assignee mortgagor from the Federal Housing Administration as a result of mortgage prepayment, constitutes gross income, for Federal income tax purposes, to a distributee not entitled to deduct his premiums, to the extent that such distribution exceeds the total of premiums paid by him or on his behalf with respect to that portion of the mortgage term beginning with the date when he assumed the mortgage.

Where the distributee is a taxpayer who was entitled to deduct the insurance premiums paid as a business expense, the total amount of the distribution received is required to be included in his gross income, except for an amount equal to the sum of any insurance premium deductions, beginning with the date he assumed the mortgage, which did not result in a reduction of his tax within the meaning of section 1.111–1(a) of the Income Tax Regulations.

Revenue Ruling 56–302, *supra*, is hereby amplified.

Rev. Rul. 58–402

Contracts and claims to receve indefinite amounts, such as those received in exchange for stock in liquidation of a corporation, must be valued for Federal income tax purposes except in rare and extraordinary cases.

Advice has been requested as to the treatment, for Federal income tax purposes, of indefinite amounts of income in respect of property consisting of a contract or a claim, for future payment of such income, acquired upon exchange of stock in liquidation of a corporation, as affected by ascertainment of value of such a contract or claim.

The gain from the sale or other disposition of property, as provided in section 111(a) of the Internal Revenue Code of 1939, shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain. The amount realized shall be the sum of any money received plus the fair market value of the property (other than money) received, as provided in section 111(b).

The amount of the fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. Section 39.111–1, Regulations 118; *Robert J. Boudreau* v. *Commissioner*, 134 Fed. (2d) 360. Whether value is ascertainable is a reviewable question of law. *Commissioner* v. *Swenson*, 56 F. (2d) 544, Ct. D. 555, C. B. XI–2, 184 (1932) 287 U. S. 618, certiorari denied. Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, as provided in section 115(c) of the Code.

The question decided in the case of *Burnet* v. *Edith Andrews Logan*, 283 U. S. 404, Ct. D. 351, C. B. X–1, 345 (1931), was whether the income taxes asserted might be imposed upon capital rather than upon income, in view of the many uncertainties in that case regarding valuation of the contract to receive 60 cents per ton of iron ore to be mined. The contract had been valued for estate tax purposes, and the Government contended that capital could be recovered through apportionment of the subsequent annual payments as capital and income. (There were no provisions for capital gains in the Revenue Acts of 1916, 1917, and 1918 involved there.)

The Court of Appeals stated in part in that case, 42 Fed. (2d) 193, as follows:

> * * * Here we have the question of whether there was any gain. * * * all the attending uncertainties which exist here * * * might prevent the return of capital. * * *

The Supreme Court of the United States stated, in part, that the transaction was not a closed one, and respondent might never recoup her capital investment from payments only conditionally promised. In that case there were many uncertainties, and it was necessary that the future payments made to the stockholders of the company amount to $1,942,111.46 before the petitioner would have a full return of her capital.

In that case the courts did not decide that contracts for indefinite payments generally have no ascertainable value, but decided that the many uncertainties there might prevent the return of capital, under the asserted method of determining income for purposes of the early Revenue Acts.

Similarly, the question whether certain contracts to receive indefinite payments had ascertainable value was neither argued nor adjudicated in the cases of *Commissioner* v. *Susan J. Carter*, 170 Fed. (2d) 911, and *Westover* v. *Agnes F. Smith*, 173 Fed. (2d) 90. The question decided there was a capital gains question and not whether value was ascertainable. *Pat O'Brien, et al.*, v. *Commissioner*, 25 T. C. 376, 385–386, acquiescence in part C. B. 1957–1, 4. It was decided that, if such contracts have no ascertainable value, the sale or exchange remains an open transaction, and the later payments received are subject to the provisions for capital gains. See also *J. C. Bradford* v. *Commissioner*, 22 T. C. 1057, 1072, acquiescence published in this Bulletin, page 6. See further, *George J. Lentz* v. *Commissioner*, 28 T. C. 1157, acquiescence published in this Bulletin, page 6. Acquiescence in *Susan J. Carter* v. *Commissioner*, 9 T. C. 364, also is published in this Bulletin, page 6.

Examples of rare and extraordinary cases of property which properly is considered to have no ascertainable value are the follow-

ing: *Robinette* v. *Helvering*, 318 U. S. 184, Ct. D. 1574 C. B. 1943, 1141, involving a certain contingent reversionary remainder; *Commissioner* v. *Edwards Drilling Co.*, 95 Fed. (2d) 719, affirming 35 B. T. A. 341, acquiescence C. B. 1939–1 (Part I), 11, where the greatly disturbed and uncertain conditions in an oil field rendered greatly uncertain that wells drilled in the field on contracts would pay out; *Thomas J. Brant* v. *Commissioner*, 13 T. C. 712, acquiescence C. B. 1950–1, 1, where it was not ascertainable whether stockholders of a land company would ever recover their capital basis out of payments which might be made by the Mexican Government.

The results, for purposes of capital gains or ordinary income, are that if the sale or exchange remains an open transaction, because of unusual uncertainties with respect to valuations in rare and extraordinary cases, then the subsequent payments received under the contract will be subject to the appropriate capital gains provisions in the statute; but, if not, then the sale or exchange is a closed transaction, by reason of valuation of the contract or claim for indefinite amounts of income, and the subsequent payments in excess of basis received under the contract or claim constitute ordinary income. *Pat O'Brien, et al.*, v. *Commissioner, supra;* compare *Mace Osenbach* v. *Commissioner*, 198 Fed. (2d) 235; also compare *Douglas Fairbanks* v. *United States*, 306 U. S. 436, Ct. D. 1391, C. B. 1939–1, (Part I), 260. Generally, when a taxpayer makes a gain from the sale or exchange of a claim or chose in action, if it is not a substitute for ordinary income, this is taxable as a capital gain; while if the gain results from the collection of the claim or chose in action, it is taxable as ordinary income. See *Osenbach* v. *Commissioner, supra.* But compare *P. G. Lake, Inc.*, v. *Commissioner*, 356 U. S. 260, Ct. D. 1823, C. B. 1958–1, 516, relative to sales of oil payments.

Therefore, it is necessary (*Fleming* v. *Commissioner*, 153 Fed. (2d) 361), in order to prevent escape from the ordinary income tax by converting income payments into capital gains, to ascertain the value of the property in the prior sale or exchange and to close that transaction, except in rare and extraordinary cases. Otherwise, the ordinary income tax on the income collected from the contract or claim after the sale or exchange is converted into a tax on capital gains. Compare *Hurlbut W. Smith* v. *Shaughnessy*, 318 U. S. 176, Ct. D. 1575, C. B. 1943, 1144, stating that in a gift tax case involving a complex property interest created by means of a trust, even though concepts of property and value may be slippery and elusive, they cannot escape taxation so long as they are used in the world of business.

There are many cases in which contracts to receive indefinite amounts of income have been valued for tax purposes. Corporate liquidation cases include *Pat O'Brien* v. *Commissioner, supra*, in which contract rights to share in expected receipts from showing of a motion picture were valued; *Fleming* v. *Commissioner, supra*, valuing the right to share in the oil to be gotten from producing wells, and others to be drilled in the same field; *Boudreau* v. *Commissioner, supra*, in which rights to share in oil to be produced and saved from certain property were valued.

Patent rights, dependent upon estimated prospective earnings or sales, have been valued in numerous cases, such as *Henry Hudson* v. *Commissioner*, 39 B. T. A. 1075, 1095–1099; *Heberlein Patent Corp.* v.

United States, decided March 9, 1938, by the United States District Court for the Southern District of New York, not officially reported, affirmed on another issue, 105 F. (2d) 965; *S. Marsh Young* v. *Commissioner*, 2 B. T. A. 457, acquiescence C. B. IV–2, 5 (1925); *B. F. Sturtevant Co.* v. *United States*, 18 Fed. Supp. 28; *Hershey Manufacturing Co.* v. *Commissioner*, 43 Fed. (2d) 298.

Approximate valuations have been made in various tax cases, such as *Helvering* v. *Enright Estate*, 312 U. S. 636, Ct. D. 1500, C. B. 1941–1, 353, stating that accrued income of a decedent included the value of the services rendered by the decedent in a law partnership, capable of approximate valuation; see *Burnet* v. *Houston*, 283 U. S. 223, Ct. D. 328 C. B. X–1, 343 (1931); *Helvering* v. *Safe Deposit and Trust Co.*, 316 U. S. 56, C. B. Ct. D. 1552, 1942–1, 246; see *Commissioner* v. *Louis Sternberger Estate*, 348 U. S. 187, Ct. D. 1777 C. B. 1955–1, 450; *cf. United States* v. *Charles A. Ludey*, 274 U. S. 295, T. D. 4046, C. B. VI–2, 157 (1927); *Commissioner* v. *Estate of Pompeo M. Maresi*, 156 Fed. (2d) 929, affirming 6 T. C. 580, acquiescence C. B. 1946–2, 4. In the *Ludey* case, *supra*, involving depletion of mineral deposits, is was stated that Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion. In the *Safe Deposit and Trust Co.* case, *supra*, it was considered far better to make such a rough estimate as the data will permit than completely to ignore the realities of the situation because of the difficulties of evaluation.

Accordingly, the Service will continue to require valuation of contracts and claims to receive indefinite amounts of income, such as those acquired with respect to stock in liquidation of a corporation, except in rare and extraordinary cases.

(Also Section 212; 1.212–1.) Rev. Rul. 58–418

An amount received in settlement of a libel suit, for both compensatory and exemplary damages for injury to personal repuation, constitutes income to the recipient to the extent that such amount represents satisfaction of exemplary damages. The proportionate share of the expense of procuring that portion of the settlement found to constitute taxable income is deductible under section 212 of the Internal Revenue Code of 1954 as an ordinary and necessary expense paid or incurred by an individual for the production or collection of income.

Advice has been requested as to the treatment, for Federal income tax purposes, of amounts received in settlement of a libel suit and the expenses incurred attributable thereto.

During the taxable year, the taxpayer received the sum of $75x$ dollars in settlement of a libel suit. The amount received was in satisfaction of a suit in which the taxpayer asked for compensatory damages in the amount of $600x$ dollars and exemplary damages in the amount of $350x$ dollars for the publication of false and defamatory matter tending to injure his personal reputation. In processing his case through the courts, prior to settlement, the taxpayer incurred various legal expenses.

The specific issues in the instant case are whether the amount received in settlement constitutes income and, if so, whether the expense

of procuring such income is deductible for Federal income tax purposes.

The taxation of amounts received pursuant to a judgment of a court or by way of settlement of a suit for injury to an individual's reputation caused by defamatory statements constituting libel or slander depends on whether such defamation results in injury to the personal reputation of an individual as distinguished from slander or libel that injures the business or professional reputation of an individual to an extent which may or has affected his income. See S. O. 132, C. B. 1–1, 92 (1922).

In *C. A. Hawkins* v. *Commissioner*, 6 B. T. A. 1023, acquiescence, C. B. VII–1, 14 (1928), the United States Board of Tax Appeals held that compensatory damages received in settlement for injury to personal reputation caused by defamatory statements constituting libel or slander were not income. No suggestion was made in such case that punitive or exemplary damages were claimed or paid.

In the case of *Commissioner* v. *Glenshaw Glass Company et al.*, 348 U. S. 426, Ct. D. 1783, C. B. 1955–1, 207, the Supreme Court of the United States held, in effect, that the fact that amounts were received as exemplary and punitive damages from wrongdoers as punishment for their unlawful conduct does not detract from their character as income to the recipients.

Under the facts of the instant case, the amount, due to lack of adjudication, is not distinguishable as to the portions allocable to satisfaction of the taxpayer's claim for compensatory damages as distinguished from his claim for punitive damages. Inasmuch as the tax consequences attributable to each claim differ, allocation is necessary and proper. See *R. J. Durkee* v. *Commissioner*, 162 Fed. (2d) 184. In the instant case, the taxpayer's complaint apparently constitutes the best evidence available to determine a proper allocation. Under such complaint, the taxpayer asked $600x$ dollars as compensatory damages and $350x$ dollars as exemplary damages, or a total of $950x$ dollars. Thus, the amount of compensatory damages asked equaled approximately 63 percent of the total asked and the amount of the exemplary damages approximately 37 percent. In the absence of other evidence, therefore, 63 percent of the amount received in settlement is considered to be in satisfaction of compensatory damages and is excludable from the taxpayer's gross income while 37 percent is considered to represent satisfaction of exemplary damages and is includible in his gross income.

Section 212 of the Internal Revenue Code of 1954 provides, in part:

> 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—
> (1) for the production or collection of income;

Inasmuch as the taxpayer has realized income to the extent of 37 percent of the amount received in settlement, 37 percent of the expense of obtaining such settlement is deductible for Federal income tax purposes under the provisions of section 212 of the Code.

Accordingly, it is held that an amount received in settlement of a libel suit, for both compensatory and exemplary damages for injury to personal reputation, constitutes income to the recipient to the extent that such amount represents satisfaction of exemplary damages. The proportionate share of the expense of procuring that portion of the

settlement found to constitute income is deductible, under section 212 of the Code, as an ordinary and necessary expense paid or incurred by an individual for the production or collection of income.

(Also Sections 1301, 1303.) Rev. Rul. 58–496

Lump-sum "severance pay" received by commissioned officers honorably discharged from the United States Armed Forces pursuant to the Officers Personnel Act of 1947 represents additional compensation for services rendered and is, therefore, includible in gross income.

Such lump-sum "severance pay" does not constitute compensation from an employment, or income from back pay within the meaning of sections 1301 and 1303 of the Internal Revenue Code of 1954, respectively, and is, therefore, includible in gross income for the taxable year in which received.

Advice has been requested as to the treatment, for Federal income tax purposes, of lump-sum "severance pay" received by commissioned officers of the United States Armed Forces under the circumstances described below.

Pursuant to the Officers Personnel Act of 1947, 10 U. S. C., Chapters 335, 573, 835, certain commissioned officers were honorably discharged from the United States Armed Forces. As provided under the Act, each commissioned officer, upon his discharge, received a lump-sum "severance pay" based upon the length of his service as a commissioned officer.

Section 61(a) of the Internal Revenue Code of 1954 provides, in part, that gross income means all income from whatever source derived, except as otherwise provided by law. The lump-sum payment described above is directly related to the number of years of commissioned service and, therefore, represents additional compensation for services rendered. Since there is no provision whereby such amount is specifically excluded from gross income, as in the case of mustering-out payments which are excludable from gross income under section 113 of the Code, the lump-sum "severance pay" is includible in gross income. See I. T. 3790, C. B. 1946–1, 50; and I. T. 1963, C. B. III–1, 104 (1924).

Under the provisions of sections 1301 and 1303 of the Code, a special tax treatment is accorded income which is attributable to several taxable years and which qualifies as compensation from an employment or income from back pay, respectively. Since the lump-sum "severance pay" described above was not received (1) pursuant to an arrangement or series of arrangements to effect a particular result or (2) as the result of an agreement or legal obligation to pay which existed prior to discharge from the Armed Forces, it does not come within the meaning of sections 1301 or 1303 of the Code, and is, therefore, includible in gross income for the taxable year in which received.

In view of the foregoing, it is held that lump-sum "severance pay" received by commissioned officers honorably discharged from the United States Armed Forces pursuant to the Officers Personnel Act of 1947, *supra*, represents additional compensation for services rendered and is, therefore, includible in gross income. Furthermore, such lump-sum "severance pay" does not constitute compensation from

an employment or income from back pay within the meaning of sections 1301 and 1303 of the Code, respectively, and is, therefore, includible in gross income for the taxable year in which received.

Rev. Rul. 58–500

The Federal Supplementary Law for the Compensation of Victims of Nationalist Socialist Persecution of September 18, 1953, is indicated in Revenue Ruling 57–505, C. B. 1957–2, 50, as one of the specific laws enacted by the Federal Republic of Germany which constituted the basis for Revenue Ruling 56–518, C. B. 1956–2, 25, relating to compensation to former German citizens, now citizens or residents of the United States, who were persecuted by the National-Socialist regime. That law was amended on August 10, 1955 and re-amended and retitled as the Federal Law for the Compensation of Victims of National Socialist Persecution (Federal Compensation Law) on June 28, 1956. *Held*, any amounts paid by the Federal Republic of Germany under the above law, as amended and retitled, are of the same character as the amounts paid under the basic laws indicated in Revenue Ruling 57–505, *supra*, as amounts which are in the nature of reimbursement for the deprivation of civil or personal rights and do not constitute taxable income to the recipients thereof for Federal income tax purposes.

The Federal Law on the Discharge of the Restitutory Monetary Obligations of the German Reich and Assimilated Legal Entities, also known as the Federal Restitution Law, enacted by the Federal Republic of Germany on July 19, 1957, provides for the filing of claims in the case of alienated identifiable property by persons entitled to restitution or their successors in right. *Held*, payments made by the Federal Republic of Germany under the provisions of the Federal Restitution Law come within the ambit of Revenue Ruling 56–518, *supra*, insofar as it holds that, if property ownership is involved, payments which are measured by the value of property taken from persecuted taxpayers do not constitute taxable income where the taxpayer has not recovered the basis of the property and the question of whether any excess represents taxable income will be determined on the basis of the facts and circumstances of each case.

Revenue Ruling 56–518, *supra*, as clarified by Revenue Ruling 57–505, *supra*, amplified.

(Also Sections 103, 1232; 1.103–1, 1.1232–1.) Rev. Rul. 58–536

Where a taxpayer has purchased secondary or "Class B" "interest" coupons at less than their face amounts (payable on their future due dates) from a broker who had detached them from the bonds of a political subdivision of a state as the commission of underwriters, whom he represented, for floating (marketing) the bonds, the excess of collections of such coupons upon their due dates over the taxpayer's cost basis thereof is then taxable as ordinary income.

Advice has been requested regarding the proper treatment, for Federal income tax purposes, of the excess of collections of secondary or "Class B" "interest" coupons upon their due dates over the taxpay-

er's cost basis thereof, where the taxpayer has purchased them at less than their face amounts (payable on their future due dates) from a broker who had detached them from bonds of a political subdivision of a state as the commission of underwriters, whom he represented, for floating (marketing) the bonds.

In order to raise necessary funds for erection of certain public school buildings, a school authority, formed under the laws of a state as a public authority to finance the construction of such buildings, was authorized to issue its bonds to underwriters thereof with two series of "interest" coupons ("Class A" and "Class B") attached. A broker, representing the underwriters, detached from the bonds, as their commission for floating the bonds, the secondary coupons (referred to herein as the "Class B" coupons). Such coupons were four in number and payable in equal amounts (of $5 on each $1,000 bond) semiannually, i. e., over a period of two years, although most of the bonds have a term of forty years and the balance mature serially in from three to twenty-three years and, while the bonds have various pre-maturity redemption provisions, none is callable in less than three years. As already indicated, such "Class B" coupons were in addition to the normal interest coupons (termed "Class A") attached to the bonds and which were not detached by the broker but remained with the bonds when they were sold to the public by the underwriters who purchased them from the school authority for such resale. The "Class A" coupons are for annual interest on the bonds at rates varying from 3.4 to five percent on their principal amount, depending on their maturities, and are payable semiannually until maturity of the bonds or earlier call thereof. The taxpayer, a bank, purchased from the broker (representing the underwriters) the "Class B" coupons, the aggregate amount of which was $57x$ dollars, for $53\frac{1}{2}x$ dollars, and intends to hold them until their due dates.

Section 61 of the Internal Revenue Code of 1954 provides generally that, except as otherwise provided, for Federal income tax purposes, "gross income means all income from whatever source derived, including (but not limited to) the following items: * * *."

Section 103(a)(1) of the Code provides that "gross income" does not include "interest" on obligations of a state or any political subdivision thereof.

It appears that the school authority which issued the bonds involved in the instant case is a "political subdivision" of a state, within the meaning of section 103(a)(1) of the Code. However, it is plainly evident that the so-called "Class B" "interest" coupons, with which the bonds were issued to the underwriters together with regular interest coupons but which were detached before the bonds were sold by them to the public, were granted as commissions to the underwriters for marketing the bonds, and do not actually represent "interest", in the sense of compensation for the use of money, as used in section 103(a)(1) of the Code. See the first conclusion of Revenue Ruling 55-73, C. B. 1955-1, 236, below. In *H. Gates Lloyd* v. *Commissioner*, 154 F. (2d) 642, certiorari denied, 329 U. S. 717, where a syndicate purchased outstanding City of Philadelphia bonds, exchanged them with the City for its new refunding bonds having "A" and "B" "interest" coupons attached, detached the "B" coupons, and almost simultaneously sold the new bonds with only the "A" coupons attached

to investors and sold the detached "B" coupons to a bank, it was held that the proceeds from the latter were not received as tax-exempt "interest," even though there was no evidence in the case that the "B" coupons therein involved were granted as either brokers' or underwriters' commissions. In the instant case, where the taxpayer has not, even for a moment, invested any of its funds in the school authority bonds, collections of the "B" coupons which it purchased from underwriters to whom it appears they were granted as commissions cannot, therefore, be treated as receipts of tax-exempt "interest" within the meaning of section 103(a)(1) of the Code.

Earnings, profits, and gains are generally taxable as ordinary "gross income" under section 61, *supra*, unless derived from the "sale or exchange" of a "capital asset", as defined in section 1221 of the Code, or they are to be so considered under a specific statutory provision. See *Dewitt M. Sherwood et ux.* v. *Commissioner*, 20 T. C. 733; *M. N. Avery* v. *Commissioner*, 111 Fed. (2d) 19, Ct. D. 1572, C. B. 1941–1, 326; and *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, Ct. D. 1787, C. B. 1955–2, 511.

Section 1232(a)(1) of the Code provides that "* * * in the case of bonds, debentures, notes, or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof—* * * Amounts received by the holder on retirement of such bonds or other evidences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954)."

In Revenue Ruling 55–73, C. B. 1955–1, 236, it was held (1) that secondary or "Class B" "interest" coupons which are detached and retained by brokers of certain municipal bonds are considered to be the brokers' commission and do not actually represent "interest" as that term is generally used; (2) that the amount of the fair market value of such coupons when received is includible in the gross income of the broker for the taxable year received; (3) that any gain realized by him from the sale of the coupons prior to their due dates (*i. e.*, at a price in excess of such fair market value previously reported) constitutes ordinary income (rather than statutory "capital gain") includible in his gross income when it is so realized; and (4) that any amount received by him from the municipality in payment of the coupons upon their due dates in excess of such fair market value previously reported constitutes ordinary income.

In Revenue Ruling 54–251, C. B. 1954–2, 172, it is held, where a taxpayer who is not a dealer in securities purchases extended past due interest coupons which have been detached from Japanese prewar dollar bonds, that (1) any gain or loss from subsequent sale thereof by him will constitute gain or loss from the sale of a capital asset; but that (2) if he holds any of the coupons until their extended due dates, the excess of the maturity value of each coupon over its cost to him is then taxable as ordinary income.

In I. T. 3312, C. B. 1939–2, 168, where a taxpayer had purchased certain additional "interest" coupons detached from corporate bonds

which could be bought and sold with or without such coupons, it is held that amounts received by him in payment of such coupons upon their due dates were not within the purview of section 117(f) of the Revenue Act of 1938, providing that "amounts received upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor," and that the amount collected by him on the coupons in excess of their cost to him was taxable as ordinary income and not as capital gain.

Thus, it long and repeatedly has been held that "interest" coupons, irrespective of whether they actually represent interest (in the ordinary sense of compensation for the use of money) or commissions and although detached from the bonds to which they were attached when issued, are not themselves "bonds, debentures, or certificates or other evidences of indebtedness" within the purview of section 117(f) of the 1939 Code and prior Revenue Acts. In the corresponding provisions of section 1232(a)(1) of the 1954 Code, the requirement that the evidences of indebtedness be issued "with interest coupons or in registered form" was eliminated. However, it appears that such change is immaterial here. As pointed out by the court in its opinion in the *Avery* case, *supra*, the House Ways and Means Committee Report No. 704, Seventy-third Congress, Second Session, C. B. 1939–1 (Part 2), 554, 577, stated with respect to such provisions, when originally proposed for enactment as a part of the Revenue Act of 1934, that "Subsection (f) provides that amounts received upon the retirement of bonds and *similar* evidences of indebtedness shall be considered as received in exchange therefor." (Italics supplied.) Manifestly, the evidences of indebtedness referred to in such statutory provisions are not the obligations of a corporation for interest on securities issued by it or for commissions for floating and/or handling them. The bonds or "other evidences of indebtedness" covered by such provisions are generally referred to in the 1954 Code House Committee on Ways and Means Report No. 1337, at page A276, and Senate Committee on Finance Report No. 1622, at page 434, as "certain securities". The change in the provisions under the 1954 Code patently was merely to include therewithin securities whether or not they were issued with interest coupons or in registered form. There is nothing in the history of section 1232(a)(1) which indicates any intent that a different holding should be made on the issue here presented under the 1954 Code than that long and repeatedly made under section 117(f) of the 1939 Code and prior Revenue Acts.

In view of the foregoing, where a taxpayer has purchased secondary or "Class B" "interest" coupons at less than their face amounts (payable on their future due dates) from a broker who had detached them from bonds of a political subdivision of a state as the commission of underwriters, whom he represented, for floating (marketing) the bonds, the excess of collections of such coupons upon their due dates over the taxpayer's cost basis thereof will then be taxable as ordinary income.

Rev. Rul. 58–555

Effect of the decision in *Teleservice Company of Wyoming Valley* v. *Commissioner*, upon outstanding acquiescences in decisions of the Board of Tax Appeals in public utility cases relating to "So-called Contributions in Aid of Construction." If and when the Internal Revenue Service should decide upon a change of position represented by the acquiescences in question, the change of position will be given nonretroactive effect.

In view of the interest in the decision of the Tax Court of the United States in *Teleservice Company of Wyoming Valley*, 27 T. C. 722, following its affirmance by the Court of Appeals for the Third Circuit, 254 Fed. (2d) 105, certiorari denied, 357 U. S. 919, the conclusion has been reached that the effect of the decision upon outstanding acquiescences in decisions of the Board of Tax Appeals in public utility cases should be anticipated to avoid possible unproductive work by personnel of the Service.

Relevant decisions and acquiescences are: *Liberty Light & Power Co.* v. *Commissioner*, 4 B. T. A. 155, acquiescence C. B. VI–1, 4 (1927); *Great Northern Railway Co.* v. *Commissioner*, 8 B. T. A. 225, acquiescence C. B. VII–2, 16, (1928); *Rio Electric Co.* v. *Commissioner*, 9 B. T. A. 1332, acquiescence C. B. VII–1, 27 (1928); *El Paso Electri Railway Co.* v. *Commissioner*, 10 B. T. A. 79, acquiescence C. B. VII–2, 12 (1928); *Wisconsin Hydro-Electric Co.* v. *Commissioner*, 10 B. T. A. 933, acquiescence C. B. VII–1, 34 (1928); *Tampa Electric Co.* v. *Commissioner*, 12 B. T. A. 1002, acquiescence C. B. VII–2, 39 (1928); *Kauai Railway Co., Ltd., et al.* v. *Commissioner*, 13 B. T. A. 686, acquiescence C. B. IX–1, 28 (1930); and *Baltimore and Ohio Railroad Co.* v. *Commissioner*, 30 B. T. A. 194, ecquiescence C. B. XIII–2, 21 (1934).

The cited decisions of the Board of Tax Appeals all dealt with contributions by customers or prospective customers to public utilities in aid of the construction of the utilities of extensions of service lines or of spur tracks or like facilities to provide service to the contributor at rates subject to regulation by a public regulatory body. It was held in all of the cited decisions that amounts so contributed did not constitute income taxable to the recipient utility company. See also *Union Pacific Railroad Co., et al.* v. *Commissioner*, 26 B. T. A. 1126, acquiescence C. B. XII–1, 13 (1933); *Southern Railway Co.* v. *Commissioner*, 27 B. T. A. 673, acquiescence C. B. XII–2, 13 (1933) and *Baltimore and Ohio Railroad Co.* v. *Commissioner*, *supra*, involving a similar question as to forfeited balances of amounts deposited under a refunding arrangement based on use of the facility within an agreed period.

The *Teleservice Company* case was litigated by the Service, notwithstanding the acquiescences in the cited decisions, because the facts of that case were considered distinguishable in that the taxpayer in *Teleservice Company* was not a regulated public utility subject to a continuing duty to provide service to its customers; that such rights as a customer derived from an agreement with the taxpayer were personal to the customer and nonassignable; that a purchaser of the original customer's premises was obliged to make his own similar arrangement with the taxpayer in order to obtain service; that a price or rate differential was made between residential and commercial

customers, based solely on ability to pay; that the amounts received by the taxpayer were not subject to substantial rights in the customer to a refund upon termination of service, and, as to the amounts actually in controversy, were no longer refundable under any circumstances. In short, the amounts involved in *Teleservice Company* were advance payments made for service and not payments for investment in facilities to be operated for an indefinite period for the benefit of the contributor.

Neither the Tax Court nor the Court of Appeals for the Third Circuit in the opinions handed down in the *Teleservice Company* case thought it necessary to consider any possible factual distinction between the *Teleservice Company* case and the line of decisions starting with *Liberty Light & Power Co., supra.* Instead, that line of decisions was repudiated as having been outmoded by more recent decisions of the Supreme Court of the United States. On the other hand, as previously indicated, the *Teleservice Company* case was litigated by the Service because it felt there were distinguishing facts.

It has now been determined that, if and when the Service should decide upon a change in the position represented by the cited acquiescences in the public utility decisions, the change of position will be given nonretroactive effect under section 7805 (b) of the Internal Revenue Code of 1954 with respect to transactions entered into prior to the effective date of the change. See I. T. 3609, C. B. 1943, 505, for the general type of nonretroactive application contemplated.

The foregoing announcement as to nonretroactivity does not apply to cases factually similar to the *Teleservice Company* case or to other cases not substantially similar to the public utility cases to which the acquiescences relate.

In any event, whether the particular case is controlled by the cited acquiescences or is of the *Teleservice Company* type, the Service will continue to follow the rule to the effect that a taxpayer receiving contributions in aid of construction may not claim a basis for the assets in which such amounts are invested, for purposes of depreciation or otherwise, to the extent that the amounts received were not included in income reported in the taxpayer's income tax returns, *Detroit Edison Company* v. *Commissioner*, 319 U. S. 98, Ct. D. 1582, C. B. 1943, 1019. The execution of protective agreements as to basis will be made a condition of any nonretroactive application of a change of position, as in I. T. 3609, *supra.*

Amounts received by the transferor, upon the transfer or rights to patents, in a case not within the scope of section 1235 of the Code. See Rev. Rul. 58–353, page 408.

An amount received by partners in consideration of the relinquishment or cancellation of rights under their management contract. See Rev. Rul. 58–394, page 374.

Educational benefits received by the taxpayer's minor son under a future employment agreement with the United States Navy. See Rev. Rul. 58–403, page 49.

Territorial cost-of-living allowance as part of basic compensation of Federal employees after conversion of their positions under section 202(7) of the Classification Act of 1949, as amended. See Rev. Rul. 58–503, page 390.

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26 CFR 1.61–2: Compensation for services, including fees, commissions, and similar items.
(Also Section 3402; 31.3402(a)–1.)

Rev. Rul. 58–495

Earnings for services donated by employees for charitable purposes under an industry-wide fund-raising plan are includible in the gross income of the employees and is subject to the withholding of income tax under section 3402 of the Internal Revenue Code of 1954 even though such earnings are paid directly to tax-exempt charitable organizations by the employers in accordance with the requirements of such plan.

Advice has been requested whether earnings for services donated by employees under an industry-wide fund-raising plan are includible in gross income as defined in section 61 of the Internal Revenue Code of 1954 and subject to the withholding of income tax for purposes of the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, of the Code).

The labor-management committee of a particular industry, with the approval of the employees concerned, has developed a plan for raising funds for community welfare activities. The plan provides that each participating employee will donate one hour's pay per day for a period of five days, as a contribution to such activities. Each employee subscribing to the plan will receive no compensation for these five hours of work. Instead, the employer will make payment for such work to a designated charitable organization which is exempt from Federal income tax as an organization described in section 501(c)(3) of the Code. In addition, the employer will contribute for such purposes an amount equal to one-half of the value of the contributions made by his employees.

Under section 61 of the Code, gross income includes, among other items, all compensation for personal services unless specifically excluded by other provisions of the Code. Section 1.61–2(c) of the Income Tax Regulations provides:

"The value of services is not includible in gross income when such services are rendered directly and gratuitously to an organization described in section 170(c). Where, however, pursuant to an agreement or understanding, services are rendered to a person for the benefit of an organization described in section 170(c) and an amount for such services is paid to such organization by the person to whom the services are rendered, the amount so paid constitutes income to the person performing the services."

Accordingly, it is held that amounts earned by employees with respect to services donated for charitable purposes under the fund-raising plan of the instant case are includible in gross income for Federal income tax purposes and subject to the withholding of income tax under section 3402 of the Code even though such earnings are paid directly to a tax-exempt charitable organization by the employer. Compare Rev. Rul. 71, C. B. 1953–1, 18, and Rev. Rul. 57–135, C. B. 1957–1,307.

Compensation received by a police officer from employment in private industry in the performance of his duties as an employee of the police department, and remitted by him to the Police Pension Fund, is not includible in his gross income for Federal income tax purposes. The Form W–2 (Withholding Tax Statement) received by the police officer from the employer in private industry should be attached to his Federal income tax return required to be filed for the taxable year during which the compensation was received, and the return should be accompanied by a statement explaining the circumstances and indicating that the compensation reported in that Form W–2 is excludable from gross income in accordance with this ruling.

Advice has been requested as to the treatment, for the Federal income tax purposes, of compensation received by a police officer from employment in private industry, if he is so employed in the performance of his duties as an employee of the police department and is required to remit the compensation from such employment to the Police Pension Fund.

A police officer, in the performance of his duties as an employee of the police department, entered into employment in private industry for the purpose of obtaining certain information for the department without disclosure of his identity. During the short period of such employment, he continued to receive his regular compensation from the department. Pursuant to the rules and procedures of the police department, he remitted the compensation received from his employment in private industry to the Police Pension Fund. After the close of the calendar year, he received Forms W–2 (Withholding Tax Statement) from both the police department and from the employer in private industry.

Section 61 (a) of the Internal Revenue Code of 1954 provides, in part, that except as otherwise provided by law, gross income means all income from whatever source derived.

Under the particular circumstances involved here, it is the opinion of the Internal Revenue Service that the police officer was employed in private industry as an agent of the police department. Accordingly, it is held that compensation which he received and remitted to the Police Pension Fund, is not includible in his gross income for Federal income tax purposes. The Form W–2 received by the police officer from the employer in private industry should be attached to his Federal income tax return required to be filed for the taxable year during which the compensation was received, and the return should be accompanied by a statement explaining the circumstances and indicating that the compensation reported in that Form W–2 is excludable from gross income in accordance with this ruling.

Inclusion in gross income of amounts received as stipends in excess of the limitations provided by section 117(b) of the 1954 Code in the case of persons who are not candidates for a degree. See Rev. Rul. 58–498, page 47.

Income from services performed in employ of instrumentality of United States. See Rev. Rul. 58–527, page 741.

26 CFR 1.61–4: Gross income of farmers.

Value of unsold livestock and farm crops of decedent, who had reported income on the cash method of accounting. See Rev. Rul. 58–436, page 366.

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26 CFR 1.61–12: Income from discharge of indebtedness. (Also Section 172; 1.172–1.) Rev. Rul. 58–600

The cancellation of the indebtedness of a taxpayer neither results in the realization of gross income nor affects the taxpayer's net operating loss carryovers from prior years where the taxpayer was insolvent before the debt cancellation and, after the debt cancellation, either remains insolvent or has no excess of assets over liabilities.

Advice has been requested whether the cancellation of the indebtedness of a taxpayer, under the circumstances described below, results in the realization of taxable income and whether the cancellation of the indebtedness affects the taxpayer's net operating loss carryovers from prior years.

The taxpayer is the sales representative in this country for a corporation located in a foreign country. It is compensated on a commission basis. There is no relationship between the stockholders of the foreign corporation and the taxpayer. From 1946 through 1951 the taxpayer expended large sums of money in its sales promotion activities. During such years, the foreign corporation, in order to continue its sales efforts in the United States, through the taxpayer as its representative, made interest-bearing loans to the taxpayer. In 1951 the foreign corporation gratuitously cancelled the interest and the notes thereafter were made noninterest-bearing. During the taxable years 1951 through 1955, the taxpayer sustained operating losses, and at the end of 1955 showed a deficit substantially in excess of its assets. On January 1, 1956, the taxpayer's indebtedness to the foreign corporation exceeded the deficit at such time. The foreign corporation thereafter voluntarily cancelled the indebtedness in an amount approximately equal to the taxpayer's deficit. The amount forgiven did not create any surplus but was sufficient to eliminate the capital deficiency of the taxpayer.

Section 1.61–12(b)(1) of the Income Tax Regulations provides in part:

Income is not realized by a taxpayer by virtue of the discharge, under section 14 of the Bankruptcy Act (11 U. S. C. 32), of his indebtedness as the result of an adjudication in bankruptcy, or by virtue of an agreement among his creditors not consummated under any provision of the Bankruptcy Act, if immediately thereafter the taxpayer's liabilities exceed the value of his assets * * *.

In *Dallas Transfer & Terminal Warehouse Co.* v. *Commissioner*, 70 Fed. (2d) 95, the Circuit Court of Appeals considered a situation not involving a formal bankruptcy or composition arrangement wherein one creditor released an insolvent debtor from an amount owing by reason of a conveyance of property the value of which was insufficient to equal the debt. The court stated:

In effect the transaction was similar to what occurs in an insolvency or bankruptcy proceeding when, upon a debtor surrendering, for the benefit of his

creditors, property insufficient in value to pay his debts, he is discharged from liability for his debts. This does not result in the debtor acquiring something of exchangeable value in addition to what he had before. There is a reduction or extinguishment of liabilities without any increase of assets. There is an absence of * * * a gain or profit * * *.

The rationale of the above decision has been applied in subsequent cases. See, for examples, *Kramon Development Co., Inc.* v. *Commissioner*, 3 T. C. 342, acquiescence, C. B. 1944, 17, and *Main Properties, Inc.* v. *Commissioner*, 4 T. C. 364, acquiescence, C. B. 1945, 5.

Accordingly, the cancellation of the indebtedness of a taxpayer neither results in the realization of gross income nor affects the taxpayer's net operating loss carryovers from prior years where the taxpayer was insolvent before the debt cancellation and, after the debt cancellation, either remains insolvent or has no excess of assets over liabilities.

Tax benefit derived from past due interest which was eliminated in a nontaxable exchange. See Rev. Rul. 58-546, page 143.

SECTION 62.—ADJUSTED GROSS INCOME DEFINED

26 CFR 1.62-1: Adjusted gross income.

Deductibility of privilege tax on retailers in the Territory of Hawaii. See Rev. Rul. 58-564, page 79.

SECTION 71.—ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

26 CFR 1.71-1: Alimony and separate maintenance payments; income to a wife or former wife.

Periodic payments received by a divorced wife not incident to a decree of divorce. See Rev. Rul. 58-451, page 914.

SECTION 72.—ANNUITIES: CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS

26 CFR 1.72-6: Investment in the contract. (Also Section 931; 1.931-1.) (Also Part II Sections 22(b), 251; Regulations 118, Sections 39.22(b)(2)-2, 39.251(a)-1.) Rev. Rul. 58-472

Where, pursuant to the provisions of the United States Civil Service Retirement Act, an annuity for services performed partly within the United States and partly within a possession of the United States is paid to a retired employee of the United States Government, or of any agency thereof, who is a citizen of the United States and on the date of retirement was a resident of the United States, the consideration paid for the annuity, for purposes of section 72 (b) or (d) of the Internal Revenue Code of 1954, is limited to

the aggregate of the amounts contributed by the employee to the civil service retirement and disability fund.

However, where the citizen-employee retired prior to January 1, 1951, and on the retirement date was a nonresident of the United States and at that time met the respective 80 percent and 50 percent requirements of section 251 (a) (1) and (3) of the 1939 Code, such annuitant's investment in the annuity contract for taxable years commencing after December 31, 1953, and ending after August 16, 1954, would, by reason of section 72 (f) (2) of the 1954 Code, include the employer's contribution to the civil service retirement and disability fund at the time of the employee's retirement, to the extent, if any, that such contribution was attributable to services rendered by the employee in a possession of the United States.

Where, because of a break in service, the entire amount of the employee's prior contributions to the fund, plus accrued interest thereon, was withdrawn and later repaid upon reemployment, such amount, plus the additional interest accrued and paid thereon by the employee for the period of the withdrawal, may be treated as a part of the consideration paid by the employee to the retirement fund for purposes of section 72 (b) or (d) of the Code.

Advice has been requested concerning the taxability of pensions received under the United States Civil Service Retirement System by two United States citizens for services performed by each wholly or partly in a possession of the United States.

The two United States citizens were employed in the Panama Canal Zone by the Panama Canal Company during the years 1921 through 1948, inclusive. During such period they and their employment were covered by the United States Civil Service Retirement Act (hereinafter sometimes referred to only as the "Act"). As required by such Act, they, through withholding from their salaries by their employer, made contributions with respect to all of their Panama Canal Zone employment to the retirement and disability fund maintained under that Act. As of December 31, 1948, while still residing in the Canal Zone, the older of such employees, hereinafter referred to as "A," having reached age 62, retired. Immediately thereafter she returned to the United States. On February 1, 1949, she commenced to receive an annuity of $1800 per year, or $150 per month, under the civil service retirement system. On the same date, the younger of the two employees, hereinafter referred to as "B," resigned her employment and returned to the United States. Upon returning to the United States, *B* withdrew from the civil service retirement and disability fund the entire amount standing to her credit therein. Upon resuming employment within the United States in 1950 with the United States government, *B* redeposited in the civil service retirement and disability fund the entire amount withdrawn in 1949, plus interest for the period during which it had been withdrawn. On July 31, 1956, having reached age 55, *B* also retired and, on the first day of the second month following the date of retirement, commenced receiving an annuity under the civil service retirement system.

Under the provisions of sections 251(a) and 931(a), respectively, of the Internal Revenue Codes of 1939 and 1954, and under a corresponding section of each prior Revenue Act subsequent to and including the Revenue Act of 1921, 42 Stat. 227, effective as of January 1, 1921, a United States citizen may, under certain circumstances, exclude from gross income for Federal income tax purposes that income derived from sources within a possession of the United States. However, commencing with section 262 of the Revenue Act of 1921 and includ-

ing section 931 of the 1954 Code, the section of law in question has always provided, in subsection (b) thereof, that, notwithstanding subsection (a), there shall be included in gross income all amounts received by such citizens within the United States, whether derived from sources within or without the United States. Effective with respect to taxable years beginning after December 31, 1950, section 251 of the 1939 Code was amended (see P. L. 82, July 23, 1951, 65 Stat. 124, C. B. 1951–2.350) by adding thereto a subsection (j), now subsection (i) of section 931 of the 1954 Code, reading as follows:

(j) EMPLOYEES OF UNITED STATES.—For purposes of this section, amounts paid for services performed by a citizen of the United States as an employee of the United States or any agency thereof shall be deemed to be derived from sources within the United States.

The Panama Canal Zone is a possession of the United States and the Panama Canal Company is an agency of the United States. Consequently, salaries received in the Panama Canal Zone by *A* and *B* for services performed therein on and prior to December 31, 1948, were excludable from their gross incomes for Federal income tax purposes since such salaries were paid and received prior to January 1951 for services performed in a United States possession and were received while the employees were nonresident of the United States.

Effective with and after the first day of the first pay period which began after June 30, 1957, section 4(a) of the Civil Service Retirement Act Amendments of 1956, 70 Stat. 743, has provided, with respect to each employee covered by that Act who has amounts withheld from his salary, pay or compensation and deposited in the retirement and disability fund, that "an equal sum shall also be contributed from the respective appropriation or fund which is used for payment of his salary, pay or compensation." Prior to the effective date of such section 4(a), as so amended, it was not the policy or practice of the United States Government and its agencies to make contributions to the civil service retirement and disability fund on behalf of employees at the same time, and in like amounts, that the employees' contributions were deposited therein. Instead, it was deemed that the government's contribution on behalf of an employee was made, in its entirety, on the effective date of the employee's retirement, death or disability when he or his beneficiary first became entitled to a pension or annuity under the terms of the Act.

The civil service retirement and disability fund, first created by the United States Civil Service Retirement Act of May 22, 1920, 41 Stat. 614, and now administered under the Civil Service Retirement Act Amendments of 1956, *supra*, is a trust held to be qualified under section 401(a), and eligible for tax-exemption under section 501(a), of the 1954 Code. See I. T. 4102, C. B. 1952–2, 173. All amounts distributed or made available from such fund are taxable to the distributee, at the time distributed or made available, as provided in section 402(a) of the 1954 Code (formerly section 165(b) of the 1939 Code). With respect to amounts distributed as pensions or annuities, that section provides that such amounts shall be taxable under section 72 (relating to annuities) except that section 72(e)(3) shall not apply. Subsection (f) of section 72 reads as follows:

(f) SPECIAL RULES FOR COMPUTING EMPLOYEES' CONTRIBUTIONS.—In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection

(d)(1), the consideration for the contract contributed by the employee, and for purposes of subsection (e)(1)(B), the aggregate premiums or other consideration paid, amounts contributed by the employer shall be included, but only to the extent that—

(1) such amounts were includable in the gross income of the employee under this subtitle or prior income tax laws; or

(2) if such amounts had been paid directly to the employee at the time they were contributed, they would not have been includible in the gross income of the employee under the law applicable at the time of such contribution.

Where a part of the consideration paid for an employee's annuity is contributed by the annuitant's employer, as in the case of civil service annuities, section 72 of the 1954 Code, effective only for taxable years commencing after December 31, 1953, and ending after August 16, 1954, provides two methods of taxing such an annuity, *i. e.*, (1) the so-called "three-year recoverable" method under subsection (d) thereof and (2) the so-called "life-expectancy" method under subsection (b) thereof.

Under section 72(d) (or the "three-year recoverable" method), where part of the consideration for the annuity is contributed by the employer and the aggregate amount receivable under the contract by the annuitant, during the three-year period beginning on the date (whether or not before January 1, 1954) on which an amount is first received under the contract as an annuity, is equal to or greater than the consideration for the contract contributed by the employee, all amounts received as an annuity under the contract shall be excluded from gross income until there has been so excluded an amount equal to the consideration for the contract contributed by the employee. Thereafter, all amounts so received under the contract shall be included in the annuitant's gross income.

Under section 72(b), or the so-called "life-expectancy" method of taxing annuities, all payments received by an annuitant are each divided into a taxable portion includible in the annuitant's gross income and a nontaxable (excludable) portion which represents a return of the annuitant's investment in the contract. The nontaxable and excludable portion is, in general, the same proportion of each annuity payment which the employee's investment in the contract is of the annuitant's expected return under the contract. See section 1.72–4 of the Income Tax Regulations.

The rules stated above supersede the one contained in section 22(b)(2) of the 1939 Code for taxable years governed by the 1939 Code, as follows:

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

Amounts received as pensions or annuities in taxable years commencing prior to January 1, 1954, or ending prior to August 17, 1954, are taxable as provided in section 22(b)(2) of the 1939 Code. See section 165(b) of the Internal Revenue Code of 1939.

On the basis of the foregoing, *A*'s annuity for the years 1949 to 1953, inclusive, was includible in and excludable from gross income

as provided in section 22(b)(2) of the 1939 Code. The "aggregate premiums or consideration paid for such annuity," within the meaning of such subsection, was limited to the sum of her own contributions to the civil service retirement and disability fund and, under the so-called three percent rule set forth in such section 22(b)(2), *A* completed a tax-free recovery of that consideration during 1950. Accordingly, for the years 1951 to 1953, inclusive, *A* had no unrecovered consideration for, or investment in, her annuity and the amount of each annuity payment received by her during those years was includible in her gross income. However, by reason of section 72(f)(2) of the 1954 Code and the provisions of section 251 of the 1939 Code as in effect on the retirement date of December 31, 1948, *A* became entitled, for taxable years beginning after December 31, 1953, to recover tax-free also the amount contributed to the civil service retirement and disability fund by the United States Government at the time of retirement with respect to the 27 years of employment in the Canal Zone. The total consideration paid by *A* was well in excess of the amount of the annual annuity of $1,800 for three years. Consequently, for 1954 and all subsequent years as long as *A* lives, *A*'s annuity is includible in, and excludable from, gross income as provided in section 72(a) and (b) of the 1954 Code. The excludable portion of each monthly payment of $150 received after December 31, 1953, is determined by multiplying $150 by a fraction, the numerator of which is the amount deemed to have been contributed on December 31, 1948, to the civil service retirement fund on *A's* behalf by the Panama Canal Company and the denominator of which is $1,800 multiplied by 16.9 (the expected return multiple of a female at age 67 on January 1, 1954, for an ordinary single-life annuity; see Table I of section 1.72–9 of the Income Tax Regulations).

It is further held, however, as to employee *B* herein, that, where a United States citizen employed by the United States or any agency thereof retires after December 31, 1950, or retires prior to that date at a time when resident in the United States, on an annuity under the civil service retirement system based (either in whole or in part) on services rendered in a possession of the United States, such citizen's "aggregate premiums or consideration paid for such annuity," within the meaning of section 22(b)(2) of the 1939 Code, or "investment in" or "consideration for" such annuity, within the meaning of section 72(b) or (d) of the 1954 Code, is limited to the aggregate of the amounts contributed by the retiring employee to the civil service retirement and disability fund. Such "aggregate" also includes any interest paid to the fund by the retiring employee, upon redeposit therein prior to retirement, of amounts, which had been previously withdrawn from the fund.

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26 CFR 1.72–13: Special rule for employee contributions recoverable in three years. Rev. Rul. 58–497

The full amount of the consideration paid or deemed to have been paid by an employee for an annuity contract should be taken into account in determining the appropriate method, under section 72 of the Internal Revenue Code, for excluding from gross income the consideration paid for the annuity, whether or not the date on which an amount is first received as an annuity under the contract is prior to January 1, 1954.

Advice has been requested with respect to the applicability of section 72(d) of the Internal Revenue Code of 1954 where the date on which an amount is first received under the contract as an annuity is prior to January 1, 1954.

Section 72(d) provides that where part of the consideration for an annuity, endowment, or life insurance contract is contributed by the employer and during the three-year period beginning on the *date* (whether or not before January 1, 1954) on which an amount is *first received* under the contract as an annuity, the aggregate amount receivable by the employee under the terms of the contract is equal to or greater than the consideration for the contract contributed by the employee, than all amounts received as an annuity under the contract shall be excluded from gross income until there has been so excluded (under section 72(d) and prior income tax laws) an amount equal to the consideration for the contract contributed by the employee.

The applicability of section 72(d) of the Code is dependent upon whether part of the consideration for the contract is contributed by the employer and whether the aggregate amount receivable by the employee under the terms of the contract during the three-year period beginning on the date (whether or not before January 1, 1954) on which an amount is first received under the contract as an annuity is equal to or greater than the consideration for the contract contributed by the employee. As provided in section 1.72–13(a)(3) of the Income Tax Regulations, the "aggregate amount receivable" within the meaning of section 72(d)(1)(B) of the Code consists of the "total of all annuity payments anticipatable * * * under the contract as a whole" within the prescribed three-year period. Thus, subsequent increases in the rate of the annuity which were not specifically provided for under the contract at the time that an amount was first received as an annuity are not includable in determining the aggregate amount receivable during the prescribed three-year period.

The "consideration for the contract contributed by the employee" within the meaning of section 72(d)(1)(B) of the Code includes those amounts contributed or deemed contributed by the employee up to and as of the date (whether or not before January 1, 1954) on which an amount is first received under the contract as an annuity as if section 1.72–8 of the regulations and the section of the Code therein referred to has been enacted prior to that date, as reduced by tax-free recoveries of such consideration prior to that date. See section 1.72–8, section 1.72–13(a)(1)(ii) and (a)(2) of the regulations. Tax-free recoveries, between the date on which an amount is first received under the contract as an annuity and January 1, 1954, of consideration contributed by the employee are not relevant in determining the applicability of section 72(d) of the Code. See also Revenue Ruling 56–82, C. B. 1956–1, 59, which holds that for the purpose of arriving at the exclusion ratio used in computing amounts of annuities which may be excluded from gross income, annual amounts contributed by a state or political subdivision thereof to employees' tax-exempt pensions funds prior to January 1, 1939, are added to contributions of employees in computing the consideration paid for the annuity contracts to the extent that the amounts so contributed represent compensation for personal services rendered in the exercise of an essential governmental function, as distinguished from a proprietary function, and were not

contributed directly or indirectly by the United States or an agency or instrumentality thereof.

If section 72(d) of the Code, is applicable, then all amounts received as an annuity under the contract during a taxable year to which the Code applies shall be excluded from gross income until the total of the amounts excluded under section 72(d) of the Code, plus all amounts excluded under prior income tax laws equals or exceeds the consideration contributed or deemed contributed by the employee. The excess, if any, and all amounts thereafter received under the contract shall be fully included in gross income. As provided in section 1.72–13(b) of the regulations, amounts which are not received as an annuity shall be included in the gross income of the recipient in accordance with the provisions of section 1.72–11 of the regulations.

Accordingly, it is held that, for purposes of determining whether section 72(d) of the Code is applicable to a contract where the date on which an amount is first received under the contract as an annuity is prior to January 1, 1954, the consideration for the contract contributed by the employee within the meaning of section 72(d)(1)(B) of the Code includes, in addition to amounts actually contributed by the employee, amounts which would have been treated as contributed by the employee as of that date under sections 72(f) and 101(b) of the Code and section 1.72–8 of the regulations as if these provisions were then in effect.

SECTION 74.—PRIZES AND AWARDS

26 CFR 1.74–1: Prizes and awards. Rev. Rul. 58–354

Awards received by a taxpayer and his family as a result of participating in a public conference sponsored by various organizations to select a family representing a specified average living routine constitute prizes and awards within the meaning of section 74(a) of the Internal Revenue Code of 1954, and the exception referred to in section 74(b) is not applicable. The fair market value of such awards are, therefore, includible in the gross income of the recipients for the taxable year in which received.

Advice has been requested as to the treatment, for Federal income tax purposes, of awards received by a taxpayer and his family in connection with a public conference sponsored by various organizations to select a family representing a specified average living routine.

The taxpayer and his family attended in a certain city a conference, designated as a "search" and not a contest, sponsored by various nonprofit and profit organizations for the purpose of selecting a representative family which typified a certain average family living routine. Each family attending the conference participated in public interviews at the conference meetings preceding the selection of the most representative family. The taxpayer's family was selected as being most representative, and they received substantial awards which the sponsors of the proceedings and the donors of the awards stated were to be considered as gifts.

Section 74(a) of the Internal Revenue Code of 1954 provides that gross income includes amounts received as prizes and awards, except as otherwise provided in subsection (b) of that section and in section 117 of the Code, relating to scholarships and fellowship grants. The exception provided by section 74(b) of the Code applies only to

prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement.

Accordingly, it is held that awards received by a taxpayer and his family as a result of participating in a public conference sponsored by various organizations to select a family representing a specified average living routine do not constitute awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement within the meaning of section 74(b) of the Code. The fair market value of such awards are, therefore, includible in the gross income of the recipients under section 74(a) of the Code for the taxable year in which received. The extent to which all or any portion of any particular item awarded to the members of the taxpayer's family are actually or constructively received by the taxpayer, or paid or applied by the sponsors or donors in satisfaction of his personal obligations, is a question of fact to be determined upon examination by the Internal Revenue Service of the Federal income tax returns required to be filed by the taxpayer.

Value of merchandise won by a contestant on a television show. See Rev. Rul. 58–347, page 878.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 102.—GIFTS AND INHERITANCES

26 CFR 1.102–1: Gifts and inheritances.

Value of unsold livestock and farm crops of decedent who had reported income on the cash method of accounting. See Rev. Rul. 58–436, page 366.

SECTION 103.—INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS

26 CFR 1.103–1: Interest upon obligations of a State, Territory, etc. **Rev. Rul. 58–452**

A water district, established under authority of Chapter 74 of the Kentucky Revised Statutes, Volume 1, 1958, is in the process of issuing revenue bonds of $1,000 denomination under Chapter 74 and related sections in Chapters 96 and 106 of the Kentucky Revised Statutes, with an insurance endorsement by the Farmers' Home Administration of the United States Department of Agriculture as authorized by section 10 of the Act of August 28, 1937, 50 Stat. 869, as amended by Public Law 597, 83rd Congress, 68 Stat. 734, 16 U. S. C. 590r–590x–3. The bonds will be payable solely from and secured by the income and revenues derived from the operation of the water works. *Held*, the bonds to be issued by the water district constitute obligations of a political subdivision of a state within the meaning of section 103 of the Internal Revenue Code of 1954 and interest from such bonds is excludable from gross income. It is not necessary for purposes of section 103 of the Code that the obligation be one which pledges the

general credit of the municipality or the use of the taxing power. See *Commissioner* v. *Michael Pontarelli*, 97 Fed. (2d) 793, affirming 35 B. T. A. 872; *Fairbanks, Morse & Co., et al.* v. *Harrision*, 63 Fed. Supp. 495; *Commissioner* v. *Carey-Reed Co.*, 101 Fed. (2d) 602; *Commissioner* v. *Estate of Alexander Shamberg*, 144 Fed. (2d) 998, Ct. D. 1648, C. B. 1945, 335, certiorari denied, 323 U. S. 792; Revenue Ruling 54–106, C. B. 1954–1, 28. Nor will the insurance endorsement by the agency of the Federal Government affect the tax-exempt nature of the interest.

Amounts received on maturing secondary interest coupons detached from bonds of a political subdivision of a state by brokers and redeemed by the party who purchased the coupons from the broker. See Rev. Rul. 58–536, page 21.

SECTION 104.—COMPENSATION FOR INJURIES OR SICKNESS

26 CFR 1.104–1: Compensation for injuries or sickness. Rev. Rul. 58–578

> Where a contract between an insurance company and the owner of an airplane provides for the payment of specified amounts to a person injured in such plane or to such person's beneficiary. Or personal representative in the event of death, upon the execution of a release of all claims for damages against the insured, such amounts constitute payment of damages under section 104 (a) (2) of the Internal Revenue Code of 1954, and, as such, are excludable from the gross income of the recipient.

Advice has been requested whether amounts received pursuant to the terms of a certain insurance policy, described below, constitute gross income to the recipient.

A certain company is the owner of an airplane which is used in connection with business for the transportation of its employees and guests. The company is insured against liablity to passengers for personal injuries by an aircraft liability policy which provides in pertinent part, that the insurer will pay specified sums to persons injured while passengers in the company's airplane, or to the persons' beneficiaries, or personal representatives in the event of death, regardless of whether the insured is legally liable for such injury or death. The policy specifies that as consideration for such payment by the insurer, the injured party, or his representative, shall first execute a full release of all claims for damages against the insured.

The specific question in the instant case is whether payments received pursuant to the above-mentioned insurance policy constitute gross income to the recipient injured party, beneficiary, or personal representative, as the case might be.

Section 104(a) of the Internal Revenue Code of 1954 provides, in part:

> (a) IN GENERAL.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—
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> * * * * * * *
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> "(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

Section 1.104–1(c) of the Income Tax Regulations provides that the term "damages received (whether by suit or agreement)" means an amount received, other than workmen's compensation, through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

The facts of the instant case indicate that the injured party, his beneficiary, or personal representative, may elect to accept the payments provided for under the policy. However, if the election is made, the injured party, beneficiary, or personal representative, as the case may be, must execute a release relieving the insured from liability for any claim for damages. The intended effect of this requirement is that the acceptance of settlement payments under the policy shall be in lieu of prosecution of a suit for damages. Payments under such an arrangement constitute damages received within the meaning of section 104(a)(2) of the Code.

Accordingly, it is held that where a contract between an insurance company and the owner of an airplane provides for the payment of specified amounts to a person injured in such plane or to such person's beneficiary, or personal representative in the event of death, upon the execution of a release of all claims for damages against the insured, such amounts constitute payment of damages under section 104(a)(2) of the Code, and, as such, are excludable from the gross income of the recipient party.

Amounts received under an accident and health insurance policy which provides for reimbursement of medical expenses on an indemnity basis without regard to the amount of medical expenses actually incurred by the policyholder. See Rev. Rul. 58–602, page 109.

SECTION 105.—AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS

26 CFR 1.105–4: Wage continuation plans. Rev. Rul. 58–371

> The exclusion under section 105(d) of the Internal Revenue Code of 1954, is not applicable to wages or payments in lieu of wages received by an employee for a legal holiday which is neither a normal working day for the employee involved nor a day on which he is required to hold himself available for a call to work.
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> The seven day waiting period does not begin on a legal holiday on which an employee is not supposed to work or to be on call; however, where a paid holiday occurs after a period of absence from work on account of sickness has begun and while the employee is still sick, a paid holiday counts as one day of the seven-day waiting period.

Advice has been requested with respect to the effect on the exclusion provided in section 105(d) of the Internal Revenue Code of 1954 of the occurrence of a legal holiday within the period during which an employee is absent from work on account of personal injury or sickness.

Section 105(a) of the Code relates to amounts received by an employee under an accident or health plan for personal injuries or sickness which (1) are attributable to contributions by the employer which were not includible in the gross income of the employee; or

(2) are paid by the employer. Section 105(d) excludes from gross income such amounts if they constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness, subject to the following limitations: (1) the exclusion does not apply to the extent that such amounts exceed a weekly rate of $100; (2) if the absence is due to sickness (as distinguished from injury), the exclusion does not apply to amounts attributable to the first seven calendar days of the absence unless the employee is hospitalized on account of sickness for at least one day during the absence.

Section 1.105–4(a) of the Income Tax Regulations provides, in part, as follows:

(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. * * *

* * * * * * *

(ii). Similarly, an employee who incurs a personal injury or sickness during his paid vacation is not allowed to exclude under section 105(d) any of the vacation pay which he receives since he is not absent from work on account of the personal injury or sickness Likewise, a teacher who becomes sick during the summer or other vacation period when he is not expected to teach, is not entitled to any exclusion under section 105(d) for the summer or vacation period. However, if an employee who would otherwise be at work during a particular period is absent from work and his absence is in fact due to a personal injury or sickness, a payment which he receives for such period under a wage continuation plan is subject to section 105(d).

(4). A period of absence from work shall commence the moment the employee first becomes absent from work and shall end the moment the employee first returns to work. However, the exclusion provided under section 105(d) is applicable only to payments attributable to a period of absence from work which is due to a personal injury or sickness, and to payments attributable to a period when the employee would have been at work but for such personal injury or sickness.

If an employee, under his contract of employment, is excused from working on a legal holiday, such holiday is a period when the employee would not have been at work because he was not expected to work, and the Income Tax Regulations preclude granting the section 105(d) exclusion with respect to wage continuation plan payments attributable to such a legal holiday. If an employee is expected to work on a particular legal holiday but is absent from work on such day on account of personal injury or sickness, the exclusion of section 105(d) should apply to any wage continuation plan payment received for such legal holiday.

If an employee is paid for a legal holiday because he is expected to be on call on that day but is sick or injured on such day so that he cannot answer the call, section 105(d) of the Code is applicable. See section 1.105–4(a)(5) of the Income Tax Regulations, which provides, in part, as follows:

* * * A member of the Armed Forces, who on a particular day has no assigned duties but to stand ready for duty, is absent from work if he is unable to answer any duty call that may be made upon him. * * *

Where the employee has been absent from work for a period on account of injuries or sickness and he has actually recovered but his return to work is delayed by a day on account of a paid holiday, the wages attributable to such day would not be excludable from the

employee's gross income to the extent provided in section 105(d) of the Code.

Where the first day of an employee's sickness is a nonworking day (such as a Saturday or a Sunday), section 1.105–4(c)(1), Example (1) of the Income Tax Regulations, provides that the period of absence from work due to sickness does not begin until the first normal working day following such nonworking day. The theory is that until such normal working day arrives the employee is not absent from work because he is not expected to work. The same theory is equally applicable where the employee is injured rather than sick and where the sickness or injury first occurs on a paid holiday or after work on the working day immediately preceding the paid holiday (as distinguished from a nonworking day).

The term "seven calendar days" as used in section 105(d) of the Code, does not necessarily mean seven working days. However, if the sickness begins on a nonworking day, that day is not counted. The seven-day waiting period begins on the next working day but will thereafter include nonworking days.

Accordingly, it is held the exclusion under section 105(d) of the Code is not applicable to wages or payments in lieu of wages received by an employee for a legal holiday which is neither a normal working day for the employee involved nor a day on which he is required to hold himself available for a call to work.

The seven-day waiting period does not begin on a legal holiday on which an employee is not supposed to work or to be on call; however, where a paid holiday occurs after a period of absence from work on account of sickness has begun and while the employee is still sick, a paid holiday counts as one day of the seven-day waiting period.

Rev. Rul. 58–462

Commissions received by a salesman on transactions with his specified customers during his absence from work because of illness, in accordance with the wage continuation policy of his employer, constitute payments received under a wage continuation plan within the meaning of section 105(d) of the Internal Revenue Code of 1954. Payments so received are excludable from his gross income to the extent provided by section 105(d) of the Code. The exclusion does not apply to commissions earned for a period prior to the salesman's illness which were received during his absence from work on account of the illness.

Advice has been requested whether commissions received by a salesman which are attributable to purchases made direct of his employer during a period when he was absent from work because of illness are excludable from his gross income under section 105(d) of the Internal Revenue Code of 1954.

The employer in the instant case had a policy of paying commissions to certain of its salesmen on transactions with their specified customers during periods of the salesmen's absence from work because of injury or sickness. In the instant case, a salesman was absent from work for a period of several weeks because of an illness for which he was hospitalized. During that time he did not contact any of his customers nor did he render any services to them; however, some of his customers purchased materials direct from the em-

ployer during the absence of the salesman. Pursuant to the wage continuation policy of his employer, the salesman received the usual commissions on these transactions with his specified customers during the period of his absence from work due to sickness. The employer's other salesmen did not perform any selling services nor did they receive any commissions with respect to these transactions.

Section 105(a) of the Internal Revenue Code of 1954 states, in part, that, except as otherwise provided in that section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(d) of the Code provides that gross income does not include amounts referred to in subsection (a) of that section if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness; but, this subsection does not apply to the extent that such amounts exceed a week rate of $100. In the case of a period during which the employee is absent from work on account of sickness, the preceding sentence shall not apply to amounts attributable to the first seven calendar days in such period unless the employee is hospitalized on account of sickness for at least one day during such period.

Section 105(d) of the Code is applicable only if the wages, or payments in lieu of wages, are paid pursuant to a wage continuation plan. The term "wage continuation plan" means an accident or health plan, as defined in section 1.105–5 of the Income Tax Regulations, under which wages, or payments in lieu of wages, are paid to an employee for a period during which he is absent from work on account of a personal injury or sickness.

Section 1.105–5 of the regulations provides, in part, as follows:

> * * * In general, an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness. A plan may cover one or more employees, and there may be different plans for different employees or classes of employees. An accident or health plan may be either insured or noninsured, and it is not necessary that the plan be in writing or that the employee's rights to benefits under the plan be enforceable. However, if the employee's rights are not enforceable, an amount will be deemed to be received under a plan only if, on the date the employee became sick or injured, the employee was covered by a plan (or a program, policy, or custom having the effect of a plan) providing for the payment of amounts to the employee in the event of personal injuries or sickness, and notice or knowledge of such plan was reasonably available to the employee. * * *

Accordingly, it is held that commissions received by the salesman in the instant case in accordance with the wage continuation policy of his employer constitute payments received under a wage continuation plan within the meaning of section 105(d) of the Code. Payments so received are excludable from his gross income to the extent provided by section 105(d) of the Code. However, the exclusion does not apply to commissions earned for a period prior to the salesman's illness which were received during his absence from work on account of the illness.

Where the lowest age at which an employee can retire under a wage continuation plan without consent of the employer is 60 in the case of a male employee and 55 in the case of a female employee, both with 20 years of service, the normal retirement age for the purpose of excluding disability annuity payments pursuant to section 1.105–4(a)(3)(i) of the Income Tax Regulations is 60 and 55 years, respectively, with 20 years of service.

Where an employee is retired for disability after 15 years of service, but will not meet the 20 year service requirement before he reaches the compulsory retirement age of 65, retirement age for excluding disability annuity payment is 65 years.

Advice has been requested as to the time at which, under the retirement plan described below, employees reach retirement age for the purpose of determining when the exclusion from gross income of disability pension benefits is no longer applicable. Under the retirement plan of *N* company employees are not required to make contributions. Notice of the plan benefits is printed in a handbook furnished all employees.

The plan provides (a) that any male employee who has reached the age of 60 years, and whose term of employment has been 20 or more years, or any female employee who has reached the age of 55 years, and whose term of employment has been 20 or more years shall, if he or she requests, or may at the discretion of the company retirement committee, be retired from active service and, upon such retirement, shall be granted a service pension.

The plan provides (b) that any employee whose term of employment has been 30 years or more or any male employee who has reached the age of 55 and whose term of employment has been 25 or more years, or any female employee who has reached the age of 50 years and whose term of employment has been 25 or more years may, if the case is approved by the committee as appropriate for such retirement, be retired from active service and, upon such retirement, be granted a service pension.

The plan provides (c) that any employee who has become totally disabled, (nonservice-connected disability) and whose term of employment has been 15 years or more, shall upon retirement by reason of such disability be granted a pension, provided that if, at the time of such retirement the employee is qualified for a service pension, a service pension shall be granted instead of a disability pension. A disability pension shall continue so long as the employee is prevented by such disability from resuming active service with the company. If the employee recovers sufficiently to resume active service, the disability pension shall be discontinued and if the employee reenters the service of the company at that time, the period of absence on disability pension shall be considered as a leave of absence and not as a break in the continuity of the employee's service.

The annual pension allowance for each employee retired with a pension on account of age, length of service or disability shall be for each year of his term of employment one percent of the average annual pay during the ten years immediately preceding retirement, provided, however, that the committee may at its discretion base such pension upon the average annual pay of the ten consecutive years of

service during which the retired employee was paid the highest rate of wages. The minimum pension, except in cases covered by (b) shall be $100 per month for a person who has attained age 65 and $75 per month for one who has not yet attained age 65.

With an exception that is not here pertinent every officer or employee becoming 65 years of age shall retire at the end of the month in which that age is reached.

Under the administration of the pension provisions of the plan, an employee who is retired for disability but, by reason of his term of employment and/or age, receives a service pension, subsequently recovers before attaining age 65, and wishes to return to work will, upon approval of the company doctor and those authorized to approve employment, be permitted to reenter the service of the company. Upon his reentering the company's service, the service pension payments are discontinued. The time absent is treated as a leave of absence without credit for time absent and upon restoration to the payroll, the employee is given immediate credit for service accrued prior to retirement. Any additional service accrued between date of reentering the service and date the employee again retires is added to the prior service and is credited in computing the ultimate pension rate. The policy of the company with respect to a pensioner reentering service is the same for an employee retired with a service pension granted under (b) above because of the proviso in (c) and an employee retired with a disability pension granted under the first provision of (c).

Section 105(d) of the Code provides that wages or payments in lieu of wages received by an employee pursuant to the provisions of a wage continuation plan for a period during which the employee is absent from work on account of personal injuries or sickness are excludable from gross income subject to the limitations stated in that section.

Section 1.105–4(a) of the Income Tax Regulations provides that section 105(d) is applicable only if the wages or payments in lieu of wages are paid pursuant to a wage continuation plan. A wage continuation plan includes plans under which payments are continued as long as the employee is absent from work on account of personal injury or sickness and plans under which benefits are continued until the employee either is able to return to work or reaches retirement age. 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 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 employee receives under this plan before he reaches retirement age. Section 105(d) does not apply to the payments which such an employee receives after he reaches retirement age.

Revenue Ruling 57–76, C. B. 1957–1, 66, provides that retirement age will be deemed to be the lowest age specified in the appropriate written employee's pension or annuity plan at which the employee, had he not been disabled and had he continued in such employment, would have had the right to retire without the consent of the employer and receive retirement benefits based on service to date of retirement computed at the full rate set forth in the plan *i. e.*, without actuarial or similar reduction because of retirement before some later specified age, provided, however, that such retirement age cor-

responds with the employer's actual practice and is reasonable in view of all the pertinent facts and circumstances.

Under the plan herein described the lowest age at which a male employee can be retired, without consent of the company is age 60 and a female employee is age 55 with 20 years or more of service. Therefore, a male employee will reach normal retirement age when he is 60 years of age and has had 20 years or more of service and a female employee will reach normal retirement age when she is 55 years of age and has had 20 years or more of service. Where an employee is retired for disability after 15 years of service, but will not meet the 20 year service requirement before he reaches the compulsory retirement age of 65, retirement age for excluding disability annuity payment is 65 years.

Accordingly, the payments which an employee of the *N* company receives under the wage continuation plan prior to the time such employee reaches normal retirement age may be excluded from his or her gross income to the extent provided in section 105(d) of the Code.

(Also Section 3401; 31.3401(d)-1.) Rev. Rul. 58-599

A member of the Armed Forces on the retired list for physical disability is no longer "absent from work" for purposes of the exclusion provided in section 105(d) of the Internal Revenue Code of 1954, when he performs services as an employee of the United States, whether such services are performed in the same department or in another department, agency or branch of the United States Government.

Revenue Ruling 57-178, C. B. 1957-1, 71, and Revenue Ruling 58-43, C. B. 1958-1, 45, clarified.

In view of the provisions of Revenue Rulings 58-43, C. B. 1958-1, 45, and 57-178, C. B. 1957-1, 71, advice has been requested with respect to the right to an exclusion, for purposes of section 105(d) of the Internal Revenue Code of 1954, of a member of the Armed Forces on the retired list for physical disability who performs services as an employee of the United States either in the same department or in another department, agency or branch of the United States Government.

Revenue Ruling 58-43, *supra*, provides, in part, as follows:

The provisions of section 402 of the Career Compensation Act of 1949 * * * and chapter 61 of Title 10 of the United States Code constitute wage continuation plans for the purpose of section 1.105-4(a)(3)(i) of the Income Tax Regulations. The disability retirement pay received by a member on the retired list pursuant to those provisions which is in excess of the amount excluded under section 104(a)(4) of the Code may be excluded from gross income to the extent provided in section 105(d) of the Code if received before the member reaches retirement age. * * *

The last paragraph of Revenue Ruling 57-178, *supra*, provides, in part, as follows:

* * * an employee who is receiving a disability pension excludable from gross income subject to the limitations provided in section 105(d) of the Code, may be engaged in a gainful occupation as a self-employed individual or as an employee of another employer without affecting the tax treatment of his disability pension. However, such a course of conduct is a factor in determining whether the employee's absence was due to personal injury or sickness, or to some other reason.

Section 1.105–4(a) of the Income Tax Regulations requires that the employee be in fact absent from work on account of personal injury or sickness in order to qualify for the exclusion under section 105(d) of the Code. That section provides, in part, as follows:

> (2) (ii) Section 105(d) is applicable if, and only if, the employee is absent from work and such absence is due to a personal injury or sickness. Thus, if an employer has a plan for continuing the wages of employees when they are absent from work, regardless of the cause of the absence from work, section 105(d) is applicable to any payments made under this plan to an employee whose absence from work is in fact due to a personal injury or sickness. * * *
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> (4) A period of absence from work shall commence the moment the employee first becomes absent from work and shall end the moment the employee first returns to work. However, the exclusion provided under section 105(d) is applicable only to payments attributable to a period of absence from work which is due to a personal injury or sickness, * * *.

The fact that an employer continues a disability pension in ignorance or disregard of an employee's recovery from injury or sickness is not in itself sufficient to entitle the employee to the exclusion. Despite the terms of a plan, section 105(d) of the Code does not apply to a pension which is paid irrespective of disability. For example, if an employee retires and under a plan receives a so-called disability pension, but in fact the employee is not disabled or has fully recovered from such disability, section 105(d) of the Code will not apply to the so-called disability pension. In this connection, however, a member of the Armed Forces would generally be in a different situation from that of the normal civilian employee since he does not necessarily receive a disability pension because of a physical inability to continue working. Such member may be fully capable of civilian employment but unfit to perform the duties of his office, grade, rank or rating within the meaning of section 402 of the Career Compensation Act of 1949, 37 U. S. C. 272, and chapter 61 of Title 10 of the United States Code, Supp. V.

Accordingly, a member of the Armed Forces on the retired list for physical disability may be engaged in a gainful occupation as a self-employed individual or as an employee of another employer without affecting the tax treatment of his disability pension. Such course of conduct would not be a factor in determining whether his absence was due to a personal injury or sickness, or to some other reason, within the meaning of Revenue Ruling 57–178, *supra*.

However, section 1.105–4(a)(5) of the regulations provides, in part, as follows:

> * * * An employee is not absent from work when he performs any services for his employer at his usual place or places of employment, whether or not the services are the usual services performed by the employee. Furthermore, the employee is not absent from work when he performs substantial services for his employer, even though they are performed at a place other than his usual place of employment. * * *

While the power of appointment with respect to officers and employees in the Government of the United States (other than that specifically reserved to the President by the Constitution) is vested by the Congress in the President, in the courts of law, or in the heads

of the departments and independent establishments (Article II, section 2, paragraph 2 of the Constitution; section 169 of the Revised Statutes, as amended, 5 U. S. C. 43), the relationship of employer and employee is between the United States and the individual so appointed. See 24 Comp. Gen. 104, and section 31.3401(d)-1(d) of the Employment Tax Regulations.

Therefore a member of the Armed Forces on the retired list for physical disability is no longer "absent from work," for purposes of the exclusion provided in section 105(d) of the Code, when he performs services as an employee of the United States whether such services are performed in the same department or in another department, agency or branch of the United States Government.

SECTION 108.—INCOME FROM DISCHARGE OF INDEBTEDNESS

26 CFR 1.108-1: Income from discharge of indebtedness.

Exclusion from gross income of income realized by the elimination of past due interest upon the nontaxable exchange of bonds. See Rev. Rul. 58-546, page 143.

SECTION 111.—RECOVERY OF BAD DEBTS, FROM TAXES, AND DELINQUENCY AMOUNTS

26 CFR 1.111-1: Recovery of certain items previously deducted or credited.

Past due interest on bonds which was eliminated in a nontaxable exchange. See Rev. Rul. 58-546, page 143.

SECTION 117.—SCHOLARSHIP AND FELLOWSHIP GRANTS

26 CFR 1.117-1: Exclusion of amounts received as a scholarship or fellowship grant. (Also Section 61; 1.61-2.) Rev. Rul. 58-498

> Stipends granted by the National Science Foundation to high school and college science teachers, including fees and allowances for incidental expenses, to attend a Summer Institute for Science sponsored by it, during the summer months for the taxable year constitute scholarships and fellowship grants, and are excludable from the gross income of the grantee either wholly or in part, depending on whether the individual grantee is or is not a candidate for a degree.

Advice has been requested regarding the treatment, for Federal income tax purposes, of stipends granted to high school and college science teachers during the summer months by the National Science Foundation to enable them to attend a Summer Institute for Science.

The National Science Foundation is an independent Government agency established for the purpose of promoting the progress of science. During the taxable year in question, a number of grants were made for the support of Summer Institutes for high school and college teachers of science and mathematics. One college conducted a six-weeks' course from June 30 to August 8 in the Biological Sciences, the Physical Sciences and Mathematics. The Institute paid $75 per week to each of the participants, plus $15 per week for each dependent up to a maximum of four, as a family allowance, plus tuition and other fees. Provision was also made for travel expenses and for a single round trip from the participant's home to the college. Most of the teachers took the courses for credit toward a Master's degree. These stipends are awarded by the Institute in the form of grants from the Foundation for the purpose of giving teachers an opportunity to improve their subject-matter knowledge and for intellectual stimulation during their free summer periods; and the grantees do not incur any independent obligation to any educational institution by accepting the stipends.

Section 117 of the Internal Revenue Code of 1954 excludes from gross income any amount received by an individual as a scholarship at an educational institution or as a fellowship grant. If the grantee is not a candidate for a degree, the exclusion is permitted if the grantor is an organization described in section 117(b)(2)(A) of the Code. The extent of exclusion allowed noncandidates in any taxable year is limited to an amount equal to $300 multiplied by the number of months for which benefits were received under the scholarship or fellowship grant during the taxable year, up to a total of 36 months, whether consecutive or not.

Under section 1.117–3 of the Income Tax Regulations, the terms "scholarship and fellowship grant" include the value of services and accommodations received—room, board and laundry—as well as the amount of tuition, matriculation, and other fees which are furnished or remitted to a student to aid him in pursuing his studies, and applies also to any payments covering expenses for incidental travel for the grantee and his family, and to any amount received in the nature of a family allowance.

In the case of those teachers attending the Summer Institute for Science who were working toward a degree, the total amount of stipends received under the grant from the National Science Foundation is excludable from their gross income. Inasmuch as the Foundation is an agency of the Federal government (an organization described in section 117(b)(2)(A) of the Code), those teachers who were not working toward a degree may exclude from gross income the amount of stipends received subject to the limitation of $300 multiplied by the number of months for which the benefits were received during the taxable year. No exclusion is allowable beyond a total of 36 months whether the benefits were received in consecutive months or not. To the extent that such stipends received by the grantees under the program exceeded these limitations as to amount and as to time, amounts received during the taxable year must be included in the gross income of the grantees under section 61 of the Code. Laboratory fees, tuition

and other fees as well as an allowance for dependents paid by the Foundation are included within the concept of scholarships and fellowship grants, and hence, must be included in computing the total amount of the grant.

Accordingly, it is held that stipends granted to high school and college science teachers including fees and allowances for incidental expenses, to attend a Summer Institute for science during the summer months of the taxable year by the National Science Foundation constitutes scholarships and fellowship grants, and are excludable from the gross income of the grantee either wholly or in part, depending on whether the grantee is or is not a candidate for a degree. It is also held that amounts received by them which are specifically designated to cover expenses for travel (including meals and lodging while traveling and an allowance for travel of the teacher's family), research, clerical help, or equipment, are incident to the grants and are excludable under section 117(a)(2) of the Code to the extent that such amounts are actually expended for these purposes. These allowances are not taken into account for purposes of the $300 per month limitation in the case of a teacher who is not a candidate for a degree.

Value of room and board furnished by accredited schools of nursing to student nurses. See Rev. Rul. 58–338, page 54.

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26 CFR 1.117–4: Items not considered as scholarships or fellowship grants. (Also Sections 61, 151, 152; 1.61–1, 1.151–3, 1.152–1.) Rev. Rul. 58–403

Educational benefits received by the taxpayer's minor son under the United States Navy's educational assistance program are not excludable from the son's gross income as a scholarship where the son is obligated to render the Navy services as an employee for a stipulated period upon graduation.

The value of such benefits must be considered by the taxpayer in determining whether he has contributed more than one-half of his son's support in order to claim a dependency deduction.

Advice has been requested whether educational benefits received by a taxpayer's minor son under the United States Navy's educational assistance program are excludable from the son's gross income as a scholarship where the son is obligated to render the Navy services as an employee for a stipulated period upon graduation; also, whether the value of such benefits is to be considered by the taxpayer in determining if he has contributed more than one half of his son's support, in order to claim a dependency deduction.

Following a competitive examination in the spring of 1957, the taxpayer's minor son was selected for employment at a Navy research laboratory. In the fall of that year he was granted leave without pay to attend college for an education in science, the Navy paying his tuition, laboratory and miscellaneous fees, and furnishing the necessary books. To qualify for this financial support, the son was required to sign a statement agreeing to continue in the employment of the Navy for a period of one year for each year of training assistance provided.

By the terms of the grant, if he refused to abide by this provision, he would have to refund the amount of tuition and fees paid on his behalf.

Section 61(a)(1) of the Internal Revenue Code of 1954 defines gross income as "all income from whatever source derived" and includes within that definition "compensation for services, including fees, commissions, and similar items." This section, however, is subject to the provisions of section 117(a)(1) of the Code which excludes from gross income any amount received as a scholarship at an educational institution.

Section 1.117-4(c) of the Income Tax Regulations provides that any amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research are not considered scholarship or fellowship grants if such amounts represent compensation for past, present, or future employment services.

The arrangement between the taxpayer's son and the United States Navy is a contract of employment and because the son is obligated to render services to the Navy, the amounts received on his behalf and for his education constitute compensation for services. See Revenue Ruling 57-484, C. B. 1957-2, 113.

Under the provisions of section 151(e) of the Code, a taxpayer may claim an exemption of $600 for a dependent son regardless of the amount of the son's gross income if the latter is a student and, as set forth in section 152 of the Code, provided the taxpayer has furnished more than one-half of his son's support during the calendar year. In determining whether the taxpayer does furnish more than one-half of his son's support and may claim him as a dependent, the son's income from all sources spent for his support must be considered. The term "support" generally includes such items of expenses as the cost of board, lodging, clothing, education, medical and dental care, and other similar expenses. In the instant case the payments made by the Navy for tuition, fees, and books must be taken into account in determining the total cost of the son's support. See I. T. 3834, C. B. 1947-1, 29.

Accordingly, it is held that educational benefits received by the taxpayer's minor son under the United States Navy's educational assistance program are not excludable from the son's gross income as a scholarship where the son is obligated to render the Navy employment services for a stipulated period upon graduation. It is also held that the value of such benefits must be considered by the taxpayer in determining whether he has contributed more than one-half of his son's support in order to claim a dependency deduction.

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

26 CFR 1.119-1: Meals or lodging furnished for the convenience of the employer. Rev. Rul. 58-545

Officers at Federal prisons who are charged for their living quarters on prison premises and for meals required to be taken in the prison employees' dining room during duty periods must include their entire salaries in gross income without deduction for

the amounts charged to them for such meals and lodging. However, since the meals and lodging are furnished on the prison premises for the convenience of the employer and the employees are required to accept lodging on such premises as a condition of their employment, the difference between the amount charged and the fair market value of such meals and lodging is excludable from the employees' gross income.

Advice has been requested concerning the deductibility, for Federal income tax purposes, of payments by certain employees of Federal prisons for meals and lodging.

A number of officers of various Federal prisons are required to live on the prison reservations in order that they may be immediately available in the event of emergency. The rentals for the living quarters are charged to the employees concerned and, while not nominal, are usually somewhat less than would be paid for similar accommodations elsewhere. Because of the hazards involved and the complexity of inspection requirements, employees may not bring lunches with them, but are required to take their meals during duty periods, for which they pay a nominal charge, in the dining room operated by the Federal penal and correctional institution.

The general rule is that all income is includible in gross income subject to Federal income tax unless it is specifically excluded by law. Section 119 of the Internal Revenue Code of 1954 provides, in part, that there shall be excluded from the gross income of an employee the value of any meals or lodging furnished to him by his employer for the convenience of the employer, but only if, in the case of meals, they are furnished on the business premises of the employer, or, in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

Section 1.119–1(c)(2) of the Income Tax Regulations provides, in part, that the exclusion provided by section 119 of the Code applies only to meals and lodging furnished in kind, without charge or cost to the employee. If the employee has an option to receive additional compensation in lieu of meals or lodging in kind or is required to reimburse the employer for meals or lodging furnished in kind, the value of such meals and lodging is not excluded from gross income.

In view of the above, it is held that officers at Federal prisons who are charged for their living quarters on prison premises and for meals required to be taken in the prison employees' dining room during duty periods must include their entire salaries in gross income without deduction for the amounts charged to them for such meals and lodging However, since the meals and lodging are furnished on the prison premises for the convenience of the employer, and the employees are required to accept the lodging on such premises as a condition of their employment, it is also held that where the employee reimburses the employer in an amount less than the fair market value of such meals and lodging, the difference between such fair market value and the amount reimbursed is excludable from the employee's gross income.

SECTION 120.—STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE

26 CFR 1.120–1: Statutory subsistence allowance received by police. T. D. 6318[1]

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

Amendment of regulations under section 120 of the Internal Revenue Code of 1954, relating to statutory subsistence allowance of policemen.

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 Income Tax Regulations (26 CFR Part 1) to the decisions of *U. S.* v. *W. J. and Cleopatra Shirah*, (1958) 253 F. 2d 798, and *J. W. and Leona Parrish* v. *U. S.*, (1958) 158 F. Supp. 238, and to section 3 of the Technical Amendments Act of 1958 [C. B. 1958–3, 254], such regulations are amended as follows:

PARAGRAPH 1. Section 1.120 of the Income Tax Regulations (26 CFR 1.120) [T. D. 6220, C. B. 1957–1, 34] is amended by adding at the end thereof the following historical note:

§ 1.120 STATUTORY PROVISIONS; STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE. * * *
[Section 120 repealed by sec. 3 of the Technical Amendments Act of 1958 (72 Stat. 1607)]

PAR. 2. Section 1.120–1 of the Income Tax Regulations (26 CFR 1.120–1) is amended by revising paragraph (a) and by adding a new paragraph (d), as follows:

§ 1.120–1. STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE.—(a) Section 120 excludes from the gross income of an individual employed as a police official by a State, Territory, or possession of the United States, by any of their political subdivisions, or by the District of Columbia, any amount received as a statutory subsistence allowance to the extent that such allowance does not exceed $5 per day. For purposes of this section, the term "statutory subsistence allowance" means an amount which is designated as a subsistence allowance under the laws of a State, a Territory, or a possession of the United States, any political subdivision of any of the foregoing, or the District of Columbia and which is paid to an individual who is employed as a police official of such governmental unit. A subsistence allowance paid to a police official by any of the foregoing governmental units which is not so provided by statute may not be excluded from gross income under the provisions of section 120. The term "police official" includes an employee of any of the foregoing governmental units who has police duties, such as a sheriff, a detective, a policeman, or a State police trooper, however designated.

* * * * * * *

(d) In the case of taxable years ending after September 30, 1958, section 120 and this section do not apply to amounts received as a statutory subsistence allowance for any day after September 30, 1958.

Because this Treasury Decision consists of only liberalizing amendments to existing regulations and an amendment necessitated by the repeal of section 120 by section 3 of the Technical Amendments Act of 1958, it is found that it is unnecessary to issue this Treasury Deci-

[1] 23 F. R. 7532.

sion 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 such 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).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved September 23, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 26, 1958, 8:50 a. m., and published in the issue of the Federal Register for September 27, 1958, 23 F. R. 7532.)

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 151.—ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS

26 CFR 1.151-2: Additional exemptions for dependents.

Student nurses in attendance at accredited schools of nursing. See Rev. Rul. 58-338, page 54.

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26 CFR 1.151-3: Definitions.

Exemption deduction for taxpayer's son receiving educational benefits included in son's gross income. See Rev. Rul. 58-403, page 49.

SECTION 152.—DEPENDENT DEFINED

26 CFR 1.152-1: General definition of a dependent. T. D. 6304 [1]

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

Regulations relating to the measurement of support in dependency cases 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 May 20, 1958, a notice of proposed rule making regarding an amendment to those provisions of the Income Tax Regulations under section 152 of the Internal Revenue Code of 1954 relating to the measurement of support in dependency cases was published in the Federal Register (23 F. R. 3403). After consideration of all such relevant

[1] 23 F. R. 6554.

matter as was presented by interested persons regarding the rules proposed, such rules are hereby adopted.

The Income Tax Regulations (26 CFR Part 1) are amended by deleting the last two sentences of paragraph (a)(2)(i) of section 1.152–1 [T. D. 6231, C. B. 1957–1, 77] and by inserting in lieu thereof the following:

> Generally, the amount of an item of support will be the amount of expense incurred by the one furnishing such item. If the item of support furnished an individual is in the form of property or lodging, it will be necessary to measure the amount of such item of support in terms of its fair market value.

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

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved August 19, 1958.

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

(Filed by the Division of the Federal Register on August 22, 1958, 8:51 a. m., and published in the issue of the Federal Register for August 23, 1958, 23 F. R. 6554.)

(Also Sections 117, 151; 1.117–1, 1.151–2.)

Rev. Rul. 58–338

> The value of room and board furnished by accredited schools of nursing to full-time student nurses, a part of whose training consists of performing services in the hospital, constitutes amounts received as scholarships under section 117 of the Internal Revenue Code of 1954. The value of such accommodations should be disregarded in determining whether student nurses received more than one-half of their support from the parent for the purpose of determining a personal exemption allowance.

Advice has been requested whether the value of room and board received by individuals who are full-time student nurses at accredited schools of nursing constitutes amounts received as scholarships and, if so, whether such value should be disregarded in determining whether any such student nurse received more than one-half of her support from the taxpayer for the purpose of determining a personal exemption allowance.

A student nurse may attend a hospital school of nursing which awards only the certificate of registered nurse at the end of a three-year course, or she may enter an educational institution granting degrees for the purpose of obtaining such a degree as Bachelor of Science in nursing, as well as the Registered Nurse certificate, at the end of a four-year course. As a part of the program towards educating the student nurse, either for the certificate or the degree, the hospital or the university utilizes separate facilities for the purpose of maintaining a regular faculty and established curriculum where an organized body of student nurses are in attendance. Other parts of the program towards the acquisition of the Bachelor of Science degree and/or the Registered Nurse certificate require the student

nurse to be present and perform services, at times individually, at other times in small groups, in various parts of the hospital where clinical activities are carried on. In order to allow the student nurse to be available at any time for the performance of such services, she is furnished with room and board at the hospital.

Section 117(a)(1)(A) of the Internal Revenue Code of 1954 excludes from gross income any amount received as a scholarship at an educational institution, with certain limitations not here material.

The term "educational institution" for the purposes of section 117, 151 and 152 of the Code means only an educational institution which normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where its educational activities are carried on. An accredited school of nursing maintained by a hospital and approved and registered by a state board for registration of nurses is an educational institution within the meaning of the Code sections cited above.

Section 1.117-3(a) of the Income Tax Regulations provides that a "scholarship" generally means an amount paid or allowed to, or for the benefit of, a student, whether an undergraduate or a graduate, to aid him in pursuing his studies. The term includes the value of contributed services and accommodations such as room, board, laundry, tuition and other fees which are furnished or remitted to a student to aid him in pursuing his studies.

Section 1.117-3(e) of the regulations states, in part, that a student who receives a scholarship for study at a secondary school or other educational institution is considered to be a "candidate for a degree." Such secondary schools do not grant "degrees" but do award diplomas or certificates upon completion of certain curricula. However, an amount awarded to a student at a secondary school on the basis of need, merit or other objective criteria, is considered a scholarship within the general concept of that term.

Section 1.117-2(a)(2) of the regulations provides that if teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition for receiving the degree, such teaching, research, or other services on the part of the recipient of a scholarship or fellowship grant who is a candidate for such degree shall not be regarded as part-time employment within the meaning of this paragraph.

Section 151(e) of the Code provides for an exemption of $600 for each dependent who is a child of the taxpayer and has not reached the age of 19, or who is a student.

Section 152(a) of the Code defines a "dependent" to include a son, daughter, stepson or stepdaughter of the taxpayer who, during the calendar year in which the taxable year of the taxpayer begins, has received more than one-half of his support from the taxpayer.

The term "student" as defined by section 151(e)(4) of the regulations includes an individual who is a full-time student at an educational institution during each of five calendar months during the calendar year in which the taxable year of the taxpayer begins. As used here, the term taxpayer refers to the taxpayer claiming the individual as a dependent.

Section 152(d) of the Code provides a special support test applicable in the case of students. For purposes of section 152(a), in the

case of an individual who is a son, stepson, daughter or stepdaughter of the taxpayer and is a student (within the meaning of section 151(e)(4)), amounts received as scholarships for study at an educational institution shall not be taken into account in determining whether such individual received more than half of his support from the taxpayer.

Since the services which all student nurses perform in hospitals are the necessary and only means whereby the student nurse can obtain the practical training required in her future work as a registered nurse and since such services are required by all such candidates, the value of the room and board received by the student nurses is not compensatory in nature but constitutes amounts received as scholarships.

Accordingly, it is held that the value of room and board furnished by accredited schools of nursing to full-time student nurses, a part of whose training consists of performing services in the hospital, constitutes amounts received as scholarships under section 117 of the Code. The value of such accommodations should be disregarded in determining whether the student nurses received more than one-half of their support from the parent for the purpose of determining a personal exemption allowance.

Rev. Rul. 58–404

The year in which the support was received and not the year of payment of the indebtedness incurred therefor is controlling in determining whether over half of the support of an individual was received from the taxpayer, regardless of the method of reporting income and disbursements used by the taxpayer in computing his taxable income. This holding does not govern the question of when a deductible support item is deductible under a taxpayer's method of reporting income.

Advice has been requested as to the taxable year in which an exemption may be claimed based on liabilities incurred in supporting a dependent in one year which were not paid until a subsequent year.

The taxpayer's dependent son entered his senior year of college in September, 1956. The taxpayer, by arrangement with the college, postponed the payment of his son's fall semester 1956 tuition and board until January of 1957. Thus, the taxpayer paid in January, 1957, the college expenses which would ordinarily have been due and payable in advance in September, 1956. The taxpayer uses the cash receipts and disbursements method of accounting in computing his income for Federal income tax purposes.

Section 151(e) of the Internal Revenue Code of 1954 provides, in part, for an exemption for each dependent (as defined in section 152 of the Code) who is a child of the taxpayer and is a student. The term "dependent" as defined in section 152 of the Code includes a son, or daughter of the taxpayer, over half of whose support was received from the taxpayer for the calendar year in which the taxable year of the taxpayer begins.

The term "support" includes education. In construing the language of section 152 of the Code, it cannot be said that payment in 1957 of indebtedness incurred in supporting an individual during 1956 constitutes an amount contributed toward support for 1957.

Accordingly, it is held that the year in which the support was received and not the year of payment of the indebtedness incurred

therefor is controlling in determining whether "over half" of the support of an individual "was received from the taxpayer," regardless of the method of reporting income and disbursements used by the taxpayer in computing his taxable income. This holding does not govern the question of when a deductible support item is deductible under a taxpayer's method of reporting income.

(Also Section 37; 1.37–4.) Rev. Rul. 58–419

The amount of insurance benefit to which a wife is entitled each month, under section 202(b) of Title II of the Social Security Act, as amended, 42 U. S. C. 402(b), equals one-half of the old-age insurance benefit of her husband for such month, except as provided in section 202(q) of the Act. Where the wife's insurance benefit and the old-age insurance benefit of her husband are received monthly through one check made payable to them jointly, for the total amount of their respective monthly benefits, and such payments are used for their support, the separate amount attributable to each must be taken into consideration in determining the amount of support furnished to each of them for purposes of determining whether such person qualifies as a dependent under section 152 of the Internal Revenue Code of 1954.

This rule is also applicable for the purpose of computing retirement income credit, under section 37 of the Code, of taxpayers receiving retirement income.

Advice has been requested concerning the attribution to a husband and wife of social security payments, for dependency or retirement income credit purposes, where such payments are received through one check made payable to them jointly.

Section 202(b) of Title II of the Social Security Act, as amended, 42 U. S. C. 402(b), provides for a wife's insurance benefit under certain conditions. Such benefits to the wife are usually received each month, along with the old-age insurance benefit of her husband through one check made payable to them jointly for the total amount of their respective monthly benefits. In this case, the payments were used by the husband and wife for their support. Since a son also contributed toward their support, he inquires as to the attribution to each parent of the benefits received by them through one joint check for the purpose of determining whether he furnished over half of the support of each parent for the year involved.

Section 202(b) of Title II of the Social Security Act, as amended, *supra*, provides in part, as follows:

(b) WIFE'S INSURANCE BENEFITS.

* * * * * * *

(2) Except as provided in subsection (q) of this section, such wife's insurance benefit for each month shall be equal to one-half of the old-age insurance benefit of her husband for each month.

Whether the amount the wife is entitled to receive is obtained in a separate check or whether it is combined in one joint check with the amount due to be received by the husband does not affect her right to receive the amount as determined by section 202(b) of the Social Security Act. This is also true as to the amount to be received by the husband.

Under section 152 of the Internal Revenue Code of 1954, a taxpayer may claim a qualified individual as a dependent provided that he

furnished over half of the support of such individual for the year involved. In computing the amount which is contributed for the support of the individual, there must be included any amount which is contributed by such individual for his own support, including amounts which are ordinarily excludable from gross income such as social security payments. In the instant case, where the wife's insurance benefit and the old-age insurance benefit of her husband were received by them through one check made payable to them jointly, the attribution of such payments as determined above must be taken into consideration in determining the amount of support furnished to each of them for purposes of determining whether such person qualifies as a dependent under section 152.

Under section 37 of the Code, a taxpayer may receive an income tax credit on any qualified retirement income received by him. The retirement income on which this credit is allowed is limited to $1,200. However, under section 37(d)(1) amounts received as a pension or annuity under title II of the Social Security Act must reduce the $1,200 limitation. Where a husband and wife receive monthly social security payments through one check made payable to them jointly for the total amount of their respective monthly benefits, the attribution of such payments as determined above must be taken into consideration in determining the amount required to reduce the $1,200 limitation for each of them in the event they receive retirement income.

Accordingly, it is held that where a wife's insurance benefit and the old-age insurance benefit of her husband are received by them monthly through one check made payable to them jointly, for the total amount of their respective monthly benefits, and such payments are used for their support, the separate amount attributable to each under section 202(b)(2) of the Social Security Act must be taken into consideration in determining the amount of support furnished to each of them for purposes of determining whether such person qualifies as a dependent under section 152 of the Code.

This rule is also applicable for the purpose of computing the retirement income credit, under section 37 of the Code, of taxpayers receiving retirement income.

Taxpayer's son receiving educational benefits included in son's gross income. See Rev. Rul. 58–403, page 49.

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26 CFR 1.152–2: Rules relating to general definition of dependent. Rev. Rul. 58–381

A citizen and resident of American Samoa, a possession of the United States, does not qualify as a dependent for Federal income tax purposes.

Advice has been requested whether an exemption may be claimed by an individual taxpayer on his Federal income tax return with respect to an individual who is a citizen and resident of American Samoa, a possession of the United States.

Section 152(b)(3) of the Internal Revenue Code of 1954 states, in part, "The term 'dependent' does not include any individual who is

not a citizen of the United States unless such individual is a resident of the United States, of a country contiguous to the United States, of the Canal Zone, or of the Republic of Panama."

Section 308 of the Immigration and Nationality Act, 8 U. S. C. 1408, states in connection with the determination of the stauts of individuals born in an outlying possession of the United States, such as American Samoa (8 U.S.C. 1101 (29)) that, unless otherwise provided in section 301 of the above-named Act, the following shall be nationals, but not citizens of the United States at birth:

> (1) A person born in an outlying possession of the United States on or after the date of formal acquisition of such possession;
> (2) A person born outside the United States and its outlying possessions of parents both of whom are nationals, but not citizens, of the United States and have had a residence in the United States, or one of its outlying possessions prior to the birth of such person.

The term "United States" when used in the geographical sense is defined in section 7701(a)(9) of the Code as including only the States, the Territories of Alaska and Hawaii, and the District of Columbia. Possessions of the United States are not included in this definition.

Accordingly, a citizen and resident of American Samoa, a possession of the United States, has the status of a national but not a citizen of the United States. He can not qualify as a dependent for Federal income tax purposes.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

SECTION 162.—TRADE OR BUSINESS EXPENSES

Rev. Rul. 58–382

A taxpayer, employed as a flight agent, is required by his employer to hold an Airline Transport Pilot Certificate and a current medical certificate. A medical examination, required before the employee can receive the certificate, must be taken twice a year at his own expense. The failure of the employee to secure the medical certificate would result in the termination of his employment. *Held*, under the circumstances in the instant case, the cost to an employee of securing periodic, routine, physical examinations sufficient to establish his physical fitness to retain his position may be deducted as ordinary and necessary business expenses under section 162(a) of the Internal Revenue Code of 1954. However, any additional expenses incurred by an employee for the purpose of securing medical aid or physical correction required to enable him to maintain the physical fitness necessary to retain his position may not be claimed as a business expense, but only as a medical expense deduction within the limitations of section 213 of the Code. See O. D. 1032, C. B. 5, 172 (1921), holding that amounts expended by a professional singer for required treatments by a throat specialist was a personal expense, rather than an ordinary or necessary business expense, and nondeductible, and *Madge H. Evans* v. *Commissioner*, Board of Tax Appeals Memorandum Opinion, entered March 8, 1939, holding that the cost of a necessary tonsillectomy was likewise not deductible by a motion picture actress.

26 CFR 1.162–1: Business expenses. Rev. Rul. 58–479
(Also Section 1441, 1.1441–2.)

Payments as commissions by a marine supplier to masters, or other personnel, of "tramp steamers" of foreign country registry where normal, usual, and customary in the industry, appropriate and helpful in obtaining business, and with the knowledge and consent of the ship owner, constitute ordinary and necessary expenses, under the provisions of section 162(a) of the Internal Revenue Code of 1954.

Such payments are subject to income tax withholding under section 1441 of the Code.

O. D. 907, C. B. 4, 232 (1921); S. M. 975, C. B. 1, 184 (1919); and G. C. M. 21575, C. B. 1939–2, 172, revoked.

Advice has been requested (1) whether amounts paid by marine suppliers as commissions to various personnel of ships of foreign registry are deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code of 1954; and (2) whether such amounts are subject to income tax withholding under section 1441 of the Code.

The taxpayer, a marine supplier, otherwise known as a "ship chandler," operates such business at a seaport of the United States. The taxpayer services both American and foreign ships with supplies. It is the taxpayer's practice, with respect to "tramp steamers" of foreign registry, to pay commissions to the masters of such ships in return for the placing of orders with the taxpayer. Under this practice, the shipmaster arranges for supplies with a particular ship chandler, and after such supplies are placed aboard ship, receives a pre-arranged percentage of the supply invoice, in cash, as a commission, for his sole benefit, from the ship chandler. The ship owners are aware of such practice.

Section 162 of the Code provides in part:

(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, including—

In interpreting the requirement that an expense be ordinary and necessary in order to be deductible 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 *Thomas H. Welch* v. *Helvering*, 290 U. S. 111, Ct. D. 755, C. B. XII–2, 112 (1933); and *Pearl E. Deputy et al.* v. *Pierre S. duPont*, 308 U. S. 488, Ct. D. 1435, C. B. 1940–1, 118. Where an expense qualifies as ordinary and necessary, deduction will not be denied unless the payment of such expense frustrates sharply defined national or state policy. See *Thomas B. Lilly* v. *Commissioner*, 343 U. S. 90, Ct. D. 1741, C. B. 1952–1, 16.

Section 1441(a) of the Code provides for the withholding of tax equal to 30 percent of any income items specified in subsection (b) of that section received by a nonresident alien individual to the extent that such items constitute gross income from sources within the

United States. Items which constitute such gross income are enumerated in subsection (b) in part, as follows:

(b) INCOME ITEMS.—The items of income referred to in subsection (a) are * * *, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, * * *.

O. D. 907, C. B. 4, 232 (1921) holds that a commission paid on account of a single transaction does not constitute fixed or determinable annual or periodical income.

S. M. 975, C. B. 1, 184 (1919) holds that the winnings of horses at a racetrack are not fixed or determinable annual or periodical income subject to the withholding of tax.

G. C. M. 21575, C. B. 1939–2, 172, holds that prizes awarded to nonresident alien artists for the best pictures exhibited in the United States do not come within the meaning of fixed or determinable annual or periodical income and are not, therefore, subject to the withholding of tax.

Section 1.1441–2(a) of the Income Tax Regulations provides that the term "fixed or determinable annual or periodical" income is merely descriptive of a class of income. The fact that an item is paid in a lump sum or in repeated payments is immaterial so long as such item falls within the class of income contemplated by the statute. Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. In *Commissioner* v. *Pelham G. Wodehouse*, 337 U. S. 369, Ct. D. 1722, C. B. 1949–2, 62, the Supreme Court of the United States, in determining that a single payment to a nonresident alien author for publication rights to a story constituted income subject to the withholding of tax under section 143(b) of the Internal Revenue Code of 1939 (now section 1441 of the 1954 Code), stated:

Fixed and determinable income, from a tax standpoint, may be received either in annual or other payments without altering in the least the need or the reasons for taxing such income or for withholding a part of it at its source. One advance payment to cover the entire 28-year period of a copyright comes within the reason and reach of the Revenue Act as well as, or even better than, two or more partial payments of the same sum.

Similarly, in *Sax Rohmer et ux.* v. *Commissioner*, 153 Fed. (2d) 61, certiorari denied, 328 U. S. 862, it was held that a lump-sum payment for publication rights, made to a nonresident alien, constituted fixed or determinable annual or periodical income from sources within the United States.

The transactions involved in O. D. 907, S. M. 975, and G. C. M. 21575, *supra*, to the extent that they relate to what constitutes fixed or determinable annual or periodical income, are now considered to be, for Federal income tax purposes, within the meaning of the *Wodehouse* and the *Rohmer* decisions, *supra*.

The facts in the instant case indicate that the payment of the commissions in question is a trade custom practiced for over 100 years. Such custom prevails not only in all of the larger coastal ports of the United States but also throughout the world. The practice is such a standard procedure that a shipmaster denied the commission by one

ship chandler will take his business elsewhere. The practice is known to the ship owners and is recognized as a legitimate means of supplementing the relatively small salary of the foreign shipmaster. See *Frank J. Valetti et ux.* v. *Commissioner*, 28 T. C. 692 acquiescence, page 8, this Bulletin; *Eugene Richardson et al.* v. *Commissioner*, T. C. Memo 1957–122; *Alexander Fiambolis et ux.* v. *United States*, 152 Fed. Supp. 10.

Accordingly, it is held that payments as commissions by a marine supplier to masters or other personnel of "tramp steamers" of foreign country registry, where normal, usual, and customary in the industry, appropriate and helpful in obtaining business, and with the knowledge and consent of the ship owners, are deductible as ordinary and necessary business expenses under the provisions of section 162(a) of the Code.

Such amounts paid to shipmasters or to other personnel are subject to the withholding of Federal income tax under section 1441 of the Code.

Pursuant to the authority contained in section 7805(b) of the Code, this Revenue Ruling will be applied prospectively only, beginning November 1, 1958, with respect to the withholding of tax on amounts so paid to shipmasters or to other ship personnel.

The application of the provisions of any of the bilateral tax conventions to which the United States is a party to the recipient of such commissions will be determined by the facts existing in the particular case.

O. D. 907, S. M. 975, and G. C. M. 21575, *supra*, are hereby revoked.

Rev. Rul. 58–480

Where the terms of an insurance policy provide that the benefit payments to be made are for loss of income, dismemberment, or loss of life, but do not specifically provide that the payments under the contract are to reimburse the policyholder for certain business overhead expenses incurred by him during a period of disability due to injury or sickness, the premiums paid on such a policy do not constitute business expenses and are not deductible under section 162 of the Internal Revenue Code of 1954.

Advice has been requested whether premiums on the disability insurance policy described below may be considered as business expenses deductible under section 162 of the Internal Revenue Code of 1954.

The insurance policy in question is called a noncancellable income protector policy. The policy provides for payments to be made to the policyholder of monthly income for partial or total disability from accidental injury, monthly income for total disability from sickness, and payment for accidental death or dismemberment, to the extent specified in the policy. The policy does not contain any provisions which expressly state that the benefits payable shall be the monthly expenses actually incurred by the insured in the normal operation of his business.

The question of whether or not premiums paid on an insurance policy are deductible as a business expense depends upon the terms of the policy. In Revenue Ruling 55–264, C. B. 1955–1, 11, it is held that

where a taxpayer purchases an insurance policy which, in accordance with its terms, would reimburse the taxpayer, to the extent specified in the policy, for certain business overhead expenses incurred by him during prolonged periods of disability due to injury or sickness, any premiums paid on such policy constitute business expenses and are deductible under section 23(a) of the Internal Revenue Code of 1939 or section 162 of the Internal Revenue Code of 1954. Thus, in Revenue Ruling 55–264, *supra*, the expense benefits payable under the policy shall be the monthly expenses actually incurred in the operation of the business. The instant policy, however, relates to a wholly different insurance contract. Its provisions closely parallel those described in Revenue Ruling 55–331, C. B. 1955–1, 271, which holds that the premiums paid by an individual for his personal disability insurance which would, in part, replace income lost by reason of the loss of, or loss of the use of, a portion of the body, do not constitute business expenses and are not deductible for Federal income-tax purposes.

In view of the above, it is held that where the terms of an insurance policy provide that the benefit payments to be made are for loss of income, dismemberment, or loss of life, but do not specifically provide that the payments under the contract are to reimburse the policyholder for certain business overhead expenses incurred by him during a period of disability due to injury or sickness, the premiums paid on such a policy do not constitute business expenses and are not deductible under section 162 of the Code.

Rev. Rul. 58–525

Amounts paid secretly to an officer of a savings and loan association for his influence in the granting of loans by the association are not allowable deductions, as ordinary and necessary trade or business expenses, under section 162 of the Internal Revenue Code of 1954.

Advice has been requested as to the applicability of the deduction provisions of section 162 of the Internal Revenue Code of 1954 to amounts expended to influence the granting of loans.

The taxpayer made cash payments to one of the officers of a savings and loan association in a secret manner for his influence in arranging loans to the taxpayer by the association. The officer was without authorization from the association to receive such payments. The payments were recorded on the books of the taxpayer as charges to loan financing.

Section 162 of the Code 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, * * *.

Even where an expense may be assumed to be necessary in the sense that it is appropriate or helpful in the development of the taxpayer's business, to qualify as a business deduction for Federal income tax purposes, the expense must also be ordinary. See *Thomas H. Welch* v. *Helvering*, 290 U. S. 111, Ct. D. 755, C. B. XII–2, 112

(1933). In interpreting the requirement that an expense be ordinary and necessary in order to be deductible for Federal income tax purposes, the word "ordinary" has consistently been given the connotation of normal, usual, or customary. The transaction which gives rise to such expense must be of common or frequent occurrence in the type of business involved. See *Deputy* v. *Pierre S. du Pont*, 308 U. S. 488, Ct. D. 1435, C. B. 1940–1, 118.

The instant payments having been paid secretly, the receipt of which was unauthorized, the nature thereof is other than normal, usual, and customary in the business in which the taxpayer is engaged.

Accordingly, it is held that amounts paid secretly to an officer of a savings and loan association for his influence in the granting of loans by the association are not allowable deductions, as ordinary and necessary trade or business expenses, under section 162 of the Code.

Amounts paid to a nonprofit corporation organized by a group of taxpayers to provide marine and radio telephone service for them. See Rev. Rul. 58–534, page 125.

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26 CFR 1.162–17: Reporting and substantiation of traveling and other business expenses of employees. T. D. 6306[1]

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

Amendment of regulations prescribed under section 162 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 March 12, 1958, notice of proposed rule making regarding the regulations for taxable years beginning after December 31, 1957, relating to the reporting and substantiation of traveling and other business expenses, was published in the Federal Register (23 F. R. 1698) as Part 19 of 26 CFR. No requests for a public hearing were received. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted by amending the Income Tax Regulations (26 CFR Part 1) under section 162 of the Internal Revenue Code of 1954, relating to trade or business expenses, which were issued as Treasury Decision 6291 (23 F. R. 2244), approved April 3, 1958 [C. B. 1958–1, 63], as follows:

PARAGRAPH 1. Section 1.162–2 is amended by adding immediately after paragraph (e) thereof the following new paragraph:

(f) For rules with respect to the reporting and substantiation of traveling and other business expenses of employees for taxable years beginning after December 31, 1957, see § 1.162–17.

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[1] 23 F. R. 6665.

PAR. 2. There is added immediately after § 1.162–16 the following new section:

§ 1.162–17 REPORTING AND SUBSTANTIATION OF TRAVELING AND OTHER BUSINESS EXPENSES OF EMPLOYEES.—(a) *Introductory.*—The purpose of the regulations in this section is to provide 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 an employee and to furnish guidance as to the type of records which will be useful in compiling such information and in its substantiation, if required. The rules prescribed in this regulation do not apply to expenses paid or incurred for incidentals, such as office supplies for the employer or local transportation in connection with an errand. Employees incurring such incidental expenses are not required to provide substantiation for such amounts. The term "ordinary and necessary business expenses" means only those expenses which are ordinary and necessary in the conduct of the taxpayer's business and are directly attributable to such business. The term does not include nondeductible personal, living or family expenses.

(b) *Expenses for which the employee is required to account to his employer.*—(1) *Reimbursements equal to expenses.*—The employee need not report on his tax return (either itemized or in total amount) expenses for travel, transportation, entertainment, and similar purposes paid or incurred by him solely for the benefit of his employer for which he is required to account and does account to his employer and which are charged directly or indirectly to the employer (for example, through credit cards) or for which the employee is paid through advances, reimbursements, or otherwise, provided the total amount of such advances, reimbursements, and charges is equal to such expenses. In such a case the taxpayer need only state in his return that the total of amounts charged directly or indirectly to his employer through credit cards or otherwise and received from the employer as advances or reimbursements did not exceed the ordinary and necessary business expenses paid or incurred by the employee.

(2) *Reimbursements in excess of expenses.*—In case the total of amounts charged directly or indirectly to the employer and received from the employer as advances, reimbursements, or otherwise, exceeds the ordinary and necessary business expenses paid or incurred by the employee and the employee is required to and does account to his employer for such expenses, the taxpayer must include such excess in income and state on his return that he has done so.

(3) *Expenses in excess of reimbursements.*—If the employee's ordinary and necessary business expenses exceed the total of the amounts charged directly or indirectly to the employer and received from the employer as advances, reimbursements, or otherwise, and the employee is required to and does account to his employer for such expenses, the taxpayer may make the statement in his return required by subparagraph (1) of this paragraph unless he wishes to claim a deduction for such excess. If, however, he wishes to secure a deduction for such excess, he must submit a statement showing the following information as part of his tax return:

(i) The total of any charges paid or borne by the employer and of any other amounts received from the employer for payment of expenses, whether by means of advances, reimbursements, or otherwise; and

(ii) The nature of his occupation, the number of days away from home on business, and the total amount of ordinary and necessary business expenses paid or incurred by him (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses.

(4) To "account" to his employer as used in this section means to submit an expense account or other required written statement to the employer showing the business nature and the amount of all the employee's expenses (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses. For this purpose, 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.

(c) *Expenses for which the employee is not required to account to his employer.*—If the employee is not required to account to his employer for his ordinary and necessary business expenses, e. g., travel, transportation, entertainment, and similar items, or, though required, fails to account for such expenses, he must submit, as a part of his tax return, a statement showing the following information:

(1) The total of all amounts received as advances or reimbursements from his employer in connection with the ordinary and necessary business expenses of the employee, including amounts charged directly or indirectly to the employer through credit cards or otherwise; and

(2) The nature of his occupation, the number of days away from home on business, and the total amount of ordinary and necessary business expenses paid or incurred by him (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses.

(d) *Substantiation of items of expense.*—(1) Although the Commissioner may require any taxpayer to substantiate such information concerning expense accounts as may appear to be pertinent in determining tax liability, taxpayers ordinarily will not be called upon to substantiate expense account information except those in the following categories:

(i) A taxpayer who is not required to account to his employer, or who does not account;

(ii) A taxpayer whose expenses exceed the total of amounts charged to his employer and amounts received through advances, reimbursements or otherwise and who claims a deduction on his return for such excess;

(iii) A taxpayer who is related to his employer within the meaning of section 267 (b); and

(iv) Other taxpayers in cases where it is determined that the accounting procedures used by the employer for the reporting and substantiation of expenses by employees are not adequate.

(2) The Internal Revenue Code contemplates that taxpayers keep such records as will be sufficient to enable the Commissioner to correctly determine income tax liability. Accordingly, it is to the advantage of taxpayers who may be called upon to substantiate expense account information to maintain as adequate and detailed records of travel, transportation, entertainment, and similar business expenses as practical since the burden of proof is upon the taxpayer to show that such expenses were not only paid or incurred but also that they constitute ordinary and necessary business expenses. One method for substantiating expenses incurred by an employee in connection with his employment is through the preparation of a daily diary or record of expenditures, maintained in sufficient detail to enable him to readily identify the amount and nature of any expenditure, and the preservation of supporting documents, especially in connection with large or exceptional expenditures. Nevertheless, it is recognized that by reason of the nature of certain expenses or the circumstances under which they are incurred, it is often difficult for an employee to maintain detailed records or to preserve supporting documents for all his expenses. Detailed records of small expenditures incurred in traveling or for transportation, as for example, tips, will not be required.

(3) Where records are incomplete or documentary proof is unavailable, it may be possible to establish the amount of the expenditures by approximations based upon reliable secondary sources of information and collateral evidence. For example, in connection with an item of traveling expense a taxpayer might establish that he was in a travel status a certain number of days but that it was impracticable for him to establish the details of all his various items of travel expense. In such a case rail fares or plane fares can usually be ascertained with exactness and automobile costs approximated on the basis of mileage covered. A reasonable approximation of meals and lodging might be based upon receipted hotel bills or upon average daily rates for such accommodations and meals prevailing in the particular community for comparable accommoda-

tions. Since detailed records of incidental items are not required, deductions for these items may be based upon a reasonable approximation. In cases where a taxpayer is called upon to substantiate expense account information, the burden is on the taxpayer to establish that the amounts claimed as a deduction are reasonably accurate and constitute ordinary and necessary business expenses paid or incurred by him in connection with his trade or business. In connection with the determination of factual matters of this type, due consideration will be given to the reasonableness of the stated expenditures for the claimed purposes in relation to the taxpayer's circumstances (such as his income and the nature of his occupation), to the reliability and accuracy of records in connection with other items more readily lending themselves to detailed record-keeping, and to all of the facts and circumstances in the particular case.

(e) *Prior regulations.*—The provisions of the regulations in this section are supplemental to existing regulations relating to information required to be submitted with income tax returns, and shall be applicable with respect to taxable years beginning after December 31, 1957, notwithstanding any existing regulation to the contrary.

(This Treasury Decision is issued under the authority contained in sections 6001 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 731, 917; 26 U. S. C. 6001, 7805).

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved August 22, 1958.

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

(Filed by the Division of the Federal Register on Aug. 27, 1958, 8:50 A. M., and published in the issue of the Federal Register for Aug. 28, 1958, 23 F. R. 6665.)

Rev. Rul. 58–453

An employee who pays or incurs ordinary and necessary business expenses for travel (including meals and lodging) and transportation for which he is paid a fixed mileage allowance or a per diem allowance in lieu of subsistence at rates not in excess of 125 percent of the maximum mileage rates or per diem 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 Income Tax Regulations.

Advice has been requested as to the circumstances under which mileage allowances for travel and per diem allowances in lieu of subsistence paid by an employer to his employee while in travel status will be approved by the Commissioner, in the exercise of his discretion provided in section 1.162–17(b)(4) of the Income Tax Regulations, as constituting reasonable business practices which will be regarded as equivalent to an accounting by the employee to his employer for purposes of section 1.162–17(b) of such regulations.

An extensive study has been made of the rates of mileage allowances and per diem allowances in lieu of subsistence paid employees by a substantial number of employers, including States and municipalities, and the method of accounting for these allowances required of the employees by such employers. On the basis of this study, it has been administratively determined that for purposes of section

1.162–17(b) of the Income Tax Regulations 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 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 such regulations.

The maximum mileage allowance on a fixed scale authorized to be paid by the Federal Government for use of a personal automobile on official travel is 10 cents per mile and the maximum per diem allowance on a fixed scale in lieu of subsistence authorized to be paid while traveling within the continental United States is $12.00 per day. Accordingly, it is held that for purposes of section 1.162–17(b) of the Income Tax Regulations an employee will be deemed to have been required to account to his employer in cases where the rates of mileage allowance or per diem allowance in lieu of subsistence paid by the employer are not in excess of 12½ cents per mile and $15.00 per day, respectively. Whenever the maximum mileage and/or per diem allowance authorized to be paid by the Federal Government is changed, the 12½ cents per mile and/or $15.00 per day will likewise at such time be adjusted to 125 percent of the changed amount.

The maximum per diem allowance in lieu of subsistence authorized to be paid by the Federal Government while traveling outside the continental United States varies depending upon the locality. For purposes of computing the maximum rates of per diem allowance in lieu of subsistence paid an employee by his employer for which the employee will be deemed to have been required to account to his employer, see 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, incorporated in this ruling by reference thereto.

If per diem allowances and mileage allowances paid by a particular employer do not fall within the scope of this revenue ruling, the presence of unusual circumstances which account for the variation may, nevertheless, constitute grounds for considering the employees of such an employer to be treated as though they accounted to the employer for their business expenses. In such a case the employer should direct a request to the Commissioner of Internal Revenue, Attention: Tax Rulings Division, Washington 25, D. C., setting 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. The burden will be upon the employer in all such cases to establish to the satisfaction of the Commissioner the reasonableness of the allowances paid under the special circumstances involved. It should be understood that the payment of per diem allowances and mileage allowances by an employer in amounts greater than those specified herein will not, in and of itself, constitute an unusual circumstance and, therefore, requests based solely on such circumstance will not be approved.

Rev. Rul. 58–453
Supplement I

Revenue Ruling 58–453, 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. See also Supplements II and III, pages 71 and 74 of this Bulletin.

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

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Changed rates, identified by asterisk, are effective November 8, 1957.

Locality	Maximum per diem rates
Aden	$11.00
Afghanistan	6.00
Alaska	17.00
Albania	10.00
*Algeria	15.00
American Samoa	11.00
*Andorra	8.00
Anglo-Egyptian Sudan (See Sudan)	
Angola	11.00
Argentina	9.00
Australia	
Melbourne	11.00
Sydney	11.00
Other	9.00
Austria	10.00
Basutoland	8.00
Bachuanaland	8.00
Belgian Congo	13.00
Belgium	14.00
Bermuda	17.00
Bolivia	13.00
Bonin Islands	6.00
Brazil	15.00
British Guiana	10.00
*British Honduras	16.00
British Somaliland	7.00
*British West Indies	
*Bahamas	
(May–Nov. incl.)	16.00
(Dec–Apr. incl.)	20.00
Jamaica	
(Apr.–Nov. incl.)	12.00
(Dec.–Mar. incl.)	18.00
British West Indies—Con.	
*Trinidad	$15.00
Other	10.00
Bulgaria	14.00
Burma	
Rangoon	13.00
Other	6.00
Cambodia	12.00
*Cameroun [1]	11.00
Canada	15.00
Canton Island	15.00
*Ceylon	12.00
Chile	13.00
China	
Taipei	13.00
Other	9.00
Colombia	11.00
Costa Rica	13.00
Cuba	
Havana	
(Apr.–Nov. incl.)	15.00
(Dec.–Mar. incl.)	20.00
Other	15.00
*Cyprus	9.00
Czechoslovakia	17.00
Denmark	12.00
Dominican Republic	
(Apr. 16–Dec. 15 incl.)	16.00
(Dec. 16–Apr. 15 incl.)	20.00
Ecuador	
Guayaquil	15.00
Other	10.00
Egypt	12.00
El Salvador	14.00

[1] Formerly called French Cameroons.

Locality	Maximum per diem rates
Eritrea	$10.00
Estonia	16.00
Ethiopia	10.00
Fiji Islands	7.00
Finland	11.00
*France	
*Boulogne sur Seine	15.00
*Foret de St. Germaine	15.00
*Garches	15.00
*Paris	15.00
*Rueil Malmaison	15.00
*Suresnes	15.00
*Versailles	15.00
*Other	11.00
*French Equatorial Africa	11.00
*French Guiana	11.00
French Morocco (See Morocco)	
*French Somaliland	9.00
*French West Africa	
*Senegal	16.00
*Other	13.00
French West Indies	13.00
Gambia	7.00
Germany	
Saarland	12.00
Other	11.00
*Ghana	15.00
Gibraltar	7.00
Gozo	9.00
Great Britain and North Ireland: London including Middlesex County, Bushey Hall, and Denham	12.00
Other	10.00
Greece	9.00
Greenland	6.00
Guam	15.00
Guatemala	14.00
Haiti	
Cap-Haitien	11.00
Port-au-Prince	14.00
Other	8.00
Hawaii	16.00
Honduras	12.00
Hong Kong	13.00
Hungary	6.00
Iceland	13.00
India	
Calcutta	12.00
New Delhi	12.00
Other	9.00
Indonesia	11.00
Iran	11.00
*Iraq	14.00
Ireland	10.00
Israel	14.00

Locality	Maximum per diem rates
*Italy	
*Rome	$15.00
Other	12.00
Iwo Jima	6.00
Japan	14.00
Jerusalem (Palestine)	14.00
Jordan	10.00
Kenya	9.00
Korea	
Seoul	20.00
Other	6.00
*Kuwait	12.00
Laos	15.00
Latvia	16.00
Lebanon	12.00
Liberia	
Monrovia	18.00
Other	8.00
Libya	
Tripoli	11.00
Wheelus Field	11.00
Other	6.00
Liechtenstein	12.00
Lithuania	16.00
Luxembourg	12.00
*Madagascar	13.00
*Malaya	10.00
Malta	9.00
Mexico	9.00
Midway	15.00
*Morocco	14.00
Mozambique	10.00
Nepal	9.00
Netherlands	11.00
Netherlands West Indies	15.00
*New Caledonia	11.00
New Zealand	9.00
Nicaragua	13.00
Nigeria	
Lagos	14.00
Other	8.00
Norway	12.00
Nyasaland	6.00
*Pakistan	11.00
Panama, including Canal Zone	13.00
Paraguay	7.00
Peru	13.00
Philippines	
Manila	16.00
Other	10.00
Poland	
Poznam	9.00
Other	6.00
Portugal	
Azores	7.00
Madeira Islands	7.00
Other	11.00
Portuguese Guinea	10.00
Puerto Rico	18.00

Locality	Maximum per diem rates
Rhodesia, Northern	$8.00
Rhodesia, Southern	9.00
Rumania	13.00
Ryukyu Islands	6.00
Saarland (See Germany)	
Saudi Arabia	
Jidda	19.00
Other	16.00
Sierra Leone	7.00
*Singapore	16.00
Southwest Africa	8.00
Spain	
Canary Islands	6.00
Other	10.00
Spanish Morocco (See Morocco)	
Spanish Sahara	7.00
Sudan	10.00
Surinam	12.00
Swaziland	8.00
Sweden	12.00
Switzerland	12.00
Syria	10.00
Tanganyika	8.00
Tangier International Zone (See Morocco)	
Thailand	
Bangkok	$14.00
Other	8.00
*Togo	9.00
*Trust Territories	
*Somaliland	12.00
The Pacific Islands	11.00
*Tunisia	13.00
*Turkey	
*Istanbul	14.00
*Other	11.00
Uganda	7.00
Union of South Africa	9.00
Union of Soviet Socialist Republics	16.00
Uruguay	13.00
Vatican City	12.00
Venezuela	20.00
Viet-Nam	16.00
Virgin Islands	
(May-Nov. incl.)	20.00
(Dec.–Apr. incl.)	30.00
Wake	15.00
Yugoslavia	7.00
Zanzibar	7.00
Other localities	9.00

Rev. Rul. 58–453
Supplement II

Revenue Ruling 58–453, relating to certain fixed mileage allowances or per diem allowances received by employes, 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 source, are published as a supplement to Revenue Ruling 58–453, and may be amended or supplemented from time to time. See also Supplements I and III, pages 69 and 74 of this Bulletin.

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

* * * * * * *

Changed rates, identified by asterisk, are effective June 1, 1958.

Locality	Maximum per diem rates
*Aden	$13.00
Afghanistan	6.00
Alaska	17.00
Albania	10.00
Algeria	15.00
American Samoa	11.00
Andorra	8.00
Anglo-Egyptian Sudan (See Sudan)	
Angola	11.00
Argentina	9.00
*Australia	
*Melbourne	14.00
*Sydney	14.00
*Other	10.00
*Austria	12.00
Basutoland	8.00
Bechuanaland	8.00
Belgian Congo	13.00
*Belgium [1]	
*Brussels	20.00
*Other	16.00
Bermuda	17.00
Bolivia	13.00
Bonin Islands	6.00
Brazil	15.00
British Guiana	10.00
British Honduras	16.00
British Somaliland	7.00
British West Indies	
Bahamas	
(May–Nov. incl.)	16.00
(Dec.–Apr. incl.)	20.00
Jamaica	
(Apr.–Nov. incl.)	12.00
(Dec.–Mar. incl.)	18.00
Trinidad	15.00
Other	10.00
Bulgaria	14.00
*Burma	
*Mandalay	12.00
*Rangoon	16.00
Other	6.00
Cambodia	12.00
*Cameroun	17.00
Canada	15.00
Canton Island	15.00
Ceylon	12.00
Chile	13.00
China	
Taipei	13.00
Other	9.00
*Colombia	12.00
Costa Rica	13.00
*Cuba	
*Havana	
*(Apr.–Nov. incl.)	$16.00
*(Dec.–Mar. incl.)	22.00
Other	15.00
Cyprus	9.00
*Czechoslovakia	15.00
Denmark	12.00
Dominican Republic	
(Apr. 16–Dec. 15 incl.)	16.00
(Dec. 16–Apr. 15 incl.)	20.00
Ecuador	
Guayaquil	15.00
Other	10.00
Egypt	12.00
El Salvador	14.00
Eritrea	10.00
Estonia	16.00
Ethiopia	10.00
Fiji Islands	7.00
*Finland	12.00
France	
Boulogne sur Seine	15.00
Foret de St. Germaine	15.00
Garches	15.00
Paris	15.00
Rueil Malmaison	15.00
Suresnes	15.00
Versailles	15.00
Other	11.00
French Equatorial Africa	11.00
French Guiana	11.00
French Morocco (See Morocco)	
French Somaliland	9.00
*French West Africa	
*Abidjan	20.00
Senegal	16.00
Other	13.00
French West Indies	13.00
Gambia	7.00
Germany	
Saarland	12.00
Other	11.00
Ghana	15.00
Gibraltar	7.00
Gozo	9.00
*Great Britain and North Ireland:	
*London including Middlesex County, Bushey Hall, and Denham	14.00
*Other	12.00

[1] Revised rates apply through October 1958; thereafter the country rate of $14 is reinstated.

Locality	Maximum per diem rates
Greece	$9.00
Greenland	6.00
Guam	15.00
Guatemala	14.00
Haiti	
Cap-Haitien	11.00
Port-au-Prince	14.00
Other	8.00
Hawaii	16.00
Honduras	12.00
Hong Kong	13.00
Hungary	6.00
*Iceland	15.00
*India	
*Calcutta	17.00
*New Delhi	13.00
Other	9.00
Indonesia	11.00
Iran	11.00
Iraq	14.00
Ireland	10.00
Israel	14.00
Italy	
Rome	15.00
Other	12.00
Iwo Jima	6.00
Japan	14.00
Jerusalem (Palestine)	14.00
Jordan	10.00
Kenya	9.00
Korea	
Seoul	20.00
Other	6.00
Kuwait	12.00
Laos	15.00
Latvia	16.00
Lebanon	12.00
Liberia	
Monrovia	18.00
Other	8.00
*Libya	11.00
Liechtenstein	12.00
Lithuania	16.00
Luxembourg	12.00
Madagascar	13.00
Malaya	10.00
Malta	9.00
*Mexico	
*Cuidad Juarez, Ensenada, Matamoros, Mexicali, Mexico, D. F., Monterrey, Nogales, Nuevo Laredo, Piedras Negras, and Tijuana	12.00
Other	9.00
Midway	15.00
Morocco	14.00
Mozambique	10.00
*Nepal	11.00
Netherlands	11.00
Netherlands West Indies	$15.00
New Caledonia	11.00
New Zealand	9.00
*Nicaragua	14.00
Nigeria	
Lagos	14.00
Other	8.00
Norway	12.00
Nyasaland	6.00
Pakistan	11.00
Panama, including Canal Zone	13.00
Paraguay	7.00
Peru	13.00
*Philippines	
Manila	16.00
*Other	12.00
Poland	
Poznam	9.00
Other	6.00
Portugal	
Azores	7.00
Madeira Islands	7.00
Other	11.00
Portuguese Guinea	10.00
Puerto Rico	18.00
Rhodesia, Northern	8.00
Rhodesia, Southern	9.00
Rumania	13.00
Ryukyu Islands	6.00
Saarland	
(See Germany)	
Saudi Arabia	
Jidda	19.00
Other	16.00
Sierra Leone	7.00
Singapore	16.00
Southwest Africa	8.00
Spain	
Canary Islands	6.00
Other	10.00
Spanish Morocco	
(See Morocco)	
Spanish Sahara	7.00
Sudan	10.00
Surinam	12.00
Swaziland	8.00
Sweden	12.00
Switzerland	12.00
Syria	10.00
Tanganyika	8.00
Tangier International Zone (See Morocco)	
*Thailand	
*Bangkok	18.00
Other	8.00
Togo	9.00
Trust Territories	
Somaliland	12.00
The Pacific Islands	11.00
Tunisia	3.00

Locality	Maximum per diem rates
Turkey	
Istanbul	$14.00
Other	11.00
Uganda	7.00
Union of South Africa	9.00
Union of Soviet Socialist Republics	16.00
Uruguay	3.00
Vatican City	2.00
*Venezuela	$2.00
Viet-Nam	6.00
Virgin Islands	
(May–Nov. incl.)	20.00
(Dec.–Apr. incl.)	30.00
Wake	15.00
Yugoslavia	7.00
Zanzibar	7.00
Other localities	9.00

Rev. Rul. 58–453 Supplement III

Revenue Ruling 58–453, 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. See also Supplements I and II, pages 69 and 71 of this Bulletin.

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 October 1, 1958.

Locality	Maximum per diem rates
Aden	$13.00
Afghanistan	6.00
Alaska	17.00
Albania	10.00
Algeria	15.00
American Samoa	11.00
Andorra	8.00
Anglo-Egyptian Sudan (See Sudan)	
Angola	11.00
*Argentina	12.00
Australia	
Melbourne	14.00
Sydney	14.00
Other	10.00
Austria	12.00
Basutoland	8.00
Bechuanaland	8.00
*Belgian Congo	14.00
Belgium [1]	
Brussels	$20.00
Other	16.00
*Bermuda	20.00
Bolivia	13.00
Bonin Islands	6.00
Brazil	15.00
British Guiana	10.00
British Honduras	16.00
British Somaliland	7.00
British West Indies	
Bahamas	
(May-Nov. incl.)	16.00
(Dec.-Apr. incl.)	20.00
Jamaica	
(Apr.-Nov. incl.)	12.00
(Dec.-Mar. incl.)	18.00
Trinidad	15.00
Other	10.00

[1] These rates apply through October 1958; thereafter the country rate of $14 is reinstated.

Locality	Maximum per diem rates
Bulgaria	$14.00
Burma	
Mandalay	12.00
Rangoon	16.00
Other	6.00
Cambodia	12.00
Cameroun	17.00
Canada	15.00
Canton Island	15.00
Ceylon	12.00
Chile	13.00
China	
Taipei	13.00
Other	9.00
Colombia	12.00
*Costa Rica	15.00
Cuba	
Havana	
(Apr.–Nov. incl.)	16.00
(Dec.–Mar. incl.)	22.00
Other	15.00
Cyprus	9.00
Czechoslovakia	15.00
Denmark	12.00
*Dominican Republic	
*Ciudad Trujillo	
(Apr. 16–Dec. 15 incl.)	16.00
(Dec. 16–Apr. 15 incl.)	20.00
*Other	11.00
Ecuador	
Guayaquil	15.00
Other	10.00
Egypt	12.00
*El Salvador	20.00
Eritrea	10.00
Estonia	16.00
Ethiopia	10.00
*Fiji Islands	10.00
Finland	12.00
*France	
Paris	15.00
Suresnes	15.00
Other	11.00
French Equatorial Africa	11.00
French Guiana	11.00
French Morocco	
(See Morocco)	
French Somaliland	9.00
French West Africa	
Abidjan	20.00
Senegal	16.00
Other	13.00
French West Indies	13.00
Gambia	7.00
Germany	
Saarland	12.00
Other	11.00
Ghana	15.00
Gibralter	7.00
Gozo	9.00

Locality	Maximum per diem rates
*Great Britain and North Ireland:	
London including Middlesex County, Bushey Hall, and Denham	$14.00
*Other	12.00
*Greece	11.00
Greenland	6.00
Guam	15.00
Guatemala	14.00
Haiti	
Cap-Haitien	11.00
Port-au-Prince	14.00
Other	8.00
Hawaii	16.00
Honduras	12.00
*Hong Kong	14.00
Hungary	6.00
Iceland	15.00
*India	
*Bombay	13.00
Calcutta	17.00
New Delhi	13.00
Other	9.00
Indonesia	11.00
Iran	11.00
Iraq	14.00
Ireland	10.00
Israel	14.00
Italy	
Rome	15.00
Other	12.00
Iwo Jima	6.00
Japan	14.00
Jerusalem (Palestine)	14.00
Jordan	10.00
Kenya	9.00
Korea	
Seoul	20.00
Other	6.00
Kuwait	12.00
Laos	15.00
Latvia	16.00
Lebanon	12.00
Liberia	
Monrovia	18.00
Other	8.00
Libya	11.00
Liechtenstein	12.00
Lithuania	16.00
*Luxembourg	14.00
Madagascar	13.00
Malaya	10.00
Malta	9.00
Mexico	
Cuidad Juarez, Ensenada, Matamoros, Mexicali, Mexico, D. F., Monterrey, Nogales, Neuvo Laredo, Piedras Negras, and Tijuana	12.00
Other	9.00

Locality	Maximum per diem rates
Midway	$15.00
Morocco	14.00
Mozambique	10.00
Nepal	11.00
*Netherlands	12.00
Netherlands West Indies	15.00
New Caledonia	11.00
New Zealand	9.00
Nicaragua	14.00
Nigeria	
Lagos	14.00
Other	8.00
Norway	12.00
Nyasaland	6.00
Pakistan	11.00
Panama, including Canal Zone	13.00
*Paraguay	11.00
Peru	13.00
Philippines	
Manila	16.00
Other	12.00
Poland	
Poznam	9.00
Other	6.00
*Portugal	
Azores	7.00
Madeira Islands	7.00
*Other	12.00
Portuguese Guinea	10.00
Puerto Rico	18.00
Rhodesia, Northern	8.00
*Rhodesia, Southern	13.00
Rumania	13.00
Ryukyu Islands	6.00
Saarland	
(See Germany)	
*Saudi Arabia	
*Jidda	14.00
*Other	11.00
Sierra Leone	7.00
Singapore	16.00
Southwest Africa	8.00
Spain	
Canary Islands	$6.00
Other	10.00
Spanish Morocco	
(See Morocco)	
Spanish Sahara	$7.00
Sudan	10.00
Surinam	12.00
Swaziland	8.00
Sweden	12.00
Switzerland	12.00
Syria	10.00
Tanganyika	8.00
Tangier International Zone	
(See Morocco)	
Thailand	
Bangkok	18.00
Other	8.00
Togo	9.00
Trust Territories	
Somaliland	12.00
The Pacific Islands	11.00
Tunisia	13.00
Turkey	
Istanbul	14.00
Other	11.00
Uganda	7.00
Union of South Africa	9.00
Union of Soviet Socialist Republics	16.00
Uruguay	13.00
Vatican City	12.00
Venezuela	22.00
*Viet-Nam	
*Saigon-Cholon Area	16.00
*Other	10.00
Virgin Islands	
(May–Nov. incl.)	20.00
(Dec.–Apr. incl.)	30.00
Wake	15.00
Yugoslavia	7.00
Zanzibar	7.00
Other localities	9.00

SECTION 164.—TAXES

26 CFR 1.164–1: Deduction for taxes. Rev. Rul. 58–454

The tax on sales of tangible personal property imposed by section 5 of the Florida Revenue Act of 1949, as amended, is a tax imposed upon the purchaser or consumer and is deductible under section 164(a) of the Internal Revenue Code of 1954, regardless of whether it is imposed with respect to property used in a trade or business. I. T. 3983, C. B. 1949–2, 31, modified.

Reconsideration has been given to I. T. 3983, C. B. 1949–2, 31, relating to the tax on sales of tangible personal property imposed by the State of Florida under section 5 of the Florida Revenue Act of 1949,

effective November 1, 1949, as amended (chapter 212, section 212.05, Florida Statutes, 1955).

I. T. 3983, *supra*, holds, in part, that the tax on sales of tangible personal property imposed by section 5 of the above Act is deductible by the persons engaged in the business of selling such property at retail. The tax collected from the purchasers must be included in the gross income of the retailers. To the extent that the tax is paid by the purchaser, otherwise than in connection with his trade or business, it is deductible by the purchaser except in the case of an individual who elects to take the optional standard deduction. Where such tax is paid in connection with a purchaser's trade or business, it is deductible by the purchaser as a business expense if the cost of the property is properly chargeable to expense. Such tax is to be treated as a capital item where the cost of the property is properly capitalized.

The Act, *supra*, provides, in part, as follows:

> Sec. 5. That it is hereby declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this State, or who rents or furnishes any of the things or services taxable under this Act, or who stores for use or consumption in this State any item or article of tangible personal property as defined herein and who leases or rents such property within the State of Florida. * * *

Subsequent to the publication of I. T. 3983, *supra*, decisions relating to the deductibility of the taxes were rendered by the Supreme Court of Florida in the cases of *C. E. Spencer et ux* v. *Mero*, 52 So. (2d) 679 and *Davis* v. *Ponte Vedra Club*, 78 So. (2d) 858. In the *Spencer* case the Court made the following statement:

> There is an ambiguity as to whether the tax is levied on the vendor or the vendee but it is clear that the law requires the vendor to bear the amount of the tax. The seller is required to collect it from the buyer. The buyer is liable for it. We conclude that it is a tax against the buyer. The seller is coerced to collect the tax and remit. To say that it is a tax on the seller is overcome by the fact that he is required to exact it of the purchaser. The spirit and intent of the law is that the purchaser, and not the seller, shall pay it.

In the *Ponte Vedra Club* case the Court commenting on the *Spencer* case stated as follows:

> The question as to who is to pay the tax, against whom the tax is levied, was set at rest by the Supreme Court in the case of *Spencer* v. *Mero*, 52 So. 2d 679. * * *

The court in the *Ponte Vedra Club* case added the following comment:

> The seller is merely an agent of the State who is charged with the duty of collecting the tax and any negligence or failure on his part to collect the tax from the purchaser does not relieve the tax paying purchaser from his tax liability. * * *

Accordingly, it is held that the tax on the sales of tangible personal property imposed by section 5 of the Florida Act of 1949, as amended, *supra*, is a tax imposed upon the purchaser or consumer and is deductible under section 164(a) of the Code, regardless of whether it is imposed with respect to property used in a trade or business. Thus, a corporate taxpayer may deduct the sales tax even though the cost of the property purchased is in the nature of a capital expenditure.

I. T. 3983, *supra*, is modified to the extent it is inconsistent with the conclusions expressed herein.

Rev. Rul. 58–463

The tax imposed by the City of Baltimore, Maryland, on cigarettes, cigars, smoking tobacco and chewing tobacco pursuant to section 69, article 37 of the Baltimore City Code, as amended, is deductible by persons or dealers who purchase the tax stamps and affix them to the packages or containers. The tax is not a retail sales tax deductible by the purchasers of the cigarettes or other tobacco items.

Advice has been requested whether the tax imposed by the City of Baltimore, Maryland, on cigarettes, cigars, smoking tobacco and chewing tobacco, under section 69 of article 37 of the Baltimore City Code (1950 Edition), as amended by Ordinance 900, effective January 1, 1954, is deductible for Federal income tax purposes as a retail sales tax.

Under the provisions of section 69 of article 37, as amended, *supra*, a tax is imposed by the City of Baltimore on all cigarettes, cigars, smoking tobacco and chewing tobacco possessed or held in that city by any person for sale on or after January 1, 1954. Under section 72(a) of article 37, *supra*, the tax is collected and paid by the purchase of stamps from the Baltimore city treasurer. The tax may also be paid by or through the use of metering machines, decalcomanias, or other devices in accordance with prescribed regulations. Each person, before selling or offering to sell any cigarettes in Baltimore, is required to purchase stamps from the city treasurer and affix the stamps to the smallest container of cigarettes to be sold to the consumer as evidencing payment of the tax imposed. Each dealer is required to affix to each container of cigarettes, cigars, smoking or chewing tobacco stamps purchased from the city treasurer evidencing payment of the tax imposed. The word "dealer" is defined in section 74 of article 37, *supra*, as any person engaged in the business of selling tobacco products. The word "person" is defined therein as including any individual, partnership, society, association, joint stock company, corporation, estate, receiver, trustee, assignee or any other person acting in a fiduciary or representative capacity, whether appointed by court or otherwise, and any combination of individuals. After the tax has once been paid and the stamps affixed by a vendor, no further tax is required to be paid or additional stamps affixed by a subsequent vendor.

Section 164(a) of the Internal Revenue Code of 1954 provides that, in computing taxable income, there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

Section 164(c)(1) of the Code relates to the deduction of retail sales taxes and gasoline taxes in computing taxable income. Such section provides that, in the case of any State or local sales tax, if the amount of the tax is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be allowed as a deduction to the consumer as if it constituted a tax imposed on, and paid by, such consumer.

Section 164(c)(2) of the Code provides that as used therein the term "State or local sales tax" means a tax imposed by a State, a Territory, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia, which tax (A) is

imposed on persons engaged in selling tangible personal property at retail (or on persons selling gasoline or other motor vehicle fuels at wholesale or retail) and is a stated sum per unit of property sold or is measured either by the gross sales price or by the gross receipts from the sale; or (B) is imposed on persons engaged in furnishing services at retail and is measured by the gross receipts for furnishing such services.

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.

Accordingly, it is held that the tax imposed by the City of Baltimore, Maryland, on cigarettes, cigars, smoking tobacco and chewing tobacco under the provisions of section 69 of article 37 of the Baltimore City Code, as amended, is deductible under section 164(a) of the Code by the persons or dealers who purchase and affix the tax stamps, or who impress the stamps to the packages or containers by means of a metering device or the use of decalcomanias and pay the tax due the City of Baltimore therefor. The tax is not a retail sales tax and, therefore, is not deductible by the purchasers of the cigarettes and other tobacco items under section 164(c) of the Code. Insofar as the ultimate consumer or purchaser is concerned, the tax represents an additional cost of the article and is not deductible in computing his taxable income.

(Also Section 62; 1.62–1.) Rev. Rul. 58–564

Treatment for Federal income tax purposes of the tax imposed by the Territory of Hawaii under section 117–14.6(b) of Chapter 117 of the Revised Laws of Hawaii, 1955, added by section 3, subsection (u) of Act 1 of the Special Session of 1957, effective July 1, 1957.

Advice has been requested as to the deductibility by consumers of the privilege tax imposed by the Territory of Hawaii under section 117–14.6(b) of Chapter 117 of the Revised Laws of Hawaii, 1955, section 3, subsection (u) of Act 1 of the Special Sesssion of 1957, effective July 1, 1957. Advice has also been requested whether the tax can be treated as a deductible business expense by the seller.

Section 3, subsection (u) of Act I of the Special Session of 1957, *supra*, amends Chapter 117 by inserting therein a new section, section 117–14.6, relating to a tax on certain retailing in the Territory of Hawaii.

Section 117–14.6(a) of Chapter 117 prescribes the types of retailing activities in the Territory of Hawaii subject to the tax and provides for certain exceptions not here material.

Section 117–14.6(b) provides that there is levied and shall be assessed and collected annually a privilege tax against persons engaging or continuing within the Territory in the retailing to which section 117–14.6 relates, on account of such retailing activities, as set forth in subsection (a) of section 117–14.6, equal to three and one-half percent of the gross proceeds of sale or gross income received or derived from such retailing. Persons on whom a tax is imposed by section 117–14.6 are called "retailers."

Section 117–14.6(c) provides, in general, that retailers subject to the tax shall be licensed.

Section 117–14.6(d) provides that no retailer shall advertise or hold out to the public in any manner, directly or indirectly, that the tax imposed by section 117–14.6 is not considered as an element in the price to be charged to the consumer; and that any person violating the provisions thereof shall be fined not more than $50.00 for each offense.

Section 117–14.6(e) provides, in general, that a retailer-taxpayer shall not be taxed in excess of three and one-half percent in respect of any item of his gross income.

Subsection (a) of section 20 of Act I of the Special Session of 1957, *supra*, provides, among other things, that section 117–14.6 of Chapter 117 of the Revised Laws of Hawaii shall take effect July 1, 1957, and shall apply to taxes accruing on and after that date.

Section 164(a) of the Internal Revenue Code of 1954 provides that, in computing taxable income, there shall be allowed as a deduction taxes paid or accrued within the taxable year with certain exceptions not here material.

Section 164(c)(1) of the Code relates to the deduction of retail sales taxes and gasoline taxes in computing taxable income. Such section provides that, in the case of any State or local sales tax, if the amount of the tax is separately stated, then, to the extent that the amount is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be allowed as a deduction to the consumer as if it constituted a tax imposed on, and paid by, such consumer.

Section 164(c)(2) of the Code provides that as used therein the term "State or local sales tax" means a tax imposed by a State, Territory, a possession of the United States, or a political subdivision of any of the foregoing or by the District of Columbia, which tax (A) is imposed on persons engaged in selling tangible personal property at retail (or on persons selling gasoline or other motor vehicle fuels at wholesale or retail) and is a stated sum per unit of property sold or is measured either by the gross sales price or by the gross receipts from the sale; or (B) is imposed on persons engaged in furnishing services at retail and is measured by the gross receipts for furnishing such services.

Section 1.164–5 of the Income Tax Regulations, relating to the deductibility of State and local sales and gasoline taxes under section 164 of the Code, provides, in part, that the requirement that the amount of the tax must be separately stated will be deemed complied with where it clearly appears that, at the time of sale to the consumer, the tax was added to the sales price and collected or charged as a separate item; and that where the law imposing the sales or gasoline tax for which the taxpayer seeks a deduction contains a prohibition against the seller absorbing the tax, it is presumed that the amount of the sales or gasoline tax was separately stated at the time paid by the consumer.

Accordingly, it is held that the privilege tax imposed by the Territory of Hawaii under section 117–14.6(b) of the amendment to Chapter 117 of the Revised Laws of Hawaii, 1955, added by section 3, subsection (u) of Act 1 of the Special Session of 1957, effective July 1, 1957, constitutes a "State or local" sales tax within the meaning of section 164(c)(2) of the Code, and consumers paying such tax (other-

wise than in connection with their trade or business) are entitled to a deduction therefor in computing their taxable income, provided the taxpayers concerned itemize their deductions and do not elect to use the standard deduction or compute their tax from the use of the optional tax table.

It is also held that such privilege tax is deductible by the retailer under section 164(a) of the Code. If the retailer is an individual, the deduction must be taken in arriving at adjusted gross income. See section 62(1) of the Code. In the case of all other retailers, the deduction is allowable in determining taxable income. The sales tax collected by a retailer from a purchaser must be included in the retailer's gross income for Federal income tax purposes.

Deduction of certain taxes imposed by any foreign country or possession of the United States. See Rev. Rul. 58–518, page 381.

SECTION 167.—DEPRECIATION

26 CFR 1.167(a)–7: Accounting for depreciable property. Rev. Rul. 58–601

> Accountants' "work sheets" or "work papers" regularly maintained for the purpose of reconciling book depreciation with tax depreciation will be considered as meeting the requirement of permanent auxiliary records if they are sufficiently complete and accurate to provide a reliable and readily accessible basis for reconciling the regularly maintained books of account and the tax returns; if the original of such "work sheets" or "work papers" are turned over to the taxpayer and associated with his regular books of account; and if they are retained so long as the contents thereof may become material in the administration of any revenue law.
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> Revenue Ruling 58–306, C. B. 1958–1, 123, modified.

The Internal Revenue Service recognizes the need for a clarification of its position concerning the use of "work sheets" which may be considered as fulfilling the requirements of the Income Tax Regulations that permanent auxiliary records be maintained for reconciling differences in depreciation reserves maintained for tax and book purposes.

Section 1.167(a)–7(c) of the Income Tax Regulations specifies that if reserves for book purposes do not correspond with reserves maintained for tax purposes, permanent auxiliary records shall be maintained with the regular books of account reconciling the differences in depreciation for tax and book purposes because of different methods of depreciation, bases, rates, salvage, or other factors.

In this connection, Revenue Ruling 58–306, C. B. 1958–1, 123, was issued holding that "work sheets" maintained by a taxpayer for the purpose of reconciling the book depreciation with the tax depreciation do not meet the requirement of the regulations that permanent auxiliary records be maintained if reserves for book purposes do not correspond with reserves maintained for tax purposes.

It was not the intention of the Service to hold that the use of accountants' "work sheets" or "work papers" would be precluded

from acceptability as auxiliary records provided they met the other requirements of section 1.167(a)-7(c) of the regulations that they be permanent in nature, be maintained with the regular books of account and are adequate in reconciling the difference in depreciation for tax and book purposes because of different methods of depreciation bases, rates, salvage, or other factors.

Accordingly, Revenue Ruling 58-306, *supra*, is modified to hold that accountants' "work sheets" or "work papers" will be considered as meeting the requirement of permanent auxiliary records if they are prepared in the normal course of business, if they are sufficiently complete and accurate to provide a reliable and readily accessible basis for reconciling the regularly maintained books of account and the tax returns; if the original of such "work sheets" or "work papers" are turned over to the taxpayer and associated with his regular books of account; and if they are retained so long as the contents thereof may become material in the administration of any revenue law.

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26 CFR 1.167(b)-3: Sum of the years—digits method. Rev. Rul. 58-355

A plan for application of the sum of the years-digits method to group, classified, and composite accounts, which is based on gross additions reduced by theoretical retirements computed in accordance with predetermined survivor curves, is not acceptable under section 167(b) of the Internal Revenue Code of 1954 or the regulations promulgated pursuant thereto.

Advice has been requested whether the sum of the years-digits method of computing the allowance for depreciation under section 167 of the Internal Revenue Code of 1954 may be applied to group, classified, and composite accounts under the plan described below.

The plan assumes that the lives of the assets within the account follow a predetermined theoretical survivor curve. The basis of each is then apportioned over its assumed useful life by the sum of the years-digits method, and the allowance for the account is the total of such individual allowances.

Section 1.167(b)-3 of the Income Tax Regulations provides for the application of the sum of the years-digits method to group, classified or composite accounts in accordance with a remaining life plan.

Under the plan in the instant case, the cost of retirements is charged to the depreciation reserve and the allowance for depreciation is computed by applying changing fractions to the unrecovered cost or other basis of the account reduced by estimated salvage. The proper application of this method requires that the estimated remaining useful life of the account be determined each year.

Under this plan, the depreciable basis is reduced only by retirements computed in accordance with a theoretical survivor curve; accordingly, the basis of the account may, at any given time, differ substantially from the basis of assets actually in service. In addition, during the early years, the depreciation allowance would be substantially higher than under other plans because it would include

the entire recoverable basis of all assets assumed to have been retired during these years.

In view of the foregoing, it is held that the plan in the instant case does not conform to section 167(b) of the 1954 Code and the regulations promulgated pursuant thereto and is not acceptable for use with the sum of the years-digits method.

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26 CFR 1.167(e)-1: Change in method. Rev. Rul. 58-420

When a change is made from the declining balance method of computing depreciation to the straight-line method, "salvage value" should be determined in accordance with the conditions existing at the date of change.

Advice has been requested whether, in changing from the declining balance method of computing depreciation to the straight line method, "salvage value" is to be determined in accordance with the conditions existing at the date of acquisition or at the time of such change.

Section 1.167(a)-1(c) of the Income Tax Regulations states in part, "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."

However, section 1.167(e)-1(b) of the Income Tax Regulations, which deals specifically with changing from the declining balance to the straight line method, requires the redetermination of useful life and salvage value at the time of such change. This section states in part, "When the change is made, the unrecovered cost or other basis (less a reasonable estimate for salvage) shall be recovered through annual allowances over the estimated remaining useful life determined in accordance with the circumstances existing at that time."

Senate Report No. 1622, 83rd Cong., page 27, discussing section 167(e) of the Internal Revenue Code of 1954 states in part as follows:

The other amendment allows taxpayers availing themselves of the declining-balance method an option to switch to straight-line depreciation at any time in the life of a property. The straight-line rate would be based on the realistic estimate of remaining life of the property at the time of the switch. Moreover, the rate would thereafter be applied to the depreciated balance of the account at the time of the switch, less a realistic estimate of salvage value.

In view of the above, it is held that "salvage value" should be determined in accordance with the conditions existing at the date of change from the declining balance method of computing depreciation to the straight-line method.

It should be noted, however, that the option to switch from the declining balance method to the straight-line method at any time in the life of the property is applicable only with respect to property that qualifies under section 167(c) of the Code for the use of the declining balance method. In order to change from the declining balance method to the straight-line method with respect to new or used tangible property acquired prior to January 1, 1954, and used tangible property acquired after December 31, 1953, it will be necessary to secure the consent of the Commissioner. See Rev. Rul. 57-510, C. B. 1957-2, 152.

SECTION 169.—AMORTIZATION OF GRAIN-STORAGE FACILITIES

26 CFR 1.169: Statutory provisions; amortization of grain-storage facilities. T. D. 6305[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 169 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 July 10, 1956, notice of proposed rule making regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under sections 161, 162, 168, and 169, relating to itemized deductions for individuals and corporations, of the Internal Revenue Code of 1954, was published in the Federal Register (21 F. R. 5091). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations under section 169 are hereby adopted as set forth below.

AUTHORITY: §§ 1.169 to 1.169–8, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.169 STATUTORY PROVISIONS; AMORTIZATION OF GRAIN-STORAGE FACILITIES.

SEC. 169. AMORTIZATION OF GRAIN-STORAGE FACILITIES.

(a) ALLOWANCE OF DEDUCTION—

(1) ORIGINAL OWNER.—Any person who constructs, reconstructs, or erects a grain-storage facility (as defined in subsection (d)) shall, at his election, be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of such facility based on a period of 60 months. The 60-month period shall begin as to any such facility, at the election of the taxpayer, with the month following the month in which the facility was completed, or with the succeeding taxable year.

(2) SUBSEQUENT OWNERS.—Any person who acquires a grain-storage facility from a taxpayer who—

(A) Elected under subsection (b) to take the amortization deduction provided by this subsection with respect to such facility, and

(B) Did not discontinue the amortization deduction pursuant to subsection (c),

shall, at his election, be entitled to a deduction with respect to the adjusted basis (determined under subsection (e)(2)) of such facility based on the period, if any, remaining (at the time of acquisition) in the 60-month period elected under subsection (b) by the person who constructed, reconstructed, or erected such facility.

(3) AMOUNT OF DEDUCTION.—The amortization deduction provided in paragraphs (1) and (2) shall be an amount, with respect to each month of the amortization period within the taxable year,

[1] The publication of this Treasury Decision in 23 F. R. 6622, dated Aug. 27, 1958 contains (1) instructions for modifying the notice of proposed rule making published in 21 F. R. 5091, dated July 10, 1956, 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.

equal to the adjusted basis of the facility at the end of such month, divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall be in lieu of the depreciation deduction with respect to such facility for such month provided by section 167.

(b) ELECTION OF AMORTIZATION.—The election of the taxpayer under subsection (a)(1) to take the amortization deduction and to begin the 60-month period with the month following the month in which the facility was completed shall be made only by a statement to that effect in the return for the taxable year in which the facility was completed. The election of the taxpayer under subsection (a)(1) to take the amortization deduction and to begin such period with the taxable year succeeding such year shall be made only by a statement to that effect in the return for such succeeding taxable year. The election of the taxpayer under subsection (a)(2) to take the amortization deduction shall be made only by a statement to that effect in the return for the taxable year in which the facility was acquired. Notwithstanding the preceding three sentences, the election of the taxpayer under subsection (a) (1) or (2) may be made, under such regulations as the Secretary or his delegate may prescribe, before the time prescribed in the applicable sentence.

(c) TERMINATION OF AMORTIZATION DEDUCTION.—A taxpayer which has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary or his delegate before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization deduction with respect to such facility.

(d) DEFINITION OF GRAIN-STORAGE FACILITY.—For purposes of this section, the term "grain-storage facility" means—

(1) Any corn crib, grain bin, or grain elevator, or any similar structure suitable primarily for the storage of grain, which crib, bin, elevator, or structure is intended by the taxpayer at the time of his election to be used for the storage of grain produced by him (or, if the election is made by a partnership, produced by the members thereof); and

(2) Any public grain warehouse permanently equipped for receiving, elevating, conditioning, and loading out grain,

the construction, reconstruction, or erection of which was completed after December 31, 1952, and on or before December 31, 1956. If any structure described in clause (1) or (2) of the preceding sentence is altered or remodeled so as to increase its capacity for the storage of grain, or if any structure is converted, through alteration or remodeling, into a structure so described, and if such alteration or remodeling was completed after December 31, 1952, and on or before December 31, 1956, such alteration or remodeling shall be treated as the construction of a grain-storage facility. The term "grain-storage facility" shall include only property of a character which is subject to the allowance for depreciation provided in section 167. The term "grain-storage facility" shall not include any facility any part of which is an emergency facility within the meaning of section 168 of this title.

(e) DETERMINATION OF ADJUSTED BASIS.—

(1) ORIGINAL OWNERS.—For purposes of subsection (a)(1)—

(A) In determining the adjusted basis of any grain-storage facility, the construction, reconstruction, or erection of which was begun before January 1, 1953, there shall be included only so much of the amount of the adjusted basis (computed without regard to this subsection) as is properly attributable

to such construction, reconstruction, or erection after December 31, 1952; and

(B) In determining the adjusted basis of any facility which is a grain-storage facility within the meaning of the second sentence of subsection (d), there shall be included only so much of the amount otherwise included in such basis as is properly attributable to the alteration or remodeling.

If any existing grain-storage facility as defined in the first sentence of subsection (d) is altered or remodeled as provided in the second sentence of subsection (d), the expenditures for such remodeling or alteration shall not be applied in adjustment of the basis of such existing facility but a separate basis shall be computed in respect of such facility as if the part altered or remodeled were a new and separate grain-storage facility.

(2) SUBSEQUENT OWNERS.—For purposes of subsection (a)(2), the adjusted basis of any grain-storage facility shall be whichever of the following amounts is the smaller:

(A) The basis (unadjusted) of such facility for purposes of this section in the hands of the transferor, donor, or grantor, adjusted as if such facility in the hands of the taxpayer had a substituted basis within the meaning of section 1016(b), or

(B) So much of the adjusted basis (for determining gain) of the facility in the hands of the taxpayer (as computed without regard to this subsection) as is properly attributable to construction, reconstruction, or erection after December 31, 1952.

(f) DEPRECIATION DEDUCTION.—If the adjusted basis of the grain-storage facility (computed without regard to subsection (e)) exceeds the adjusted basis computed under subsection (e), the depreciation deduction provided by section 167 shall, despite the provisions of subsection (a)(3) of this section, be allowed with respect to such grain-storage facility as if the adjusted basis for the purpose of such deduction were an amount equal to the amount of such excess.

(g) LIFE TENANT AND REMAINDERMAN.—In the case of property held by one person for life with remainder to another person, the amortization deduction provided in subsection (a) shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant.

§ 1.169–1 GENERAL SCOPE OF SECTION 169.—(a) Section 169 provides for the amortization of grain-storage facilities, as defined therein over a period of 60 months. The amortization deduction is allowable at the election of the taxpayer and subject to the provisions of section 169. The amortization deduction is not only allowable to the original owner of a grain-storage facility, but may be allowable to any subsequent owner who acquires the facility from another person who elected to take the amortization deduction and had not discontinued such deduction under the statute. In the case of the original owner of a grain-storage facility the amortization period is 60 months. For a subsequent owner the amortization period is the period, if any, remaining at the time of his acquisition in the 60-month period elected by the person who completed construction, reconstruction, or erection of the grain-storage facility.

(b) Cross-references: For the right of estates and trusts to amortize grain-storage facilities, see section 642(f) and the regulations thereunder. For the allowance of the amortization deduction in the case of grain-storage facilities of partnerships, see section 703(b) and the regulations thereunder.

§ 1.169–2 DEFINITION OF GRAIN-STORAGE FACILITY.—(a) *General.*—For the purpose of section 169 the term "grain-storage facility" means—

(1) Any corn crib, grain bin, or grain elevator, or any similar structure suitable primarily for the storage of grain, but only if the taxpayer at the time of his election to take the amortization deduction allowed under section 169 intends such crib, bin, elevator, or structure to be used for the storage of grain produced by him or, in case the election to take the amortization deduction is made by a partnership, only if such crib, bin, elevator, or structure is intended by the partnership at the time of its election to be used for the storage of grain produced by members of the partnership; and

(2) Any public grain warehouse or elevator permanently equipped for receiving, elevating, conditioning, and loading out grain,

the construction, reconstruction, or erection of which was completed after December 31, 1952, and on or before December 31, 1956. The term "grain" includes all products commonly classed as grain, such as wheat, corn, oats, barley, rye, rice, soybeans, grain sorghums, flaxseed, and dry edible beans.

(b) *Private grain-storage facilities.*—In the case of any structure described in paragraph (a) (1) of this section, the construction, reconstruction, or erection of which was completed after December 31, 1952, and on or before December 31, 1956, the taxpayer at the time of his election to take the amortization deduction with respect to the structure must intend to use the facility for the storage of grain produced or to be produced by him. If the election is made by a partnership, the structure must be intended at the time of the election to be used for the storage of grain produced by one or more members of the partnership. The statute does not require that the facility be actually used at the time of the election for the storage of grain. The intent required by the statute at the time of the taxpayer's election to take the amortization deduction is applicable not only to the original owner who completed the construction, reconstruction, or erection of the facility, but to any subsequent owner of the facility. The existence of the requisite intent is a question of fact to be ascertained from the circumstances of each particular case. The lack of the required intent with respect to the use of the facility by a subsequent owner does not affect the allowance of the amortization deduction to a preceding owner for the period during which the facility was owned by him. However, the absence of the required intent as to the use of the facility on the part of either the original owner or any intervening owner precludes any subsequent owner from taking the amortization deduction with respect to the facility. A structure is not suitable primarily for the storage of grain if it is of a type customarily used for other purposes, even though it may actually be used for storing again. For example, no part of a residential dwelling may qualify as a grain-storage facility. Nor is a structure suitable primarily for the storage of grain unless it is so constructed as to be especially adapted to efficient storage of grain. Thus, a general utility type of building does not qualify under the statute as a grain-storage facility, even though it may be actually used for storing grain. However, structures not suitable primarily for the storage of grain may through alteration or remodeling qualify as grain-storage facilities (see paragraph (d) of this section). On

the other hand, a structure which is suitable primarily for the storage of grain is not disqualified under the statute merely because it may at times be used for other purposes. The structures described in paragraph (a)(1) of this section may include trackside grain-storage facilities.

(c) *Public grain-storage facilties.*—The term "public grain warehouse" as used in section 169(d) includes only a grain warehouse or elevator transacting business with members of the general public. The amortization deduction, however, is not available to a person who stores only grain purchased for consumption in his business, such as a milling company which constructs storage facilities for purchased grain held for processing. The statute also requires that the grain warehouse or elevator must be permanently equipped for receiving, elevating, conditioning, and loading out grain. A public grain warehouse must be a permanent structure, of either the elevator or so-called "flat storage" type, suitable primarily for the storage of grain, and the equipment for receiving, elevating, conditioning, or loading out grain must be either permanently installed or permanently available for use. When such equipment is permanently installed, it is considered a part of the grain warehouse or elevator for the purpose of section 169. On the other hand, portable equipment will not be considered a part of the grain warehouse or elevator for such purpose. The term "conditioning" as used in section 169(d) includes turning, drying, aerating, fumigating, or other processing of grain. While it is not essential for qualification as a grain-storage facility that a public grain warehouse or elevator be permanently equipped to render all services embraced within the meaning of "conditioning", the grain warehouse or elevator must be permanently equipped for turning, drying, or similar processing of grain. The fact that a public grain warehouse accepts for storage, in addition to products commonly classed as grain (see paragraph (a) of this section), other products which are ordinarily stored in grain warehouses does not disqualify the warehouse as a grain-storage facility for the purpose of section 169.

(d) *Alteration or remodeling.*—(1) If any structure described in paragraph (a)(*1*) or (*2*) of this section is altered or remodeled so that its capacity for the storage of grain is increased, and such alteration or remodeling was completed after December 31, 1952, and on or before December 31, 1956, for the purpose of section 169 such alteration or remodeling is treated as the construction of a grain-storage facility. Such alteration or remodeling may qualify as a grain-storage facility, whether or not the original structure constituted a grain-storage facility as defined in section 169(d). If the original structure did qualify as a grain-storage facility for the purpose of section 169, the amortization deduction allowable under section 169(a) may be taken with respect to such alteration or remodeling, whether or not the taxpayer or any preceding owner elected to take the amortization deduction allowable with respect to the original structure.

(2) Likewise, if any structure not described in paragraph (a)(*1*) or (*2*) of this section is converted through alteration or remodeling into a structure so described, and such alteration or remodeling was completed after December 31, 1952, and on or before December 31,

1956, for the purpose of section 169 such alteration or remodeling is treated as the construction of a grain-storage facility.

(3) For election to take the amortization deduction with respect to alteration or remodeling described in subparagraphs (1) and (2) of this paragraph, see § 1.169–4. For determination of adjusted basis for the purpose of the amortization deduction with respect to a grain-storage facility attributable to such alteration or remodeling, see § 1.169–6.

(e) *Excluded property.*—(1) *Nondepreciable property.*—The term "grain-storage facility" includes only property of a character which is subject to the allowance for depreciation provided in section 167. Thus, "grain-storage facility" does not include the land on which a structure defined in paragraph (a) of this section is erected.

(2) *Emergency facilities.*—(i) The term "grain-storage facility" does not include any facility any part of which is considered an emergency facility within the meaning of section 168. For the definition of "emergency facility" for the purpose of section 168, see § 1.168–4.

(ii) If all or any part of the adjusted basis (computed under section 1011) of a structure described in paragraph (a) of this section is certified as an "emergency facility" under section 168(e), such structure cannot qualify as a "grain-storage facility" for the purposes of section 169. However, if, prior to the making of any election to take the amortization deduction allowable under section 168(a) with respect to such structure, the certificate made under section 168(e) is cancelled by the certifying authority, such structures will be considered a "grain-storage facility" for the purposes of section 169.

(iii) In the case of any alteration or remodeling described in paragraph (d)(1) or (2) of this section, if all or any part of the adjusted basis (computed under section 1011) of the original structure is certified as an "emergency facility" under section 168(e), such alteration or remodeling may, nevertheless, qualify as a "grain-storage facility" for the purposes of section 169, provided the following conditions are met:

(*a*) None of the expenditures attributable to such alteration or remodeling represents construction, reconstruction, erection, installation, or acquisition included in the certificate made under section 168(e) with respect to the original structure, and

(*b*) A separate certificate is not made under section 168(e) with respect to such alteration or remodeling as a new and separate emergency facility, or if a separate certificate was made, such certificate, prior to the making of any election to take the amortization deduction allowable under section 168(a) with respect to such alteration or remodeling, is cancelled by the certifying authority.

§ 1.169–3 Amortization Deduction.—(a) *Original owner.*—Any person who constructs, reconstructs, or erects a grain-storage facility as defined in section 169(d) is entitled at his election to a deduction with respect to the amortization of the adjusted basis (for determining gain) of such facility based on a period of 60 months. As to the adjusted basis of a grain-storage facility, see § 1.169–6. The taxpayer may, with respect to a grain-storage facility, elect to begin the 60-month amortization period with (1) the month following the month in which such facility was completed, or (2) the first month of the taxable year succeeding that in which such facility was completed (see

§ 1.169–4). The date on which, or the month within which, a grain-storage facility is completed is to be determined upon the facts in the particular case. A statement of the date ascertained by the taxpayer, together with a statement of the pertinent facts relied upon, should be filed with the taxpayer's election to take amortization deductions with respect to such facility.

(b) *Subsequent owner.*—Any person who acquires a grain-storage facility from a taxpayer who elected to take the amortization deduction provided by section 169(a) with respect to such facility and who, prior to the acquisition by such person, had not discontinued the amortization deduction pursuant to section 169(c), is entitled at his election to a deduction with respect to the amortization of the adjusted basis (determined under section 169(e)(2)) of such facility based on the period, if any, remaining at the time of his acquisition in the 60-month period elected by the original owner of such facility. For the determination of the adjusted basis of a grain-storage facility in the hands of a subsequent owner for the purpose of the amortization deduction, see § 1.169–6.

(c) *Amount of deduction.*—(1) In general, with respect to each month of the 60-month period which falls within the taxable year, the amortization deduction is an amount equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the particular month for which the deduction is computed) remaining in the 60-month period. If a grain storage facility is held successively by two or more persons during a single month, the amortization deduction, if any, allowable to each of such persons in respect of that month shall be only that portion of the amount to which each such person would be entitled for a full month which the number of days in such month during which the facility was held by him bears to the total number of days in such month. The adjusted basis of the grain-storage facility at the end of any month shall be computed without regard to the amortization deduction with respect to such facility for such month. The total amortization deduction with respect to a grain-storage facility for a particular taxable year is the sum of the amorization deductions allowable with respect to such facility for each month of the 60-month period which falls within such taxable year.

(2) The amortization deduction with respect to a grain-storage facility for any month is in lieu of the deduction for depreciation which would otherwise be allowable under section 167 with respect to the facility for that month. If the original owner of a grain-storage facility elects to begin the 60-month amortization period with the first month of the taxable year succeeding that in which the facility was completed, the deduction for depreciation provided in section 167 is allowable with respect to the facility for the period intervening between the completion of the facility and the beginning of the 60-month period. However, if the original owner elects to begin the 60-month amortization period with the month following that in which the facility was completed, no deduction under section 167 is allowable in respect of the month in which the facility was completed. For depreciation allowable with respect to any amount not subject to amortization, see § 1.169–7.

(d) *Examples.*—This section may be illustrated by the following examples:

Example (1). On July 1, 1954, A, who makes his income tax return on a calendar year basis, begins the construction of a grain-storage facility which is completed on September 30, 1954, at a cost of $24,000, not including the cost of the land on which the facility is erected. A elects to take the amortiation deduction with respect to the facility and to begin the 60-month amortization period with October 1954, the month following its completion. The adjusted basis of the facility at the end of October is $24,000. The allowable amortization deduction with respect to such facility for the taxable year 1954 is $1,200, computed as follows:

Monthly Amortization Deductions:		
October:	$24,000 divided 60	$400
November:	$23,600 ($24,000 minus $400) divided by 59	400
December:	$23,200 ($23,600 minus $400) divided by 58	400
Total Amortization Deduction for 1954		$1,200

Example (2). The X Corporation, which makes its income tax return on the calendar year basis, begins the construction of a grain storage facility on June 15, 1954. The facility is completed on August 2, 1954. The X Corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with September 1954, the month following its completion. At the end of the first month of the amortization period the adjusted basis of the facility is $30,000. In October 1954, the facility is damaged by fire, as the result of which the adjusted basis is properly reduced by $2,537. The allowable amortization deduction with respect to the facility for the calendar year 1954 is $1,871, computed as follows:

Monthly amortization deductions:		
September:	$30,000 divided by 60	$500
October:	$26,963 ($30,000 minus $500 and $2,537) divided by 59	457
November:	$26,506 ($26,963 minus $457) divided by 58	457
December:	$26,049 ($26,506 minus $457) divided by 57	457
Total amortization deduction for 1954		$1,871

For illustration in the case of a subsequent owner of a grain-storage facility, see example (2) in § 1.169-6(f):

§ 1.169-4 Election of Amortization.—(a) *General rule.*—(1) *Original owner.*—The election by a taxpayer who constructs, reconstructs, or erects a grain-storage facility to take amortization deductions with respect to the facility and to begin the 60-month amortization period, either with the month following the month in which the facility was completed or with the first month of the taxable year succeeding the taxable year in which such facility was completed, shall be made by a statement to that effect in the taxpayer's return for the taxable year in which falls the first month of the 60-month amortization period so elected. Such statement shall include the following information:

(i) A description clearly identifying each grain-storage facility for which an amortization deduction is claimed.

(ii) The date on which the construction, reconstruction, or erection of each such facility was completed.

(iii) The total costs and expenditures paid or incurred in the construction, reconstruction, or erection of any such facility, excluding the cost of any land.

(iv) If the construction, reconstruction, or erection of any such facility was begun before January 1, 1953, the amount of the costs and expenditures properly attributable to such construction, reconstruction, or erection after December 31, 1952.

(v) In the case of a private grain-storage facility described in § 1.169–2(b), a statement that the taxpayer intends to use the facility for the storage of grain produced or to be produced by him or, in case the election is being made by a partnership, that the structure is intended to be used for the storage of grain produced by one or more members of the partnership.

(2) *Subsequent owner.*—The election by a subsequent owner (that is, a person who acquires a grain-storage facility from a taxpayer who elected to take the amortization deduction with respect to the facility and who, prior to the acquisition by the subsequent owner, had not discontinued the amortization deduction under section 169(c)) to take amortization deductions with respect to the facility shall be made by a statement to that effect in the taxpayer's return for the taxable year in which falls the month in which the facility was acquired. Such statement shall include the following information:

(i) The name and address of the preceding owner.

(ii) The date and the manner of the acquisition of the grain-shortage facility from such preceding owner.

(iii) A statement of the basis (unadjusted) of the facility in the hands of the preceding owner for amortization purposes, adjusted to the date of acquisition by the taxpayer.

(iv) A statement of the adjusted basis of the facility in the hands of the taxpayer for amortization purposes, computed as of the date of acquisition by the taxpayer.

(v) In the case of a private grain-storage facility described in § 1.169–2(b), a statement that the taxpayer intends to use the facility for the storage of grain produced or to be produced by him or, in case the election is being made by a partnership, that the structure is intended to be used for the storage of grain produced by one or more members of the partnership.

(b) *Special rules for making election prior to filing of return.*—If, prior to the time prescribed in paragraph (a) of this section for making the election to take amortization deductions with respect to a grain-storage facility, such facility is acquired by a subsequent owner, the preceding owner of the facility may make such election within 60 days after the date of acquisition of such facility by the subsequent owner. In the event that the preceding owner dies or ceases to exist prior to making an election, the election may be made within such time by the duly authorized representatives of the preceding owner. Unless the election to take amortization deductions with respect to the facility is made by the preceding owner or on his behalf, the subsequent owner of the facility shall not be entitled to take the amorti-

zation deductions allowable under section 169(a) with respect to such facility. A statement of election under this paragraph shall be filed with the district director for the district in which the return of the taxpayer is required to be filed, and shall contain the same information required with respect to a statement of election under paragraph (a) of this section. However, in the case of a private grain-storage facility described in § 1.169–2(b), in lieu of the statement regarding the intended use of the facility at the time of the election, the statement of election under this paragraph shall include a statement that the preceding owner, at the time of the construction, reconstruction, erection, or acquisition of the facility by him, intended to use the facility for the storage of grain produced or to be produced by him. If the preceding owner of the facility was the original owner, the statement of election must specify the beginning of the 60-month amortization period. Unless the grain-storage facility is acquired from the original owner after the beginning of his taxable year succeeding the taxable year in which such facility was completed, an election made under this paragraph must begin the 60-month amortization period with the month following the month in which the facility was completed.

(c) *Election not made at the time or in the manner prescribed by this section.*—(1) The district director ha sno authority to extend the time prescribed in section 169(b) and paragraph (a) of this section for making an election to take amortization deductions allowable under section 169(a). However, the district director in his discretion may, for good cause shown, grant a reasonable extension of time for the making of an election under paragraph (b) of this section.

(2) Except as provided in the preceding subparagraph, if a statement of election under paragraph (a) or (b) of this section does not comply with the requirements prescribed therein, it may, in the discretion of the district director and for good cause shown, be made in such manner and form as may be approved by him.

(3) No method of making the election to take the amortization deductions with respect to a grain-storage facility other than those prescribed in this section shall be permitted. A taxpayer who fails to elect to take amortization deductions with respect to such a facility shall not be entitled to amortization deductions with respect to such facility.

(d) *Alteration or remodeling of existing grain-storage facility.*—If an existing grain-storage facility, as defined in scction 169(d), is altered or remodeled and such alteration or remodeling is treated under section 169(d) as the construction of a grain-storage facility (see §§ 1.169–2(d) and 1.169–6(e)), the part of the facility altered or remodeled is treated as a new and separate grain-storage facility. In such case, unless the taxpayer who completes such alternation or remodeling makes a separate election, in the manner and within the time provided in this section, to take amortization deductions and to begin a new 60-month period with respect to such alteration or remodeling, he shall not be entitled to amortization deductions with respect to such alteration or remodeling. Such alteration or remodeling is also treated as a separate grain-storage facility in the hands of a subsequent owner.

§ 1.169–5 Termination of Amortization Deduction.—(a) If a taxpayer has elected to take amortization deductions with respect to a grain-storage facility he may, prior to the expiration of the 60-month amortization period and prior to the acquisition of such facility by another person, discontinue the amortization deductions with respect to such facility for the remainder of the 60-month period. An election to discontinue the amortization deductions shall be made by notice in writing filed with the district director for the district in which the return of the taxpayer is required to be filed, specifying the month as of the beginning of which the taxpayer elects to discontinue such deductions. Such notice shall be filed before the beginning of the month specified therein, and shall contain a description clearly identifying the grain-storage facility with respect to which the taxpayer elects to discontinue the amortization deductions. If the taxpayer elects in the manner provided herein to discontinue the amortization deductions with respect to a grain-storage facility, he shall not be entitled to any further amortization deductions with respect to such facility.

(b) A taxpayer who elects to discontinue amortization deductions with respect to a grain-storage facility is entitled to a deduction for depreciation under section 167 with respect to such facility. The deduction for depreciation shall begin with the first month as to which the amortization deduction is not applicable and shall be computed on the adjusted basis of the property as of the beginning of such month (see section 1011 and the regulations thereunder).

(c) This section may be illustrated by the following example:

Example. On February 1, 1954, the Y Corporation, which makes its income tax returns on the calendar year basis, begins the construction of a grain-storage facility. The facility is completed on June 30, 1954, at a cost of $306,000, of which $60,000 is allocable to the land and $246,000 to the facility. The corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with July 1954, the month following its completion. On March 25, 1955, the corporation files notice with the district director of its election to discontinue the amortization deductions beginning with the month of April 1955. The adjusted basis of the facility on July 31, 1954, is $246,000. The amortization deductions for the taxable year 1954 and the months of January, February, and March 1955, amount to $36,900, or $4,100 per month for nine months. Accordingly, the adjusted basis of the facility as of April 1, 1955, is $209,100. Beginning as of that date, the deduction for depreciation under section 167 is allowable with respect to the property. Such deduction shall be computed on the adjusted basis ($209,100) of the property as of April 1, 1955.

§ 1.169–6 Adjusted Basis of Grain-Storage Facility.—(a) *General.*—Section 169(e) provides rules which apply in the determination of the adjusted basis of a grain-storage facility for the purpose of computing the amortization deductions allowable under section 169 (a). Section 169(e) does not purport to provide an all-inclusive formula for the computation of adjusted basis for amortization purposes, but only prescribes certain modifications in the amount which would otherwise constitute the adjusted basis of the facility. As a result of these modifications, the adjusted basis for the purpose of computing

the amortization deductions allowable with respect to the facility will differ in some cases from the adjusted basis of the facility determined under section 1011 without regard to section 169(e). The adjusted basis for amortization purposes may also differ from the adjusted basis of the facility for other purposes in that it shall be the adjusted basis for determining gain (see sections 1011–1022, inclusive). The adjusted basis for amortization purposes is derived from the unadjusted basis of the grain-storage facility determined in accordance with the provisions of section 1012. The special rules provided in section 169(e) are applicable in translating the unadjusted basis determined in accordance with the provisions of section 1012 into the unadjusted basis for amortization purposes under section 169. The unadjusted basis for amortization purposes, less the adjustments properly allocable thereto, becomes the adjusted basis for amortization purposes. These adjustments are those specified in sections 1016 and 1017. However, adjustments which increase the adjusted basis under section 1011 are not to be taken into account in determining the adjusted basis for amortization purposes (see paragraph (d) of this section).

(b) *Original owners.*—Section 169(e)(1) provides rules which apply in the determination of the adjusted basis for amortization purposes of a grain-storage facility in the hands of an original owner (see § 1.169–3(a)). As the result of the application of the rules stated in subparagraphs (1) and (2) below, the adjusted basis of the facility for amortization purposes will be smaller than the amount which would otherwise constitute the adjusted basis of the facility. The rules are the following:

(1) If the construction, reconstruction, or erection of the facility was begun before January 1, 1953, there is to be included only so much of the entire unadjusted basis of the facility as is properly attributable to construction, reconstruction, or erection after December 31, 1952.

(2) If a structure which is not an existing grain-storage facility as defined in section 169(d) is altered or remodeled and such alteration or remodeling is treated under section 169(d) as the construction of a grain-storage facility (see § 1.169–2(d)), there is to be included only so much of the entire unadjusted basis of such structure as is properly attributable to such alteration or remodeling as was completed after December 31, 1952, and on or before December 31, 1956. In the case of alteration or remodeling of an existing grain-storage facility, see paragraph (e) of this section.

(c) *Subsequent owners.*—A special rule is provided in section 169(e)(2) for the determination of the adjusted basis for amortization purposes of a grain-storage facility in the hands of a subsequent owner (see § 1.169–3(b)). Such adjusted basis is the smaller of the following amounts:

(1) The adjusted basis determined by including an amount in respect of unadjusted basis equal to the adjusted basis of the facility for amortization purposes in the hands of the preceding owner, determined as of the date of acquisition of the facility by the taxpayer. For the purpose of this paragraph, in determining the adjusted basis of the facility for amortization purposes in the hands of the preceding owner the adjustments required under section 1016 shall include an adjustment in respect of the amount of the amortization deduction

allowable to the preceding owner for the month in which the facility was acquired by the taxpayer. See § 1.169–3(c). For the rule excluding capital additions from the adjusted basis of a grain-storage facility for amortization purposes, see paragraph (d) below.

(2) The adjusted basis (computed under section 1011 for determining gain) of the facility in the hands of the taxpayer. If the construction, reconstruction, or erection of the facility was begun before January 1, 1953, in determining such adjusted basis there is to be included only so much of the entire unadjusted basis of the facility (in the hands of the taxpayer) as is properly attributable to construction, reconstruction, or erection after December 31, 1952.

(d) *Capital additions.*—If after the completion or acquisition of a grain-storage facility further expenditures are made for construction, reconstruction, or erection, such expenditures shall not be added to the adjusted basis of the facility for amortization purposes. If such expenditures result in alteration or remodeling which under section 169(d) is treated as the construction of a grain-storage facility, see paragraph (e) below.

(e) *Alteration or remodeling of existing grain-storage facility.*—If an existing grain-storage facility as defined in section 169(d) is altered or remodeled and such alteration or remodeling is treated under section 169(d) as the construction of a grain-storage facility (see § 1.169–2(d)), the expenditures for such alteration or remodeling shall not be applied in adjustment of the basis of the existing facility, but a separate basis shall be computed by reference to such expenditures as if such alteration or remodeling represented a new and separate grain-storage facility. A structure which was not an existing grain-storage facility prior to alteration or remodeling which is treated under section 169(d) as the construction of a grain-storage facility becomes an existing grain-storage facility for the purposes of this paragraph. Thus, if a structure which is an existing grain-storage facility by reason of such alteration or remodeling is again altered or remodeled and such alteration or remodeling is treated under section 169(d) as the construction of a grain-storage facility, the provisions of this subparagraph are also applicable to such later alteration or remodeling.

(f) *Examples.*—The computation of the adjusted basis of a grain-storage facility for amortization purposes may be illustrated in the following examples:

Example (1). On February 28, 1953, A completes the construction of a grain-storage facility as defined in section 169 (d) at a cost of $2,000 for the land and $6,000 for the construction. Only $3,000 of the total cost of the facility is properly attributable to construction after December 31, 1952. A elects to claim the amortization deduction and to begin the 60-month period on March 1, 1953. Under section 169(e), the adjusted basis of the facility for the purpose of section 169(a) as of that date is only $3,000, the amount attributable to construction after December 31, 1952. In determining the adjusted basis of the facility as of any subsequent date for the purpose of computing the amortization deduction, the amortization deductions allowable in respect of the period prior to such date must be taken into account. See section 1016. Thus, the adjusted basis of the facility for the purpose of computing the amount of the amortization

deduction allowable for the month of January 1954, is $2,500 ($3,000 minus $500, the amortization deductions allowable prior to January 1, 1954).

Example (*2*). A began on January 1, 1954, and completed on June 30, 1954, the construction of a grain-storage facility as defined in section 169(d) at a cost of $5,000 for the land and $30,000 for the construction. A elects to claim the amortization deduction and to begin the 60-month period on July 1, 1954. On May 1, 1955, A sells the grain-storage facility to B for a price of $34,000, of which $6,000 is allocable to the land. B elects to claim the amortization deduction on the basis of the 50 months remaining in the amortization period. B, in determining the adjusted basis of the facility in his hands, must start with the unadjusted basis of the facility in the hands of A ($30,000) and adjust such basis under section 1016 in respect of amortization claimed by A during his ownership of the facility ($5,000). Since this amount ($25,000) is smaller than the adjusted basis (for determining gain) of the facility in B's hands as of May 1, 1955 ($28,000, that is $34,000 less $6,000 allocable to land), the adjusted basis of the facility for the purpose of section 169(a) in B's hands as of May 1, 1955, is $25,000. B, therefore, may include only $25,000 in determining the adjusted basis of the facility in his hands as of May 1, 1955, the date of the purchase. The amortization deductions claimed by B must, of course, be applied in reduction of such adjusted basis in determining the adjusted basis of the facility as of any subsequent date for the purpose of his amortization deduction under section 169(a). The amount by which the purchase price paid by B and allocable to depreciable property ($28,000) exceeds the adjusted basis determined under section 169(e) for such property ($25,000)—or $3,000—is treated as the adjusted basis (as of May 1, 1955) for the purpose of the depreciation deduction allowable under section 167. See § 1.169-7.

§ 1.169-7 Depreciation of Portion of Grain-Storage Facility Not Subject to Amortization.—The rule set forth in section 169(a) (see § 1.169-3), that the amortization deduction with respect to a grain-storage facility is in lieu of any deduction for depreciation which would otherwise be allowable under section 167 with respect to the facility, is subject to an exception provided in section 169(f). Under this exception, if the adjusted basis of the facility as computed under section 1011 for purposes other than the amortization deductions (see § 1.1011-1) is in excess of the adjusted basis computed under section 169(e) for the purpose of the amortization deductions (see § 1.169-6), any excess shall be charged off over the useful life of the facility and recovered through depreciation deductions allowable under section 167. Thus, if the construction of a grain-storage facility was begun before January 1, 1953, no amortization deductions are allowable with respect to the amount attributable to such construction before such date (see § 1.169-6). However, the depreciation deduction provided by section 167 and the regulations thereunder is allowable with respect to the amount attributable to construction before January 1, 1953. Similarly, in the case of a subsequent owner the adjusted basis of a grain-storage facility computed under section 1011 for purposes other than the amortization deductions (see

§ 1.1011–1) may exceed the adjusted basis of the facility computed under section 169(e) for amortization purposes. In such case the excess will be subject to the allowance for depdeciation provided by section 167. For illustration of the treatment of the portion of a grain-storage facility which is subject to the allowance for depreciation, see example (2) in § 1.169–6(f).

§ 1.169–8 LIFE TENANT AND REMAINDERMAN.—In the case of a grain-storage facility held by one person for life with the remainder to another person, the amortization deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant during his life.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved August 21, 1958.

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

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

Rev. Rul. 58–405

The cost to the taxpayer of creating a statue which he donated to a foreign government that formally presented it to a city in the United States does not constitute a contribution or gift by the taxpayer to the city within the meaning of section 170 of the Internal Revenue Code of 1954. Accordingly, the cost of creating the statue is not deductible by the taxpayer in computing his taxable income for Federal income tax purposes.

Advice has been requested whether the cost to a taxpayer of creating a statue which he gave to a foreign government that presented it to a city in the United States is deductible by the taxpayer as a contribution or gift to the city receiving the statue.

The taxpayer, who is a sculptor, has for many years been interested in the art and culture of a certain foreign country. As a means of sustaining good will between the people of that country and the people of the United States, he made arrangements with representatives of the foreign country to create a statue of one of its national heroes, which, when completed would be erected in a public park of a certain city located in the United States. Upon completion of the statue, the taxpayer, who had borne the entire expense prior to its actual erection in the park, donated the statue to the foreign government whose representatives, at the unveiling ceremonies, made a formal presentation of the statue to the city. An inscription on the pedestal of the statue stated that it was a gift from the foreign government and the taxpayer's name appeared thereon as the sculptor.

Section 170 of the Internal Revenue Code of 1954 provides for the deduction from gross income, in computing taxable income, of contributions or gifts payment of which is made within the taxable year to or for the use of a State, a Territory, a possession of the United

States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia for exclusively public purposes.

Accordingly, it is held that the cost to the taxpayer of creating a statue which he donated to a foreign government that formally presented it to a city in the United States does not constitute a contribution or gift by the taxpayer to the city within the meaning of section 170 of the Code. Therefore, the cost of creating the statue is not deductible by the taxpayer in computing his taxable income for Federal income tax purposes.

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26 CFR 1.170–1: Charitable, etc., contributions and gifts; allowance of deduction. Rev. Rul. 58–372

Where a corporation assigns to an organization described in section 170(c)(2) of the Internal Revenue Code of 1954 life insurance policies payable to itself or its successors or assigns on the same day that initial premiums were paid, the corporation may deduct an amount equal to the initial premium within the limitations of section 170 of the Code.

Advice has been requested as to the amount a corporation may deduct under section 170(a)(1) of the Internal Revenue Code of 1954 for the contribution to an organization described in section 170(c)(2) of the Code of life insurance policies on the lives of certain of its officers and stockholders.

In the instant case a corporation applied for the issuance of life insurance policies on the lives of certain of its officers and stockholders payable to the corporation itself or its successors or assigns. On the same date the corporation paid the initial premium and then irrevocably assigned all its rights, title, and interest in the policies to an organization described in section 170(c)(2) of the Code.

Section 170(a)(1) of the Code states that to the extent provided therein there shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made in the taxable year. Section 1.170–1(c) of the Income Tax Regulations provide, in part, that if a contribution is made in property other than money the basis for the calculation of the amount thereof is the fair market value of the property at the time of the contribution. The fair market value of an insurance policy on the day when the initial premium is paid is the price that any person of the same age, sex and condition of health as the insured would have to pay for a similar life insurance policy with the same insurance company on the date the assignment took place. Compare *Charles Cutler Parsons* v. *Commissioner*, 16 T. C. 256; and Revenue Ruling 54–264, C. B. 1954–2, 57. The price such other person would have to pay for the same policy in the same circumstances is the same as the premium that was paid by the taxpayer.

Accordingly, where a corporation assigns to an organization described in section 170(c)(2) of the Code life insurance policies payable to itself or its successors or assigns on the same day that initial premiums were paid, the corporation may deduct an amount equal to the initial premium within the limitations of section 170 of the Code.

Rev. Rul. 58–455

An owner of an art object who transfers to an organization described in section 170(c) of the Internal Revenue Code of 1954, by delivery of a formally executed and acknowledged deed of gift, one-half of his right, title and interest in the art object, subject to his retention of the right to custody and control thereof during his lifetime, is entitled, under section 170(a) of the Code (subject to the limitations of section 170(b) of the Code), to a deduction of the present value of the remainder interest thus transferred.

Advice has been requested as to the deductibility of a gift to an organization described in section 170(c) of the Internal Revenue Code of 1954 of a one-half interest in an object of art.

A donor transferred and assigned to an organization described in section 170(c) of the Code a one-half interest in a painting on condition that he have the right to retain custody and control of the painting during his lifetime. The deed of gift provided that the donee's representative would have access to the painting from time to time for the purpose of inspection.

Revenue Ruling 57–293, C. B. 1957–2, 153, holds, in part, that where an owner of an art object transfers present title thereto to an organization described in section 170(c) of the Code by delivery of a formally executed and acknowledged deed of gift, but reserves in himself the right to the use and enjoyment of the object during his lifetime, a deduction of the present value of the remainder interest thus transferred will be allowable under section 170(a) of the Code, subject to the limitations of section 170(b) of the Code.

The provisions of the deed of gift in the instant case are within the purview of Example 1 of Revenue Ruling 57–293, *supra*, except that the donor has transferred to the organization only one-half of his right, title and interest in the painting subject to his right to custody and control of the painting during his lifetime.

Accordingly, it is held that the donor is entitled to a deduction of the present value of the remainder interest in the undivided one-half interest in the object of art which was transferred to an organization described in section 170(c) of the Code, pursuant to the terms of a deed of gift, in computing his taxable income for the taxable year in which the property was transferred, subject to the limitations of section 170(b) of the Code.

Rev. Rul. 58–473

The Township of Falls Authority, which is engaged in constructing, maintaining, and operating a sewer and water system for the benefit of the residents of such township, is a political subdivision of the Commonwealth of Pennsylvania, and contributions made to it are deductible by the donors as made to or for the use of a political subdivision of a State to the extent provided in section 170 of the Internal Revenue Code of 1954 in computing their taxable income for Federal income tax purposes.

Advice has been requested whether amounts contributed to the Township of Falls Authority are deductible by the donors under the provisions of section 170 of the Internal Revenue Code of 1954.

The Township of Falls Authority (hereinafter called the "Authority") was incorporated under the laws of the Commonwealth of

Pennsylvania pursuant to the Municipality Authorities Act of 1945, Act No. 164, May 2, 1945, P. L. 382, as amended, and pursuant to an Ordinance enacted June 8, 1951, by the Board of Supervisors of the Township of Falls, Bucks County, Pennsylvania. By ordinance dated January 29, 1952, the Authority was authorized to maintain and operate, for the benefit of the residents of the Township of Falls and an adjoining township, sewer systems (including sewage treatment works) theretofore acquired and constructed by it and to maintain and operate water works, water supply works, and water distribution systems.

The authority has no issue or outstanding capital stock. Financing is provided by the sale of bonds. The cost of construction of any sewer by the Authority is chargeable against the properties benefited on the "foot of frontage rule" basis. Such charges are assessed and collected in the manner provided by the Municipal Authorities Act of 1945, as amended. (Such assessments are not under any circumstances deductible under section 170 as charitable contributions. Furthermore, such assessments are not deductible as taxes. See section 1.164–4 of the Regulations and I. T. 3423, C. B. 1940–2, 74.)

All of the income of the Authority is derived from contributions, rentals and charges imposed upon and paid by the users of the sewer systems and sewage treatment works, and all of its net earnings are applied exclusively for public purposes. In the event of the dissolution of the Authority, all of its property will vest in the Township.

The Township of Falls Authority is, therefore, a political subdivision of the State of Pennsylvania within the meaning of section 170(c)(1) of the Code.

Section 170(a) of the Code provides, in part, 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, or, in the case of a corporation reporting its taxable income on the accrual basis, if its board of directors authorizes the contribution during the taxable year and payment is made on or before the fifteenth day of the third month following the close of such taxable year, within the limitations prescribed by subsection (b). Section 170(c) defines "charitable contributions" as including a contribution or gift to or for the use of a State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

Accordingly, it is held that contributions made to the Township of Falls Authority, which is engaged in constructing, maintaining, and operating a sewer and water system for the benefit of the residents of such township, is a political subdivision of the Commonwealth of Pennsylvania, and contributions made to it are deductible by the donors as made to or for the use of a political subdivision of a State to the extent provided in section 170 of the Code in computing their taxable income for Federal income tax purposes. See also Rev. Rul. 55–150, C. B. 1955–1, 14; Rev. Rul. 55–75, C. B. 1955–1, 238; Rev. Rul. 55–76, C. B. 1955–1, 239; Rev. Rul. 57–308, C. B. 1957–2, 94; Rev. Rul. 56–410, C. B. 1956–2, 884; Rev. Rul. 56–467, C. B. 1956–2, 884.

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26 CFR 1.170–2: Charitable deductions by individuals; limitations. Rev. Rul. 58–433

Where the principal purpose and functions of an organization are the collection and preservation of coins and medals, and the maintenance of a museum and library and other facilities for research, with secondary activities consisting of the employment of its museum, library and other facilities in furtherance of the organization's educational aims in the graduate and post-graduate study of numismatics and related fields, the organization does not constitute an educational organization referred to in section 170(b)(1)(A)(ii) of the Internal Revenue Code of 1954. Consequently, the additional deduction of ten percent of adjusted gross income provided by the special rule under section 170(b)(1)(A) does not apply to contributions or gifts made by individuals to such organization.

Advice has been requested whether an organization formed for the purpose of collecting and preserving coins and medals and related activities, including maintenance of facilities for research in such fields, constitutes an educational organization within the meaning of section 170(b)(1)(A)(ii) of the Internal Revenue Code of 1954, and whether contributions made to it will qualify for the additional deduction of ten percent of adjusted gross income provided by the special rule under section 170(b)(1)(A) of the Code.

The particular business and activity of the instant organization consists of collecting coins and medals, maintaining a museum and library, conducting a summer seminar and scholastic research projects, and providing instruction and supervision of post-graduate students. The organization has an average of 35 persons on the post-graduate level during a regular academic year studying numismatics and the history of numismatics as related to the fields of history, humane studies, architecture, art and social science, with each such student under the supervision and guidance of one of the organization's staff of experts. In addition, the facilities of the organization are employed by scholars the world over, either by attendance or by use of the organization's publications to further their research.

The instant organization is a domestic public organization organized and operated for one or more of the purposes specified in section 501(c)(3) of the Code, contributions made to the organization are deductible by the individual donors to the extent of the general limitation of 20 percent of adjusted gross income as provided by section 170(b)(1)(B) of the Code.

Under section 170(b)(1)(A) of the Code, individuals are allowed an additional deduction of not exceeding ten percent of their adjusted gross income for a contribution made to certain organizations including an educational organization referred to in section 503(b)(2) of the Code, which is an organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. However, such educational activities must be more than incidental to other functions of the organization. Only those "educational organizations" organized primarily for, and engaged in, the presentation of formal education in the instructive sense constitute "educational organizations" within the meaning of section

170(b)(1)(A)(ii) of the Code. See Revenue Ruling 56-262, C. B. 1956-1, 131.

Accordingly, where the principal purpose and functions of an organization are the collection and preservation of coins and medals and the maintenance of a museum, library and other facilities for research, with secondary activities consisting of the employment of its museum, library and other facilities in furtherance of the organization's educational aims in the graduate and post-graduate study of numismatics and related fields, the organization does not constitute an educational organization of the type referred to in section 170(b)(1)(A)(ii) of the Code. Consequently, the additional deduction of ten percent of adjusted gross income provided by the special rule under section 170(b)(1)(A) does not apply to charitable contributions made by individuals to such organization.

Rev. Rul. 58-464

Contributions made to a civic organization whose activities are designed to promote the welfare of a particular community and to restrict business interests in the area are not deductible, in computing taxable income, under section 170 of the Internal Revenue Code as contributions to or for the use of a political subdivision of a state for exclusively public purposes.

Advice has been requested whether a contribution, payment of which is made to or for the use of an association created to promote the general welfare of a community, as described below, is deductible as a charitable contribution.

The organization in question was incorporated to promote the civic, social and general welfare of residents of a particular community; to aid financially and otherwise community groups such as libraries, churches, youth movements and safety programs; and to combat, oppose and guard against the establishment of saloons, gambling places, slum areas, public nuisances, and other things detrimental to the peace and beauty of the area or the welfare of the inhabitants. Membership in the organization is open to all residents of the community. Since incorporating, the organization has successfully opposed the encroachment in the area of commercial establishments, as well as saloons and night clubs.

It is contended that since this organization is operated for social welfare and contributions to it are in the nature of gifts for a public purpose, contributions should be deductible. It is also contended that, while not qualifying as a political subdivision, the organization engages in activities of the type normally performed by a political subdivision of a state.

Section 170 of the Internal Revenue Code of 1954 provides, in part:

(a) ALLOWANCE OF DEDUCTIONS.—(1) GENERAL RULE.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. * * *

* * * * * * *

(c) CHARITABLE CONTRIBUTION DEFINED.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

(1) A State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing * * * but only if the contribution or gift is made for exclusively public purposes.

* * * * * * *

The organization in question has as its objective the maintenance of a desirable residential community and effective opposition to the establishment in the area of business interests which are considered by the organization to be detrimental in carrying out its purpose.

The activities of the organization, designed to protect the interests of a particular group of individuals and to oppose intrusions by other groups or business enterprises which, while considered objectionable by the organization, are of general interest to the public, may not be said to be "for exclusively public purposes."

Accordingly, it is held that contributions made to a civic organization whose activities are designed to promote the welfare of a particular community and to restrict business interest in the area are not deductible, in computing taxable income, under section 170 of the Internal Revenue Code as contributions to or for the use of a political subdivision of a state for exclusively public purposes.

SECTION 172.—NET OPERATION LOSS DEDUCTION

26 CFR 1.172–1: Net operating loss deduction.

Effect of cancellation of indebtedness on a net operating loss. See Rev. Rul. 58–600, page 29.

SECTION 174.—RESEARCH AND EXPERIMENTAL EXPENDITURES

26 CFR 1.174–3: Treatment as expenses. Rev. Rul. 58–356

The deduction of research and experimental expenditures in an income tax return filed for the first taxable year beginning after December 31, 1953, and ending after August 16, 1954, although such deduction is not separately shown as such in the return, effectuates the adoption of the expense method provided by section 174(a) of the Internal Revenue Code of 1954.

Advice has been requested whether a taxpayer has adopted the expense method of treating research and experimental expenditures where a deduction therefor has been claimed in his income tax return, but without showing such deduction separately.

The taxpayer incurred and paid research and experimental expenditures, of the type defined in section 1.174–2 of the Income Tax Regulations, for the first time during the year 1954. These expenditures were deducted in its income tax return filed for the calendar year 1954 by their inclusion in various expense accounts such as salaries and supplies. No mention was made of research and experimental expenses in the return filed.

Section 174 of the Internal Revenue Code of 1954, relating to research and experimental expenditures, provides, in part, as follows:

(a) TREATMENT AS EXPENSES.—
(1) IN GENERAL.—A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.
(2) WHEN METHOD MAY BE ADOPTED.—
(A) WITHOUT CONSENT.—A taxpayer may, without the consent of the Secretary or his delegate, adopt the method provided in this subsection for his first taxable year—
(i) which begins after December 31, 1953, and ends after the date on which this title is enacted, and
(ii) for which expenditures described in paragraph (1) are paid or incurred.
(3) SCOPE.—The method adopted under this subsection shall apply to all expenditures described in paragraph (1). The method adopted shall be adhered to in computing taxable income for the taxable year and for all subsequent taxable years unless, with the approval of the Secretary or his delegate, a change to a different method is authorized with respect to part or all of such expenditures.

Section 1.174–3(b)(1) of the Income Tax Regulations provides that the taxpayer may adopt the expense method of treating research and experimental expenditures by claiming in his income tax return for his first taxable year, as described in section 174(a)(2)(A) of the Code, a deduction for such expenditures.

Inasmuch as there are no specific requirements as to the captions or headings under which these expenditures should be reflected in the return, and no statement of election is required, the taxpayer, in the instant case, has complied with the requirements of the Code and Income Tax Regulations to effectuate the adoption of the method of treating these expenditures as expenses.

Accordingly, the deduction of research and experimental expenditures in an income tax return filed for the first taxable year beginning after December 31, 1953, and ending after August 16, 1954, although such deduction is not separately shown as such in the return, effectuates the adoption of the expense method provided by section 174(a) of the Code. The adoption of the expense method in such a manner is a binding election within the scope of section 174(a)(3) of the Code.

Notwithstanding this conclusion, it is the view of the Internal Revenue Service that, in order to avoid any question as to taxpayers' intentions with respect to their adoption and use of the expense method, it is preferable that the total amount of the deduction for research or experimental expenditures be shown on the taxpayers' returns as a separate item of expense. In any event, the records of taxpayers claiming deductions for research or experimental expenditures must be maintained in sufficient detail to permit verification of the total of the amount of such expenditures deducted upon examination of their returns. See sections 1.174–3(b)(3)(v) and 1.174–4(b)(1)(vi) of the regulations which indicate the accounting segregation which taxpayers are required to make on their books and records with respect to research or experimental expenditures treated in accordance with the provisions of section 174 of the Code.

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

Temporary rules under section 179, as added to the 1954 Code by section 204 of the Small Business Tax Revision Act of 1958. See T. D. 6335, page 1112.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

SECTION 212.—EXPENSES FOR PRODUCTION OF INCOME

26 CFR 1. 212–1 : Nontrade or nonbusiness expenses.

Legal expenses incurred in bringing an action for libel. See Rev. Rul. 58–418, page 18.

SECTION 213.—MEDICAL, DENTAL, ETC., EXPENSES

Temporary rules implementing the provisions of the Technical Amendments Act of 1958, relating to an increase in limitation on medical deduction if a taxpayer or his spouse has attained age 65 and is disabled. See T. D. 6335, page 1112.

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26 CFR 1.213–1 : Medical, dental, etc., expenses. Rev. Rul. 58–339

The taxpayer's wife was afflicted with a disease for many years and was under the care of several doctors. The doctors advised that someone be obtained to stay in the home to care for the home and small children in order to relieve the wife's mind and enable her to have complete rest. Part of the recognized treatment for the disease is rest, and the patient is making satisfactory recuperative progress; however, any overexertion of the patient may cause a severe relapse and recurrence of the disease. *Held*, the expense incurred by the taxpayer for domestic help to care for his home and children in order that his wife might have complete rest, as prescribed by physicians in order to prevent a recurrence of her disease, does not qualify as an amount paid for "prevention of disease" within the intendment of section 213 of the Internal Revenue Code of 1954. Such expense is a personal or family expense the deduction of which is prohibited by section 262 of the Code. However, any portion of the expense of the domestic servant attributable to services rendered directly to the wife, and which are of a type which would be rendered by a nurse, does qualify as a medical expense. See *Samual Ochs* v. *Commissioner*, 195 Fed. (2d) 692; certiorari denied 344 U. S. 827; Revenue Ruling 55–261, C. B. 1955–1, 307; *Estate of Jacob Hentz, Jr.* v. *Commissioner*, Tax Court Memorandum Opinion, entered April 6, 1953.

Rev. Rul. 58–481

Expenses incurred by a taxpayer for the purpose of maintaining his mentally retarded son at a home that cares for such cases which was recommended by a physician, and where the supervised and restricted environment provided is considered therapeutically necessary for him, constitute medical expenses for Federal income-tax purposes and are deductible in computing taxable income to the extent provided in section 213 of the Internal Revenue Code of 1954.

Advice has been requested whether amounts expended by a taxpayer for the purpose of maintaining his mentally retarded son at a special home are deductible as medical expense for Federal income-tax purposes.

The taxpayer's son suffered brain damage in childhood, and at the age of 13 was so severely disturbed and mentally retarded that his physician concluded that it was neither safe nor practical for him to remain with his parents or in an urban community. Accordingly, he advised the taxpayer to place the boy in a certain home that cared for such cases. The taxpayer accepted the recommendation and placed his son at the home where the son lives in a supervised and restricted environment and where, because of the conditions, he has an opportunity to make a marginal adjustment.

Section 213(a) of the Internal Revenue Code of 1954 allows as a deduction expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, subject to certain limitations.

Under section 213(e) of the Code, the term "medical care" means amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance), or for transportation primarily for and essential to medical care.

Section 1.213–1(e) of the Income Tax Regulations provides, in part, that the cost of in-patient hospital care (including the cost of meals and lodging therein) is an expenditure for medical care. The extent to which expenses for care in an institution other than a hospital constitute medical care is primarily a question of fact which depends upon the condition of the individual and the nature of the services he receives (rather than the nature of the institution). A private institution which is regularly engaged in providing medical care is considered an "institution" for purposes of section 1.213 of the regulations.

Where an individual is in an institution because his condition is such that the availability of medical care in such institution is the principal reason for his presence there, and meals and lodging are furnished as a necessary incident to such care, the entire cost of the medical care and the meals and lodging at the institution, which are furnished while the individual requires continual medical care, constitute an expense for medical care. For example, medical care includes the entire cost of institutional care for a person who is mentally ill and unsafe when left alone.

In view of the foregoing, it is held that the costs incurred by the instant taxpayer for the purpose of maintaining his mentally retarded

son at a home that cares for such cases which was recommended by a physician, constitute medical expenses for Federal income-tax purposes and are deductible in computing taxable income to the extent provided in section 213 of the Code, where the supervised and restricted environment provided is considered therapeutically necessary for him.

Rev. Rul. 58–533

The entire cost of maintaining a mentally ill daughter while living at a specially equipped children's center where she receives continued medical care from qualified medical personnel, is deductible as a medical expense subject to the limitations prescribed in section 213 of the Internal Revenue Code of 1954.

If, on the basis of competent medical advice, it is deemed necessary for the parents to visit their child at regular intervals as a part of her therapy and medical management, the cost of transportation for such visits will qualify as cost of "transportation primarily for and essential to medical care" within the meaning of section 213(e) of the Code, and will be deductible as a medical expense for Federal income tax purposes.

Advice has been requested relative to the deductibility, for Federal income tax purposes, of expenses for medical care, meals and lodging, and travel, incurred by a taxpayer in order that his child may get psychiatric therapy at a specially equipped center.

In the instant case, a child of the taxpayer lives at a specially equipped center where she receives psychiatric therapy, welfare, and guidance from qualified medical personnel. All fees for such services are paid by the taxpayer. In addition, on the advice of her doctors, the parents make periodic visits to their daughter as an essential part of her therapy and medical management.

Section 213 of the Internal Revenue Code of 1954 allows as a deduction expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, subject to certain limitations.

The term "medical care" is defined in section 213(e) of the Code as meaning amounts paid (1) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance), or (2) for transportation primarily for and essential to medical care referred to in (1) above.

Section 1.213–1(e)(1)(v)(a) of the Income Tax Regulations provides that where an individual is in an institution because his condition is such that the availability of medical care in such institution is a principal reason for his presence there, and meals and lodging are furnished as a necessary incident to such care, the entire cost of medical care and meals and lodging at the institution, which are furnished while the individual requires continual medical care, shall constitute an expense for medical care.

In view of the above, it is held that the entire cost of maintaining a mentally ill child while living at a specially equipped children's center where she receives continued medical care from qualified medical personnel, is deductible as a medical expense subject to the limitations prescribed in section 213 of the Code.

If, on the basis of competent medical advice, it is deemed necessary for the parents to visit their child at regular intervals as a part of her therapy and medical management, the cost of transportation for such visits will qualify as cost of "transportation primarily for and essential to medical care" within the meaning of section 213(e) of the Code, and will be deductible as a medical expense for Federal income tax purposes.

(Also Section 104; 1.104–1.) Rev. Rul. 58–602

The premium paid for an accident and health insurance policy which provides solely for indemnification of the policyholder for hospital and surgical expenses, is deductible as a medical expense to the extent provided in section 213 of the Internal Revenue Code of 1954, even though the benefits under the policy are paid irrespective of the amount of medical expenses incurred by the policyholder. Further, such policy constitutes an accident and health insurance policy within the purview of section 104(a)(3) of the Code and the amounts received by the policyholder, pursuant to the provisions of the policy, are excludable from his gross income to the extent provided in section 104(a)(3) of the Code.

Advice has been requested as to the proper treatment, for Federal income tax purposes, of the premium paid and benefits received by a taxpayer who holds an accident and health policy which provides insurance against the costs of medical care, where the benefits are not paid on a reimbursement basis, but rather on an indemnity basis, the benefits under the policy being paid irrespective of the amount of expenses incurred by the policyholder.

In the instant case, the policy issued by an indemnity and life insurance company insures the policyholder against loss due to certain hospital and surgical expenses incurred as a result of accidental bodily injury which is received while the policy is in effect, or as a result of sickness which first manifests itself while the policy is in effect. However, such indemnity is provided only if and to the extent that the policy makes specific provision therefor and is subject to the exclusions relating to workmen's compensation laws, to Federal Government hospitals, and to other exceptions, limitations, reductions and other provisions contained therein. In essence, the policy provides hospital and surgical benefits on an indemnity basis with the amount of the benefit provided under the policy being payable irrespective of the amount of the hospital and surgical expenses incurred by the policyholder. The facts in the instant case disclose that the premium paid by the policyholder is for insurance against medical and surgical expenses and that the payments received by the policyholder are not reimbursement for loss of earnings, but are made only for the purpose of covering medical and surgical expenses, even though, under the policy, he could receive payments greater in amount than was actually expended by him for such purpose.

Section 213 of the Internal Revenue Code of 1954 allows as a deduction expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, subject to certain limitations.

The term "medical care" is defined in section 213 of the Code as meaning amounts paid for the diagnosis, cure, mitigation, treatment,

or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance), or for transportation primarily for and essential to medical care.

Section 1.213–1(e)(1) of the Income Tax Regulations provides that amounts paid for hospitalization insurance, for membership in an association furnishing cooperative or so-called free choice medical service, or for group hospitalization and clinical care are expenses paid for medical care. However, premiums paid by a taxpayer under an insurance contract which provides reimbursement for loss of earnings due to accident or illness do not constitute amounts expended for medical care. See also Revenue Ruling 19, C. B. 1953–1, 59.

Section 104(a)(3) of the Code provides, insofar as pertinent, that, except in the case of amounts attributable to (but not in excess of) deductions allowed under section 213 of the Code for any prior taxable years, gross income does not include amounts received through accident or health insurance for personal injury or sickness. Section 1.104–1(d) of the Income Tax Regulations further provides that if an individual purchases a policy of accident or health insurance out of his own funds, amounts received thereunder for personal injuries or sickness are excludable from his gross income under section 104(a)(3) of the Code. However, in computing the deduction for medical expense allowable under section 213 of the Code the aggregate amounts expended by taxpayer for medical care must be reduced by the aggregate indemnities received under these insurance policies. Rev. Rul. 56–18, C. B. 1956–1, 135.

Accordingly, the premium paid in the instant case for an accident and health insurance policy, which provides solely for indemnification of the policyholder for hospital and surgical expenses, is deductible as a medical expense to the extent provided in section 213 of the Internal Revenue Code of 1954, even though the benefits under the policy are paid irrespective of the amount of medical expenses incurred by the policyholder. Further, such policy constitutes an accident and health insurance policy within the purview of section 104(a)(3) of the Code and the amounts received by the policyholder, pursuant to the provisions of the policy, are excludable from gross income to the extent provided in section 104(a)(3) of the Code.

SECTION 214.—EXPENSES FOR CARE OF CERTAIN DEPENDENTS

26 CFR 1.214–1: Taxpayers who may qualify for the deduction. (Also Section 873.) Rev. Rul. 58–434

Amounts paid by a nonresident alien wife, who is legally separated from her husband, for care of a dependent child will be allowed as a deduction from gross income where such expenses arise as a consequence of the alien's performance of personal services within the United States and the conditions of section 214 of the Internal Revenue Code of 1954 are satisfied.

Advice is requested as to the applicability of the deduction for child care provision of section 214 of the Internal Revenue Code of 1954 in the case of a nonresident alien individual.

The taxpayer, a Canadian citizen who is legally separated from her husband, has two children wholly dependent upon her. The taxpayer is employed in the United States but maintains a household in Canada where she employs a woman to care for her children. The taxpayer pays all of her income tax to the United States.

Section 214 of the Code provides, in part, as follows:

(a) GENERAL RULE.—There shall be allowed as a deduction expenses paid during the taxable year by a taxpayer who is a woman or a widower for the care of one or more dependents (as defined in subsection (c)(1)), but only if such care is for the purpose of enabling the taxpayer to be gainfully employed.

Section 214 in providing for this deduction recognizes the fact that a woman or a widower with small children may be compelled to incur child care expenses in order to earn a livelihood and that these expenses are comparable to an employee's business expenses. See Report of the Committee on Finance, United States Senate, No. 1622, 83rd Congress, 2nd Session.

The status of the woman or widower is determined as of the year in which the expenses are incurred. However, the deduction itself is allowable only for the taxable year during which the child care expense is actually paid.

Section 873 of the Code provides, in part, as follows:

(a) GENERAL RULE.—In the case of a nonresident alien individual the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

Therefore, in the apportionment and allocation of deductions there may be deducted from items of gross income received from sources within the United States by a nonresident alien individual the expenses, losses or other deductions provided by statute which are connected with such items.

In order to be eligible for the deduction, under the terms of section 214(b)(2), a working wife must file a joint return with her husband. At the same time, section 6013(a)(1) of the Code specifically prohibits the filing of a joint return where either spouse is a nonresident alien. However, under section 1.214–1(b)(4) of the Income Tax Regulations, the limitations described in section 214(b)(2) shall not apply to a woman who is, at the close of the taxable year, legally separated from her husband under a decree of divorce or of separate maintenance.

Accordingly, it is held that if the conditions of section 214 of the Code are satisfied by a nonresident alien widower, widow, unmarried woman, or wife who has been legally divorced or separated from her husband, the expenses paid by the nonresident alien for child care in connection with services performed by the taxpayer within the United States are deductible from gross income to the extent provided in such section.

SECTION 215.—ALIMONY, ETC., PAYMENTS

26 CFR 1.215–1: Periodic alimony, etc., payments.

Periodic payments to a divorced wife not incident to a decree of divorce. See Rev. Rul. 58–451, page 914.

SECTION 216.—AMOUNTS REPRESENTING TAXES AND INTEREST PAID TO COOPERATIVE HOUSING CORPORATION

26 CFR 1.216–1: Amounts representing taxes and interest paid to cooperative housing corporation. Rev. Rul. 58–421

The sale of floor space in a cooperative apartment building, which has been incorporated as a cooperative apartment corporation, to a banking corporation, or real estate partnership, to be used for commercial purposes will not prevent the cooperative apartment corporation from being classified as a "cooperative housing corporation" within the meaning of section 216(b)(1)(B) of the Internal Revenue Code of 1954, provided that 80 percent of its gross income is derived from tenant-stockholders who are individuals.

Advice has been requested whether a sale of space to a banking corporation for use as a branch bank and a sale to a partnership for use as a real estate management and sales office will prevent a cooperative apartment corporation from being considered a "cooperative housing corporation" within the meaning of section 216(b)(1)(B) of the Internal Revenue Code of 1954, thus causing a denial to the individual tenant-stockholders of the deductions of their pro rata share of interest and taxes paid by the cooperative apartment corporation.

A newly-formed cooperative corporation purchased a site for an apartment house. The apartment house is currently under construction. After completion, the building will consist of 272 apartments of varying sizes plus space reserved for commercial use on a portion of the first floor. Identical cooperative ownership contracts were issued both to the tenant-stockholders and to the purchasers of the commercial space. Such contract provides in part that the first holder (or holders), whether a person, firm or corporation, shall be deemed a resident member with occupancy rights.

82 percent of the building has been subscribed for, including 100 percent of the commercial space. Slightly over one-half of the commercial space involved has been subscribed for by a banking corporation for use as a branch bank. The remaining portion of the commercial space has been subscribed for by a real estate partnership for use as a real estate office as well as an office for managing the bulding. The total commercial space represents approximately two and one-half percent of the physical space being offered for sale. Approximately 95 percent of the gross income of the cooperative corporation will be derived from tenant-stockholders.

Section 216(a) of the Code provides that in the case of a tenant-stockholder, as defined in subsection (b)(2), there shall be allowed as a deduction amounts (amounts not otherwise deductible) paid or accrued to a cooperative housing corporation within the taxable year to the extent that such amounts represent his proportionate share of the real estate taxes and interest allowable as a deduction to the corporation.

Section 216(b) provides, in part, as follows:

(b) DEFINITIONS.—For purposes of this section—

(1) COOPERATIVE HOUSING CORPORATION.—The term "cooperative housing corporation" means a corporation—

(A) having one and only one class of stock outstanding,

(B) each of the stockholders of which is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation,

* * * * * * *

(D) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in subsection (a) are paid or incurred is derived from tenant-stockholders.

(2) TENANT-STOCKHOLDER.—The term "tenant-stockholder" means an individual who is a stockholder in a cooperative housing corporation, * * *.

Accordingly, in this case, the sale of space in a cooperative apartment building, which has been incorporated as a cooperative corporation, to a banking corporation or a real estate partnership to be used for commercial purposes will not prevent the corporation from qualifying as a "cooperative housing corporation" within the purview of section 216 of the Code, "nor will it affect the rights of a tenant-stockholder, as that term is used in subsection (a) of section 216, to deduct his prorata share of the interest and taxes paid by the cooperative apartment corporation". However, in determining whether a cooperative housing corporation has derived 80 percent of its gross income from "tenant-stockholders," the income derived from stockholders who are not individuals cannot be included as income from tenant stockholders. See Rev. Rul. 55–654, C. B. 1955–2, 58.

PART VIII.—SPECIAL DEDUCTIONS FOR CORPORATIONS

SECTION 247.—DIVIDENDS PAID ON CERTAIN PREFERRED STOCK OF PUBLIC UTILITIES

26 CFR 1.247–1: Deduction for dividends paid on preferred stock of public utilities.

Deduction in respect of dividends paid on public utility preferred stock issued on or after October 1, 1942, to replace preferred stock issued by another corporation not a "public utility" at the time of such replacement. See Rev. Rul. 58–621, page 918.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 261.—GENERAL RULE FOR DISALLOWANCE OF DEDUCTIONS

26 CFR 1.261: Statutory provisions; general rule for disallowance of deductions.
(Also Sections 262, 263, 265, 266, 273; 1.262, 1.263(a), 1.265, 1.266, 1.273.)

T. D. 6313 [1]

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

Regulations under sections 261, 262, 263, 265, 266, and 273 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 March 19, 1958, notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under sections 261, 262, 263, 265, 266, and 273 of the Internal Revenue Code of 1954, relating to items not deductible, was published in the Federal Register (23 F. R. 1829). 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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Authority: §§ 1.261 to 1.263 (c)–1, incl., §§ 1.265 to 1.266–1, incl., and §§ 1.273 to 1.273–1, 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 23 F. R. 7172, dated September 16, 1958, contains (1) instructions for modifying the notice of proposed rulemaking published in 23 F. R. 1829, dated March 19, 1958, 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.

ITEMS NOT DEDUCTIBLE

§ 1.261 Statutory Provisions; General Rule for Disallowance of Deductions.

SEC. 261. GENERAL RULE FOR DISALLOWANCE OF DEDUCTIONS.

In computing taxable income no deduction shall in any case be allowed in respect of the items specified in this part.

§ 1.261–1 General Rule for Disallowance of Deductions.—In computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954, in respect of any of the items specified in sections 262 to 273, inclusive, and the regulations thereunder.

§ 1.262 Statutory Provisions; Personal, Living, and Family Expenses.

SEC. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

§ 1.262–1 Personal, Living, and Family Expenses.—(a) *In general.*—In computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954, for personal, living, and family expenses.

(b) *Examples of personal, living, and family expenses.*—Personal, living, and family expenses are illustrated in the following examples:

(1) Premiums paid for life insurance by the insured are not deductible. See also section 264 and the regulations thereunder.

(2) The cost of insuring a dwelling owned and occupied by the taxpayer as a personal residence is not deductible.

(3) Expenses of maintaining a household, including amounts paid for rent, water, utilities, domestic service, and the like, are not deductible. A taxpayer who rents a property for residential purposes, but incidentally conducts business there (his place of business being elsewhere) shall not deduct any part of the rent. If, however, he uses part of the house as his place of business, such portion of the rent and other similar expenses as is properly attributable to such place of business is deductible as a business expense.

(4) Losses sustained by the taxpayer upon the sale or other disposition of property held for personal, living, and family purposes are not deductible. But see section 165 and the regulations thereunder for deduction of losses sustained to such property by reason of casualty, etc.

(5) Expenses incurred in traveling away from home (which include transportation expenses, meals, and lodging) and any other transportation expenses are not deductible unless they qualify as expenses deductible under section 162, § 1,162–2, and paragraph (d) of § 1.162–5 (relating to trade or business expenses), section 170 and paragraph (a)(2) of § 1.170–2 (relating to charitable contributions), section 212 and § 1.212–1 (relating to expenses for production of income), or section 213(e) and paragraph (e) of § 1.213–1 (relating to medical expenses). The taxpayer's costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible expenses. The costs of the taxpayer's lodging not incurred in traveling away from home are personal expenses.

Except as permitted under section 162 or 212, the costs of the taxpayer's meals not incurred in traveling away from home are personal expenses.

(6) Amounts paid as damages for breach of promise to marry, and attorney's fees and other costs of suit to recover such damages, are not deductible.

(7) Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either the husband or the wife. However, the part of an attorney's fee and the part of the other costs paid in connection with a divorce, legal separation, written separation agreement, or a decree for support, which are properly attributable to the production or collection of amounts includible in gross income under section 71 are deductible by the wife under section 212.

(8) The cost of equipment of a member of the armed services is deductible only to the extent that it exceeds nontaxable allowances received from such equipment and to the extent that such equipment is especially required by his profession and does not merely take the place of articles required in civilian life. For example, the cost of a sword is an allowable deduction in computing taxable income, but the cost of a uniform is not. However, amounts expended by a reservist for the purchase and maintenance of uniforms which may be worn only when on active duty for training for temporary periods, when attending service school courses, or when attending training assemblies are deductible except to the extent that nontaxable allowances are received for such amounts.

(c) *Cross references.*—Certain items of a personal, living, or family nature are deductible to the extent expressly provided under the following sections, and the regulations under those sections:

(1) Section 163 (interest).
(2) Section 164 (taxes).
(3) Section 165 (losses).
(4) Section 166 (bad debts).
(5) Section 170 (charitable, etc., contributions and gifts).
(6) Section 213 (medical, dental, etc., expenses).
(7) Section 214 (expenses for care of certain dependents).
(8) Section 215 (alimony, etc., payments).
(9) Section 216 (amounts representing taxes and interest paid to cooperative housing corporation).

§ 1.263 (a) STATUTORY PROVISIONS; CAPITAL EXPENDITURES; GENERAL RULE.

SEC. 263. CAPITAL EXPENDITURES.

(a) GENERAL RULE.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) Expenditures for the development of mines or deposits deductible under section 616,

(B) Research and experimental expenditures deductible under section 174, or

(C) Soil and water conservation expenditures deductible under section 175.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

§ 1.263(a)-1 CAPITAL EXPENDITURES; IN GENERAL.—(a) Except as otherwise provided in chapter 1 of the Internal Revenue Code of 1954, no deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, or

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has bene made in the form of a deduction for depreciation, amortization, or depletion.

(b) In general, the amounts referred to in paragraph (a) of this section include amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, such as plant or equipment, or (2) to adapt property to a new or different use. Amounts paid or incurred for incidental repairs and maintenance of property are not capital expenditures within the meaning of subparagraphs (1) and (2) of this paragraph. See section 162 and § 1.162–4.

(c) The provisions of paragraph (a)(1) of this section shall not apply to expenditures deductible under—

(1) Section 616 and §§ 1.616–1 through 1.616–3, relating to the development of mines or deposits,

(2) Section 174 and §§ 1.174–1 through 1.174–4, relating to research and experimentation, and

(3) Section 175 and §§ 1.175–1 through 1.175–6, relating to soil and water conservation.

§ 1.263(a)-2 EXAMPLES OF CAPITAL EXPENDITURES.—The following paragraphs include examples of capital expenditures:

(a) The cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

(b) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments.

(c) The cost of defending or perfecting title to property.

(d) The amount expended for architect's services.

(e) Commissions paid in purchasing securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense.

(f) Amounts assessed and paid under an agreement between bondholders or shareholders of a corporation to be used in a reorganization of the corporation or voluntary contributions by shareholders to the capital of the corporation for any corporate purpose. Such amounts are capital investments and are not deductible. See section 118 and § 1.118–1.

(g) A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stockholdings in the subsidiary shall not deduct amounts paid in carrying out this guaranty in computing its taxable income, but such payments are capital expenditures to be added to the cost of its stock in the subsidiary.

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(h) The cost of goodwill in connection with the acquisition of the assets of a going concern is a capital expenditure.

§ 1.263(a)-3 ELECTION TO DEDUCT OR CAPITALIZE CERTAIN EXPENDITURES.—(a) Under certain provisions of the Internal Revenue Code, taxpayers may elect to treat capital expenditures as deductible expenses or as deferred expenses, or to treat deductible expenses as capital expenditures.

(b) The sections referred to in paragraph (a) of this section include:

(1) Section 173 (circulation expenditures).
(2) Section 174 (research and experimental expenditures).
(3) Section 175 (soil and water conservation expenditures).
(4) Section 177 (trademark and trade name expenditures).
(5) Section 248 (organizational expenditures of a corporation).
(6) Section 266 (carrying charges).
(7) Section 615 (exploration expenditures).
(8) Section 616 (development expenditures).

§ 1.263(b) STATUTORY PROVISIONS; CAPITAL EXPENDITURES; EXPENDITURES FOR ADVERTISING AND GOOD WILL.

SEC. 263. CAPITAL EXPENDITURES. * * *

(b) EXPENDITURES FOR ADVERTISING AND GOOD WILL.—If a corporation has, for the purpose of computing its excess profits tax credit under chapter 2E or subchapter D of chapter 1 of the Internal Revenue Code of 1939 claimed the benefits of the election provided in section 733 or section 451 of such code, as the case may be, no deduction shall be allowable under section 162 to such corporation for expenditures for advertising or the promotion of good will which, under the rules and regulations prescribed under section 733 or section 451 of such code, as the case may be, may be regarded as capital investments.

§ 1.263(b)-1 EXPENDITURES FOR ADVERTISING OR PROMOTION OF GOOD WILL.—See § 1.162-14 for the rules applicable to a corporation which has elected to capitalize expenditures for advertising or the promotion of good will under the provisions of section 733 or section 451 of the Internal Revenue Code of 1939, in computing its excess profits tax credit under subchapter E of chapter 2, or subchapter D of chapter 1, of the Internal Revenue Code of 1939.

§ 1.263(c) STATUTORY PROVISIONS; CAPITAL EXPENDITURES; INTANGIBLE DRILLING AND DEVELOPMENT COSTS IN THE CASE OF OIL AND GAS WELLS.

SEC. 263. CAPITAL EXPENDITURES. * * *

(c) INTANGIBLE DRILLING AND DEVELOPMENT COSTS IN THE CASE OF OIL AND GAS WELLS.—Notwithstanding subsection (a), regulations shall be prescribed by the Secretary or his delegate under this subtitle corresponding to the regulations which granted the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells and which were recognized and approved by the Congress in House Concurrent Resolution 50, Seventy-ninth Congress.

§ 1.263(c)-1 INTANGIBLE DRILLING AND DEVELOPMENT COSTS IN THE CASE OF OIL AND GAS WELLS.—For rules relating to the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells, see § 1.612-4.

§ 1.265 STATUTORY PROVISIONS; EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.

SEC. 265. EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.

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 other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle.

(2) INTEREST.—Interest on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from the taxes imposed by this subtitle.

§ 1.265–1 EXPENSES RELATING TO TAX-EXEMPT INCOME.—(a) *Nondeductibility of expenses allocable to exempt income.*—(1) No amount shall be allowed as a deduction under any provision of the Internal Revenue Code of 1954 for any expense or amount which is otherwise allowable as a deduction and which is allocable to a class or classes of exempt income other than a class or classes of exempt interest income.

(2) No amount shall be allowed as a deduction under section 212 (relating to expenses for production of income) for any expense or amount which is otherwise allowable as a deduction and which is allocable to a class or classes of exempt interest income.

(b) *Exempt income and nonexempt income.*—(1) As used in this section, the term "class of exempt income" means any class of income (whether or not any amount of income of such class is received or accrued) wholly exempt from the taxes imposed by subtitle A of the Internal Revenue Code of 1954. For purposes of this section, a class of income which is considered as wholly exempt from the taxes imposed by subtitle A includes any class of income which is—

(i) Wholly excluded from gross income under any provision of subtitle A, or

(ii) Wholly exempt from the taxes imposed by subtitle A under the provisions of any other law.

(2) As used in this section the term "nonexempt income" means any income which is required to be included in gross income.

(c) ALLOCATION OF EXPENSES TO A CLASS OR CLASSES OF EXEMPT INCOME.—Expenses and amounts otherwise allowable which are directly allocable to any class or classes of exempt income shall be allocated thereto; and expenses and amounts directly allocable to any class or classes of nonexempt income shall be allocated thereto. If an expense or amount otherwise allowable is indirectly allocable to both a class of nonexempt income and a class of exempt income, a reasonable proportion thereof determined in the light of all the facts and circumstances in each case shall be allocated to each.

(d) STATEMENT OF CLASSES OF EXEMPT INCOME; RECORDS.—(1) A taxpayer receiving any class of exempt income or holding any property or engaging in any activity the income from which is exempt shall submit with his return as a part thereof an itemized statement, in detail, showing (i) the amount of each class of exempt income, and (ii) the amount of expenses and amounts otherwise allowable allocated to each such class (the amount allocated by apportionment being

shown separately) as required by paragraph (c) of this section. If an item is apportioned between a class of exempt income and a class of nonexempt income, the statement shall show the basis of the apportionment. Such statement shall also recite that each deduction claimed in the return is not in any way attributable to a class of exempt income.

(2) The taxpayer shall keep such records as will enable him to make the allocations required by this section. See section 6001 and the regulations thereunder.

§ 1.265–2 Interest Relating to Tax-Exempt Income.—No amount shall be allowed as a deduction for interest on any indebtedness incurred or continued to purchase or carry obligations, the interest on which is wholly exempt from tax under subtitle A of the Internal Revenue Code of 1954, such as municipal bonds, Panama Canal loan 3-percent bonds, or obligations of the United States, the interest on which is wholly exempt from tax under substitute A, and which were issued after September 24, 1917, and not originally subscribed for by the taxpayer. Interest paid or accrued within the taxable year on indebtedness incurred or continued to purchase or carry (a) obligations of the United States issued after September 24, 1917, the interest on which is not wholly exempt from the taxes imposed under subtitle A of the Internal Revenue Code of 1954, or (b) obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer, the interest on which is wholly exempt from the taxes imposed by subtitle A of the Internal Revenue Code of 1954, is deductible. For rules as to the inclusion in gross income of interest on certain governmental obligations, see section 103 and §§ 1.103–1 through 1.103–6.

§ 1.266 Statutory Provisions; Carrying Charges.

Sec. 266. Carrying charges.

No deduction shall be allowed for amounts paid or accrued for such taxes and carrying charges as, under regulations prescribed by the Secretary or his delegate, are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable.

§ 1.266–1 Taxes and Carrying Charges Chargeable to Capital Account and Treated as Capital Items.—(a) *In general.*—In accordance with section 266, items enumerated in paragraph (b) (1) of this section may be capitalized at the election of the taxpayer. Thus, taxes and carrying charges with respect to property of the type described in this section are chargeable to capital account at the election of the taxpayer, notwithstanding that they are otherwise expressly deductible under provisions of subtitle A of the Internal Revenue Code of 1954. No deduction is allowable for any items so treated.

(b) *Taxes and carrying charges.*—(1) The taxpayer may elect, as provided in paragraph (c) of this section, to treat the items enumerated in this subparagraph which are otherwise expressly deductible under the provisions of subtitle A of the Internal Revenue Code of 1954 as chargeable to capital account either as a component of original cost or other basis, for the purposes of section 1012, or as an adjustment to basis, for the purposes of section 1016(a)(1). The items thus chargeable to capital account are—

(i) In the case of unimproved and unproductive real property: Annual taxes, interest on a mortgage, and other carrying charges.

(ii) In the case of real property, whether improved or unimproved and whether productive or unproductive:

(*a*) Interest on a loan (but not theoretical interest of a taxpayer using his own funds),

(*b*) Taxes of the owner of such real property measured by compensation paid to his employees,

(*c*) Taxes of such owner imposed on the purchase of materials, or on the storage, use, or other consumption of materials, and

(*d*) Other necessary expenditures,

paid or incurred for the development of the real property or for the construction of an improvement or additional improvement to such real property, up to the time the development or construction work has been completed. The development or construction work with respect to which such items are incurred may relate to unimproved and unproductive real estate whether the construction work will make the property productive of income subject to tax (as in the case of a factory) or not (as in the case of a personal residence), or may relate to property already improved or productive (as in the case of a plant addition or improvement, such as the construction of another floor on a factory or the installation of insulation therein).

(iii) In the case of personal property:

(*a*) Taxes of an employer measured by compensation for services rendered in transporting machinery or other fixed assets to the plant or installing them therein,

(*b*) Interest on a loan to purchase such property or to pay for transporting or installing the same, and

(*c*) Taxes of the owner thereof imposed on the purchase of such property or on the storage, use, or other consumption of such property,

paid or incurred up to the date of installation or the date when such property is first put into use by the taxpayer, whichever date is later.

(iv) Any other taxes and carrying charges with respect to property, otherwise deductible, which in the opinion of the Commissioner are, under sound accounting principles, chargeable to capital account.

(2) The sole effect of section 266 is to permit the items enumerated in subparagraph (1) of this paragraph to be chargeable to capital account notwithstanding that such items are otherwise expressly deductible under the provisions of subtitle A of the Internal Revenue Code of 1954. An item not otherwise deductible may not be capitalized under section 266. Thus, since the taxes imposed by the Federal Inurance Contributions Act and the Federal Unemployment Tax Act are not taxes deductible under section 164, and since such taxes may not be deducted under section 162 when they are paid or incurred in connection with the construction or acquisition of a capital asset, they are not subject to section 266 and must be capitalized without regard to such section.

(3) In the absence of a provision in this section for treating a given item as a capital item, this section has no effect on the treatment otherwise accorded such item. Thus, items which are otherwise deductible are deductible notwithstanding the provisions of this section, and items which are otherwise treated as capital items are to be so treated. Similarly, an item not otherwise deductible is not made deductible by this section. Nor is the absence of a provision in this section for treat-

ing a given item as a capital item to be construed as withdrawing or modifying the right now given to the taxpayer under any other provisions of subtitle A of the Internal Revenue Code of 1954, or of the regulations thereunder, to elect to capitalize or to deduct a given item.

(c) *Election to charge taxes and carrying charges to capital account.*—(1) If for any taxable year there are two or more items of the type described in paragraph (b)(1) of this section, which relate to the same project to which the election is applicable, the taxpayer may elect to capitalize any one or more of such items even though he does not elect to capitalize the remaining items or to capitalize items of the same type relating to other projects.

However, if expenditures for several items of the same type are incurred with respect to a single project, the election to capitalize must, if exercised, be exercised as to all items of that type. For purposes of this section, a "project" means, in the case of items described in paragraph (b)(1)(ii) of this section, a particular development of, or construction of an improvement to, real property, and in the case of items described in paragraph (b)(1)(iii) of this section, the transportation and installation of machinery or other fixed assets.

(2)(i) An election with respect to an item described in paragraph (b)(1)(i) of this section is effective only for the year for which it is made.

(ii) An election with respect to an item described in—

(*a*) Paragraph (b)(1)(ii) of this section is effective until the development or construction work described in that subdivision has been completed;

(*b*) Paragraph (b)(1)(iii) of this section is effective until the later of either the date of installation of the property described in that subdivision, or the date when such property is first put into use by the taxpayer;

(*c*) Paragraph (b)(1)(iv) of this section is effective as determined by the Commissioner.

Thus, an item chargeable to capital account under this section must continue to be capitalized for the entire period described in this subdivision applicable to such election although such period may consist of more than one taxable year.

(3) If the taxpayer elects to capitalize an item or items under this section, such election shall be exercised by filing with the original return for the year for which the election is made a statement indicating the item or items (whether with respect to the same project or to different projects) which the taxpayer elects to treat as chargeable to capital account. Elections filed for taxable years beginning before January 1, 1954, and for taxable years ending before August 17, 1954, under section 24(a)(7) of the Internal Revenue Code of 1939, and the regulations thereunder, shall have the same effect as if they were filed under this section. See section 7807(b)(2).

(d) The following examples are illustrative of the application of the provisions of this section:

Example (1). In 1956 and 1957, A pays annual real property taxes and interest on a mortgage on a piece of real property. During 1956 the property is vacant and unproductive, but in January 1957 A converts the property into a parking lot and operates it as such thereafter.

A may elect to capitalize the real property tax and mortgage interest paid in 1956 but not such amounts paid in 1957. Moreover, for 1956, A may elect to capitalize the taxes and to deduct the interest, or he may elect to capitalize the mortgage interest and to deduct the taxes paid on such real property.

Example (2). In February 1957, B began the erection of an office building for himself in Illinois. B in 1957, in connection with the erection of the building, paid $6,000 in Illinois unemployment insurance contributions (considered as taxes under section 164, relating to taxes), which in his 1957 return he elected to capitalize. B must continue to capitalize these unemployment insurance contributions paid in connection with the erection of the building until its completion.

Example (3). Assume the same facts as in example (2) except that in November 1957, B also began to build a hotel in Illinois. In 1957 B paid $3,000 in Illinois unemployment insurance contributions in connection with the erection of the hotel. B's election to capitalize the unemployment insurance contributions paid in erecting the office building started in February 1957 does not bind him to capitalize the unemployment insurance contributions paid in erecting the hotel; he may deduct the $3,000 unemployment insurance contributions paid in erecting the hotel.

Example (4). In 1957, C purchased machinery for installation in his factory located in the District of Columbia and building material for an addition to the factory. In connection with the purchase, transportation, and installation of the machinery and building material, C paid social security, sales, and use taxes in the following amounts:

Tax imposed by Federal Insurance Contributions Act (F. I. C. A.)	$2,500
Tax imposed by Federal Unemployment Tax Act (F. U. T. A.)	500
District of Columbia gross sales tax	10,000
District of Columbia compensating-use tax	1,000
District of Columbia unemployment compensation contributions	150

Under the provisions of section 266 and the regulations thereunder, C has an election to capitalize only the $1,000 paid to the District of Columbia as a compensating-use tax. Since the F. I. C. A. and F. U. T. A. taxes are not deductible as taxes under section 164, no deduction is allowed for such amounts and they must be capitalized when paid or incurred in connection with an item which is a capital expenditure under section 263. A similar treatment is required in the case of the District of Columbia unemployment compensation contributions since they are not classified as taxes. As the District of Columbia gross sales tax is imposed on the seller and passed on to the buyer, the tax must also be capitalized, since it was incurred by C in connection with the purchase of machinery and building material for use in his business.

Example (5). D purchased machinery in 1957 for use in his factory. He pays a use tax on the machinery, as well as interest on a loan to obtain funds to pay for the machinery and for transportation and installation costs. D may capitalize either the use tax or the interest, or both, up to the date of installation or until the machinery is first put into use by him, whichever date is later.

(e) *Allocation.*—If any tax or carrying charge with respect to property is in part a type of item described in paragraph (b) of this section

and in part a type of item or items with respect to which no election to treat as a capital item is given, a reasonable proportion of such tax or carrying charge, determined in the light of all the facts and circumstances in each case, shall be allocated to each item. The rule of this paragraph may be illustrated by the following example:

Example. N Corporation, the owner of a factory in New York on which a new addition is under construction, in 1957 pays its general manager, B, a salary of $10,000 and also pays a New York State unemployment insurance tax of $81 on B's salary. B spends nine-tenths of his time in the general business of the firm and the remaining one-tenth in supervising the construction work. N Corporation treats as expenses $9,000 of B's salary, and charges the remaining $1,000 to capital account. N Corporation may elect to capitalize $8.10 of the $81 New York State unemployment insurance tax paid in 1957, since such tax is deductible under section 164.

§ 1.273 STATUTORY PROVISIONS; HOLDERS OF LIFE OR TERMINABLE INTEREST.

SEC. 273. HOLDERS OF LIFE OR TERMINABLE INTEREST.

Amounts paid under the laws of a State, a Territory, the District of Columbia, a possession of the United States, or a foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time.

§ 1.273–1 LIFE OR TERMINABLE INTERESTS.—Amounts paid as income to the holder of a life or a terminable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called by depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deduction for shrinkage or exhaustion thereof due to the passage of time. For the treatment generally of distributions to beneficiaries of an estate or trust, see sections 641 through 668, and the regulations thereunder. For basis of property acquired from a decedent and by gifts and transfers in trust, see sections 1014 and 1015, and the regulations thereunder.

LEO SPEER,
Acting Commissioner of Internal Revenue.

Approved September 11, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 16, 1958, 8:51 a. m., and published in the issue of the Federal Register for September 17, 1958, 23 F. R. 7172.)

SECTION 262.—PERSONAL, LIVING, AND FAMILY EXPENSES

26 CFR 1.262: Statutory provisions; personal, living, and family expenses.

Regulations under the Internal Revenue Code of 1954. See T. D. 6313, page 114.

SECTION 263.—CAPITAL EXPENDITURES

Rev. Rul. 58–373

A voluntary contribution by a corporation to defray in part the cost of state construction of a bridge of sufficient capacity to be traveled by trucks in transferring stone from the corporation's quarries on the south side of a river to its plant on the north side of the river constitutes an exhaustible capital expenditure which is depreciable or amortizable over the estimated useful life (period of economic usefulness to the corporation) of the bridge even though the corporation has no legal title thereto. See G. C. M. 25503, C. B. 1948–1, 40.

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26 CFR 1.263(a) : Statutory provisions; capital expenditures.

Regulations under the Internal Revenue Code of 1954. See T. D. 6313, page 114.

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26 CFR 1.263(a)–1 : Capital expenditures; in general. Rev. Rul. 58–534

(Also Section 162; 1.162–1.)

A group of taxpayers organized a nonprofit, noncapital stock corporation, exempt from Federal income tax under section 501(c)(12) of the Internal Revenue Code of 1954, for the purpose of rendering certain services necessary to the business activities of the organizers. Each of them, under a method of voluntary assessments, made pro rata payments to the corporation which it would use to purchase equipment, and to meet its operating expenses. The proprietary account of the corporation was so recorded as to reflect ratable portions being owned by each organizer, in lieu of issuing capital stock therefor in equivalent amounts. *Held:* inasmuch as the assessment payments will be utilized in dual capacities, the portion attributable to the purchase of equipment would constitute a capital investment, under the provisions of section 263(a)(1) of the Code, the amount of which is subject to depreciation only in the proprietorship accounts of the nonprofit corporation. The portion of the assessments utilized by the nonprofit corporation to meet its current operating expenses would constitute payment for services rendered by it to the organizers and would be deductible pro rata by them as ordinary and necessary business expenses, under section 162(a) of the Code.

SECTION 265.—EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME

26 CFR 1.265: Statutory provisions; expenses and interest relating to tax-exempt income.

Regulations under the Internal Revenue Code of 1954. See T. D. 6313, page 114.

SECTION 266.—CARRYING CHARGES

26 CFR 1.266: Statutory provisions; carrying charges.

Regulations under the Internal Revenue Code of 1954. See T. D. 6313, page 114.

SECTION 267.—LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS

26 CFR 1.267(a): Statutory provisions; losses, expenses, and interest with respect to transactions between related taxpayers; deductions disallowed. T. D. 6312[1]

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

Regulations under section 267 of the Internal Revenue Code of 1954; Income Tax Regulations (26 CFR 1.707-1(b)(3)) 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 November 30, 1957, notice of proposed rulemaking regarding regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, except as specifically provided otherwise, under section 267 of the Internal Revenue Code of 1954 and regarding an amendment to § 1.707-1(b)(3) (26 CFR 1.707-1(b)(3)) for such taxable years was published in the Federal Register (22 F. R. 9596). Consideration has been given to all such relevant matter as was presented by interested persons regarding the rules proposed.

PARAGRAPH 1. The following regulations are hereby prescribed under section 267 of the Internal Revenue Code of 1954.

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Authority: §§ 1.267 to 1.267(d)-2 incl., and § 1.707-1(b)(3), issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

[1] The publication of this Treasury Decision in 23 F. R. 7035, dated September 11, 1958, contains (1) instructions for modifying the notice of proposed rulemaking published in 23 F. R. 9596, dated November 30, 1957, 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.

§ 1.267(a) STATUTORY PROVISIONS; LOSSES, EXPENSES, AND INTERESTS WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS; DEDUCTION DISALLOWED.

SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS.

(a) DEDUCTIONS DISALLOWED. NO DEDUCTION SHALL BE ALLOWED.—

(1) LOSSES.—In respect of losses from sales or exchanges of property (other than losses in cases of distributions in corporate liquidations), directly or indirectly, between persons specified within any one of the paragraphs of subsection (b).

(2) UNPAID EXPENSES AND INTEREST.—In respect of expenses, otherwise deductible under section 162 or 212, or of interest, otherwise deductible under section 163—

(A) If within the period consisting of the taxable year of the taxpayer and 2½ months after the close thereof (i) such expenses or interest are not paid, and (ii) the amount thereof is not includible in the gross income of the person to whom the payment is to be made; and

(B) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(C) If, at the close of the taxable year of the taxpayer or at any time within 2½ months thereafter, both the taxpayer and the person to whom the payment is to be made are persons specified within any one of the paragraphs of subsection (b).

§ 1.267(a)-1 DEDUCTIONS DISALLOWED.—(a) *Losses.*—Except in cases of distributions in corporate liquidations, no deduction shall be allowed for losses arising from direct or indirect sales or exchanges of property between persons who, on the date of the sale or exchange, are within any one of the relationships specified in section 267(b). See § 1.267(b)-1.

(b) *Unpaid expenses and interest.*—(1) No deduction shall be allowed a taxpayer for trade or business expenses otherwise deductible under section 162, for expenses for production of income otherwise deductible under section 212, or for interest otherwise deductible under section 163—

(i) If, at the close of the taxpayer's taxable year within which such items are accrued by the taxpayer or at any time within 2½ months thereafter, both the taxpayer and the payee are persons within any one of the relationships specified in section 267(b) (see § 1.267(b)-1); and

(ii) If the payee is on the cash receipts and disbursements method of accounting with respect to such items of gross income for his taxable year in which or with which the taxable year of accrual by the debtor-taxpayer ends; and

(iii) If, within the taxpayer's taxable year within which such items are accrued by the taxpayer and 2½ months after the close thereof, the amount of such items is not paid and the amount of such items is not otherwise (under the rules of constructive receipt) includible in the gross income of the payee.

(2) The provisions of section 267(a)(2) and this paragraph do not otherwise affect the general rules governing the allowance of deductions under an accrual method of accounting. For example, if the accrued expenses or interest are paid after the deduction has become disallowed under section 267(a)(2), no deduction would be allowable for the taxable year in which payment is made, since an

accrual item is deductible only in the taxable year in which it is properly accruable.

(3) The expenses and interest specified in section 267(a)(2) and this paragraph shall be considered as paid for purposes of that section to the extent of the fair market value on the date of issue of notes or other instruments of similar effect received in payment of such expenses or interest if such notes or other instruments were issued in such payment by the taxpayer within his taxable year or within 2½ months after the close thereof. The fair market value on the date of issue of such notes or other instruments of similar effect is includible in the gross income of the payee for the taxable year in which he receives the notes or other instruments.

(4) The provisions of this paragraph may be illustrated by the following example:

Example. A, an individual, is the holder and owner of an interest-bearing note of the M Corporation, all the stock of which was owned by him on December 31, 1956. A and the M Corporation make their income tax returns for a calendar year. The M Corporation uses an accrual method of accounting. A uses a combination of accounting methods permitted under section 446(c)(4) in which he uses the cash receipts and disbursements method in respect of items of gross income. The M Corporation does not pay any interest on the note to A during the calendar year 1956 or within 2½ months after the close of that year, nor does it credit any interest to A's account in such a manner that it is subject to his unqualified demand and thus is constructively received by him. M Corporation claims a deduction for the year 1956 for the interest accruing on the note in that year. Since A is on the cash receipts and disbursements method in respect of items of gross income, the interest is not includible in his return for the year 1956. Under the provisions of section 267(a)(2) and this paragraph, no deduction for such interest is allowable in computing the taxable income of the M Corporation for the taxable year 1956 or for any other taxable year. However, if the interest had actually been paid to A on or before March 15, 1957, or if it had been made available to A before that time (and thus had been constructively received by him), the M Corporation would be allowed to deduct the amount of the payment in computing its taxable income for 1956.

(c) *Scope of section.*—Section 267(a) requires that deductions for losses or unpaid expenses or interest described therein be disallowed even though the transaction in which such losses, expenses, or interest were incurred was a bona fide transaction. However, section 267 is not exclusive. No deduction for losses or unpaid expenses or interest arising in a transaction which is not bona fide will be allowed even though section 267 does not apply to the transaction.

§ 1.267(b) STATUTORY PROVISIONS; LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS; RELATIONSHIPS.

SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS. * * *

(b) RELATIONSHIPS.—The persons referred to in subsection (a) are:
(1) Members of a family, as defined in subsection (c)(4);
(2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(3) Two corporations more than 50 percent in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(4) A grantor and a fiduciary of any trust;

(5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;

(6) A fiduciary of a trust and a beneficiary of such trust;

(7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

(8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust; or

(9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual.

§ 1.267(b)-1 RELATIONSHIPS.—(a) *In general.*—(1) The persons referred to in section 267(a) and § 1.267(a)-1 are specified in section 267(b).

(2) Under section 267(b)(3), it is not necessary that either of the two corporations be a personal holding company or a foreign personal holding company for the taxable year in which the sale or exchange occurs or in which the expenses or interest are properly accruable, but either one of them must be such a company for the taxable year next preceding the taxable year in which the sale or exchange occurs or in which the expenses or interest are accrued.

(3) Under section 267(b)(9), the control of certain educational and charitable organizations exempt from tax under section 501 includes any kind of control, direct or indirect, by means of which a person in fact controls such an organization, whether or not the control is legally enforceable and regardless of the method by which the control is exercised or exercisable. In the case of an individual, control possessed by the individual's family, as defined in section 267(c)(4) and § 1.267(c)-1(a)(4), shall be taken into account.

(b) *Partnerships.*—(1) Since section 267 does not include members of a partnership and the partnership as related persons, transactions between partners and partnerships do not come within the scope of section 267. Such transactions are governed by section 707 for the purposes of which the partnership is considered to be an entity separate from the partners. See section 707 and § 1.707-1. Any transaction described in section 267(a) between a partnership and a person other than a partner shall be considered as occurring between the other person and the members of the partnership separately. Therefore, if the other person and a partner are within any one of the relationships specified in section 267(b), no deductions with respect to such transactions between the other person and the partnership shall be allowed—

(i) To the related partner to the extent of his distributive share of partnership deductions for losses or unpaid expenses or interest resulting from such transactions, and

(ii) To the other person to the extent the related partner acquires an interest in any property sold to or exchanged with the partnership by such other person at a loss, or to the extent of the related partner's distributive share of the unpaid expenses or interest payable to the partnership by the other person as a result of such transaction.

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

Example (1). A, an equal partner in the ABC partnership, personally owns all the stock of M Corporation. B and C are not related to A. The partnership and all the partners use an accrual method of accounting, and are on a calendar year. M Corporation uses the cash receipts and disbursements method of accounting and is also on a calendar year. During 1956 the partnership borrowed money from M Corporation and also sold property to M Corporation, sustaining a loss on the sale. On December 31, 1956, the partnership accrued its interest liability to the M Corporation and on April 1, 1957 (more than 2½ months after the close of its taxable year), it paid the M Corporation the amount of such accrued interest. Applying the rules of this paragraph, the transactions are considered as occurring between M Corporation and the partners separately. The sale and interest transactions considered as occurring between A and M Corporation fall within the scope of section 267(a) and (b), but the transactions considered as occurring between partners B and C and M Corporation do not. The latter two partners may, therefore, deduct their distributive shares of partnership deductions for the loss and the accrued interest. However, no deduction shall be allowed to A for his distributive shares of these partnership deductions. Furthermore, A's adjusted basis for his partnership interest must be decreased by the amount of his distributive share of such deductions. See section 705(a)(2).

Example (2). Assume the same facts as in example (1) of this subparagraph except that the partnership and all the partners use the cash receipts and disbursements methods of accounting, and that M Corporation uses an accrual method. Assume further, that during 1956 M Corporation borrowed money from the partnership and that on a sale of property to the partnership during that year M Corporation sustained a loss. On December 31, 1956, the M Corporation accrued its interest liability on the borrowed money and on April 1, 1957 (more than 2½ months after the close of its taxable year) it paid the accrued interest to the partnership. The corporation's deduction for the accrued interest is not allowed to the extent of A's distributive share (one-third) of such interest income. M Corporation's deduction for the loss on the sale of the property to the partnership is not allowed to the extent of A's one-third interest in the purchased property.

§ 1.267(c) STATUTORY PROVISIONS; LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTION BETWEEN RELATED TAXPAYERS; CONSTRUCTIVE OWNERSHIP OF STOCK.

SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS. * * *

(c) CONSTRUCTIVE OWNERSHIP OF STOCK.—For purposes of determining, in applying subsection (b), the ownership of stock—

(1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(3) An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1), (2), or (3), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

§ 1.267(c)-1 CONSTRUCTIVE OWNERSHIP OF STOCK.—(a) *In general.*—(1) The determination of stock ownership for purposes of section 267(b) shall be in accordance with the rules in section 267(c).

(2) For an individual to be considered under section 267(c)(2) as constructively owning the stock of a corporation which is owned, directly or indirectly, by or for members of his family it is not necessary that he own stock in the corporation either directly or indirectly. On the other hand, for an individual to be considered under section 267(c)(3) as owning the stock of a corporation owned either actually, or constructively under section 267(c)(1), by or for his partner, such individual must himself actually own, or constructively own under section 267(c)(1), stock of such corporation.

(3) An individual's constructive ownership, under section 267(c)(2) or (3), of stock owned directly or indirectly by or for a member of his family, or by or for his partner, is not to be considered as actual ownership of such stock, and the individual's constructive ownership of the stock is not to be attributed to another member of his family or to another partner. However, an individual's constructive ownership, under section 267(c)(1), of stock owned directly or indirectly by or for a corporation, partnership, estate, or trust shall be considered as actual ownership of the stock, and the individual's ownership may be attributed to a member of his family or to his partner.

(4) The family of an individual shall include only his brothers and sisters, spouse, ancestors, and lineal descendants. In determining whether any of these relationships exist, full effect shall be given to a legal adoption. The term "ancestors" includes parents and grandparents, and the term "lineal descendents" includes children and grandchildren.

(b) *Examples.*—The application of section 267(c) may be illustrated by the following examples:

Example (1). On July 1, 1957, A owned 75 percent, and AW, his wife, owned 25 percent, of the outstanding stock of the M Corporation. The M Corporation in turn owned 80 percent of the outstanding

stock of the O Corporation. Under section 267(c)(1), A and AW are each considered as owning an amount of the O Corporation stock actually owned by M Corporation in proportion to their respective ownership of M Corporation stock. Therefore, A constructively owns 60 percent (75 percent of 80 percent) of the O Corporation stock and AW constructively owns 20 percent (25 percent of 80 percent) of such stock. Under the family ownership rule of section 267(c)(2), an individual is considered as constructively owning the stock actually owned by his spouse. A and AW, therefore, are each considered as constructively owning the M Corporation stock actually owned by the other. For the purpose of applying this family ownership rule, A's and AW's constructive ownership of O Corporation stock is considered as actual ownership under section 267(c)(5). Thus, A constructively owns the 20 percent of the O Corporation stock constructively owned by AW, and AW constructively owns the 60 percent of the O Corporation stock constructively owned by A. In addition, the family ownership rule may be applied to make AWF, AW's father, the constructive owner of the 25 percent of the M Corporation stock actually owned by AW. As noted above, AW's constructive ownership of 20 percent of the O Corporation stock is considered as actual ownership for purposes of applying the family ownership rule, and AWF is thereby considered the constructive owner of this stock also. However, AW's constructive ownership of the stock constructively and actually owned by A may not be considered as actual ownership for the purpose of again applying the family ownership rule to make AWF the constructive owner of these shares. The ownership of the stock in the M and O Corporations may be tabulated as follows:

Person	Stock ownership in M corporation		Total under section 267	Stock ownership in O corporation		Total under section 267
	Actual	Constructive		Actual	Constructive	
A	75%	25%	100%	None	60% 20%	80%
AW (A's wife)	25%	75%	100%	None	20% 60%	80%
AWF (AW's father)	None	25%	25%	None	20%	20%
M Corporation				80%	None	80%
O Corporation	None	None	None			

Assuming that the M Corporation and the O Corporation make their income tax returns for calendar years, and that there was no distribution in liquidation of the M or O Corporation, and further assuming that either corporation was a personal holding company under section 542 for the calendar year 1956, no deduction is allowable with respect to losses from sales or exchanges of property made on July 1, 1957, between the two corporations. Moreover, whether or not either corporation was a personal holding company, no loss would be allowable on a sale or exchange between A or AW and either corporation. A deduction would be allowed, however, for a loss sustained in an arm's length sale or exchange between A and AWF, and between AWF and the M or O Corporation.

Example (2). On June 15, 1957, all of the stock of the N Corporation was owned in equal proportions by A and his partner, AP. Except in the case of distributions in liquidation by the N Corporation, no deduction is allowable with respect to losses from sales or exchanges of property made on June 15, 1957, between A and the N Corporation or AP and the N Corporation since each partner is considered as owning the stock owned by the other; therefore, each is considered as owning more than 50 percent in value of the outstanding stock of the N Corporation.

Example (3). On June 7, 1957, A owned no stock in X Corporation, but his wife, AW, owned 20 percent in value of the outstanding stock of X, and A's partner, AP, owned 60 percent in value of the outstanding stock of X. The partnership firm of A and AP owned no stock in X Corporation. The ownership of AW's stock is attributed to A, but not that of AP since A does not own any X Corporation stock either actually, or constructively under section 267(c)(1). A's constructive ownership of AW's stock is not the ownership required for the attribution of AP's stock. Therefore, deductions for losses from sales or exchanges of property made on June 7, 1957, between X Corporation and A or AW are allowable since neither person owned more than 50 percent in value of the outstanding stock of X, but deductions for losses from sales or exchanges between X Corporation and AP would not be allowable by section 267(a) (except for distributions in liquidation of X Corporation).

§ 1.267(d) STATUTORY PROVISIONS; LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS; AMOUNT OF GAIN WHERE LOSS PREVIOUSLY DISALLOWED.

SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS. * * *

(d) AMOUNT OF GAIN WHERE LOSS PREVIOUSLY DISALLOWED.—If—

(1) In the case of a sale or exchange of property to the taxpayer a loss sustained by the transferor is not allowable to the transferor as a deduction by reason of subsection (a) (1) (or by reason of section 24(b) of the Internal Revenue Code of 1939); and

(2) After December 31, 1953, the taxpayer sells or otherwise disposes of such property (or of other property the basis of which in his hands is determined directly or indirectly by reference to such property) at a gain,

then such gain shall be recognized only to the extent that it exceeds so much of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer. This subsection applies with respect to taxable years ending after December 31, 1953. This subsection shall not apply if the loss sustained by the transferor is not allowable to the transferor as a deduction by reason of section 1091 (relating to wash sales) or by reason of section 118 of the Internal Revenue Code of 1939.

§ 1.267(d)–1 AMOUNT OF GAIN WHERE LOSS PREVIOUSLY DISALLOWED.—(a) *General rule.*—(1) If a taxpayer acquires property by purchase or exchange from a transferor who, on the transaction, sustained a loss not allowable as a deduction by reason of section 267(a)(1) (or by reason of section 24(b) of the Internal Revenue Code of 1939), then any gain realized by the taxpayer on a sale or other disposition of the property after December 31, 1953, shall be recognized only to the extent that the gain exceeds the amount of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer.

(2) The general rule is also applicable to a sale or other disposition of property by a taxpayer when the basis of such property in the taxpayer's hands is determined directly or indirectly by reference to other property acquired by the taxpayer from a transferor through a sale or exchange in which a loss sustained by the transferor was not allowable. Therefore, section 267(d) applies to a sale or other disposition of property after a series of transactions if the basis of the property acquired in each transaction is determined by reference to the basis of the property transferred, and if the original property was acquired in a transaction in which a loss to a transferor was not allowable by reason of section 267(a)(1) (or by reason of section 24(b) of the Internal Revenue Code of 1939).

(3) The benefit of the general rule is available only to the original transferee but does not apply to any original transferee (e. g., a donee) who acquired the property in any manner other than by purchase or exchange.

(4) The application of the provisions of this paragraph may be illustrated by the following examples:

Example (1). H sells to his wife, W, for $500, certain corporate stock with an adjusted basis for determining loss to him of $800. The loss of $300 is not allowable to H by reason of section 267(a)(1) and § 1.267(a)-1(a). W later sells this stock for $1,000. Although W's realized gain is $500 ($1,000 minus $500, her basis), her recognized gain under section 267(d) is only $200, the excess of the realized gain of $500 over the loss of $300 not allowable to H. In determining capital gain or loss W's holding period commences on the date of the sale from H to W.

Example (2). Assume the same facts as in example (1) except that W later sells her stock for $300 instead of $1,000. Her recognized loss is $200 and not $500 since section 267(d) applies only to the nonrecognition of gain and does not affect basis.

Example (3). Assume the same facts as in example (1) except that W transfers her stock as a gift to X. The basis of the stock in the hands of X for the purpose of determining gain, under the provisions of section 1015, is the same as W's, or $500. If X later sells the stock for $1,000 the entire $500 gain is taxed to him.

Example (4). H sells to his wife, W, for $5,500, farmland, with an adjusted basis for determining loss to him of $8,000. The loss of $2,500 is not allowable to H by reason of section 267(a)(1) and § 1.267(a)-1(a). W exchanges the farmland, held for investment purposes, with S, an unrelated individual, for two city lots, also held for investment purposes. The basis of the city lots in the hands of W ($5,500) is a substituted basis determined under section 1031(d) by reference to the basis of the farmland. Later W sells the city lots for $10,000. Although W's realized gain is $4,500 ($10,000 minus $5,500), her recognized gain under section 267(d) is only $2,000, the excess of the realized gain of $4,500 over the loss of $2,500 not allowable to H.

(b) *Determination of basis and gain with respect to divisible property.*—(1) *Taxpayer's basis.*—When the taxpayer acquires divisible property or property that consists of several items or classes of items by a purchase or exchange on which loss is not allowable to the transferor, the basis in the taxpayer's hands of a particular part, item, or class of such property shall be determined (if the taxpayer's basis for that part is not known) by allocating to the particular part, item, or

class a portion of the taxpayer's basis for the entire property in the proportion that the fair market value of the particular part, item, or class bears to the fair market value of the entire property at the time of the taxpayer's acquisition of the property.

(2) *Taxpayer's recognized gain.*—Gain realized by the taxpayer on sales or other dispositions after December 31, 1953, of a part, item, or class of the property shall be recognized only to the extent that such gain exceeds the amount of loss attributable to such part, item, or class of property not allowable to the taxpayer's transferor on the latter's sale or exchange of such property to the taxpayer.

(3) *Transferor's loss not allowable.*—(i) The transferor's loss on the sale or exchange of a part, item, or class of the property to the taxpayer shall be the excess of the transferor's adjusted basis for determining loss on the part, item, or class of the property over the amount realized by the transferor on the sale or exchange of the part, item, or class. The amount realized by the transferor on the part, item, or class shall be determined (if such amount is not known) in the same manner that the taxpayer's basis for such part, item, or class is determined. See subparagraph (1) of this paragraph.

(ii) If the transferor's basis for determining loss on the part, item, or class cannot be determined, the transferor's loss on the particular part, item, or class transferred to the taxpayer shall be determined by allocating to the part, item, or class a portion of his loss on the entire property in the proportion that the fair market value of such part, item, or class bears to the fair market value of the entire property on the date of the taxpayer's acquisition of the entire property.

(4) *Examples.*—The application of the provisions of this paragraph may be illustrated by the following examples:

Example (1). During 1953, H sold class A stock which had cost him $1,100, and common stock which had cost him $2,000, to his wife W for a lump sum of $1,500. Under section 24(b)(1)(A) of the 1939 Code, the loss of $1,600 on the transaction was not allowable to H. At the time the stocks were purchased by W, the fair market value of class A stock was $900 and the fair market value of common stock was $600. In 1954, W sold the class A stock for $2,500. W's recognized gain is determined as follows:

Amount realized by W on sale of class A stock		$2,500
Less: Basis allocated to class A stock—$900/$1,500 x $1,500		900
Realized gain on transaction		1,600
Less: Loss sustained by H on sale of class A stock to W not allowable as a deduction:		
Basis to H of class A stock	$1,100	
Amount realized by H on class A stock—$900/$1,500 x $1,500	900	
Unallowable loss to H on sale of class A stock		200
Recognized gain on sale of class A stock by W		1,400

Example (2). Assume the same facts as those stated in example (1) of this subparagraph except that H originally purchased both classes of stock for a lump sum of $3,100. The unallowable loss to H on the sale of all the stock to W is $1,600 ($3,100 minus $1,500). An exact determination of the unallowable loss sustained by H on sale to W of class A stock cannot be made because H's basis for class A stock cannot be determined. Therefore, a determination of the unallowable loss is

made by allocating to class A stock a portion of H's loss on the entire property transferred to W in the proportion that the fair market value of class A stock at the time acquired by W ($900) bears to the fair market value of both classes of stock at that time ($1,500). The allocated portion is $900/$1,500 x $1,600, or $960. W's recognized gain is, therefore, $640 (W's realized gain of $1,600 minus $960).

(c) *Special rules.*—(1) Section 267(d) does not affect the basis of property for determining gain. Depreciation and other items which depend on such basis are also not affected.

(2) The provisions of section 267(d) shall not apply if the loss sustained by the transferor is not allowable to the transferor as a deduction by reason of section 1091, or section 118 of the Internal Revenue Code of 1939, which relate to losses from wash sales of stock or securities.

(3) In determining the holding period in the hands of the transferee of property received in an exchange with a transferor with respect to whom a loss on the exchange is not allowable by reason of section 267, section 1223(2) does not apply to include the period during which the property was held by the transferor. In determining such holding period, however, section 1223(1) may apply to include the period during which the transferee held the property which he exchanged where, for example, he exchanged a capital asset in a transaction which, as to him, was nontaxable under section 1031 and the property received in the exchange has the same basis as the property exchanged.

§ 1.267(d)-2 Effective Date; Taxable Years Subject to the Internal Revenue Code of 1939.—Pursuant to section 7851(a)(1)(C), the regulations prescribed in § 1.267(d)-1, to the extent that they relate to determination of gain resulting from the sale or other disposition of property after December 31, 1953, with respect to which property a loss was not allowable to the transferor by reason of section 267(a)(1) (or by reason of section 24(b) of the Internal Revenue Code of 1939), shall also apply to taxable years beginning before January 1, 1954, and ending after December 31, 1953, and taxable years beginning after December 31, 1953, and ending before August 17, 1954, which years are subject to the Internal Revenue Code of 1939.

Par. 2. Section 1.707-1(b)(3) as prescribed by Treasury Decision 6175 (21 F. R. 3500), approved May 23, 1956 [C. B. 1956-1, 211], is amended to read as follows:

(3) *Ownership of a capital or profits interest.*—In determining the extent of the ownership by a partner, as defined in section 761(b), of his capital interest or profits interest in a partnership, the rules for constructive ownership of stock provided in section 267(c)(1), (2), (4), and (5) shall be applied for the purpose of section 707(b) and this paragraph. Under these rules, ownership of a capital or profits interest in a partnership may be attributed to a person who is not a partner as defined in section 761(b) in order that another partner may be considered the constructive owner of such interest under section 267(c). However, section 707(b)(1)(A) does not apply to a constructive owner of a partnership interest since he is not a partner as defined in section 761(b). For example, where trust T is a partner in the partnership ABT, and AW, A's wife, is the sole beneficiary of the trust, the ownership of a capital and profits interest in the partnership by T will be attributed to AW only for the purpose of further attributing the ownership of such interest to A. See section 267(c)(1) and (5). If A, B, and T are equal partners, then A will be considered as owning more than 50 percent of the capital and profits interest in the partnership, and losses on transactions between him and the partnership will be disallowed by section

707(b)(1)(A). However, a loss sustained by AW on a sale or exchange of property with the partnership would not be disallowed by section 707, but will be disallowed to the extent provided in § 1.267(b)-1(b). See section 267 (a) and (b), and the regulations thereunder.

LEO SPEER,
Acting Commissioner of Internal Revenue.

Approved September 8, 1958

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 10, 1958, 8:54 a. m., and published in the issue of the Federal Register for September 11, 1958, 23 F. R. 7035.)

SECTION 273.—HOLDERS OF LIFE OR TERMINABLE INTEREST

26 CFR 1.273: Statutory provisions; holders of life or terminable interest.

Regulations under the Internal Revenue Code of 1954. See T. D. 6313, page 114.

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATIONS

Subpart A.—Effects on Recipients

SECTION 301.—DISTRIBUTIONS OF PROPERTY

26 CFR 1.301–1: Rules applicable with respect to distributions of money and other property.

Distribution to shareholders made by a corporation which fails to qualify as a regulated investment company. See Rev. Rul. 58–466, page 379.

A distribution pursuant to a plan of partial liquidation. See Rev. Rul. 58–565, page 140.

PART II.—CORPORATE LIQUIDATIONS

Subpart A.—Effects on Recipients

SECTION 331.—GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS

26 CFR 1.331–1: Corporate liquidation.

Amounts distributed in complete liquidation by a thrift club to its members. See Rev. Rul. 58–391, page 139.

SECTION 334.—BASIS OF PROPERTY RECEIVED IN LIQUIDATIONS

26 CFR 1.334–1: Basis of property received in liquidations. T. D. 6298[1]

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

Regulations under section 334(b)(2) 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 March 29, 1958, notice of proposed rule making regarding an amendment to the regulations under section 334(b)(2) of the Internal Revenue Code of 1954 was published in the Federal Register (23 F. R. 2104). No objection to the rules proposed having been received during the 30-day period prescribed in the notice, the amendment set forth below is hereby adopted:

Section 1.334–1(c) of the Income Tax Regulations (26 CFR Part 1) is amended by striking subparagraph (3) and inserting in lieu thereof the following:

(3) (i) Except as provided in subdivision (ii) of this subparagraph, in the case of a series of purchases of stock, the two-year period specified in section 334(b)(2)(A) shall begin on the day following the earliest date which is the end of a period of twelve months or less within which the amount of stock required by section 334(b)(2)(B) was acquired. For example, assume that 20 percent of the stock of corporation A is purchased on each of the following dates: April 1, 1956, June 30, 1956, September 30, 1956, December 31, 1956, and June 1, 1957. The two-year period shall begin on January 1, 1957. However, if the first purchase of 20 percent of the stock occurs on November 1, 1955 (instead of April 1, 1956), then the two-year period shall begin on June 2, 1957.

(ii) If a plan of liquidation is adopted on or before December 24, 1958, subdivision (i) of this subparagraph shall not apply and the rule of subdivision (iii) of this subparagraph shall apply unless the parent corporation elects to have the rule of subdivision (i) of this subparagraph apply. Such election shall be made by the parent corporation either in a statement attached to its return (filed within the time prescribed for filing, including any extensions of time) for the taxable year within which such plan is adopted, or in a statement filed on or before September 22, 1958, with the district director with whom such corporation's return for such taxable year was filed. The election, once made, shall be irrevocable.

(iii) The rule referred to in subdivision (ii) of this subparagraph is as follows:

(*a*) In the case of a series of purchases of stock, the two-year period specified in section 334(b)(2)(A) shall begin on the day following the date of the last such purchase if the amount of stock specified in section 334(b)(2)(B) is purchased during the preceding twelve months.

(*b*) Application of the rule prescribed in (*a*) of this subdivision may be illustrated by the following example:

Example. Twenty percent of the stock of corporation A is purchased on each of the following dates: April 1, 1954, June 30, 1954, September 30, 1954, December 31, 1954, and April 1, 1955. Although 80 percent of the stock of corporation A had been purchased as of

[1] 23 F. R. 4528.

December 31, 1954, the date of the last transaction of the series of transactions described in section 334(b)(2)(B) is April 1, 1955, and therefore the two-year period shall begin on April 2, 1955.

(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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved June 18, 1958.

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

(Filed by the Division of the Federal Register on June 23, 1958 at 8:45 a. m., and published in the issue of the Federal Register for June 24, 1958, 23 F. R. 4528.)

Subpart B.—Effects on Corporation

SECTION 337.—GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS

26 CFR 1.337–2: Sales or exchanges within the scope of section 337. (Also Section 331; 1.331–1.) Rev. Rul. 58–391

For the purpose of determining the 12-month period specified in section 337(a) of the Internal Revenue Code of 1954, the date of the adoption of a plan of complete liquidation by an unincorporated employees' club (treated as a corporation for Federal income tax purposes) was the date on which the plan was adopted by the board of directors, since the members of the club had no power to pass upon the plan of liquidation.

Advice has been requested whether the adoption of a plan to completely liquidate an unincorporated thrift club by its board of directors complies with the requirements of section 337(a) of the Internal Revenue Code of 1954. (The club is treated as a corporation for Federal income tax purposes.)

All matters relating to the conduct of the club's affairs, including determinations of whether, when, and how the club may be dissolved or liquidated, were governed wholly by contract between the members, since there was no applicable state statute relating to the liquidation of an association of this type. Such contract conferred no powers on the members except the right to elect a board of directors. All rights and authority, including the right to liquidate the club, were vested in the board of directors, the members having no right to concur in, pass on, veto, or modify any action of the board of directors.

On January 10, 1957, the board of directors adopted a resolution to dissolve the club as of January 31, 1957. In the following two months all loans were collected, all investment securities were sold (for an amount in excess of their basis), and the balances in the members' accounts as of December 31, 1956 (adjusted for subsequent deposits and withdrawals), were paid to the members. Thereafter, within the 12-month period beginning on January 10, 1957, all of the remaining assets of the club were distributed to the members.

Section 337 of the Code relating to the recognition of gain or loss on sales or exchanges in connection with certain liquidations provides, in part, as follows:

(a) GENERAL RULE.—If—
(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and
(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,
then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

Section 1.337–2(b) of the Income Tax Regulations states that, ordinarily, the date of the adoption of a plan of complete liquidation by a corporation is the date of adoption by the shareholders of the resolution authorizing the distribution of all the assets of the corporation (other than those retained to meet claims) in redemption of all of its stock. Then, after listing certain cases requiring special treatment, the regulations provide, "In all other cases, the date of adoption of the plan of liquidation shall be determined from all the facts and circumstances." In the instant case, the board of directors of the club had sole power to liquidate such club, the members having no right to pass upon the plan of liquidation. Therefore, in this instance, the date of the adoption of the plan of complete liquidation is the date of adoption by the board of directors.

Accordingly, it is held that, pursuant to section 337(a) of the Code, no gain or loss is recognized to the club from the sale of property during the 12-month period beginning on the date of the adoption of a plan of complete liquidation by the board of directors, followed by the complete liquidation of the club within such 12-month period. The distributions to the club members are treated as full payment in exchange for their shares within the meaning of section 331(a)(1) of the Code.

Subpart D.—Definition

SECTION 346.—PARTIAL LIQUIDATION DEFINED

26 CFR 1.346–1: Partial liquidation. (Also Section 301; 301–1). Rev. Rul. 58–565

Where a real estate corporation sold a building in 1952 and used the proceeds in its remaining business, the distribution in 1957 to the stockholders of an amount equal to the sale proceeds does not qualify as a "partial liquidation" under section 346 of the Internal Revenue Code of 1954. Such distribution is therefore treated as a dividend under section 301(a) of the Code to the extent of the earnings and profits as defined in section 316 of the Code.

Advice has been requested whether a distribution by a corporation to its shareholders of an amount equal to the proceeds from a sale of one of its buildings qualifies as a partial liquidation within the meaning of section 346(a) of the Internal Revenue Code of 1954.

The corporation was organized in 1933 for the purposes of owning, building, leasing, renting, and otherwise dealing in real property. Early in 1952, its principal assets consisted of three store buildings

and one parking lot, all purchased prior to 1937 and all rented. In December 1952, the corporation sold one of the store buildings for $125x$ dollars, $35x$ dollars down and a mortgage of $90x$ dollars. The mortgage was amortized at the rate of $9x$ dollars per annum for four years and, in 1957, the entire balance of $54x$ dollars was paid. The net proceeds of the sale, after deduction of Federal income taxes and the expenses of the sale, were in the amount of $93x$ dollars.

There was no mortgage on the property sold at the time of the sale. The proceeds of the sale were retained by the corporation and used for repayment of existing corporate indebtedness.

No plan of partial liquidation was adopted until 1957. That year the corporation and its shareholders adopted an alleged plan of partial liquidation. The corporation then distributed $93x$ dollars (a sum equal to the proceeds of the sale) in redemption of a portion of its outstanding stock.

Section 346 of the Code, defining a partial liquidation, provides, in part:

> (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).
>
> * * * * * * *
>
> (b) TERMINATION OF A BUSINESS.—A distribution shall be treated as a distribution described in subsection (a)(2) if the requirements of paragraphs (1) and (2) of this subsection are met.
>
> (1) The distribution is attributable to the corporation's ceasing to conduct, or consist of the assets of, a trade or business which had been actively conducted throughout the 5-year period immediately before the distribution, of the distribution and was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.
>
> (2) Immediately after the distribution the liquidating corporation is actively engaged in the conduct of a trade or business, which trade or business was actively conducted throughout the 5-year period ending on the date of the distribution and was not acqiured by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

The distribution of the proceeds of the sale of one of several businesses, actively conducted for five years, may qualify as a distribution under section 346(a)(2) and section 346(b) of the Code. However, for a distribution to qualify under section 346(b), the Income Tax Regulations provide in section 1.346–1(c)(2) that the proceeds of the sale of the assets of a business must be distributed as soon after the sale as reasonably possible. In addition, the requirements of section 346 are not satisfied if the proceeds of the sale are used in the corporation's remaining business for any period of time. In the instant case, the property was sold in 1952, the payments being made over a five-year period. The down payment and the annual payments were not distributed and were not segregated, but were instead used in the corporate business and to pay existing corporate liabilities. Thus, section 346 does not apply to the later distribution of an amount equal to the proceeds of the sale in view of the use of the bulk of the sale proceeds in the corporate business and in view of the lapse of time.

Accordingly, it is held that the distribution in 1957 by the corporation of an amount equal to the proceeds of a sale, which was consummated in 1952, in redemption of a portion of its outstanding stock does not constitute a distribution in partial liquidation within the meaning of section 346(a) of the Code, when the proceeds of the sale were used by the corporation in its remaining business. Hence, pursuant to the provisions of section 302(d) of the Code, such distribution is treated as a dividend under section 301(a) of the Code to the extent of the earnings of the corporation as defined in section 316 of the Code.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

Subpart B.—Effects on Shareholders and Security Holders

SECTION 354.—EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS

26 CFR 1.354–1: Exchanges of stock and securities in certain reorganizations.

An exchange by holders of German dollar bonds in private German corporation. See Rev. Rul. 58–397, page 412.

A voluntary exchange by bondholders of old bonds with defaulted interest for new bonds of the same face amount together with an exchange of old stock for new stock by the stockholders. See Rev. Rul. 58–546, page 143.

SECTION 356.—RECEIPT OF ADDITIONAL CONSIDERATION

26 CFR 1.356–1: Receipt of additional consideration in connection with an exchange.

An exchange involving the recovery of certain German bonds for new bonds, scrip, and cash. See Rev. Rul. 58–397, page 412.

Subpart C.—Effects on Corporation

SECTION 361.—NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS

26 CFR 1.361–1: Nonrecognition of gain or loss to corporations.

Transfer of funds from an insurer to a trust in a consolidation of qualified pension plans as a result of a section 368(a)(1)(C) reorganization. See Rev. Rul. 58–406, page 153.

SECTION 368.—DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges. (Also Sections 61, 108, 111, 354; 1.61–12, 1–108(a)–1, 1.111–1, 1.354–1.)

Rev. Rul. 58–546

Where the bondholders of a corporation, by voluntary agreement, surrender their old bonds and claims for past due interest for new bonds in the same face amount as the old bonds, and the preferred and common shareholders surrendered their old preferred and common stock for new common stock, the transaction constitutes a nontaxable recapitalization (reorganization) within the purview of sections 368(a)(1)(E) and section 354 of the Internal Revenue Code of 1954. All of the liability for past due interest gave rise to income tax deductions when it was accrued (although not all of these deductions gave rise to an income tax benefit), and all of this liability is eliminated in the transaction. The elimination of that portion of the liability attributable to deductions which did not give rise to any tax benefits is excluded from gross income by section 111 of the Code, however, the elimination of this portion of the liability increases the earnings and profits of the corporation available as dividends under section 316 of the Code. The elimination of that portion of the liability attributable to deductions which did give rise to tax benefits is includible in gross income under section 61(a)(12), but may be excluded from gross income upon compliance by the corporation with the provisions of section 108 of the Code.

Advice has been requested as to the tax consequence of a transaction in which a corporation issued new mortgage bonds for old mortgage bonds plus the interest accrued thereon, and new common stock in exchange for the old preferred and common stock.

The fair market value of the assets of a certain corporation (as assets of a going concern) was substantially greater than its liabilities. However, the corporation did not earn enough to pay dividends on its preferred stock and had failed to pay a large part of the interest on its bonds for several years. The corporation's stock and its bonds were owned by different persons. The balance sheet of the corporation immediately prior to the transaction here described was as follows:

ASSETS	
Total Assets	500x dollars
LIABILITIES, CAPITAL AND SURPLUS	
Current Liabilities	50x dollars
6% Mortgage Bonds	360x dollars
Accrued Interest on bonds	45x dollars
Stock Preferred 100x	
Common 100x	200x dollars
Earnings and Profit deficit	(155x) dollars
Total Liabilities, Capital and Surplus	500x dollars

A voluntary plan of recapitalization approved by the shareholders was effectuated to eliminate the bond interest past due, to provide for

a lower interest rate on the bonds, and to convert the preferred stock to common. Under this plan, one new three percent $1,000 bond was issued in exchange for each old six percent $1,000 bond and the $125 claim for past due interest on such bond. Each preferred shareholder received one share of new common stock in exchange for one share of the old preferred stock and each common shareholder received one share of new common stock in exchange for every 20 shares of the old common stock held by him.

The interest accrued on the old mortgage bonds was deducted in the years of accrual by the corporation for Federal income tax purposes. The corporation received income tax benefits from such deductions to the extent of $25x$ dollars of such deductions, and received no income tax benefits to the extent of $20x$ dollars of such deductions.

In view of the facts presented, the Internal Revenue Service holds that, since in the transaction all of the stock after the recapitalization is held by persons who were stockholders before it and by no others, the transaction constitutes a reorganization within the meaning of section 368(a)(1)(E) of the Internal Revenue Code of 1954. Under section 354 of the code, the exchanges by the bondholders of the old bonds plus the claims for accrued interest for new bonds resulted in no gain or loss to the bondholders. Similarly, the exchanges of old preferred stock and old common stock for new common stock resulted in no gain or loss to the stockholders under that section. Under section 358 of the Code, the basis of the new bonds and new stock received in the reorganization is the same as the basis of the property exchanged therefor. Because of section 111 of the Code, income was not realized by the corporation upon the cancellation of that part of the accrued interest, the original deduction of which did not give rise to a tax benefit. However, since it becomes apparent, upon the cancellation of this amount of interest, that it will not be paid and that the corporation is no longer liable for it, the entries made at the time of deduction must be corrected in order to reflect the correct earnings and profits of the corporation. Therefore, the elimination of that part of the bond interest liability which did not give rise to a tax benefit results in a corresponding increase in the current earnings and profits of the corporation for the year in which the recapitalization occurs. The cancellation of that portion of the bond interest liability eliminated in the recapitalization, which originally gave rise to a tax benefit, gives rise to gross income under section 61(a)(12) of the Code. However, the corporation elected to use section 108 of the Code and, therefore, this amount is excluded from gross income upon the making of a proper adjustment to the basis of the corporation's assets. No adjustment is made in the earnings and profits account in respect of the amount so excluded from gross income. Accordingly, immediately after the recapitalization and immediately after the exercise of the election to use section 108, the corporation's balance sheet is as follows:

ASSETS

Assets Before Recapitalization	$500x$	dollars
Adjustment under section 108 IRC	$(25x)$	dollars
Total Assets	$475x$	dollars

LIABILITIES, CAPITAL & SURPLUS

Current Liabilities	$50x$	dollars
3% mortgage bonds (exchanged in recapitalization for $360x$ in 6% bonds and $45x$ in accrued interest)	$360x$	dollars
Accrued interest on 6% bonds (Eliminated in recapitalization)	none	
Common Stock	$200x$	dollars
Current Earnings and profits (from elimination of bond interest liability in recapitalization)	$20x$	dollars
Earnings and profits (deficit)	$(155x)$	dollars
Total Liabilities, Capital and Surplus	$475x$	dollars

(Whether or not the principal indebtedness on the old bonds was accelerated as a result of the default in interest is immaterial.)

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26 CFR 1.368–2: Definition of terms.

Taxable year in the case of a corporate reorganization involving subsidiaries which comes within the provisions of sections 368(a)(1)(F) and 381(b) of the 1954 Code. See Rev. Rul. 58–422, below.

PART V.—CARRYOVERS

SECTION 381.—CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS

(Also Section 368; 26 CFR 1.368–2.) Rev. Rul. 58–422

Revenue Ruling 57–276 is applicable where a certain transaction, otherwise qualifying as a statutory merger under the reorganization provisions of section 368(a)(1)(A) of the Internal Revenue Code of 1954, also qualifies under subparagraph (F) of that section of the Code, notwithstanding the fact that two subsidiary corporations were involved in the merger agreement.

Advice has been requested regarding the applicability of Revenue Ruling 57–276, C. B. 1957–1, 126, to a transaction in which a new corporation (formed by its former parent in a different state) acquired all the assets of the parent and its two wholly-owned subsidiaries by way of a statutory merger under section 368(a)(1)(A) of the Internal Revenue Code of 1954.

Revenue Ruling 57–276, *supra*, holds, in part, that, if an existing corporation reincorporates under the law of a state other than that of the original incorporation and then merges into its newly organized corporation under applicable merger statutes of the states concerned, the transaction comes within the reorganization provisions of section 368(a)(1)(F) of the Code, notwithstanding the fact that such reorganization also qualifies under another provision of section 268(a)(1) of the Code. Therefore, under section 381(b) of the Code, relating to carryovers in certain corporate acquisitions, that part of the taxable year before the reorganization and that part of the taxable year after the reorganization constitute a single taxable year of the acquiring corporation. The transferor corporation is not required to file an income tax return for any portion of the taxable year involved since

all income and deductions for all of that year are includible in the return of the acquiring corporation.

In the instant case, a corporation desired, for valid business purposes, to reincorporate in a state other than the state of its incorporation and to acquire and operate directly the assets and businesses of its two wholly-owned subsidiaries. To carry out these purposes, the corporation organized a new corporation under the laws of the desired other state, and the new corporation, the parent, and the two subsidiaries entered into an agreement of statutory merger under which the new corporation was to be the surviving corporation. On the effective date of the merger, the new corporation succeeded to and became the owner of all of the assets of, and assumed all of the liabilities of, the parent and the two subsidiaries, and the separate existence of the three old corporations thereupon ceased. The new corporation issued shares of its common stock, share for share, to the stockholders of the parent in exchange for their shares of common stock of the parent (the only stock of the parent outstanding). The stock of the two subsidiaries was surrendered and cancelled.

It is the opinion of the Internal Revenue Service that the liquidations of the two subsidiaries in pursuance of the merger agreement are liquidations to which section 332 of the Code applies. However, a question is raised whether the merger, under the circumstances, effects a mere change in place of organization of the parent, within the meaning of section 368(a)(1)(F) of the Code, thereby bringing it within the applicability of Revenue Ruling 57–276, *supra*.

Revenue Ruling 57–276, *supra*, is applicable in all cases where there is no change in the existing stockholders or change in the assets of the corporations involved. In the instant case, the fact that the subsidiaries of the former parent were liquidated at the same time that the said parent reincorporated in a different state did not constitute a change in the stockholders or assets of the merged corporation. The stockholders of the former parent had the same equity in the surviving corporation that they had in the three old corporations, inasmuch as all of the assets of the three transferor corporations were held by the surviving corporation. In this connection, had the subsidiaries liquidated under the nontaxable provisions of section 332 of the Code before the merger and, subsequently, the parent reincorporated in a different state, the latter transaction would have been considered a reorganization coming within the provisions of section 368(a)(1)(F) of the Code. The fact that the two transactions were consummated simultaneously does not change the above conclusion.

In view of the foregoing, it is held that the transaction in the instant case, insofar as it relates to the transfer of the assets and liabilities of the parent to the new corporation, constitutes a reorganization within the meaning of section 368(a)(1)(F) of the Code (even though it also qualifies under section 368(a)(1)(A)), notwithstanding the fact that the two subsidiaries of the parent were also parties to the merger agreement. Therefore, pursuant to the provisions of section 381(b) of the Code, the former parent corporation is not required to file an income tax return for any portion of the taxable year prior to the effective date of the reorganization, but that portion of the taxable year prior to the effective date of the

reorganization and that portion of the taxable year after such effective date constitute a single taxable year of the new corporation. However, the two subsidiaries are required to file returns for the taxable year which ends on the effective date of the merger in which their separate corporate existence is terminated.

Rev. Rul. 58–603 [1]

In Libson Shops, Inc., v. *Koehler*, 353 U. S. 382, Ct. D. 1809, C. B. 1957–2, 891, the Supreme Court of the United States announced the principle that, under the Internal Revenue Code of 1939, a surviving corporation in a merger may not carry over and deduct pre-merger net operating losses of one business against post-merger income of another business which was operated and taxed separately before the merger. The principle announced in that case will not be relied upon by the Internal Revenue Service under the Internal Revenue Code of 1954 as to a merger or any other transaction described in section 381(a) of the 1954 Code. However, see sections 382(b) and 269 of the 1954 Code for the possible disallowance of net operating loss carryovers in such transactions, and see the Income Tax Regulations under section 368 of the 1954 Code for the Requirements of a reorganization.

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.

Regulations under the Internal Revenue Code of 1954 are amended. See T. D. 6301, page 197.

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26 CFR 1.401–4: Discrimination as to contributions or benefits. Rev. Rul. 58–604

Guides concerning the manner in which the qualification of an employees' pension, annuity, profit-sharing, or stock bonus plan will be affected by the nonretroactive application of the rule governing the granting of early retirement benefits with the employer's consent.

Revenue Ruling 58–151, C. B. 1958–1, 192, amplified.

A series of questions have been presented to the Internal Revenue Service relative to the nonretroactive application of Part 5(f) of Revenue Ruling 57–163, C. B. 1957–1, 128, at 149, as modified by Revenue Ruling 58–151, C. B. 1958–1, 192.

Part 5 (f) of Revenue Ruling 57–163, *supra*, published April 22, 1957, concerns the granting of optional retirement under an employees' pension, annuity, profit-sharing, or stock bonus plan prior to normal

[1] Based on Technical Information Release 89, dated August 25, 1958.

retirement age and holds, in part, that any reasonable optional early retirement age will generally be acceptable provided that, if the employer's consent is required, the value of the early retirement benefits does not exceed the value of the employee's vested benefits at that time. Prior to the publication of that ruling, the early retirement benefits were not limited to an employee's vested interest provided the prohibited discrimination was not likely to result.

Revenue Ruling 58–151, *supra*, modified that portion of Part 5(f) of Revenue Ruling 57–163, *supra*, but reaffirmed it in all other respects and held that the effect of that ruling, as reaffirmed, will not be applied retroactively to those plans containing a provision for early retirement with the employer's consent which are not in conformance with this standard but with respect to which favorable determination letters as to qualification under section 401(a) of the Internal Revenue Code of 1954 (or section 165(a) of the 1939 Code) had been issued prior to April 22, 1957. Such favorable determination letters would continue in effect unless and until revoked.

The questions concerning the manner in which the nonretroactive application of Part 5(f) of Revenue Ruling 57–163, *supra*, will affect the qualification of employee pension, annuity, profit-sharing, or stock bonus plans and the issuance of determination letters thereon, and the answers to these questions, are as follows:

Question 1. Must an employer who amends any provision of its plan after April 21, 1957, also amend the early retirement provision to conform with Part 5(f) of Revenue Ruling 57–163, *supra*, in order to maintain the qualified status of the trust forming a part of such plan under section 40(a) of the Code?

Answer. No; unless the District Director of Internal Revenue having jurisdiction in the case finds that the discretionary powers with respect to optional early retirement prior to normal retirement age granted by such plan have been exercised, in the prior operation of the plan, in such a way as to have resulted in the discrimination which is prohibited by section 401(a)(4) of the Code.

Question 2. May a favorable determination letter as to the qualification of an employees' plan be issued to a wholly-owned subsidiary which, after April 21, 1957, became a party to the plan of its parent corporation, without amending the early retirement provision of the plan, as to such subsidiary, to conform with Part 5(f) of Revenue Ruling 57–163, *supra*?

Answer. No. With respect to a single trust or plan for employees adopted by a group of affiliated or nonaffiliated employers, the provisions of the Code, in regard to qualifying under section 401(a) thereof, are applicable to each such employer separately, regardless of the affiliated status of the participating or adopting group. See the fourth paragraph of PS No. 14, dated August 24, 1944, which was continued in effect by Revenue Ruling 57–163, C. B. 1957–1, 128, at 154.

Question 3. May an employer, who amended the early retirement provision of its employees' plan prior to the publication of Revenue Ruling 58–151, *supra*, solely to comply with Part 5(f) of Revenue Ruling 57–163, *supra*, now revoke such amendment without adversely affecting the qualified status of the trust forming a part of the plan under section 401(a) of the Code?

Answer. Yes, unless, and except where the District Director of Internal Revenue having jurisdiction in such case finds that the discretionary powers granted by the plan with respect to optional early retirement have been exercised, in the prior operation of the plan, in such a way as to have resulted in the discrimination prohibited by section 401(a)(4) of the Code.

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. 58-383

Where a corporation takes over the assets, business and employees of another previously unrelated corporation pursuant to a merger agreement involving a tax-free exchange of stock for stock under section 354(a) of the Code, in pursuance of a plan of reorganization under section 368(a)(1)(B) and a subsequent statutory merger within the meaning of section 368(a)(1)(A), pursuant to the same plan, and, coincident with the merger, terminal distributions are made to beneficiaries of a qualified employees' trust of the acquired corporation, such distributions are on account of a separation from the service of the former employer and are entitled to long-term capital gain treatment under section 402(a)(2) of the Code.

Advice has been requested whether terminal distributions from an employees' trust, which has been held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 and to be exempt under section 501(a) of the Code, may be treated as having been made on account of separation from the service and as thus entitled to the long term capital gain treatment provided for by section 402(a)(2) of the Code, where such distributions are incident to a corporate acquisition and statutory merger, as described below, notwithstanding that the employees of the acquired corporation became employees of the corporation surviving the merger.

The *M* corporation, a manufacturer of household appliances, desiring to acquire the assets and business of the *O* corporation, a smaller corporation engaged in the manufacture of a major component of the appliances manufactured by the *M* corporation and other manufacturers, entered into an agreement of merger with the *O* corporation. The stock of the *O* corporation was widely held, and the two corporations had been previously unrelated except for business dealings as buyer and seller of the component supplied by *O* corporation. Under the merger agreement *M* corporation offered to exchange shares of its voting stock for shares of the outstanding common stock of *O* corporation, the sole class of stock outstanding, in a stated per share ratio, provided that at least 80 percent of the shares of the *O* corporation is offered for exchange pursuant to the agreement.

More than the required 80 percent of the stock of *O* corporation was so offered in exchange, and the agreed exchanges were duly effected. Immediately following its acquisition of stock of the *O* corporation (constituting control within the meaning of section 368(c) of the Code), the *M* corporation in accordance with the plan of reorganiza-

tion took the necessary steps to effect a statutory merger of the *O* corporation into itself under the law of the state involved. The business previously conducted by the *O* corporation was continued and all employees of the *O* corporation were taken over as employees of the *M* corporation.

The profit-sharing plan and employees' trust established by the *O* corporation have been held to meet the requirements of section 401(a) of the Code and the trust has been held to be exempt under section 501(a). Since the *M* corporation made no provisions for continuing the plan, the trust was terminated as of the date of the merger and lump-sum distributions of the participants' interests in the assets of the trust were made at that time.

Distributions under a qualified employees' trust are taxable in accordance with the provisions of section 402(a) of the Code. Paragraph (1) of that section provides, in part, that amounts actually distributed or made available shall be taxable in the year in which received or made available, under section 72 of the Code, except that section 72(e)(3) shall not apply. Section 402(a)(2) of the Code provides that if the total distributions payable under a qualified trust with respect to any employee 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 his separation from the 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.

In Revenue Ruling 58–94, C. B. 1958–1, 194, where the assets and business of one corporation were acquired by another under an agreement and plan of reorganization within the meaning of section 368(a)(1)(C) of the Code, and terminal distributions under the employees' pension plan and trust of the corporation whose properties had been acquired under the plan were made on account of the transfer of the business to the acquiring corporation, it was held that such distributions to employees taken over by the acquiring corporation were on account of a "separation from the service" of the former employer within the meaning of section 402(a)(2) of the Code and hence qualified for long-term capital gain treatment. That Revenue Ruling reviewed in some detail the legislative history of section 402(a)(2) and section 402(e) of the Code and in the light of that history, reached the conclusion that a corporate liquidation or reorganization which brings about a change in employment relationship in no more than a formal or technical sense, and which does not involve a subtantial change in the make-up of employees, does not constitute a "separation from the service" under section 402(a)(2), but that a separation from the service of a corporate employer does occur where a corporate liquidation or reorganization is not itself the cause of termination of the employer's plan but is merely incident to such a change in the ownership of the business as might occur in the case of a noncorporate employer. In Revenue Ruling 58–95, I. R. B. 1958–11, 21, the same rule was applied to reach the conclusion that a separation from the service occurs within the meaning of section 402(a)(2) where the termination of a corporate employer's qualified pension trust is incident to the acquisition of all of its stock by another corpora-

tion for cash, in a transaction amounting in substance to a purchase of assets for cash, even though shortly thereafter the acquired corporation is liquidated under section 332(b) of the Code and its employees are taken over by the acquiring corporation.

The instant case differs slightly from the cases dealt with in those Revenue Rulings as to the nature of the acquisition transaction, which involved both a reorganization under section 368(a)(1)(B) of the Code, incident to which the initial exchanges of stock were tax free under section 354(a), and a statutory merger qualifying as a reorganization under section 368(a)(1)(A). Nevertheless, the acquisition of the stock of the *O* corporation in the instant case in combination with the statutory merger by which that corporation was merged into the *M* corporation amounted in substance to the acquisition of the assets and business of the *O* corporation for stock of the *M* corporation. In substance, therefore, the case is the same as the case dealt with in Revenue Ruling 58–94, *supra*.

On the facts here presented, it does not matter that the acquisition of the assets of the former employer corporation involved a statutory merger and that for some purposes the corporation surviving in a statutory merger is deemed to be a continuation of the corporation which loses its corporate life in the merger. The question here being one of statutory construction, that rule is of no greater moment for present purposes than the court deemed it to be in deciding an otherwise unrelated question of statutory construction in *Libson Shops, Inc.* v. *Koehler*, 353 U. S. 382, at 386, Ct. D. 1809, C. B. 1957–2, 891. Had the facts surrounding the statutory merger been such as were involved in *Stanton Brewery, Inc* v. *Commissioner*, 176 Fed. 2d 573, or *Newmarket Manufacturing Co.* v. *United States*, 233 Fed. 2d 493, involving, in the former case, the merger of an operating company into its parent holding corporation and, in the latter, the re-incorporation of a single business in a new state, the problem of statutory construction would differ and the rule in question would be a factor to be considered along with the absence of a real change in ownership of the business.

It is accordingly held that where a corporation takes over the assets, business and employees of another previously unrelated corporation pursuant to a merger agreement involving a tax-free exchange of stock for stock under section 354(a) of the Code, in pursuance of a plan of reorganization under section 368(a)(1)(B) and a subsequent statutory merger within the meaning of section 368(a)(1)(A), pursuant to the same plan, and, coincident with the merger, terminal distributions are made to beneficiaries of a qualified employees' trust of the acquired corporation, such distributions are on account of a separation from the service of the former employer and are entitled to long-term capital gain treatment under section 402(a)(2) of the Code.

(Also Section 643; 1.643(a)–3.) Rev. Rul. 58–423

The long-term capital gain treatment authorized by section 402(a)(2) of the Internal Revenue Code of 1954 is applicable in a case where the total distribution under a qualified employees' profit-sharing plan are paid, on account of the employee's death, to an inter vivos trust which he has designated as his beneficiary.

The taxation of such distribution as it relates to the trust and its beneficiaries is to be determined in accordance with the general rules under Part I of sub-chapter J of Chapter 1 of the Code.

Advice has been requested whether the long-term capital gain treatment authorized by section 402(a)(2) of the Internal Revenue Code of 1954 is applicable in a case where a lump-sum distribution of an employee's interest under a qualified employees' profit-sharing plan is paid, upon the employee's death to a trust established by the employee.

In the instant case, a decedent had been an employee of a corporation and a participant in the employer's profit-sharing plan which had been held to meet the requirements of section 401(a) of the Code. Under the provisions of the plan, each participant was entitled to designate the persons to whom his interest under the plan was to be paid in the event of the employee-participant's death prior to receipt of full payment and to designate the time or times at which such payments were to be made to his beneficiary. Pursuant to these provisions, the employee elected to have his interest under the plan payable in a lump sum to the trustee of an inter vivos trust which he had established for his wife and children, such amount to become part of the trust fund and subject to the provisions thereof. The employee's death occurred while he was still in the employ of the employer, and the trust, as his beneficiary, received in a lump-sum distribution the total amount of the decedent's interest payable under the profit-sharing plan.

Section 402 (a)(2) of the Code provides in part that if an employee's entire interest in a qualified plan is paid out to him or his beneficiary within one taxable year because of his death or other separation from service or because of his death after separation, the excess of the distribution over the employee's own contributions is treated as long-term capital gain. Neither section 402(a)(2) nor the regulations thereunder contain any provisions restricting this capital gain treatment to a particular class or group of beneficiaries; furthermore, the character or nature of the beneficiaries is of no import in qualifying under this section.

Therefore, it is held that the long-term capital gain treatment authorized by section 402(a)(2) of the Code is applicable in a case where the total distributions payable to an employee under a qualified profit-sharing plan are paid, on account of the employee's death, to a trust, as his beneficiary, within one taxable year.

For Federal income tax purposes, that part of the lump-sum payment considered under section 402(a)(2) of the Code to be capital gain would be includible in the gross income of the trust. However, if during the year of receipt, such capital gain is utilized in determining the amount which is distributed or required to be distributed to beneficiaries of the trust, or is allocated to corpus and actually distributed during the taxable year, it would be included in determining the trust's distributable net income as defined in section 643(a) of the Code. Likewise, if in the year of receipt by the trust, the grantor's widow dies and the trust is terminated and the principal, including capital gains, is distributed to his children, the capital gains would be included in computing distributable net income. See section 1.643(a)–3 of the Income Tax Regulations.

Where, in the year of receipt by the trust, capital gain is includible in distributable net income and is distributed to the beneficiaries, it retains its character as capital gain in the hands of the recipients and each beneficiary would report on his individual income tax return his proportionate share of the capital gain included in distributable net income of the trust.

SECTION 403.—TAXATION OF EMPLOYEE ANNUITIES

Temporary rules under section 403(b), as added to the 1954 Code by the Technical Amendments Act of 1958, relating to contributions by certain tax-exempt organizations to purchase annuity contracts for employees. See T. D. 6335, page 1112.

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)-1: Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; general rule. Rev. Rul. 58-406

(Also Section 361; 1.361-1.)

The transfer of the assets and liabilities of one corporation to another corporation, under an exchange constituting a reorganization within the meaning of section 368(a)(1)(C) of the Internal Revenue Code of 1954, and the resultant consolidation of the qualified pension plans established by the two corporations will not affect the allowability of amounts claimed as deductions by the predecessor corporation for contributions to its pension plan prior to such reorganization. The transfer of funds from the insurer under the predecessor's plan to the trust forming a part of the combined plan will not result in taxable income to the successor corporation.

Advice has been requested as to the deductibility of contributions made by a corporation under its qualified employees' pension plan prior to a reorganization with another corporation where the plan was combined with the qualified plan of the successor corporation. Also, advice has been requested whether the transfer of funds from the insurer of the predecessor corporation's plan to the trust forming a part of the plan of the successor corporation will result in taxable income to such successor corporation.

Under an agreement and plan of reorganization, a corporation acquired substantially all of the assets and liabilities of another corporation solely in exchange for a portion of the voting stock of the former. The exchange was held to constitute a reorganization as defined in section 368(a)(1)(C) of the Internal Revenue Code of 1954.

The predecessor corporation had established a noncontributory nontrusteed pension plan for its employees whereby the benefits were insured under a group annuity contract. The successor corporation

had in effect a noncontributory trusteed pension plan for the benefit of its employees. The two pension plans provided identical benefits and were the result of negotiations with the employees' labor unions. Both plans had been held to meet the requirements of section 401(a) of the Code and the trust established by the successor corporation was held to be exempt under section 501(a) of the Code.

Upon the reorganization of the two corporations, funds held by the insurer under the predecessor's pension plan were transferred to the trustee under the successor's pension plan. The two pension plans were then consolidated and participants under the predecessor's plan became participants under the successor's plan, receiving credit for all continuous service immediately prior to the reorganization.

Contributions by an employer under an annuity plan are deductible under section 404(a)(2) of the Code in the taxable year when paid, within the limits of section 404(a)(1), if they are paid toward the purchase of retirement annuities and such purchase is a part of a plan which meets the requirements of section 401(a)(3), (4), (5), and (6), and if refunds of premiums are applied within the current taxable year or next succeeding taxable year toward the purchase of such retirement annuities.

The termination of the group plan did not violate any of the requirements of section 401 of the Code and the regulations thereunder and, consequently, did not affect the prior qualification of the transferor's plan.

Accordingly, it is held that, under an exchange of assets of one corporation for stock of another, constituting a reorganization within the meaning of section 368(a)(1)(C) of the Code, and the resultant consolidation of the qualified pension plans established by the two corporations, the allowability of amounts claimed as deductions by the predecessor corporation for contributions to its pension plan prior to such reorganization will not be affected solely as a result of such reorganization and the transfer of funds from the insurer under the predecessor's plan to the trust forming a part of the successor's plan will not result in taxable income to the successor corporation.

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26 CFR 1.404(a)–10: Profit-sharing plan of an affiliated group; application of section 404(a)(3)(B). Rev. Rul. 58–392

A domestic corporation owns or controls, directly or indirectly, 100 percent of the capital stock (exclusive of directors' qualifying shares) of two other corporations which are organized under the laws of a contiguous foreign country. These foreign corporations are maintained by the domestic corporation solely for the purpose of complying with certain laws of such country. The domestic corporation elects to exercise the option of treating such subsidiaries as domestic corporations for the purposes of subtitle A of the Internal Revenue Code of 1954. With such an election, the subsidiaries and the parent corporation, as domestic corporations and members of an affiliated group within the meaning of section 1504 of the Code, may each avail itself of the advantages of section 404(a)(3)(B) of the Code in making deductible contributions on behalf of the other's employees to the employees' profit-sharing trust of the "affiliated group" of corporations which both qualifies and is exempt, respectively, under sections 401(a) and 501(a) of the Code, or would be exempt except for the fact that it is a trust created or organized outside the United States.

Advice has been requested whether a domestic parent corporation and its wholly-owned subsidiaries, organized and situated in a contiguous foreign country but doing business in the United States, may each make contributions to the employees' profit-sharing trust of the other on behalf of the other's employees which are deductible by the contributing corporation under section 404(a)(3)(B) of the Internal Revenue Code of 1954.

A domestic parent corporation had established a profit-sharing plan on behalf of its employees and, as a part thereof, a trust created or situated in the United States. The parent corporation had two wholly-owned subsidiaries in Canada, both doing some business in the United States. Both subsidiaries subscribed to and adopted the plan of the parent company. One subsidiary, however, funded the plan through a separate trust which was situated in Canada,but constituted a part of the parent's plan which was qualified under section 401(a).

The subsidiary corporations had been organized and maintained by the domestic parent corporation solely for the purpose of complying with the laws of the contiguous foreign country and 100 percent of the capital stock of each (exclusive of directors' qualifying shares) was owned by the parent corporation.

Determination letters had been issued, pursuant to section 2 of Revenue Procedure 56–12, C. B. 1956–1, 1029, to the effect (1) that the trust created and situated in the United States qualified under section 401(a), and was eligible for exemption under section 501(a), of the Code as to both of the adopting employers and (2) that the trust created in Canada so qualified, and would be so exempt except for the fact that it is a trust created or organized outside the United States. See sections 402(c) and 404(a)(4) of the Code. See also the Appendix to Rev. Rul. 57–163, C. B. 1957–1, 128 at 154, continuing P. S. Release No. 14, dated August 24, 1944, to the effect that in every case where two or more employers adopt the same plan and trust instruments, there are, in fact, as many separate plans and trusts as there are adopting employers.

In the case of a profit-sharing plan, or of a stock bonus plan in which contributions are determined with reference to profits, of a group of corporations which is an affiliated group within the meaning of section 1504 of the Code, section 404(a)(3)(B) of the Code, governing the deductibility of certain employer contributions to a profit-sharing or to a profit-sharing type of stock bonus trust which is exempt under section 501(a) of the Code, provides, in part, that if any member of such affiliated group is prevented from making a contribution which it would otherwise have made under the plan, by reason of having no current or accumulated earnings or profits or because such earnings or profits are less than the contributions which it would otherwise have made, then so much of the contributions which such member was so prevented from making may be made, for the benefit of the employees of such member, by the other members of the group, to the extent of current or accumulated earnings or profits, except that such contribution by each such other members shall be limited, where the group does not file a consolidated return, in certain respects therein specified.

An "affiliated group" of corporations is defined in section 1504(a) of the Code as one or more chains of includible corporations connected

through stock ownership with a common parent corporation which is an includible corporation if (1) stock possessing at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and (2) the common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations. Subsection (b) of section 1504 excludes foreign corporations from the term "includible corporations." However, subsection (d) provides that in the case of a domestic corporation owning or controlling, directly or indirectly, 100 percent of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of Subtitle A of the Code as a domestic corporation.

The subsidiary corporations in the instant case, being foreign corporations, could not, except for exercise by their domestic parent corporation of the aforementioned option granted under the provisions of section 1504(d) of the Code, be recognized as "includible corporations" within an affiliated group of corporations for purposes of section 404(a)(3)(B) of the Code. If, but only if, the parent corporation exercises such option, then the subsidiaries and the parent corporation are all three treated as domestic corporations for all purposes of Subtitle A of the Code. They are not just so treated for purposes of section 404(a)(3)(B) of Chapter 1 of such Code. They are also members of an affiliated group, within the meaning of section 1504 of the Code, and may each avail itself of the advantage of section 404(a)(3)(B) of the Code in making deductible contributions to the profit-sharing trust of the other on behalf of the other's employees if such other's profit-sharing trust is exempt under section 501(a) of the Code at the time the contribution is made or would be exempt under section 501(a) except for the fact that it is a trust created or organized outside the United States.

On the other hand, if the parent corporation, with or without exercising the option in section 1504(d), should pay direct to an employee of one of its contiguous foreign subsidiaries such amount as would be required to equalize the participants of its foreign subsidiary's trust with the participants of the parent corporation's trust who would be under similar circumstances, the payment would not be deductible by the parent corporation since it would not constitute an ordinary and necessary trade or business expense of the parent corporation within the meaning of section 162 of the Code.

Accordingly, it is held that if the domestic parent corporation of wholly-owned subsidiaries in a contiguous country elects to exercise the option, under section 1504(d) of the Code, of treating such subsidiaries, for purposes of subtitle A of the Code, as domestic corporations and members of an affiliated group, within the meaning of section 1504(a) of the Code, may each avail itself of the advantages of section 404(a)(3)(B) of the Code in making deductible contributions to the employees' profit-sharing trust of the other on behalf of

the other's employees if such trust is a trust which both qualifies and is exempt, respectively, under sections 401(a) and 501(a) of the Code, or would be exempt except for the fact that it is a trust created or organized outside the United States.

PART II.—MISCELLANEOUS PROVISIONS

SECTION 421.—EMPLOYEE STOCK OPTIONS

26 CFR 1.421–4: Modification, extension, or renewal. Rev. Rul. 58–499

The terms of stock options granted by a corporation to its employees provided that the options, which qualified as restricted stock options would terminate upon dissolution or liquidation of the corporation, or upon any merger if that corporation were not the surviving corporation, but that the options would be exercisable in full immediately prior to such events. Under a plan of reorganization, the assets of the corporation were exchanged solely for voting stock of another corporation and options to buy stock of the acquiring corporation were substituted pursuant to the reorganization agreement for the stock options previously held by the employees. *Held*, the transaction constitutes a substitution of a new for the old stock option, or an assumption of the old option, within the meaning of section 421(g) of the Internal Revenue Code of 1954, provided the price at which the shares can be purchased under the new options meets the conditions of section 421(g)(1) of the Code.

Advice has been requested concerning the status, for Federal income tax purposes, of employee stock options issued by an acquiring corporation in a corporate reorganization in exchange for the employee stock options of the acquired corporation, which options, by their terms, were to terminate in the event of the dissolution or liquidation of the option or corporation or of a reorganization in which the optionor did not survive.

Under a reorganization plan, all of the assets of *N* corporation were exchanged solely for voting stock of *M* corporation. Thereafter, *N* corporation distributed in liquidation the *M* corporation shares so received in cancellation of its own shares of stock on the basis on one share of *M* stock for two shares of *N* stock outstanding.

The terms of restricted stock options granted to key employees of *N* prior to the reorganization provided that the options were to be terminated upon the dissolution or liquidation of *N* or upon any merger if *N* were not the surviving corporation, but that the options were to be exercisable in full immediately prior to such events. However, *M* assumed the options and substituted for each such option an option to purchase shares of *M* stock under terms and conditions which, in the absence of the reorganization, would have applied to the optionee's purchase of *N* stock. Such assumption was a part of the reorganization agreement.

The assumption by *M* changed existing options only to the extent that (1) the substituted options applied to *M* stock instead of *N* stock; and (2) the number of *M* shares subject to each option was one-half of the number of *N* shares originally subject to the options.

Section 421(e)(2)(A) of the Internal Revenue Code of 1954 provides that the term "modification" shall not include a change in the terms of the option attributable to the issuance or assumption of an option under section 421(g) of the Code.

Section 421(g) of the Code provides that, for the purpose of section 421 of the Code, the term "issuing or assuming a stock option in a transaction to which subsection (g) is applicable" means a substitution of a new option for the old option, or an assumption of the old option by an employer corporation or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation, if (1) the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and (2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

Section 1.421–4(d)(3) of the Income Tax Regulations provides, in part, that section 421(g) of the Code may apply where the restricted stock option which is being assumed or replaced expressly provides that it will terminate upon the occurrence of certain corporate transactions.

Accordingly, it is held that the transaction described above will be considered a substitution of a new for the old option, or an assumption of the old option, within the meaning of section 421(g) of the Code, provided the price at which *M* shares can be purchased under the substituted option meets the conditions of section 421(g)(1) of the Code. In the case of each optionee, it will be necessary to make a mathematical verification to determine that the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares. Since the determination is factual, it should be made by the District Director of Internal Revenue having jurisdiction of the particular income tax returns involved.

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

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. 58–474

Where a manufacturer's letter established the right of a dealer using the accrual method of accounting to a refund of the unspent portion of his contributions to an advertising and promotional fund, and the amount thereof can be determined with reasonable accuracy before the due date for filing his income tax return for the tax-

able year in which the right was established, the dealer should accrue and include in his gross income for that taxable year the amount so determined.

Advice has been requested regarding the treatment, for Federal income tax purposes, by a taxpayer using the accrual method of accounting of a right to a refund of certain advertising expenses.

For many years, the taxpayer, a dealer in the products of a certain manufacturer, contributed amounts to a fund for advertising and promoting the sale of the manufacturer's products. Each year the taxpayer, who uses the accrual method of accounting and reports his income on the calendar-year basis, deducted in his income tax return the amounts accrued or contributed to the fund for that year. The advertising agencies which handled the fund maintained a separate record for each dealer, showing the amount of contributions to the fund, the charges attributable to each dealer, and the net balance. Each dealer received an annual statement showing his balance in the fund.

In November, 1956, the taxpayer was notified by letter from the manufacturer that the above-described advertising and promotional program would be discontinued at the end of that month and a new program would be established in which the manufacturer would assume the full responsibility for its cost and administration. The letter also announced that each dealer would receive a refund of the unspent portion of his contributions to the advertising and promotional fund. The approximate amount of each dealer's unexpended balance on November 30, 1956, was known and the information was available to the dealers in January, 1957. Actual refunds were made beginning in February, 1957.

Section 1.446–1(c) of the Income Tax Regulations provides, in part, as follows:

(ii) *Accrual method.*—Generally, under an accrual method. income is to be included for the taxable year when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Under such a method, deductions are allowable for the taxable year in which all the events have occurred which establish the fact of the liability giving rise to such deduction and the amount thereof can be determined with reasonable accuracy. * * *

In reporting income under the accrual method, it is the valid right to receive income independent of the occurrence of any future event, and not actual or constructive receipt, that determines the inclusion of an item of income in gross income. When the right to receive income becomes fixed, the income accrues, regardless of the time of actual receipt of the income. *Helvering* v. *Estate of John M. Enright*, 312 U. S. 636, Ct. D. 1500, C. B. 1941–1, 353. Where income is properly accruable under the foregoing rules, accrual may not be postponed merely because of a possibility that the income may have to be returned or may be subject to diminution or offset. *Arthur M. Brown* v. *Helvering*, 291 U. S. 193, Ct. D. 786, C. B. XIII–1, 223 (1934).

In the instant case, the manufacturer's letter is considered to have established the taxpayer's right to receive the unspent portion of his contributions to the advertising fund. Furthermore, the amount of the refund could be determined with reasonable accuracy from information available to the taxpayer before the due date for filing his 1956 income tax return.

In view of the foregoing, it is held that where a manufacturer's letter established the right of a dealer using the accrual method of accounting to a refund of the unspent portion of his contributions to an advertising and promotional fund, and the amount thereof can be determined with reasonable accuracy before the due date for filing his income tax return for the taxable year in which the right was established, the dealer should accrue and include in his gross income for that taxable year the amount so determined.

Subpart B.—Taxable Year for Which Items of Gross Income Included

SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

26 CFR 1. 451–1: General rule for taxable year of inclusion.

The time of accrual by a dealer using the accrual method of accounting of his right to a refund of certain advertising expenses established by a letter from the manufacturer. See Rev. Rul. 58–474, page 158.

SECTION 453.—INSTALLMENT METHOD

26 CFR 1.453: Statutory provisions; installment method. T. D. 6314[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 453 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 11, 1958, notice of proposed rulemaking with respect to regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under section 453 (relating to the installment method of reporting income) of the Internal Revenue Code of 1954, was published in the Federal Register (23 F. R. 228). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. Consideration is being given to the issuance of separate rules dealing with the matter of whether income from so-called "revolving credit sales" may be reported under the installment method of accounting provided for under section 453.

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[1] The publication of this Treasury Decision in 23 F. R. 7210, dated September 18, 1958, contains (1) instructions for modifying the notice of proposed rulemaking published in 23 F. R. 228, dated January 11, 1958, 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.

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AUTHORITY: §§ 1.453 to 1.453–10, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.453 STATUTORY PROVISIONS; INSTALLMENT METHOD.

SEC. 453. INSTALLMENT METHOD.

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

(b) SALES OF REALTY AND CASUAL SALES OF PERSONALTY.—

(1) GENERAL RULE.—Income from—

(A) A sale or other disposition of real property, or

(B) A casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) LIMITATION.—Paragraph (1) shall apply—

(A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition—

(i) There are no payments, or

(ii) The payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

(B) In the case of a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was (by reason of section 44(b) of the Internal Revenue Code of 1939) returnable on the basis and in the manner prescribed in section 44(a) of such code.

(c) CHANGE FROM ACCRUAL TO INSTALLMENT BASIS.—

(1) GENERAL RULE.—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his taxable income on the installment basis, then in computing his taxable income for such year (referred to in this subsection as "year of change") or for any subsequent year—

(A) Installment payments actually received during any such year on account of sales or other dispositions of property made in any taxable year before the year of change shall not be excluded; but

(B) The tax imposed by this chapter for any taxable year (referred to in this subsection as "adjustment year") beginning after December 31, 1953, shall be reduced by the adjustment computed under paragraph (2).

(2) ADJUSTMENT IN TAX FOR AMOUNTS PREVIOUSLY TAXED.—In determining the adjustment referred to in paragraph (1)(B), first determine, for each taxable year before the year of change, the amount which equals the lesser of—

(A) The portion of the tax for such prior taxable year which is attributable to the gross profit which was included in gross income for such prior taxable year, and which by reason of paragraph (1)(A) is includible in gross income for the taxable year, or

(B) The portion of the tax for the adjustment year which is attributable to the gross profit described in subparagraph (A).

The adjustment referred to in paragraph (1)(B) for the adjustment year is the sum of the amounts determined under the preceding sentence.

(3) RULE FOR APPLYING PARAGRAPH (2).—For purposes of paragraph (2), the portion of the tax for a prior taxable year, or for the adjustment year, which is attributable to the gross profit described in such paragraph is that amount which bears the same ratio to the tax imposed by this chapter (or by the corresponding provisions of prior revenue laws) for such taxable year (computed without regard to paragraph (2)) as the gross profit described in such paragraph bears to the gross income for such taxable year. For purposes of the preceding sentence, the provisions of chapter 1 (other than of subchapter D, relating to excess profits tax, and of subchapter E, relating to self-employment income) of the Internal Revenue Code of 1939 shall be treated as the corresponding provisions of the Internal Revenue Code of 1939.

(d) GAIN OR LOSS ON DISPOSITION OF INSTALLMENT OBLIGATIONS.—

(1) GENERAL RULE.—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and—

(A) The amount realized, in the case of satisfaction at other than face value or a sale or exchange, or

(B) The fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.

Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.

(2) BASIS OF OBLIGATION.—The basis of an installment obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

(3) SPECIAL RULE FOR TRANSMISSION AT DEATH.—Except as provided in section 691 (relating to recipients of income in respect of decedents), this subsection shall not apply to the transmission of installment obligations at death.

(4) EFFECT OF DISTRIBUTION IN CERTAIN LIQUIDATIONS.—

(A) LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—If—

(i) An installment obligation is distributed by one corporation to another corporation in the course of a liquidation, and

(ii) Under section 332 (relating to complete liquidations of subsidiaries) no gain or loss with respect to the receipt of such obligation is recognized in the case of the recipient corporation.

then no gain or loss with respect to the distribution of such obligation shall be recognized in the case of the distributing corporation.

(B) LIQUIDATIONS TO WHICH SECTION 337 APPLIES.—If—

(i) An installment obligation is distributed by a corporation in the course of a liquidation, and

(ii) Under section 337 (relating to gain or loss on sales or exchanges in connection with certain liquidations) no

gain or loss would have been recognized to the corporation if the corporation had sold or exchanged such installment obligation on the day of such distribution,

then no gain or loss shall be recognized to such corporation by reason of such distribution.

§ 1.453–1 INSTALLMENT METHOD OF REPORTING INCOME.—(a) *In general.*—Section 453 permits dealers in personal property, that is, persons who regularly sell or otherwise dispose of personal property on the installment plan, to return the income from the sale or other disposition thereof on the installment method. The installment method may also be applied with certain limitations (see paragraph (c) of this section) to sale or other disposition of real property and the casual sale or other casual disposition of certain personal property.

(b) *Income to be reported.*—Persons permitted to use the installment method of accounting prescribed in section 453 may return as income from installment sales in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when the property is paid for bears to the total contract price. In the case of dealers in personal property, for this purpose, gross profit means sales less cost of goods sold. See § 1.453–2 for rules applicable to the computation of income of dealers in personal property reporting on the installment method. In the case of sales of real estate and casual sales of personal property, gross profit means the selling price less the adjusted basis as defined in section 1011 and the regulations thereunder. Gross profit, in the case of a sale of real estate by a person other than a dealer and a casual sale of personal property, is reduced by commissions and other selling expenses for purposes of determining the proportion of installment payments returnable as income. For rules applicable in determining "selling price" and the use of certain other terms, see also paragraph (c) of § 1.453–4.

(c) *Limitations on the use of the installment method.*—(1) Income from the sale or other disposition of real property or from casual sales or other casual dispositions of personal property may be reported on the installment method for taxable years beginning after December 31, 1953, only if, in the taxable year of the sale or other disposition, (i) there are no payments or (ii) the payments (exclusive of evidence of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

(2) The income from a casual sale or other casual disposition of personal property may be reported on the installment method only if (i) the property is not of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, and (ii) its sale price exceeds $1,000.

(d) *Treatment of gain or loss on default by the purchaser of personal property sold on the installment plan.*—If for any reason the purchaser defaults in any of his installment payments, and the vendor (whether he is a dealer in personal property or a person who has made a casual sale or other casual disposition of personalty), returning income on the installment method, repossesses the property sold, whether title thereto had been retained by the vendor or transferred to the purchaser, gain or loss for the year in which the repossession occurs is to be computed upon any installment obligations of the pur-

chaser which are satisfied or discharged upon the repossession or are applied by the vendor to the purchase or bid price of the property. Such gain or loss is to be measured by the difference between the fair market value at the date of repossession of the property repossessed and the basis in the hands of the vendor of the obligations of the purchaser which are so satisfied, discharged, or applied, with proper adjustment for any other amounts realized or costs incurred in connection with the repossession. (See also § 1.453–6.) The basis in the hands of the vendor of the obligations of the purchaser satisfied, discharged, or applied upon the repossession of the property shall be the excess of the face value of such obligations over an amount equal to the income which would be returnable were the obligations paid in full. For definition of the basis of an installment obligation, see section 453(d)(2) and paragraph (b)(2) of § 1.453–9. No deduction for a bad debt shall in any case be taken on account of any portion of the obligations of the purchaser which are treated by the vendor as not having been satisfied, discharged, or applied upon the repossession unless it is clearly shown that after the property was repossessed the purchaser remained liable for such portion; and in no event shall the amount of the deduction exceed the basis in the hands of the vendor of the portion of the obligations with respect to which the purchaser remained liable after the repossession. (See also section 166 and the regulations thereunder.) If the property repossessed is bid in by the vendor at a lawful public auction or judicial sale, the fair market value of the property shall be presumed to be the purchase or bid price thereof in the absence of clear and convincing proof to the contrary. The fair market value of the property repossessed shall be reflected in the appropriate permanent records of the vendor at the time of such repossession.

(e) *Other accounting methods.*—If the vendor chooses as a matter of consistent practice to return the income from installment sales on an accrual method or on the cash receipts and disbursements method, such a course is permissible.

(f) *Records.*—In adopting the installment method of accounting the seller must maintain such records as are necessary to clearly reflect income in accordance with this section, section 446 and § 1.446–1.

§ 1.453–2 Special Rules Applicable to Dealers in Personal Property.—(a) *In general.*—A person who regularly sells personal property on the installment plan may adopt (but is not required to do so), one of the following four ways of protecting his interest in case of default by the purchaser:

(1) By an agreement that title is to remain in the vendor until the purchaser has completely performed his part of the transaction;

(2) By a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the selling price;

(3) By a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the vendor; or

(4) By conveyance to a trustee pending performance of the contract and subject to its provisions.

(b) *Installment income of dealers in personal property.*—The income from installment sales of a dealer, that is, a person regularly

engaged in the sale of personal property on the installment plan, may be ascertained by treating as income that proportion of the total payments received in the taxable year from installment sales (such payments being allocated to the year against the sales of which they apply) which the gross profit realized or to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year. A dealer who desires to compute income by the installment method shall maintain accounting records in such a manner as to enable an accurate computation to be made by such method in accordance with the provisions of this section, section 446, and § 1,446–1.

(c) *Treatment of payments on sales made in years prior to change to installment method.*—No payments received in the taxable year shall be excluded in computing the amount of income to be returned on the ground that they were received under a sale the total profit from which was returned as income during a taxable year or years prior to the change by the taxpayer to the installment method of returning income. In this regard, however, see section 453(c) and § 1.453–7 for the computation of the adjustments for amounts previously included in income in the case of a change from an accrual method to the installment method. Deductible items are not to be allocated to the years in which the profits from the sales of a particular year are to be returned as income, but must be deducted for the taxable year in which the items are "paid or incurred" or "paid or accrued". See sections 461 and 7701(a)(25), and the regulations thereunder.

§ 1.453–3 Special Rules Applicable to Casual Sales or Casual Dispositions of Personal Property.—Income shall be computed and reported separately for each casual sale or other casual disposition of personal property as installment payments are received in the year of sale and subsequent years. See § 1.453–1(c) for limitations on the use of the installment method.

§ 1.453–4 Sale of Real Property Involving Deferred Periodic Payments.—(a) *In general.*—Sales of real property involving deferred payments include (1) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (2) sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

(b) *Classes of sales.*—Such sales, under either paragraph (a) (1) or (2) of this section, fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of real property which may be accounted for on the installment method, that is, sales of real property in which (i) there are no payments during the taxable year of the sale or (ii) the payments in such taxable year (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price, or

(2) Deferred-payment sales of real property in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 30 percent of the selling price.

(c) *Determination of "selling price".*—In the sale of mortgaged property the amount of the mortgage, whether the property is merely

taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall, for the purpose of determining whether a sale is on the installment plan, be included as a part of the "selling price"; and for the purpose of determining the payments and the total contract price as those terms are used in section 453, and §§ 1.453–1 through 1.453–7, the amount of such mortgage shall be included only to the extent that it exceeds the basis of the property. The term "payments" does not include amounts received by the vendor in the year of sale from the disposition to a third person of notes given by the vendee as part of the purchase price which are due and payable in subsequent years. Commissions and other selling expenses paid or incurred by the vendor shall not reduce the amount of the payments, the total contract price, or the selling price.

§ 1.453–5 Sale of Real Property Treated on Installment Method.—(a) *In general.*—In any transaction described in paragraph (b) (1) of § 1.453–4, that is, sales of real property in which there are no payments during the year of sale or the payments in that year do not exceed 30 percent of the selling price, the vender may return as income from each such transaction in any taxable year that proportion of the installment payments actually received in that year which the gross profit (as described in paragraph (b) of § 1.453–1) realized or to be realized when the property is paid for bears to the total contract price. In any case, the sale of each lot or parcel of a subdivided tract must be treated as a separate transaction and gain or loss computed accordingly. (See paragraph (a) of § 1.61–6.)

(b) *Defaults and repossessions.*—If the purchaser of real property on the installment plan defaults in any of his payments, and the vendor returning income on the installment method reacquires the property sold, whether title thereto had been retained by the vendor or transferred to the purchaser, gain or loss for the year in which the reacquisition occurs is to be computed upon any installment obligations of the purchaser which are satisfied or discharged upon the reacquisition or are applied by the vendor to the purchase or bid price of the property. Such gain or loss is to be measured by the difference between the fair market value at the date of reacquisition of the property reacquired (including the fair market value of any fixed improvements placed on the property by the purchaser) and the basis in the hands of the vendor of the obligations of the purchaser which are so satisfied, discharged, or applied, with proper adjustment for any other amounts realized or costs incurred in connection with the reacquisition. The basis in the hands of the vendor of the obligations of the purchaser satisfied, discharged, or applied upon the reacquisition of the property will be the excess of the face value of such obligations over an amount equal to the income which would be returnable were the obligations paid in full. For definition of the basis of an installment obligation, see section 453(d) (2) and paragraph (b) (2) of § 1.453–9. No deduction for a bad debt shall in any case be taken on account of any portion of the obligations of the purchaser which are treated by the vendor as not having been satisfied, discharged, or applied upon the reacquisition of the property. unless it is clearly shown that after the property was reacquired the purchaser remained liable for such portion; and in no event shall the amount of the deduc-

tion exceed the basis in the hands of the vendor of the portion of the obligations with respect to which the purchaser remained liable after the reacquisition. (See section 166 and the regulations thereunder.) If the property reacquired is bid in by the vendor at a foreclosure sale, the fair market value of the property shall be presumed to be the purchase or bid price thereof in the absence of clear and convincing proof to the contrary. If the property reacquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of reacquisition (including the fair market value of any fixed improvements placed on the property by the purchaser).

§ 1.453–6 DEFERRED-PAYMENT SALE OF REAL PROPERTY NOT ON INSTALLMENT METHOD.—(a) *Value of obligations.*—(1) In transactions included in paragraph (b) (2) of § 1.453–4, that is, sales of real property involving deferred payments in which the payments received during the year of sale exceed 30 percent of the selling price, the obligations of the purchaser received by the vendor are to be considered as an amount realized to the extent of their fair market value in ascertaining the profit or loss from the transaction. Such obligations, however, are not considered in determining whether the payments during the year of sale exceed 30 percent of the selling price.

(2) If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount thereof being the difference between the reduced basis as provided in the preceding sentence and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

(b) *Title retained by vendor.*—(1) If the vendor in sales referred to in paragraph (a) of this section has retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property, the difference between (i) the entire amount of the payments actually received on the contract and retained by the vendor plus the fair market value at the time of repossession of fixed improvements placed on the property by the purchaser and (ii) the sum of the profits previously returned as income in connection therewith and an amount representing what would have been a proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property during the period the property was in the hands of the purchaser had the sale not been made, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed.

(2) The basis of the property described in subparagraph (1) of this paragraph in the hands of the vendor will be the original basis at the time of the sale plus the fair market value at the time of repossession of fixed improvements placed on the property by the purchaser, except as provided in subparagraph (3) of this paragraph.

(3) With respect to repossessions occurring after the date of publication in the Federal Register of final regulations under section 453, the basis of property determined in accordance with subparagraph (2)

of this paragraph shall be reduced by what would have been a proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property during the period the property was in the hands of the purchaser had the sale not been made.

(c) *Title transferred to purchaser.*—If the vendor in sales described in paragraph (a) of this section has previously transferred title to the purchaser, and the purchaser defaults in any of his payments, and the vendor accepts a voluntary reconveyance of the property, in partial or full satisfaction of the unpaid portion of the purchase price, the receipt of the property so reacquired, to the extent of its fair market value at that time, including the fair market value of fixed improvements placed on the property by the purchaser, shall be considered as the receipt of payment on the obligations satisfied. If the fair market value of the property is greater than the basis of the obligations of the purchaser so satisfied (generally, such basis being the fair market value of such obligations previously recognized in computing income), the excess constitutes ordinary income. If the value of such property is less than the basis of such obligations, the difference may be deducted as a bad debt if uncollectible, except that if the obligations satisfied are securities (as defined in section 165(g)(2)(C)), any gain or loss resulting from the transaction is a capital gain or loss subject to the provisions of sections 1201 through 1241. If the property reacquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of reacquisition including the fair market value of the fixed improvements placed on the property by the purchaser. See section 166 and the regulations thereunder with respect to property reacquired in a foreclosure proceeding.

§ 1.453–7 Change From Accrual to Installment Method by Dealers.—(a) *In general.*—A taxpayer who is a dealer in personal property and who is entitled to the benefits of section 453(a) may elect to report his taxable income on the installment method of accounting without securing consent of the Commissioner. In the event a dealer elects to change from an accrual method of accounting to the installment method, any installment payments actually received in the year of change or in subsequent taxable years on account of sales or other dispositions of property made in any taxable year before the year of change shall not be excluded from taxable income. This means that profits attributable to installment sales even though included in taxable income in their entirety in a year of sale before the year in which the change to the installment method is made are also includible in taxable income as payments are received in the year of change and in subsequent taxable years. But the tax imposed for the year of change or any subsequent taxable years (such years being referred to as "adjustment years") beginning after December 31, 1953, shall be reduced by an adjustment proportionate to the tax attributable to the gross profit which is, by reason of the change to the installment method, included in gross income a second time, determined by the method of computation described in section 453(c) and paragraph (b) of this section.

(b) *Adjustment to tax.*—(1) The adjustment to tax under section 453(c)(2) is determined as follows:

(i) Determine separately the portion of the tax for each taxable year before the year of change which is attributable to the gross profit from installment sales which was included in gross income in that year and which is also includible in gross income for any adjustment year;

(ii) Determine separately the portion of the tax for each adjustment year which is attributable to the gross profit described in subdivision (i);

(iii) Select for each adjustment year the lesser of the amounts determined under subdivisions (i) and (ii);

(iv) The tax imposed in any adjustment year shall be reduced by the amount as determined in subdivision (iii) or the sum of all such amounts if more than one prior taxable year is involved;

(v) The portion of the tax for any taxable year attributable to the gross profit described in subdivision (i) shall be that proportion of the tax determined for such year without regard to the adjustments under this paragraph, which the gross profit included in gross income in the prior year and includible in gross income for the adjustment year bears to the gross income of that year.

(2) The tax determined in any of the steps provided in subparagraph (1) of this paragraph shall be the tax imposed by chapter 1, subtitle A of the Internal Revenue Code of 1954; or chapter 1, not including subchapter D, relating to excess profits tax, nor subchapter E, relating to tax on self-employment income, of the Internal Revenue Code of 1939.

(3) The computation of the adjustment provided in section 453(c)(2) may be illustrated by the following example:

Adjustments in Tax on Change to Installment Method

	Taxable years prior to change		Adjustment years after change	
	Year 1	Year 2	Year 3	Year 4
Gross profit from installment sales (receivable in periodic payments over 5 years)	$100,000	$50,000	[1] $20,000 [2] 10,000 [3] 80,000	[4] $12,000 [5] 8,000 [6] 40,000 [7] 90,000
Other income	80,000	200,000	90,000	90,000
Gross income	$180,000	$250,000	$200,000	$240,000
Deductions	60,000	50,000	50,000	60,000
Taxable income	120,000	200,000	150,000	180,000
Tax rate assumed	30%	50%	40%	40%
Tax would be	$36,000	$100,000	$60,000	$72,000

[1] and [4] from Year 1 Sales.
[2] and [5] from Year 2 Sales.
[3] and [6] from Year 3 Sales.
[7] from Year 4 Sales.

Computation of Adjustment in Year 3

	Year 1 Items	*Lesser tax portion*
In Year 3 portion of tax	20,000/200,000 x 60,000=$6,000	
In Year 1 portion of tax	20,000/180,000 x 36,000= 4,000	$4,000
	Year 2 Items	
In Year 3 portion of tax	10,000/200,000 x 60,000= 3,000	3,000
In Year 2	10,000/250,000 x 100,000= 4,000	
Adjustment to tax of Year 3		$7,000

Computation of Adjustment in Year 4

	Year 1 Items	*Lesser tax portion*
In Year 4 portion of tax	12,000/240,000 x 72,000=$3,600	
In Year 1 portion of tax	12,000/180,000 x 36,000= 2,400	$2,400
	Year 2 Items	
In Year 4 portion of tax	8,000/240,000 x 72,000= 2,400	2,400
In Year 2 portion of tax	8,000/250,000 x 100,000= 3,200	
Adjustment of tax of Year 4		$4,800

(c) *Special rules for partnerships.*—In the case of a change from an accrual method of accounting to the installment method of accounting by a partnership which is a dealer in personal property, payments attributable to installment sales under such accrual method shall be included in the gross income of the partnership in their entirety as payments are received in the year of change and in subsequent taxable years, even though included in gross income of the partnership for a year before the year in which the change to the installment method is made. Each partner's distributive share of the profits attributable to installment sales included in partnership taxable income for the year of sale and for each "adjustment year" shall be taken into account separately in accordance with section 702(a)(8) and § 1.702–1(a)(8). The income tax of each partner for adjustment years shall be computed with the adjustment provided by section 453(c)(2) for amounts previously taxed. However, it is not necessary for a partner to have been a member of the partnership for the year of sale and each subsequent taxable year, including adjustment years, in order to apply the adjustment to tax provided by section 453(c)(2).

§ 1.453–8 Requirements for Adoption of or Change to Installment Method.—(a) *Dealers in personal property.*—(1) *Adoption of installment method.*—A taxpayer who adopts the installment method of accounting in the first taxable year in which he makes installment sales must indicate in his income tax return for that taxable year that the installment method of accounting is being adopted.

(2) *Change to installment method.*—A taxpayer who changes to the installment method in accordance with § 1.453–7 shall attach a statement to his income tax return for the taxable year with respect to which the change is made. This statement must show—

(i) The method of accounting used in computing taxable income before the change;

(ii) The span of taxable years over which it will be necessary to compute adjustments; and

(iii) A schedule similar to the schedule shown in the example in paragraph (b)(3) of § 1.453–7, showing the computation of the required adjustments under section 453(c)(2).

Similar statements must be attached to and filed with income tax returns for subsequent taxable years in which adjustments are required because of the inclusion of installment payments in gross income a second time.

(b) *Sales of real property and casual sales of personal property.*—(1) A taxpayer who sells or otherwise disposes of real property, or who makes a casual sale or other casual disposition of personal property, and who elects to report the income therefrom on the installment method must set forth in his income tax return (or in a statement attached thereto) for the year of the sale or other disposition the computation of the gross profit on the sale or other disposition under the installment method. In any taxable year in which the taxpayer receives payments attributable to such sale or other disposition, he must also show in his income tax return the computation of the amount of income which is being reported in that year on such sale or other disposition.

(2) The information required by subparagraph (1) of this paragraph must be submitted for each separate sale or other disposition but, in the case of multiple sales or other dispositions, separate computations may be shown in a single statement.

(c) *Installment method and other accounting methods.*—Notwithstanding the fact that a dealer in personal property may change to the installment method of accounting without permission, a dealer may not change from the installment method of accounting for sales on the installment plan to an accrual method of accounting or to any other method of accounting without the permission of the Commissioner.

§ 1.453–9 Gain or Loss on Disposition of Installment Obligations.—(a) *In general.*—Subject to the exceptions contained in section 453(d)(4) and paragraph (c) of this section, the entire amount of gain or loss resulting from any disposition or satisfaction of installment obligations, computed in accordance with section 453(d), is recognized in the taxable year of such disposition or satisfaction and shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received by the taxpayer.

(b) *Computation of gain or loss.*—(1) The amount of gain or loss resulting under paragraph (a) of this section is the difference between the basis of the obligation and (i) the amount realized, in the case of satisfaction at other than face value or in the case of a sale or exchange, or (ii) the fair market value of the obligation at the time of disposition, if such disposition is other than by sale or exchange.

(2) The basis of an installment obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

(3) The application of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example (1). In 1960 the M Corporation sold a piece of unimproved real estate to B for $20,000. The company acquired the property in 1948 at a cost of $10,000. During 1960 the company received $5,000 cash and vendee's notes for the remainder of the selling price, or $15,000, payable in subsequent years. In 1962, before the vendee made any further payments, the company sold the notes for $13,000 in cash. The corporation makes its returns on the calendar year basis. The income to be reported for 1962 is $5,500, computed as follows:

Proceeds of sale of notes		$13,000
Selling price of property	$20,000	
Cost of property	10,000	
Total profit	10,000	
Total contract price	20,000	
Percent of profit, or proportion of each payment returnable as income, $10,000 divided by $20,000, 50 percent.		
Face value of notes	15,000	
Amount of income returnable were the notes satisfied in full, 50 percent of $15,000	7,500	
Basis of obligation—excess of face value of notes over amount of income returnable were the notes satisfied in full		7,500
Taxable income to be reported for 1962		5,500

Example (2). Suppose in example (1) the M Corporation, instead of selling the notes, distributed them in 1962 to its shareholders as a dividend, and at the time of such distribution, the fair market value of the notes was $14,000. The income to be reported for 1962 is $6,500, computed as follows:

Fair market value of notes	$14,000
Basis of obligation—excess of face value of notes over amount of income returnable were the notes satisfied in full (computed as in example (1))	7,500
Taxable income to be reported for 1962	6,500

(c) *Disposition from which no gain or loss is recognized.*—(1) Under section 453(d)(4), no gain or loss shall be recognized to a distributing corporation with respect to the distribution of installment obligations, in certain corporate liquidations, under the following conditions:

(i) If the distribution is made, pursuant to a plan for the complete liquidation of a subsidiary meeting the requirements of section 332, to a corporation in the hands of which no gain or loss is recognized with respect to such distribution, or

(ii) If the distribution is made, pursuant to a plan for the complete liquidation of a corporation which meets the requirements of section 337, under conditions whereby no gain or loss would have been recognized to the corporation had such installment obligations been sold or exchanged on the day of distribution.

(2) Where the Internal Revenue Code provides for exceptions to the recognition of gain or loss in the case of certain dispositions, no gain or loss shall result under section 453(d) in the case of a disposition of an installment obligation. Such exceptions include: certain transfers to corporations under sections 351 and 361; contributions of property to a partnership by a partner under section 721; and distributions by a partnership to a partner under section 731 (except as provided by section 736 and section 751).

(3) Any amount received by a person in payment or settlement of an installment obligation acquired in a transaction described in subparagraphs (1) or (2) of this paragraph (other than an amount received by a stockholder with respect to an installment obligation distributed to him pursuant to section 337) shall be considered to have the character it would have had in the hands of the person from whom such installment obligation was acquired.

(d) *Carryover of installment method.*—For the treatment of income derived from installment obligations received in transactions to which section 381(a) is applicable, see section 381(c)(8) and the regulations thereunder.

(e) *Installment obligations transmitted at death.*—Where installment obligations are transmitted at death, see section 691(a)(4) and the regulations thereunder for the treatment of amounts considered income in respect of a decedent.

(f) *Losses.*—See sections 1201–1241, as to the limitation on capital losses sustained by corporations and the limitation as to both capital gains and capital losses of individuals.

§ 1.453–10 Effective Date.—(a) Except as provided in this section, the provisions of section 453 and §§ 1.453–1 through 1.453–7, and 1.453–9 shall apply to any taxable year beginning after December 31, 1953, and ending after August 16, 1954.

(b) The provisions of § 1.453–8 shall apply to taxable years ending more than 90 days after the publication of final regulations under section 453 in the Federal Register.

(c) Under the provisions of sections 453(b) and 7851(a)(1)(C), section 453(b)(1) and the regulations with respect thereto shall also apply—

(1) To a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was returnable (by reason of section 44(b) of the Internal Revenue Code of 1939) on the basis and in the manner prescribed in section 44(a) of such Code.

(2) To a sale or other disposition during a taxable year beginning after December 31, 1953, and ending before August 17, 1954, though such taxable year is subject to the provisions of the Internal Revenue Code of 1939.

(d) Under the provisions of sections 453(c)(1)(B) and 7851(a)(1)(C), section 453(c) and the regulations with respect thereto shall also apply to taxable years beginning after December 31, 1953, and ending before August 17, 1954, though such taxable years are subject to the provisions of the Internal Revenue Code of 1939.

(e) The provisions of § 1.453–6(b)(3) shall apply to repossessions occurring after the date of publication in the Federal Register of regulations under section 453.

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved September 12, 1958.

Nelson P. Rose,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 17, 1958, 8:52 a. m., and published in the issue of the Federal Register for September 18, 1958, 23 F. R. 7210.)

SECTION 454.—OBLIGATIONS ISSUED AT DISCOUNT

26 CFR 1.454–1: Obligations issued at discount.

Effect of the election, by the executor of an estate, to treat the increment in value of Series E, United States savings bonds accruing in the taxable year as income received in such taxable year. See Rev. Rul. 58–435, page 370.

SECTION 455.—PREPAID SUBSCRIPTION INCOME

Temporary rules under section 455, as added to the 1954 Code by the Technical Amendments Act of 1958, relating to the taxable year of inclusion in gross income of prepaid income from newspaper and periodical subscriptions. See T. D. 6335, page 1112.

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. 58–340

Taxpayers employing the accrual method of accounting who, under I. T. 3956, C. B. 1949–1, 78, chose to continue to accrue and deduct vacation pay for the year in which paid must continue on that basis until they adopt completely vested vacation pay plans which meet the requirements of Revenue Ruling 54–608, C. B. 1954–2, 8. Accrual-method taxpayers who have been deducting vacation pay on a paid basis and who adopt completely vested vacation pay plans may deduct, in the taxable year in which they adopt such a plan, payments made during such taxable year under the old plan as well as vacation pay accrued at the end of such taxable year under the new vested plan. The extension of the effective date of Revenue Ruling 54–608, by Revenue Ruling 57–325, C. B. 1957–2, 302, merely operates to permit those taxpayers, who were properly accruing vacation pay under I. T. 3956, to continue on that basis and to permit them sufficient time to adopt a plan meeting the requirements of Revenue Ruling 54–608.

Subpart D.—Inventories

SECTION 471.—GENERAL RULE FOR INVENTORIES

(Also Part II, Section 22(c); Regulations 118, Section 39.22(c)-6.) Rev. Rul. 58–393

Determination of inventories of farmers under the unit-livestock-price method and under the community property laws of the State of Texas where one spouse dies during the taxable year.

Advice has been requested as to the proper method of determining inventories under the unit-livestock-price method under the community property laws of the State of Texas where one spouse dies during the taxable year.

The taxpayer and her husband, for many years prior to his death, had been engaged in the business of ranching and farming under the community property laws of the State of Texas. For Federal income tax purposes, they had reported on the calendar-year basis and determined income under the accrual method of accounting, using inventories determined under the unit-livestock-price method of valuation.

The taxpayer's husband died on March 5, 1955, and the decedent's entire estate, including his one-half of the community ranch and farm business, passed to outside parties. The executors of the estate have established a fiscal year ending August 31 for Federal income tax purposes. Since under Texas law the executors of the estate will administer the entire community property of the taxpayer and the deceased husband during the period of probate, the taxpayer was granted permission to change her accounting period to a fiscal year ending August 31, beginning with the taxable year ending August 31, 1955.

Under the above circumstances, the taxpayer filed a Federal income tax return for the period January 1, 1955, through August 31, 1955, taking into consideration the unit-livestock-price method of inventory valuation used in the operation of the ranch and farm business. Since the taxpayer's husband died during such period and the entire estate is being administered by the executors during the period of probate, the question arises how to determine the taxpayer's income for this period, particularly with reference to the valuation of the inventory at the date of death of the spouse and the valuation of such inventory as of August 31, 1955.

In order to determine the taxpayer's income for the taxable period January 1, 1955, through August 31, 1955, with respect to the ranching and farming operations, it is necessary to take into account, in determining the opening and closing inventories for such taxable period, separate inventory adjustments for the periods January 1, 1955, through March 5, 1955 (date of death of spouse), and March 6, 1955, through August 31, 1955.

First, inventory adjustments to be taken into account for the period January 1 through March 5 would include the opening inventory of January 1, 1955, and the closing inventory as of March 5, 1955, both of which would be determined on the prevailing unit-livestock-price method of valuation. The closing inventory as of March 5, 1955, would include only that pro rata portion of the established differential which the period January 1 through March 5 bears to the established differential for the entire year. For example, if the differential is established in the amount of $12,000 for the calendar year 1955, then 64/365 of the $12,000, or $2,104.11 would be included as a differential in the closing inventory as of March 5, 1955. See Rev. Rul. 55–736, C. B. 1955–2, 522.

Second, inventory adjustments to be taken into account for the period March 6, 1955, through August 31, 1955, would include the

fair market value of the livestock on hand March 6, 1955. This, in effect, would be the opening inventory for the period beginning March 6, 1955, and ending August 31, 1955. A closing inventory would be determined on August 31, 1955, on the unit-livestock-price method as revised. This revision of the unit-livestock-price method is necessary to reflect the change in basis of the opening livestock inventory as of March 6, 1955, occasioned by the death of the taxpayer's spouse. See section 1014(a) and (b)(6) of the Internal Revenue Code of 1954. The closing inventory as of August 31, 1955, would include only that pro rata portion of the established differential which the period March 6 through August 31 bears to the established differential for the calendar year 1955 (179/365 of $12,000, or $5,884.93).

Upon determining the correct opening and closing inventories for each of the periods mentioned above, the resulting inventory adjustment for the period January 1, 1955, through March 5, 1955, should be considered with the resulting inventory adjustment for the period March 6, 1955, through August 31, 1955, to ascertain the taxpayer's inventory adjustment to income.

The above is also applicable with respect to other states having community property laws similar to those of the State of Texas.

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26 CFR 1.471: Statutory provisions; general rule for inventories. (Also Sections 472, 1.472.) T. D. 6336[1]

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

Regulations prescribed under sections 471 and 472 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 December 11, 1957, notice of proposed rule making regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under sections 471 and 472 of the Internal Revenue Code of 1954, relating to inventories, was published in the Federal Register (22 F. R. 9888). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations as so proposed are hereby adopted. Consideration is being given to the issuance as a separate Treasury decision under section 472 of detailed rules with respect to the use of the so-called "dollar-value" method of pricing inventories.

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[1] 23 F. R. 9290.

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AUTHORITY: §§ 1.471 to 1.472–7, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

INVENTORIES

§ 1.471 STATUTORY PROVISIONS; GENERAL RULE FOR INVENTORIES

SEC. 471. GENERAL RULE FOR INVENTORIES.

Whenever in the opinion of the Secretary or his delegate the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary or his delegate may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

§ 1.471–1 NEED FOR INVENTORIES.—In order to reflect taxable income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. 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 will 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. A purchaser should include an inventory merchandise purchased (including containers), title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected. (But see § 1.472–1.)

§ 1.471–2 Valuation of Inventories.—(a) Section 471 provides two tests to which each inventory must conform:

(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and

(2) It must clearly reflect the income.

(b) It follows, therefore, that inventory rules cannot be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with §§ 1.471–1 through 1.471–9. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

(c) The bases of valuation most commonly used by business concerns and which meet the requirements of section 471 are (1) cost and (2) cost or market, whichever is lower. (For inventories by dealers in securities, see § 1.471–5.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less direct cost of disposition, whether basis (1) or (2) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value. Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date. The burden of proof will rest upon the taxpayer to show that such exceptional goods as are valued upon such selling basis come within the classifications indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.

(d) In respect of normal goods, whichever method is adopted must be applied with reasonable consistency to the entire inventory of the taxpayer's trade or business except as to those goods inventoried under the last-in, first-out method authorized by section 472 or to animals inventoried under the elective unit-livestock-price-method authorized by § 1.471–6. See § 1.446–1(d) for rules permitting the use of different methods of accounting if the taxpayer has more than one trade or business. Where the taxpayer is engaged in more than one trade or business the Commissioner may require that the method of valuing inventories with respect to goods in one trade or business also be used with respect to similar goods in other trades or business if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income. Taxpayers were given an option to adopt the basis of either (1) cost or (2) cost or market, whichever is lower, for their 1920 inventories. The basis properly adopted for that year or any subsequent year is controlling, and a change can now be made only after permission is secured from the Commissioner. Application for permission to

change the basis of valuing inventories shall be made in writing and filed with the Commissioner as provided in § 1.446–1(e). Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired. But see section 472 as to last-in, first-out inventories. Where the taxpayer maintains book inventories in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year), the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such book inventories should be verified by physical inventories at reasonable intervals and adjusted to conform therewith.

(e) Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the district director, and the taxpayer must satisfy the district director of the correctness of the prices adopted.

(f) The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with the regulations in this part:

(1) Deducting from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(2) Taking work in process, or other parts of the inventory, at a nominal price or at less than its proper value.

(3) Omitting portions of the stock on hand.

(4) Using a constant price or nominal value for so-called normal quality of materials or goods in stock.

(5) Including stock in transit, shipped either to or from the taxpayer, the title to which is not vested in the taxpayer.

§ 1.471–3 Inventories at Cost.—Cost means: (a) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(b) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(c) In the case of merchandise produced by the taxpayer since the beginning of the taxable year, (1) the cost of raw materials and supplies entering into or consumed in connection with the product, (2) expenditures for direct labor, (3) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management ex-

penses, but not including any cost of selling or return on capital, whether by way of interest or profit.

(d) In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. Among such cases are: (1) Farmers and raisers of livestock (see § 1.471–6); (2) miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike (see § 1.471–7); and (3) retail merchants who use what is known as the "retail method" in ascertaining approximate cost (see § 1.471–8).

§ 1.471–4 INVENTORIES AT COST OR MARKET, WHICHEVER IS LOWER.—(a) Under ordinary circumstances and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases—

(1) Of goods purchased and on hand, and

(2) Of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, under which the taxpayer is protected against actual loss, which goods must be inventoried at cost.

(b) Where no open market exists or where quotations are nominal, due to inactive market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less direct cost of disposition, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market.

(c) Where the inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article on hand at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article.

§ 1.471–5 INVENTORIES BY DEALERS IN SECURITIES.—A dealer in securities who in his books of account regularly inventories unsold securities on hand either—

(a) At cost,

(b) At cost or market, whichever is lower, or

(c) At market value,

may make his return upon the basis upon which his accounts are kept, provided that a description of the method employed is included in or attached to the return, that all the securities are inventoried by the same method, and that such method is adhered to in subsequent years, unless another method is authorized by the Commissioner pursuant to a written application therefor filed as provided in § 1.446–1(e). A dealer in securities in whose books of account separate computations of the gain or loss from the sale of the various lots of securities sold are made on the basis of the cost of each lot shall be regarded, for the purposes of this section, as regularly inventorying his securities at cost. For the purposes of this section, a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as provided in this section may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this section.

§ 1.471–6 Inventories of Livestock Raisers and Other Farmers.—(a) A farmer may make his return upon an inventory method instead of the cash receipts and disbursements method. It is optional with the taxpayer which of these methods of accounting is used but, having elected one method, the option so exercised will be binding upon the taxpayer for the year for which the option is exercised and for subsequent years unless another method is authorized by the Commissioner as provided in § 1.446–1(e).

(b) In any change of accounting method from the cash receipts and disbursements method to an inventory method, adjustments shall be made as provided in section 481 (relating to adjustments required by change in method of accounting) and the regulations thereunder.

(c) Because of the difficulty of ascertaining actual cost of livestock and other farm products, farmers who render their returns upon an inventory method may value their inventories according to the "farm-price method", and farmers raising livestock may value their inventories of animals according to either the "farm-price method" or the "unit-livestock-price method".

(d) The "farm-price method" provides for the valuation of inventories at market price less direct cost of disposition. If this method of valuing inventories is used, it must be applied to the entire inventory except as to livestock inventoried, at the taxpayer's election, under the "unit-livestock-price method". If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of valuing inventories from that employed in prior years, permission for such change shall first be secured from the Commissioner as provided in § 1.446–1(e).

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(e) The "unit-livestock-price method" provides for the valuation of the different classes of animals in the inventory at a standard unit price for each animal within a class. A livestock raiser electing this method of valuing his animals must adopt a reasonable classification of the animals in his inventory with respect to the age and kind included so that the unit prices assigned to the several classes will reasonably account for the normal costs incurred in producing the animals within such classes. Thus, if a cattle raiser determines that it costs approximately $15 to produce a calf, and $7.50 each year to raise the calf to maturity, his classifications and unit prices would be as follows: Calves, $15; yearlings, $22.50; 2-year olds, $30; mature animals, $37.50. The classification selected by the livestock raiser, and the unit prices assigned to the several classes, are subject to approval by the district director upon examination of the taxpayer's return.

(f) A taxpayer who elects to use the "unit-livestock-price method" must apply it to all livestock raised, whether for sale or for draft, breeding, or dairy purposes. Once established, the unit prices and classifications selected by the taxpayer must be consistently applied in all subsequent taxable years in the valuation of livestock inventories. No changes in the classification of animals or unit prices will be made without the approval of the Commissioner.

(g) A livestock raiser who uses the "unit-livestock-price method" must include in his inventory at cost any livestock purchased, except that animals purchased for draft, breeding, or dairy purposes can, at the election of the livestock raiser, be included in inventory or be treated as capital assets subject to depreciation after maturity. If the animals purchased are not mature at the time of purchase, the cost should be increased at the end of each taxable year in accordance with the established unit prices, except that no increase is to be made in the taxable year of purchase if the animal is acquired during the last six months of that year. If the records maintained permit identification of a purchased animal, the cost of such animal will be eliminated from the closing inventory in the event of its sale or loss. Otherwise, the first-in, first-out method of valuing inventories must be applied.

(h) If a taxpayer using the "farm-price method" desires to adopt the "unit-livestock-price method" in valuing his inventories of livestock, permission for the change shall first be secured from the Commissioner as provided in § 1.446–1(e). However, a taxpayer who has filed returns on the basis of inventories at cost, or cost or market whichever is lower, may adopt the "unit-livestock-price method" for valuing his inventories of livestock without formal application for permission, but the classifications and unit prices selected are subject to approval by the district director upon examination of the taxpayer's return. A livestock raiser who has adopted a constant unit-price method of valuing livestock inventories and filed returns on that basis will be considered as having elected the "unit-livestock-price method".

(i) If returns have been made in which the taxable income has been computed upon incomplete inventories, the abnormality should be corrected by submitting with the return for the current taxable year a statement for the preceding taxable year. In this statement such adjustments shall be made as are necessary to bring the closing inventory for the preceding taxable year into agreement with the opening com-

plete inventory for the current taxable year. If necessary clearly to reflect income, similar adjustments may be made as at the beginning of the preceding year or years, and the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such year or years.

§ 1.471–7 Inventories of Miners and Manufacturers.—A taxpayer engaged in mining or manufacturing who by a single process or uniform series of processes derives a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product, which in the aggregate will absorb the total cost of production, may, with the consent of the Commissioner, use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective selling values of the different kinds, sizes, or grades of product. See section 472 as to last-in, first-out inventories.

§ 1.471–8 Inventories of Retail Merchants.—(a) Retail Merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that method, provided that the use of such method is designated upon the return, that accurate accounts are kept, and that such method is consistently adhered to unless a change is authorized by the Commissioner as provided in § 1.446–1(e). Under the retail method the total of the retail selling prices of the goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by deducting therefrom an amount which bears the same ratio to such total as—

(1) The total of the retail selling prices of the goods included in the opening inventory plus the retail selling prices of the goods purchased during the year, with proper adjustment to such selling prices for all mark-ups and mark-downs, less

(2) The cost of the goods included in the opening inventory plus the cost of the goods purchased during the year, bears to (1). The result should represent as accurately as may be the amounts added to the cost price of the goods to cover selling and other expenses of doing business and for the margin of profit.

(b) For further adjustments to be made in the case of a retail merchant using the last-in, first-out inventory method authorized by section 472, see § 1.472–1(k).

(c) A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage of profit based upon an average of his entire business, but should compute and use in valuing his inventory the proper percentages for the respective departments or classes of goods.

(d) A taxpayer (other than one using the last-in, first-out inventory method) who previously has determined inventories in accordance with the retail method, except that, to obtain a basis of approximate cost or market, whichever is lower, has consistently and uniformly followed the practice of adjusting the retail selling prices of the goods included in the opening inventory and purchased during the taxable year for mark-ups but not for mark-downs, may continue such practice subject to the conditions prescribed in this section. The adjustments must be bonafide and consistent and uniform. Where

mark-downs are not included in the adjustments, mark-ups made to cancel or correct mark-downs shall not be included; and the mark-ups included must be reduced by the mark-downs made to cancel or correct such mark-ups.

(e) In no event shall mark-downs not based on actual reduction of retail sale prices, such as mark-downs based on depreciation and obsolescence, be recognized in determining the retail selling prices of the goods on hand at the end of the taxable year.

(f) A taxpayer (other than one using the last-in, first-out inventory method) who previously has determined inventories without following the practice of eliminating mark-downs in making adjustments to retail selling prices, may adopt such practice, provided permission to do so is obtained in accordance with, and subject to the terms provided by, § 1.446–1(e). A taxpayer filing a first return of income may adopt such practice subject to approval by the district director upon examination of the return.

(g) A taxpayer using the last-in, first-out inventory method in conjunction with retail computations must adjust retail selling prices for mark-downs as well as mark-ups, in order that there may be reflected the approximate cost of the goods on hand at the end of the taxable year regardless of market values.

§ 1.471–9 INVENTORIES OF ACQUIRING CORPORATIONS.—For additional rules in the case of certain corporate acquisitions specified in section 381(a), see section 381(c)(5) and the regulations thereunder.

§ 1.472 STATUTORY PROVISIONS; LAST-IN, FIRST-OUT INVENTORIES.

SEC. 472. LAST-IN, FIRST-OUT INVENTORIES.

(a) AUTHORIZATION.—A taxpayer may use the method provided in subsection (b) (whether or not such method has been prescribed under section 471) in inventorying goods specified in an application to use such method filed at such time and in such manner as the Secretary or his delegate may prescribe. The change to, and the use of, such method shall be in accordance with such regulations as the Secretary or his delegate may prescribe as necessary in order that the use of such method may clearly reflect income.

(b) METHOD APPLICABLE.—In inventorying goods specified in the application described in subsection (a), 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.

(c) CONDITION.—Subsection (a) shall apply only if the taxpayer establishes to the satisfaction of the Secretary 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.

(d) PRECEDING CLOSING INVENTORY.—In determining income for the taxable year preceding the taxable year for which the method described in subsection (b) is first used, the closing inventory of such preceding

year of the goods specified in the application referred to in subsection (a) shall be at cost.

(e) SUBSEQUENT INVENTORIES.—If a taxpayer, having complied with subsection (a), uses the method described in subsection (b) for any taxable year, then such method shall be used in all subsequent taxable years unless—

(1) With the approval of the Secretary or his delegate a change to a different method is authorized; or,

(2) The Secretary or his delegate determines that the taxpayer has used for any such subsequent taxable year some procedure other than that specified in paragraph (1) of subsection (b) in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (A) to shareholders, partners, or other proprietors, or beneficiaries, or (B) for credit purposes; and requires a change to a method different from that prescribed in subsection (b) beginning with such subsequent taxable year or any taxable year thereafter.

If paragraph (1) or (2) of this subsection applies, the change to, and the use of, the different method shall be in accordance with such regulations as the Secretary or his delegate may prescribe as necessary in order that the use of such method may clearly reflect income.

(f) CROSS REFERENCE.—For provisions relating to involuntary liquidation and replacement of LIFO inventories, see section 1321.

§ 1.472–1 LAST-IN, FIRST-OUT INVENTORIES.—(a) Any taxpayer permitted or required to take inventories pursuant to the provisions of section 471, and pursuant to the provisions of §§ 1.471–1 to 1.471–9, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 472, this section, and § 1.472–2. Under this last-in, first-out (LIFO) inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

(1) Those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

(2) Those acquired during the taxable year.

The LIFO inventory method is not dependent upon the character of the business in which the taxpayer is engaged or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year.

(b) If the LIFO inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedging on a futures market, matches purchases with sales, then firm purchases and sales contracts (i. e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the taxpayer and provided that, in the opinion of the Commissioner, income is clearly reflected thereby.

(c) A manufacturer or processor who has adopted the LIFO inventory method as to a class of goods may elect to have such method apply to the raw materials only (including those included in goods in process and in finished goods) expressel in terms of appropriate units. If such method is adopted, the adjustments are confined to costs of the raw material in the inventory and the cost of the raw material in goods in process and in finished goods produced by such manufacturer or proces-

sor and reflected in the inventory. The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume that the opening inventory had 10 units of raw material, 10 units of goods in process, and 10 units of finished goods, and that the raw material cost was 6 cents a unit, the processing cost 2 cents a unit, and overhead cost 1 cent a unit. For the purposes of this example, it is assumed that the entire amount of goods in process was 50 percent processed.

OPENING INVENTORY

	Raw material	Goods in process	Finished goods
Raw material	$0. 60	$0. 60	$0. 60
Processing cost		. 10	. 20
Overhead		. 05	. 10

In the closing inventory there are 20 units of raw material, 6 units of goods in process, and 8 units of finished goods and the costs were: Raw material 10 cents, processing cost 4 cents, and overhead 1 cent.

CLOSING INVENTORY

(Based on cost and prior to adjustment)

	Raw material	Goods in process	Finished goods
Raw material	$2. 00	$0. 60	$0. 80
Processing costs		. 12	. 32
Overhead		. 03	. 08
Total	2. 00	. 75	1. 20

There were 30 units of raw material in the opening inventory and 34 units in the closing inventory. The adjustment to the closing inventory would be as follows:

CLOSING INVENTORY AS ADJUSTED

	Raw material	Goods in process	Finished goods
Raw material:			
20 at 6 cents	$1. 20		
6 at 6 cents		$0. 36	
4 at 6 cents			$0. 24
4 at 10 cents [1]			. 40
Processing costs		. 12	. 32
Overhead		. 03	. 08
Total	1. 20	. 51	1. 04

[1] This excess is subject to determination of price under section 472(b)(1) and § 1.472-2. If the excess falls in goods in process, the same adjustment is applicable.

The only adjustment to the closing inventory is the cost of the raw material; the processing costs and overhead cost are not changed.

Example (2). Assume that the opening inventory had 5 units of raw material, 10 units of goods in process, and 20 units of finished goods, with the same prices as in example (1), and that the closing inventory had 20 units of raw material, 20 units of goods in process, and 10 units of finished goods, with raw material costs as in the closing inventory in example (1). The adjusted closing inventory would be as follows in so far as the raw material is concerned:

Raw material, 20 at 6 cents	$1.20
Goods in process:	
15 at 6 cents	.90
5 at 10 cents [1]	.50
Finished goods:	
None at 6 cents	.00
10 at 10 cents [1]	1.00

[1] This excess is subject to determination of price under section 472(b)(1) and § 1.472-2.

The 20 units of raw material in the raw state plus 15 units of raw material in goods in process make up the 35 units of raw material that were contained in the opening inventory.

(d) For the purposes of this section, raw material in the opening inventory must be compared with similar raw material in the closing inventory. There may be several types of raw materials, depending upon the character, quality, or price, and each type of raw material in the opening inventory must be compared with a similar type in the closing inventory.

(e) In the cotton textile industry there may be different raw materials depending upon marked differences in length of staple, in color or grade of the cotton. But where different staple lengths or grades of cotton are being used at different times in the same mill to produce the same class of goods, such differences would not necessarily require the classification into different raw materials.

(f) As to the pork packing industry a live hog is considered as being composed of various raw materials, different cuts of a hog varying markedly in price and use. Generally a hog is processed into approximately 10 primal cuts and several miscellaneous articles. However, due to similarity in price and use, these may be grouped into fewer classifications, each group being classed as one raw material.

(g) When the finished product contains two or more different raw materials as in the case of cotton and rayon mixtures, each raw material is treated separately and adjustments made accordingly.

(h) Upon written notice addressed to the Commissioner of Internal Revenue, Attention T:R, Washington 25, D. C., by the taxpayer, a taxpayer who has heretofore adopted the LIFO inventory method in respect of any goods may adopt the method authorized in this section and limit the election to the raw material including raw materials entering into goods in process and in finished goods. If this method is adopted as to any specific goods, it must be used exclusively for such goods for any prior taxable year (not closed by agreement) to which the prior election applies and for all subsequent taxable years, unless permission to change is granted by the Commissioner.

(i) The election may also be limited to that phase in the manufacturing process where a product is produced that is recognized gen-

erally as a salable product as, for example, in the textile industry where one phase of the process is the production of yarn. Since yarn is generally recognized as a salable product, the election may be limited to that portion of the process when yarn is produced. In the case of copper and brass processors, the election may be limited to the production of bars, plates, sheets, etc., although these may be further processed into other products.

(j) The election may also apply to any one raw material, when two or more raw materials enter into the composition of the finished product; for example, in the case of cotton and rayon yarn, the taxpayer may elect to inventory the cotton only. However, a taxpayer who has previously made an election to use the LIFO inventory method may not later elect to exclude any raw materials that were covered by such previous election.

(k) If a taxpayer using the retail method of pricing inventories, authorized by § 1.471–8, elects to use in connection therewith the LIFO inventory method authorized by section 472 and this section, the apparent cost of the goods on hand at the end of the year, determined pursuant to § 1.471–8, shall be adjusted to the extent of price changes therein taking place after the close of the preceding taxable year. The amount of any apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indexes established to the satisfaction of the Commissioner. Price indexes prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indexes which are based upon inadequate records, or which are not subject to complete and detailed audit within the Internal Revenue Service, will not be approved.

(l) If a taxpayer uses consistently the so-called "dollar-value" method of pricing inventories, or any other method of computation established to the satisfaction of the Commissioner as reasonably adaptable to the purpose and intent of section 472 and this section, and if such taxpayer elects under section 472 to use the LIFO inventory method authorized by such section, the taxpayer's opening and closing inventories shall be determined under section 472 by the use of the appropriate adaptation.

§ 1.472–2 Requirements Incident to Adoption and Use of LIFO Inventory Method.—Except as otherwise provided in § 1.472–1 with respect to raw material computations, with respect to retail inventory computations, and with respect to "dollar-value" and other methods of computation established to the satisfaction of the Commissioner as reasonably adapted to the purpose and intent of section 472, the adoption and use of the LIFO inventory method is subject to the following requirements:

(a) The taxpayer shall file an application to use such method specifying with particularly the goods to which it is to be applied.

(b) The inventory shall be taken at cost regardless of market value.

(c) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of

units on hand. The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the prior taxable year with the exception that restoration shall be made with respect to any writedown to market values resulting from the pricing or former inventories.

(d) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices and regardless of specific cost accounting records, at costs determined pursuant to the provisions of subparagraph (1) or (2) of this paragraph, dependent upon the character of the transactions in which the taxpayer is engaged:

(1) (i) In the case of a taxpayer engaged in the purchase and sale of merchandise, such as a retail grocer or druggist, or engaged in the initial production of merchandise and its sale without processing, such as a miner selling his or ore output without smelting or refining, such costs shall be determined—

(*a*) By reference to the actual cost of the goods most recently purchased or produced;

(*b*) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(*c*) By application of an average unit cost equal to the aggregate cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 472 as having been acquired all at the same time; or

(*d*) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

(ii) Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the LIFO inventory method is used by the taxpayer.

(iii) The application of subdivisions (i) and (ii) of this subparagraph may be illustrated by the following examples:

Example (1). Suppose that the taxpayer adopts the LIFO inventory method for the taxable year 1957 with an opening inventory of 10 units at 10 cents per unit, that it makes 1957 purchases of 10 units as follows:

January	1	at $0.11	=	$0.11
April	2	at .12	=	.24
July	3	at .13	=	.39
October	4	at .14	=	.56
Totals	10			1.30

and that it has a 1957 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(*a*) Most recent purchases—

	10	at $0.10	=	$1.00
	4	at .14 (October)	=	.56
	1	at .13 (July)	=	.13
Totals	15			1.69

or

(*b*) In order of acquisition—

	10	at $0.10	=	$1.00
	1	at .11 (January)	=	.11
	2	at .12 (April)	=	.24
	2	at .13 (July)	=	.26
Totals	15			1.61

or

(*c*) At an annual average—

	10	at $0.10	=	$1.00
	5	at .13 ($^{130}/_{10}$)	=	.65
Totals	15			1.65

Example (*2*). Suppose that the taxpayer's closing inventory for 1958, the year following that involved in example (1) of this subdivision, reflects an inventory decrease for the year, and not an increase; suppose that there is, accordingly, a 1958 closing inventory of 13 units. Inasmuch as the decreased closing inventory will be determined wholly by reference to the 15 units reflected in the opening inventory for the year, and will be taken "in the order of acquisition" pursuant to section 472(b) (1), and inasmuch as the character of the taxpayer's opening inventory for 1958 will be dependent upon its method of valuing its 5-unit inventory increase for 1957, the closing inventory for 1958 will be computed as follows:

(*a*) In case the increase for 1957 was taken by reference to the most recent purchases—

	10	at $0.10 (from 1956)	=	$1.00
	1	at .13 (July 1957)	=	.13
	2	at .14 (October 1957)	=	.28
Totals	13			1.41

or

(*b*) In case the increase for 1957 was taken in the order of acquisition—

	10	at $0.10 (from 1956)	=	$1.00
	1	at .11 (January 1957)	=	.11
	2	at .12 (April 1957)	=	.24
Totals	13			1.35

or

(*c*) In case the increase for 1957 was taken on the basis of an average—

	10	at $0.10 (from 1956)	=	$1.00
	3	at .13 (from 1957)	=	.39
Totals	13			1.39

(2) In the case of a taxpayer engaged in manufacturing, fabricating, processing, or otherwise producing merchandise, such costs shall be determined—

(i) In the case of raw materials purchased or initially produced by the taxpayer, in the manner elected by the taxpayer under sub-

paragraph (1) of this paragraph to the same extent as if the taxpayer were engaged in purchase and sale transactions; and

(ii) In the case of goods in process, regardless of the stage to which the manufacture, fabricating, or processing may have advanced, and in the case of finished goods, pursuant to any proper method which, in the opinion of the Commissioner, clearly reflects income.

(e) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining income, profit, or loss for the taxable year for which the LIFO inventory method is first used or for any subsequent taxable year, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, has not used any inventory method other than that referred to in § 1.472–1 or at variance with the requirement referred to in paragraph (c) of this section. The taxpayer's use of market value in lieu of cost or his issuance of reports or credit statements covering a period of operations less than the whole of the taxable year is not considered at variance with this requirement.

(f) Goods of the specified type on hand as of the close of the taxable year preceding the taxable year for which this inventory method is first used shall be included in the taxpayer's closing inventory for such preceding taxable year at cost determined in the manner prescribed in paragraph (c) of this section.

(g) The LIFO inventory method, once adopted by the taxpayer with the approval of the Commissioner, shall be adhered to in all subsequent taxable years unless—

(1) A change to a different method is approved by the Commissioner; or

(2) The Commissioner determines that the taxpayer, in ascertaining income, profit, or loss for the whole of any taxable year subsequent to his adoption of the LIFO inventory method, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, has used any inventory method at variance with that referred to in § 1.472–1 and requires of the taxpayer a change to a different method for such subsequent taxable year or any taxable year thereafter.

(h) The records and accounts employed by the taxpayer in keeping his books shall be maintained in conformity with the inventory method referred to in § 1.472–1; and such supplemental and detailed inventory records shall be maintained as will enable the district director readily to verify the taxpayer's inventory computations as well as his compliance with the requirements of section 472 and §§ 1.472–1 through1.472–7.

(i) Where the taxpayer is engaged in more than one trade or business, the Commissioner may require that if the LIFO method of valuing inventories is used with respect to goods in one trade or business the same method shall also be used with respect to similar goods in the other trades or businesses if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income.

§ 1.472–3 Time and Manner of Making Election.—(a) The LIFO inventory method may be adopted and used only if the taxpayer files with his income tax return for the taxable year as of the

close of which the method is first to be used, in triplicate on Form 970, and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the LIFO inventory method is proposed first to be used, and also as of the beginning of the prior taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use of finished products. Each group of products shall be clearly described.

(b) The taxpayer shall submit for the consideration of the Commissioner in connection with the taxpayer's adoption or use of the LIFO inventory method such other detailed information with respect to his business or accounting system as may be at any time requested by the Commissioner.

(c) As a condition to the taxpayer's use of the LIFO inventory method, the Commissioner may require that the method be used with respect to goods other than those specified in the taxpayer's statement of election if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income.

(d) Whether or not the taxpayer's application for the adoption and use of the LIFO inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method, will be determined by the Commissioner in connection with the examination of the taxpayer's income tax returns.

§ 1.472–4 Adjustments To Be Made by Taxpayer.—A taxpayer may not change to the LIFO method of taking inventories unless, at the time he files his application for the adoption of such method, he agrees to such adjustments incident to the change to or from such method, or incident to the use of such method, in the inventories of prior taxable years or otherwise, as the district director upon the examination of the taxpayer's returns may deem necessary in order that the true income of the taxpayer will be clearly reflected for the years involved.

§ 1.472–5 Revocation of Election.—An election made to adopt and use the LIFO inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method is required by the Commissioner, or authorized by him pursuant to a written application therefor filed as provided in § 1.446–1(e).

§ 1.472–6 Change from LIFO Inventory Method.—If the taxpayer is granted permission by the Commissioner to discontinue the us of LIFO method of taking inventories, and thereafter to use some other method, or if the taxpayer is required by the Commissioner to discontinue the use of the LIFO method by reason of the tax-

payer's failure to conform to the requirements detailed in § 1.472–2, the inventory of the specified goods for the first taxable year affected by the change and for each taxable year thereafter shall be taken—

(a) In conformity with the method used by the taxpayer under section 471 in inventorying goods not included in his LIFO inventory computations; or

(b) If the LIFO inventory method was used by the taxpayer with respect to all of his goods subject to inventory, then in conformity with the inventory method used by the taxpayer prior to his adoption of the LIFO inventory method; or

(c) If the taxpayer had not used inventories prior to his adoption of the LIFO inventory method and had no goods currently subject to inventory by a method other than the LIFO inventory method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or

(d) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

§ 1.472–7 Inventories of Acquiring Corporations.—For additional rules in the case of certain corporate acquisitions specified in section 381(a), see section 381(c)(5) and the regulations thereunder.

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved November 25, 1958.

Dan Throop Smith,
Deputy to Secretary of the Treasury.

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SECTION 472.—LAST-IN, FIRST-OUT INVENTORIES

Rev. Rul. 58–615

Price indexes for July 1958, published by the Bureau of Labor Statistics on September 4, 1958, for use by department stores employing the retail inventory and last-in, first-out inventory methods.

The following price indexes for July 1958, published by the Bureau of Labor Statistics on September 4, 1958, 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 Treasury Decision 5605, C. B. 1948–1, 16, and Mimeograph 6244, C. B. 1948–1, 21, for appropriate application to inventories for taxable years of 12 months ended June 30, 1958, and July 31, 1958.

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 1958	July 1957	Percent change from July 1957 to July 1958
I	Piece goods	201. 1	200. 1	+0. 5
II	Domestics and draperies	200. 8	200. 2	+ . 3
III	Women's and children's shoes	242. 2	236. 8	+2. 3
IV	Men's and boys' shoes	232. 3	228. 7	+1. 6
V	Infants' wear	175. 2	174. 9	+. 2
VI	Women's underwear	176. 7	174. 4	+1. 3
VII	Women's and girls' hosiery	158. 3	160. 9	−1. 6
VIII	Women's and girls' accessories	177. 5	174. 9	+1. 5
IX	Women's outerwear and girls' wear	182. 3	181. 0	+. 7
X	Men's clothing	215. 1	213. 4	+. 8
XI	Men's furnishings	198. 4	199. 8	−. 7
XII	Boys' clothing and furnishings	206. 8	206. 1	+. 3
XIII	Jewelry	172. 3	170. 4	+1. 1
XIV	Notions	167. 4	166. 2	+. 7
XV	Toilet articles and drugs	188. 0	181. 5	+3. 6
XVI	Furniture and bedding	218. 3	217. 8	+. 2
XVII	Floor covering	194. 2	195. 2	−. 5
XVIII	Housewares	222. 9	217. 6	+2. 4
XIX	Major appliances	135. 6	138. 8	−2. 3
XX	Radios and television sets	129. 4	138. 4	−6. 5
	Groups I–XV: Soft goods	195. 6	193. 9	+. 9
	Groups XVI–XX: Durable goods	193. 8	194. 0	−. 1
Store total		195. 1	193. 9	+. 6

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26 CFR 1.472: Statutory provisions; last-in, first-out inventories.

Regulations under the Internal Revenue Code of 1954. See T. D. 6336, page 176.

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

SECTION 501.—EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

Rev. Rul. 58–442

Where a trust is established by a corporation pursuant to the provisions of a supplemental unemployment benefit plan, negotiated as the result of a collective bargaining agreement, for the sole purpose of furnishing supplemental unemployment benefits to a designated class of its employees during a period of temporary layoff or reduction in force, a voluntary employees' beneficiary association within the meaning of section 501(c)(9) of the Internal Revenue Code of 1954 is created. Income derived by the trustees for payment of benefits to the members is exempt from Federal income tax if the other requirements of the section are met.

Advice has been requested whether a trust established pursuant to a supplemental unemployment benefit plan, negotiated as the result of a collective bargaining agreement, for the purpose of furnishing supplemental unemployment benefits to a designated class of employees as a result of a reduction in force or temporary layoff, is entitled to exemption from Federal income tax as a voluntary employees' beneficiary association under the provisions of section 501(c)(9) of the Internal Revenue Code of 1954.

In the instant case, an agreement was entered into by the corporation and the exclusive representatives of all of its employees in a contract unit establishing a supplemental unemployment benefit plan, as a result of a labor agreement negotiated on behalf of such employees, to supplement state system unemployment compensation benefits in a prescribed manner during a particular period to eligible employees as a result of a reduction in force or temporary layoff. The plan established the conditions and requirements of employee eligibility based on accredited service and other pertinent factors and provides for cash payments to eligible employees to supplement weekly state system unemployment benefits to specified levels. The plan also sets forth the terms and conditions for payment of benefits in the event supplementation of state system benefits is not permitted.

In accordance with the terms of the agreement, the corporation is obligated to establish a trust fund which, after an initial maximum funding, shall consist of cash contributions on the basis of hours worked by eligible employees, except for months in which the fund position is 100 percent or more. The trustees were authorized to hold, invest and reinvest the assets of the trust fund and to make payments upon instructions issued by the corporation in accordance with the conditions contained in the plan. No part of the corpus or income of the fund may be used for or diverted to purposes other than for the exclusive benefit of employees covered by the plan, and no person shall have any right, title or interest in or to any of the assets of the fund except to the extent provided in the plan.

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and provides, in part, as follows:

> (9) Voluntary employees' 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.

A question involved in this case is whether there is an "association" for the purposes of section 501(c)(9). It is apparent that the plan and the trust are interdependent agreements. Together they create a "voluntary employees' beneficiary association" within the contemplation of that term for purposes of section 501(c)(9).

A further requirement to be met for purposes of that section is that the supplemental unemployment benefits are sufficiently similar to life, sick, or accident benefits so as to qualify as "other benefits" within the meaning of section 501(c)(9) of the Code. Unemploy-

ment benefits of the type described in the instant case are designed to provide economic benefits at a time when the personal earning power of the employee has been interrupted. In addition, unemployment benefits are peculiarly adapted to the hazards of being an employee. Consequently, it is the position of the Internal Revenue Service that the supplemental unemployment benefits to be paid by the trust, in accordance with the terms of the supplemental unemployment benefit plan, may be considered as "other benefits" within the contemplation of section 501(c)(9) of the Code.

In view of the foregoing, it is held that since the trust in the instant case was established by a corporation pursuant to a supplemental unemployment benefit plan negotiated as a result of a collective bargaining agreement for the sole purpose of furnishing supplemental unemployment benefits to a designated class of its employees during a period of temporary layoff or reduction in force, a voluntary employees' beneficiary association within the meaning of section 501(c)(9) of the Code is created, and income derived by the trustees for payment of benefits to the members is exempt from Federal income tax if the other requirements of the section are met.

Benefits paid by such trust are includible in the gross income of the individual recipients for the year in which received. See Rev. Rul. 56–249, C. B. 1956–1, 488.

An organization may not consider itself exempt from tax merely because it falls within the scope of this Revenue Ruling. In order to establish its exemption, it is necessary that every organization claiming exemption file an appropriate application form 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 organizations. An organization claiming exemption under section 501(c)(9) must file its application on Form 1026, Exemption Application. See section 1.501(a)–1 of the Income Tax Regulations.

Rev. Rul. 58–517

The membership of a corporation is composed of war veterans of the armed services of the United States organized for the purpose of conducting the normal activities attendant to the operation of a war veterans' organization. The corporation has the exclusive right to operate a bathhouse and bathing beach and to sell miscellaneous refreshments at a lake resort. The operation of the concession involves the rental of boats, swim suits, and towels; the operation of the bathing and bathhouse facilities; and the sale of bait, fishing licenses, food, beverages, and other miscellaneous merchandise. The major portion of its net receipts is derived from its operation of the concession and is expended in furtherance of its various benevolent purposes and in liquidating its indebtedness on property which it uses in the conduct of its organizational functions. The organization's activities, other than those incident to the concession, include participation in various civic and charitable drives, organizational welfare activities, free classes in swimming instruction, free swimming for a limited number of children (whose transportation is also furnished without charge), and the free use of the organization's hall for a number of charitable and civic activities.

Held, that inasmuch as the corporation is engaged in an activity which is ordinarily carried on for profit and a portion of its income is used for purposes other than social welfare, it is not operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4) of the Internal Revenue Code of 1954 even though, in connection with such business activity, the corporation furnishes some free services of a civic nature. Accordingly, the corporation is not entitled to exemption from Federal income tax under section 501 of the Code.

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26 CFR 1.501(a): Statutory provision; exemption from tax on corporations, certain trusts, etc.
(Also Sections 401, 502, 503, 504, 511, 512, 513, 514, 521, 522, 6012, 6033; 1.401-1, 1.502, 1.503(a), 1.504, 1.511, 1.512(a), 1.513, 1.514(a), 1.521, 1.522, 1.6012, 1.6033.)

T. D. 6301 [1]

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

Regulations under sections 501 through 526, 6012, and 6033 of the Internal Revenue Code of 1954; Income Tax Regulations (26 CFR 1.401-1(e)) 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 21, 1956, notice of proposed rule making regarding the regulations under sections 501 through 526 of the Internal Revenue Code of 1954 was published in the Federal Register (21 F. R. 460). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations set forth in paragraph 1 below are hereby adopted under sections 501 through 526, 6012, and 6033 of the Internal Revenue Code of 1954. However, this Treasury decision does not contain regulations under paragraphs (3) and (4) of section 501(c). Regulations under such paragraphs will be the subject of a separate Treasury decision. Portions of the regulations in § 1.501(a)-1 of the notice of proposed rule making are included in this document as regulations under sections 6012 and 6033. Paragraph (a)(3) of section 1.6033-1 was previously published as a part of T D 6203 (21 F. R. 7269), [C. B. 1956-2, 219] and is reprinted in this document merely for convenient reference. Section 1.401-1(e) (26 CFR 1.401-1(e)) is hereby amended as set forth in paragraph 2 below. The regulations contained in this Treasury decision are applicable for taxable years beginning after December 31, 1953, and ending after August 16, 1954, except as otherwise expressly provided.

PARAGRAPH 1. The following regulations are hereby adopted under sections 501 through 526, 6012, and 6033 of the Internal Revenue Code of 1954.

[1] 23 F. R. 5192.

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AUTHORITY: §§ 1.501(a) to 1.526, incl., §§ 1.6012, 1.6012–2(e) and (f), and 1.6012–3(a)(5), §§ 1.6033 and 1.6033–1 issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

EXEMPT ORGANIZATIONS

GENERAL RULE

§ 1.501(a) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

(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.

§ 1.501(a)–1 EXEMPTION FROM TAXATION.—(a) *In general; proof of exemption.*—(1) Section 501(a) provides an exemption from income taxes for organizations which are described in section 501(c) or (d) and section 401(a), unless such organization is a "feeder organization" (see section 502), or unless it engages in a transaction described in section 503 or in an activity described in section 504. However, the exemption does not extend to "unrelated business taxable income" of such an organization (see sections 511 to 515).

(2) An organization, other than an employees' trust described in section 401(a), is not exempt from tax merely because it is not organized and operated for profit. In order to establish its exemption, it

is necessary that every such organization claiming exemption file an application form as set forth below 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. However, an organization which has been granted exemption under the provisions of the Internal Revenue Code of 1939 or prior law may rely on that ruling, unless affected by substantive changes in the 1954 Code or any changes in the character, purposes, or methods of operation of the organization, and it is not necessary in such case for the organization to request a new determination as to its exempt status.

(3) (i) An organization claiming exemption under section 501(a) and described in section 501(c)(2), (3), (4), (5), (6), (7), (8), (9), (12), (13), or (15) shall file the form of application appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. The following forms shall be filed: For organizations described in section 501(c)(3), Form 1023; in section 501(c)(4), (5), (6), or (8), Form 1024; in section 501 (c)(7), Form 1025; and in section 501(c)(2), (9), (12), (13), or (15), Form 1026. State chartered credit unions described in section 501(c)(14) shall submit an application for exemption showing the State and date of incorporation. The application should show that the State credit union law with respect to loans, investments, and dividends, if any, is being complied with. All other organizations claiming exemption, other than employees' trusts described in section 401(a), shall file an application for exemption showing the character of the organization, the purpose for which it is organized, its actual activities, the sources of its income and receipts and the disposition thereof, whether or not any of its income or receipts is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To each such form or application shall be attached a conformed copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization. Each such form or application shall contain or be verified by a written declaration that it is made under the penalties of perjury.

(ii) For the rules relating to obtaining a determination of exempt status by an employees' trust described in section 401(a), see paragraph (e) of section 1.401–1.

(b) *Additional proof by particular classes of organizations.*—(1) Organizations mentioned below shall submit with and as a part of their applications the following information:

(i) Mutual insurance companies shall submit copies of the policies or certificates of membership issued by them.

(ii) In the case of title holding companies described in section 501(c)(2), if the organization for which title is held has not been specifically notified in writing by the Internal Revenue Service that it is held to be exempt under section 501(a), the title holding company shall submit the information indicated herein as necessary for a determination of the status of the organization for which title is held.

(2) In addition to the information specifically called for by this section, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 501(a), and when deemed advisable in the interest of an efficient administration of the internal revenue laws, he may in the cases of particular types of organizations prescribe the form in which the proof of exemption shall be furnished.

(3) An organization claiming to be specifically exempted by section 6033(a) from filing annual returns shall submit with and as a part of its application a statement of all the facts on which it bases its claim.

(c) "*Private shareholder or individual*" *defined.*—The words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

(d) *Requirement of annual returns.*—For the annual return requirements of organizations exempt under section 501(a), see section 6033 and section 1.6033–1.

§ 1.501(b) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; TAX ON UNRELATED BUSINESS INCOME.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(b) TAX ON UNRELATED BUSINESS INCOME.—An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in part II of this subchapter (relating to tax unrelated income), but, notwithstanding part II, shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

§ 1.501(c)(1) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; LIST OF EXEMPT ORGANIZATIONS; INSTRUMENTALITIES OF THE UNITED STATES.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

(1) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes.

§ 1.501(c)(2) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; CORPORATIONS ORGANIZED TO HOLD TITLE TO PROPERTY FOR EXEMPT ORGANIZATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

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

§ 1.501(c)(2)–1 CORPORATIONS ORGANIZED TO HOLD TITLE TO PROPERTY FOR EXEMPT ORGANIZATIONS.—(a) A corporation described in section 501(c)(2) and otherwise exempt from tax under section 501(a) is taxable upon its unrelated business taxable income if the

income is payable to an organization which is itself subject to the tax imposed by section 511 or if the income is payable to a church or to a convention or association of churches. See sections 511 to 515, inclusive, and the regulations thereunder. Since a corporation described in section 501(c)(2) cannot be exempt under section 501(a) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in section 512 other than unrelated business rental income described in section 514.

(b) A corporation described in section 501(c)(2) cannot accumulate income and retain its exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is itself exempt from tax under section 501 (a).

§ 1.501(c)(3) [Reserved]

§ 1.501(c)(4) [Reserved]

§ 1.501(c)(5) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; LABOR, AGRICULTURAL, AND HORTICULTURAL ORGANIZATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(5) Labor, agricultural, or horticultural organizations.

§ 1.501(c)(5)-1 LABOR, AGRICULTURAL, AND HORTICULTURAL ORGANIZATIONS.—(a) The organizations contemplated by section 501(c)(5) as entitled to exemption from income taxation are those which:

(1) Have no net earnings inuring to the benefit of any member, and

(2) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

(b) Organizations described in section 501(c)(5) and otherwise exempt from tax under section 501(a) are taxable upon their unrelated business taxable income. See sections 511 to 515, inclusive, and the regulations thereunder.

§ 1.501(c)(6) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; BUSINESS LEAGUES, CHAMBERS OF COMMERCE, REAL ESTATE BOARDS AND BOARDS OF TRADE.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(6) Business leagues, chambers of commerce, real estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

§ 1.501(c)(6)-1 BUSINESS LEAGUES, CHAMBERS OF COMMERCE, REAL ESTATE BOARDS, AND BOARDS OF TRADE.—A businesss league is an association of persons having some common business interest, the pur-

pose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated. A stock or commodity exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of section 501(c)(6) and is not exempt from tax. Organizations otherwise exempt from tax under this section are taxable upon their unrelated business taxable income. See sections 511 to 515, inclusive, and the regulations thereunder.

§ 1.501(c)(7) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; SOCIAL CLUBS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(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.

§ 1.501(c)(7)-1 SOCIAL CLUBS.—(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). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

§ 1.501(c)(8) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; FRATERNAL BENEFICIARY SOCIETIES.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(8) Fraternal beneficiary societies, orders, or associations—

(A) Operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) Providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

§ 1.501(c)(8)-1 FRATERNAL BENEFICIARY SOCIETIES.—(a) A fraternal beneficiary society is exempt from tax only if operated under the "lodge system" or for the exclusive benefit of the members so operating. "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

(b) To be exempt a fraternal beneficiary society must be operated in furtherance of its fraternal purposes and may not engage in business activities of a kind carried on for profit, except that the carrying on of activities which raise revenues from members and their guests will not deprive the society of its exemption.

§ 1.501(c)(9) STATUTORY PROVISIONS; FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(9) Voluntary employees' 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.

§ 1.501(c)(10) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(10) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the

members of such association or their dependents or their designated beneficiaries, if—

(A) Admission to membership in such association is limited to individuals who are officers or employees of the United States Government, and

(B) No part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

§ 1.501(c)(11) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; TEACHERS' RETIREMENT FUND ASSOCIATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are refered to in subsection (a): * * *

(11) Teachers' retirement fund associations of a purely local character, if—

(A) No part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

(B) The income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

§ 1.501(c)(12) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; LOCAL BENEVOLENT LIFE INSURANCE ASSOCIATIONS, MUTUAL IRRIGATION AND TELEPHONE COMPANIES AND LIKE ORGANIZATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(12) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

§ 1.501(c)(12)-1 LOCAL BENEVOLENT LIFE INSURANCE ASSOCIATIONS, MUTUAL IRRIGATION AND TELEPHONE COMPANIES, AND LIKE ORGANIZATIONS.—(a) An organization described in section 501(c)(12) must receive at least 85 percent of its income from amounts collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, or if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 percent of its income is derived, it is not entitled to exemption. On the other hand, an organization may be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

(b) The phrase "of a purely local character" applies to benevolent life insurance associations, and not to the other organizations specified in section 501(c)(12). It also applies to any organization seeking exemption on the ground that it is an organization similar to a benevolent life insurance association. An organization of a purely local

character is one whose business activities are confined to a particular community, place, or district, irrespective, however, of political subdivisions. If the activities of an organization are limited only by the borders of a State, it cannot be considered to be purely local in character.

§ 1.501(c)(13) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; CEMETERY COMPANIES.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(13) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

§ 1.501(c)(13)-1 CEMETERY COMPANIES.—(a) A cemetery company may be entitled to exemption—

(1) If it is owned by and operated exclusively for the benefit of its lot owners who hold such lots for bona fide burial purposes and not for purpose of resale, or

(2) If it is not operated for profit.

(b) Any cemetery corporation chartered solely for burial purposes and not permitted by its charter to engage in any business not necessarily incident to that purpose is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual. A cemetery company which fulfills the other requirements of section 501(c)(13) may be exempt, even though it issues preferred stock entitling the holders to dividends at a fixed rate, not exceeding the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, provided that its articles of incorporation reqiure:

(1) That the preferred stock shall be retired at par as soon as sufficient funds available therefor are realized from sales, and

(2) That all funds not required for the payment of dividends upon or for the retirement of preferred stock shall be used by the company for the care and improvement of the cemetery property.

§ 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, 1951, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of, shares or deposits in—

(A) Domestic building and loan associations.

(B) Cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

(C) Mutual savings banks not having capital stock represented by shares.

§ 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).

§ 1.501(c)(15) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; MUTUAL INSURANCE ORGANIZATIONS OTHER THAN LIFE OR MARINE.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(15) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) does not exceed $75,000.

[Sec. 501(c)(15) as amended by the Life Insurance Company Tax Act for 1955]

§ 1.501(c)(15)-1 MUTUAL INSURANCE COMPANIES OR ASSOCIATIONS.—(a) *Taxable years beginning after December 31, 1954.*—An insurance company or association described in section 501(c)(15) is exempt under section 501(a) if it is a mutual company or association (other than life or marine) or if it is a mutual interinsurer or reciprocal underwriter (other than life or marine) and if the gross amount received during the taxable year from the sum of the following items does not exceed $75,000:

(1) Interest, dividends, rents, and royalties,

(2) The entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derivevs interest, rents, or royalties.

(3) The alteration or termination of any instrument or agreement described in subparagraph (2) of this paragraph, and

(4) Premiums (including deposits and assessments).

(b) *Taxable years beginning after December 31, 1953, and before January 1, 1955.*—An insurance company or association described in section 501(c)(15) is exempt under section 501(a) if it is a mutual company or association (other than life or marine) or if it is a mutual interinsurer or reciprocal underwriter (other than life or maine)

and if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed $75,000.

§ 1.501(c)(16) STATUTORY PROVISIONS; EXEMPTIONS FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; CORPORATIONS ORGANIZED TO FINANCE CROP OPERATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a): * * *

(16) Corporations organized by an association subject to part III of this subchapter or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exception shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, on dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

§ 1.501(c)(16)-1 CORPORATIONS ORGANIZED TO FINANCE CROP OPERATIONS.—A corporation organized by a farmers' cooperative marketing or purchasing association, or the members thereof, for the purpose of financing the ordinary crop operations of such members or other producers is exempt, provided the marketing or purchasing association is exempt under section 521 and the financing corporation is operated in conjunction with the marketing or purchasing association. The provisions of section 1.521-1 relating to a reserve or surplus and to capital stock shall also apply to corporations coming under this section.

§ 1.501(d) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; RELIGIOUS AND APOSTOLIC ORGANIZATIONS.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(d) RELIGIOUS AND APOSTOLIC ORGANIZATIONS.—The following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

§ 1.501(d)-1 RELIGIOUS AND APOSTOLIC ASSOCIATIONS OR CORPORATIONS.—(a) Religious or apostolic associations or corporations are described in section 501(d) and are exempt from taxation under section 501(a) if they have a common treasury or community treasury, even though they engage in business for the common benefit of the members, provided each of the members includes (at the time of filing

his return) in his gross income his entire pro rata share, whether distributed or not, of the net income of the association or corporation for the taxable year of the association or corporation ending with or during his taxable year. Any amount so included in the gross income of a member shall be treated as a dividend received.

(b) For annual return requirements of organiaztions described in section 501(d), see section 6033 and paragraph (a)(5) of section 1.6033–1.

§ 1.501(e) STATUTORY PROVISIONS; EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.; CROSS REFERENCE.

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. * * *

(e) CROSS REFERENCE.—For nonexemption of Communist-controlled organizations, see section 11(b) of the Internal Security Act of 1950 (64 Stat. 997; 50 U. S. C. 790(b)).

§ 1.501(e)–1 COMMUNIST-CONTROLLED ORGANIZATIONS.—Under section 11(b) of the Internal Security Act of 1950, as amended, which is made applicable to the Internal Revenue Code of 1954 by section 7852(b) of that Code, no organization is entitled to exemption under sections 501(a) or 521(a) for any taxable year if at any time during such year such organization is registered under section 7 of such Act or if there is in effect a final order of the Subversive Activities Control Board established by section 12 of such Act requiring such organization to register under section 7 of such Act, or determining that it is a Communist-infiltrated organization.

§ 1.502 STATUTORY PROVISIONS; FEEDER ORGANIZATIONS.

SEC. 502. FEEDER ORGANIZATIONS.

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501 from taxation. For purposes of this section, the term "trade or business" shall not include the rental by an organization of its real property (including personal property leased with the real property).

§ 1.502–1 FEEDER ORGANIZATIONS.—(a) In the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the ground that all the profits of such organization are payable to one or more organizations exempt from taxation under section 501. For the purpose of this rule, the term "trade or business" does not include the rental by an organization of its real property (including personal property leased with the real property). In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501.

(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated

for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the subsidiary is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.

(c) In certain cases an organization which carries on a trade or business for profit but is not operated for the primary purpose of carrying on such trade or business is subject to the tax imposed under section 511 on its unrelated business taxable income.

§ 1.503(a) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; DENIAL OF EXEMPTION TO ORGANIZATIONS ENGAGED IN PROHIBITED TRANSACTIONS.

SEC. 503. REQUIREMENTS FOR EXEMPTION.

DENIAL OF EXEMPTION TO ORGANIZATIONS ENGAGED IN PROHIBITED TRANSACTIONS.—

(1) GENERAL RULE.—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; and 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.

(2) TAXABLE YEARS AFFECTED.—An organization described in section 501(c)(3) or section 401(a) shall be denied exemption from taxation under section 501(a) by reason of paragraph (1) only for taxable years after the taxable year during which it is notified by the Secretary or his delegate that it has engaged in a prohibited transaction, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.

§ 1.503(a)-1 DENIAL OF EXEMPTION TO ORGANIZATIONS ENGAGED IN PROHIBITED TRANSACTIONS.—(a) The prohibited transactions enumerated in section 503(c) are in addition to and not in limitation of the restrictions contained in section 501(c)(3) and section 401(a). Even though an organization has not engaged in any of the prohibited transactions referred to in section 503(c), it still may not qualify for tax exemption in view of the general provisions of section 501(c)(3) and section 401(a). Thus, if a trustee or other fiduciary of the organization (whether or not he is also a creator of such organization) enters into a transaction with the organization, such transaction will be closely scrutinized in the light of the fiduciary principle

requiring undivided loyalty to ascertain whether the organization is in fact being operated for the stated exempt purposes.

(b) An organization described in section 501(c)(3) which after July 1, 1950, has engaged in any prohibited transaction as defined in section 503(c), unless it is excepted by the provisions of section 503(b), and an organization described in section 401(a) which after March 1, 1954, has engaged in any such prohibited transaction shall not be exempt from taxation under section 501(a) for any taxable year subsequent to the taxable year in which there is mailed to it a notice in writing by the Commissioner that it has engaged in such prohibited transaction. Such notification by the Commissioner shall be by registered or certified mail to the last known address of the organization. However, notwithstanding the requirement of notification by the Commissioner, exemption shall be denied with respect to any taxable year if such organization during or prior to such taxable year commenced the prohibited transaction with the purpose of diverting income or corpus from its exempt purposes and such transaction involved a substantial part of the income or corpus of such organization. For the purpose of this section, the term "taxable year" means the established annual accounting period of the organization; or, if the organization has no such established annual accounting period, the "taxable year" of the organization means the calendar year.

(c) The application of section 503(c) may be illustrated by the following examples:

Example (1). A creates a foundation in 1954 ostensibly for educational purposes. B, a trustee, accumulates the foundation's income from 1957 until 1959 and then uses a substantial part of this accumulated income and to send A's children to college. The foundation would lose its exemption for the taxable years 1957 through 1959 and for subsequent taxable years until it regains its exempt status.

Example (2). If under the facts in example (1) such private benefit was the purpose of the foundation from its inception, such foundation is not exempt by reason of the general provisions of section 501(c)(3), without regard to the provisions of section 503, for all years since its inception, that is, for the taxable years 1954 through 1959 and subsequent taxable years, since under section 501(c)(3) the organization must be organized and operated exclusively for exempt purposes. See section 1.501(c)(3)–1. See also section 1.504–1 for loss of exemption in the case of certain organizations accumulating income.

§ 1.503(b) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; ORGANIZATIONS TO WHICH SECTION APPLIES.

SEC. 503. REQUIREMENTS FOR EXEMPTION. * * *

(b) ORGANIZATIONS TO WHICH SECTION APPLIES.—This section shall apply to any organization described in section 501(c)(3) or section 401(a) except—

(1) A religious organization (other than a trust);

(2) An educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;

(3) An organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or

other purpose or function constituting the basis for its exemption under section 501 (a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public;

(4) An organization which is operated, supervised, controlled, or principally supported by a religious organization (other than a trust) which is itself not subject to the provisions of this section; and

(5) An organization the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research or agricultural research.

§ 1.503(c) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; PROHIBITED TRANSACTIONS.

SEC. 503. REQUIREMENTS FOR EXEMPTION. * * *

(c) PROHIBITED TRANSACTIONS.—For purposes of this section, the term "prohibited transaction" means any transaction in which an organization subject to the provisions of this section—

(1) Lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to;

(2) Pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

(3) Makes any part of its services available on a preferential basis to;

(4) Makes any substantial purchase of securities or any other property, for more than adequate consideration in money or money's worth, from;

(5) Sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or

(6) Engages in any other transaction which results in a substantial diversion of its income or corpus to;

the creator of such organization (if a trust); a person who has made a substantial contribution to such organization; a member of the family (as defined in section 267(c)(4)) of an individual who is the creator of such trust or who has made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

§ 1.503(c)-1 PROHIBITED TRANSACTIONS.—(a) *In general.* The term "prohibited transaction" means any transaction set forth in section 503(c) engaged in by an organization described in section 501(c)(3) or section 401(a), other than those organizations excepted by section 503(b). Whether a transaction is a prohibited transaction depends on the facts and circumstances of the particular case. This section is intended to deny tax-exempt status to those organizations described in sections 501(c)(3) and 401(a) which engage in certain transactions which inure to the private advantage of (1) the creator of such organization (if it is a trust); (2) any substantial contributor to the organization; (3) a member of the family (as defined in section 267(c)(4)) of an individual who is such creator of or such substantial contributor to such organization; or (4) a corporation controlled, as set forth in section 503(c), by such creator or substantial contributor.

(b) *Loans as prohibited transactions under section 503(c)(1).*—(1) *Adequate security.*—For the purposes of section 503(c)(1), which treats as prohibited transactions certain loans by an organization with-

out receipt of adequate security and a reasonable rate of interest, the term "adequate security" means something in addition to and supporting a promise to pay, which is so pledged to the organization that it may be sold, foreclosed upon, or otherwise disposed of in default of repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan. Mortgages or liens on property, accommodation endorsements of those financially capable of meeting the indebtedness, and stock or securities issued by corporations other than the borrower may constitute security for a loan to the persons or organizations described in section 503(c). Stock of a borrowing corporation does not constitute adequate security. A borrower's evidence of indebtedness, irrespective of its name, is itself not security for a loan, whether or not it was issued directly to the exempt organization. However, if any such evidence of indebtedness provides for security that may be sold, foreclosed upon, or otherwise disposed of in default of repayment of the loan, there may be adequate security for such loan. If an organization subject to section 503(c) purchases debentures issued by a person specified in section 503(c), the purchase is considered, for purposes of section 503(c)(1), as a loan made by the purchaser to the issuer on the date of such purchase. For example, if an exempt organization subject to section 503(c) makes a purchase through a registered security exchange of debentures issued by a person described in section 503(c), and owned by an unknown third party, the purchase will be considered as a loan to the issuer by the purchaser. For rules relating to loan of funds to, or investment of funds in stock or securities of, persons described in section 503(c) by an organization described in section 401(a), see paragraph (b)(5) of section 1.401–1.

(2) *Effective dates.*—The effective dates for the application of the definition of adequate security in subparagraph (1) of this paragraph are:

(i) March 15, 1956, for loans (other than debentures) made after March 15, 1956;

(ii) January 31, 1957, for loans (other than debentures) made before March 16, 1956, and continued after January 31, 1957;

(iii) November 8, 1956, for debentures which were purchased after November 8, 1956;

(iv) March 15, 1959, or the ninetieth day after the date on enactment of legislation amending section 503 and relating to adequate security, whichever date is earlier, for debentures which were purchased before November 9, 1956, and held after such earlier date.

(v) If an employees' pension, stock bonus, or profit-sharing trust described in section 401(a) made a loan before March 1, 1954, repayable by its terms after December 31, 1955, and which would constitute a prohibited transaction if made on or after March 1, 1954, the loan shall not constitute a prohibited transaction if held until maturity (determined without regard to any extension or renewal thereof).

(c) *Examples.*—The following examples illustrate the operation of section 503(c)(1):

Example (1). A, creator of an exempt trust subject to section 503, borrows $100,000 from such trust in 1960, giving his unsecured promissory note. The net worth of A is $1,000,000. The net worth of A is not "security" for such loan and the transaction is a prohibited trans-

action. If, however, the note is secured by a mortgage on property of sufficient value, or is accompanied by acceptable collateral of sufficient value, or carries with it the secondary promise of repayment by an accommodation endorser financially capable of meeting the indebtedness, it may be adequately secured. However, subordinated debenture bonds of a partnership which are guaranteed by the general partners are not adequately secured since the general partners are liable for the firm's debt and their guaranty adds no additional security.

Example (2). Assume the same facts as in example (1) except that A's promissory note in the amount of $100,000 to the trust is secured by property which has a fair market value of $75,000. A's promissory note secured to the extent of $75,000 is not adequately secured within the meaning of section 503(c)(1) since the security at the time of the transaction must be sufficient to repay the indebtedness, interest, and charges which may pertain thereto.

Example (3). Corporation M, a substantial contributor to an exempt organization subject to section 503, borrows $150,000 from such organization in 1960, giving its promissory note accompanied by stock of the borrowing corporation with a fair market value of $200,000. Since promissory notes and debentures have priority over stock in the event of liquidation of the corporation, stock of a borrowing corporation may not be adequate security. Likewise, debenture bonds which are convertible on default into voting stock of the issuing corporation may not constitute "adequate security" under section 503(c)(1).

Example (4). B, creator of an exempt trust subject to section 503, borrows $100,000 from such trust in 1960, giving his secured promissory note at the rate of 3 percent interest. The prevailing rate of interest charged by financial institutions in the community where the transaction takes place is 5 percent for a loan of the same duration and similarly secured. The loan by the trust to the grantor is a prohibited transaction since section 503(c)(1) requires both adequate security and a reasonable rate of interest. Further, a promise to repay the loan plus a percentage of future profits which may be greater than the prevailing rate of interest does not meet the reasonable rate of interest requirement.

Example (5). N Corporation, a substantial contributor to an exempt organization subject to section 503, borrows $50,000 on or after March 16, 1956, from the organization. If the loan is not adequately secured, the organization has committed a prohibited transaction at the time the loan was made. If the loan had been made on or before March 15, 1956, and is continued after January 31, 1957, it must be adequately secured on February 1, 1957, or it will be considered a prohibited transaction on that date. However, if the exempt organization were an employees' trust, described in section 401(a), and the loan were made before March 1, 1954, repayable by its terms after December 31, 1955, it would not have to be adequately secured on February 1, 1957.

Example (6). An exempt organization subject to section 503 purchases a debenture issued by O Corporation, which is a substantial contributor to the organization. The organization purchases the debenture in an arm's length transaction from a third person on or after November 9, 1956. The purchase is considered as a loan by the organization to O Corporation and the loan must be adequately secured

when it is made, or it is considered as a prohibited transaction at that time. If the organization purchased the debenture on or before November 8, 1956, and holds it after the earlier of the dates set forth in paragraph (b) (2) (iv) of this section the debenture must be adequately secured on the day after such earlier date or it will be then considered as a prohibited transaction. However, if the organization were an employee's trust described in section 401(a), and if the debenture were purchased before March 1, 1954, and its maturity date is after December 31, 1955, the debenture does not have to be adequately secured.

§ 1.503(d) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; FUTURE STATUS OF ORGANIZATIONS DENIED EXEMPTION.

SEC. 503 REQUIREMENTS FOR EXEMPTION. * * *

(d) FUTURE STATUS OF ORGANIZATIONS DENIED EXEMPTION.—Any organization described in section 501(c)(3) or section 401(a)—which is denied exemption under section 501(a) by reason of subsection (a) of this section, with respect to any taxable year following the taxable year in which notice of denial of exemption was received, may, under regulations prescribed by the Secretary or his delegate, file claim for exemption, and if the Secretary or his delegate, pursuant to such regulations, is satisfied that such organization will not knowingly again engage in a prohibited transaction, such organization shall be exempt with respect to taxable years after the year in which such claim is filed.

§ 1.503(d)-1 FUTURE STATUS OF ORGANIZATIONS DENIED EXEMPTION.—(a) Any organization described in section 501(c)(3) or an employees' trust described in section 401(a), which is denied exemption under section 501(a) by reason of the provisions of section 503(a), may file, in any taxable year following the taxable year in which notice of denial was issued, a claim for exemption. Form 1023, the exemption application, shall be used for this purpose in the case of an organization described in section 501(c)(3), and shall be filed 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 claiming exemption. In the case of an employees' trust described in section 401(a), the information described in section 1.404(a)-2 shall be submitted with a letter claiming exemption. An employees' trust described in section 401(a) shall submit this information to the district director of internal revenue with whom a request for a determination as to its qualification under section 401 and exemption under section 501 may be submitted under paragraph (1) of section 601.201 of this chapter (Statement of Procedural Rules). A claim for exemption must contain or have attached to it, in addition to the information generally required of such an organization claiming exemption as an organization described in section 501(c)(3) or 401(a), a written declaration made under the penalties of perjury by a principal officer of such organization authorized to make such declaration that the organization will not knowingly again engage in a prohibited transaction. See section 1.501(a)-1 for proof of exemption requirements in general.

(b) If the Commissioner is satisfied that such organization will not knowingly again engage in a prohibited transaction and that the organization also satisfies all other requirements under section 501(c)(3) or section 401(a), the organization will be so notified in writing.

In such case the organization will be exempt (subject to the provisions of section 501(c)(3), 401(a), 503, and 504) with respect to the taxable years subsequent to the taxable year in which the claim prescribed in section 503(d) is filed. Section 503 contemplates that an organization denied exemption because of the terms of such section will be subject to taxation for at least one full taxable year. For the purpose of this section, the term "taxable year" means the established annual accounting period of the organization; or, if the organization has no such established annual accounting period, the "taxable year" of the organization means the calendar year.

§ 1.503(d)-2 FISCAL YEARS AND SHORT TAXABLE YEARS ENDING AFTER MARCH 1, 1954, SUBJECT TO THE INTERNAL REVENUE CODE OF 1939.—Pursuant to section 7851(a)(1)(C), the regulations prescribed in sections 1.503(a)-1 to 1.503(d)-1, inclusive, as they relate to the denial of exemption to organizations described in section 401(a) engaged in prohibited transactions after March 1, 1954, shall also apply to taxable years beginning after December 31, 1953, and ending after March 1, 1954, but before August 17, 1954, and to taxable years beginning before January 1, 1954, and ending after March 1, 1954, which years are subject to the Internal Revenue Code of 1939.

§ 1.503(e) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS.

SEC. 503. REQUIREMENTS FOR EXEMPTION. * * *

(e) DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS.—No gift or bequest for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), otherwise allowable as a deduction under section 170, 642(c), 545(b)(2), * * * shall be allowed as a deduction if made to an organization described in section 501(c)(3) which, in the taxable year of the organization in which the gift or bequest is made, is not exempt under section 501(a) by reason of this section. With respect to any taxable year of the organization for which the organization is not exempt pursuant to subsection (a) by reason of having engaged in a prohibited transaction with the purpose of diverting the corpus or income of such organization from its exempt purposes and such transaction involved a substantial part of such corpus or income, and which taxable year is the same, or prior to the, taxable year of the organization in which such transaction occurred, such deduction shall be disallowed the donor only if such donor or (if such donor is an individual) any member of his family (as defined in section 267(c)(4)) was a party to such prohibited transaction.

§ 1.503(e)-1 DISALLOWANCE OF CERTAIN CHARITABLE DEDUCTIONS.—(a) No gift or contribution which would otherwise be allowable as a charitable or other deduction under section 170, 642(c), or 545(b)(2) shall be allowed as a deduction if made to an organization described in section 501(c)(3) which at the time the gift or contribution is made is not exempt under section 501(a) by reason of the provisions of section 503.

(b) If an organization which is described in section 501(c)(3) is not exempt because it engaged in a prohibited transaction involving a substantial part of its income or corpus with the purpose of diverting its income or corpus from its exempt purposes, and if the organization receives a gift or contribution during, or prior to, its taxable year in which such prohibited transaction occurred, then a deduction by the donor with respect to the gift or contribution shall not be dis-

allowed under section 503(e) unless the donor (or any member of his family if the donor is an individual) is a party to such prohibited transaction. For the purpose of the preceding sentence, "family" is defined in section 267(c)(4) and includes brothers and sisters, whether by whole or half blood, spouse, ancestors, and lineal descendants. See the regulations under section 267(c).

(c) The application of section 503(e) may be illustrated by the following example:

Example. In 1954, Corporation M, which files its income tax returns on the calendar year basis, creates a foundation purportedly for charitable purposes and deducts from its gross income for that year the amount of the gift to the foundation. Corporation M makes additional gifts to this foundation in 1955, 1956, and 1957, and takes charitable deductions for such years. B, an individual, also contributes to the foundation in 1955, 1956, and 1957, and takes charitable deductions for such years. In 1955, the foundation commences purposely to divert its corpus to the benefit of Corporation M, and a substantial amount of such corpus is so diverted by the close of the taxable year 1956. For 1955 and subsequent taxable years, the exemption allowed the foundation as an organization described in section 501(c)(3) is denied by reason of the provisions of section 503(a). Both Corporation M and individual B would be disallowed any deduction for the contributions made during 1957 to the foundation. Moreover, the charitable deductions taken by Corporation M for contributions to the foundation in the years 1955 and 1956 would also be disallowed since Corporation M was a party to the prohibited transaction. If the facts and surrounding circumstances indicate that the contribution in 1954 by Corporation M was for the purpose of the prohibited transaction, then the charitable deduction for the year 1954 shall also be disallowed with respect to Corporation M, since the prohibited transaction would then have commenced with the making of such contribution and the exemption allowed the foundation would then be denied for 1954 by reason of the provisions of section 503(e). B's deductions for his contributions for the years 1955 and 1956 will not be disallowed since he was not a party to the prohibited transaction.

§ 1.503(f) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; DEFINITIONS.

SEC. 503. REQUIREMENTS FOR EXEMPTION. * * *

(f) DEFINITION.—For purposes of this section, the term "gift or bequest" means any gift, contribution, bequest, devise, legacy, or transfer.

§ 1.503(g) STATUTORY PROVISIONS; REQUIREMENTS FOR EXEMPTION; SPECIAL RULE FOR LOANS.

SEC. 503. REQUIREMENTS FOR EXEMPTION. * * *

(g) SPECIAL RULE FOR LOANS.—For purposes of the application of subsection (c)(1), in the case of a loan by a trust described in section 401(a), the following rules shall apply with respect to a loan made before March 1, 1954, which would constitute a prohibited transaction if made on or after March 1, 1954:

(1) If any part of the loan is repayable prior to December 31, 1955, the renewal of such part of the loan for a period not extending beyond December 31, 1955, on the same terms, shall not be considered a prohibited transaction.

(2) If the loan is repayable on demand, the continuation of the loan without the receipt of adequate security and a reasonable rate of interest beyond December 31, 1955, shall be considered a prohibited transaction.

§ 1.503(g)–1 CROSS REFERENCE.—For provisions relating to loans by a trust described in section 401(a), see section 1.503(c)–1.

§ 1.504 STATUTORY PROVISIONS; DENIAL OF EXEMPTION.

SEC. 504. DENIAL OF EXEMPTION.

(a) GENERAL RULE.—In the case of any organization described in section 501(c)(3) to which section 503 is applicable, exemption under section 501 shall be denied for the taxable year if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—

(1) Are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for exemption under section 501(a) of an organization described in section 501(c)(3); or

(2) Are used to a substantial degree for purposes or functions other than those constituting the basis for exemption under section 501(a) of an organization described in section 501(c)(3); or

(3) Are invested in such a manner as to jeopardize the carrying out of the charitable, educational, or other purpose or function constituting the basis for exemption under section 501(a) of an organization described in section 501(c)(3).

Paragraph (1) shall not apply to income attributable to property of a decedent dying before January 1, 1951, which is transferred under his will to a trust created by such will. In the case of a trust created by the will of a decedent dying on or after January 1, 1951, if income is required to be accumulated pursuant to the mandatory terms of the will creating the trust, paragraph (1) shall apply only to income accumulated during a taxable year of the trust beginning more than 21 years after the date of death of the last life in being designated in the trust instrument.

(b) CROSS REFERENCES.—For limitation on charitable contributions in case of unreasonable accumulations by certain trusts, see section 681(c)(2).

§ 1.504–1 DENIAL OF EXEMPTION.—(a) The restrictions enumerated in section 504 are in addition to and not in limitation of the restrictions contained in section 501(c)(3). Even though an organization has not violated any of the terms of section 504, it still may not qualify for tax exemption in view of the general provisions of section 501(c)(3). Thus, if a trustee or other fiduciary of the organization (whether or not he is also a creator of such organization) enters into a transaction with the organization, such transaction will be closely scrutinized in the light of the fiduciary principle requiring undivided loyalty to ascertain whether the organization is in fact being operated for the stated exempt purposes.

(b)(1) Any organization described in section 501(c)(3) other than an organization described in section 503(b)(1) through (5), inclusive, shall not be exempt under section 501(a) if the amounts accumulated out of income during the taxable year, or any prior taxable year, and not actually paid out for exempt purposes by the end of the taxable year, are unreasonable. Amounts accumulated out of income become unreasonable when more income is accumulated than is needed, or when the duration of the accumulation is longer than is needed in order to carry out the purpose constituting the basis for the organization's exemption. Furthermore, such an organization shall not be exempt under section 501(a) if amounts accumulated out of income

are used to a substantial degree for purposes or functions other than those constituting the basis for the organization's exemption, or if such amounts are invested in such a manner as to jeopardize the carrying out of the purpose or function constituting the basis for the organization's exemption.

(2) The provisions for the denial of exemption for unreasonable accumulations of income will not apply to income attributable to property of a decedent dying before January 1, 1951, which is transferred under his will to a trust created by such will. In the case of a trust created by the will of a decedent dying on or after January 1, 1951, where income is required to be accumulated by the trust, the denial of exemption for unreasonable accumulations of income under paragraph (b)(1) will apply only to income accumulated during a taxable year of the trust beginning more than 21 years after the date of death of the last life in being designated in the trust instrument.

(c) For the purpose of section 504, the term "income" means gains, profits, and income determined under the principles applicable in determining the earnings or profits of a corporation. The amount accumulated out of income during the taxable year or any prior taxable year shall be determined under the principles applicable in determining the accumulated earnings or profits of a corporation. In determining the reasonableness of an accumulation out of income, there will be disregarded the following:

(1) The accumulation of gain upon the sale or exchange of a donated asset to the extent that such gain represents the excess of the fair market value of such asset when acquired by the organization over its substituted basis in the hands of the organization;

(2) The accumulation of gain upon the sale or exchange of property held for the production of investment income, such as dividends, interest, and rents, where the proceeds of such sale or exchange are within a reasonable time reinvested in property acquired and held in good faith for the production of investment income.

(d) Whether the conditions specified in paragraphs (1), (2), and (3) of section 504(a) are present in any case must be determined from all the facts. The conditions specified in section 504(a)(1), (2), and (3) may result from the use of only one organization or of a chain of two or more organizations.

(e) An organization that has lost its exempt status by reason of the provisions of section 504 may, in order to reestablish its exemption, file a claim 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. Form 1023, the exemption application, shall be used for this purpose. The claim for exemption must contain or be accompanied by information or evidence showing that the circumstances that caused the loss of exemption under section 504 no longer exist, and a written declaration made under the penalties of perjury, by a principal officer of such organization authorized to make such declaration, that the organization will not knowingly again violate the terms of section 504. See section 1.501(a)-1 for proof of exemption requirements in general. The provisions of section 504 contemplate that an organization denied exemption thereunder will be subject to taxation for at least

one full taxable year. For the purpose of this section, the term "taxable year" means the established annual accounting period of the organization; or, if the organization has no such established annual accounting period, the "taxable year" of the organization means the calendar year.

(f) In the case of an organization described in section 501(c)(3) denied exemption under section 501(a) solely by reason of the provisions of section 504, deductions otherwise allowable under section 170, 545(b)(2), or 642(c) for gifts or contributions to such organization shall not be disallowed for the year during which the exemption is denied and prior years.

TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

§ 1.511 Statutory Provisions; Impositions of Tax on Unrelated Business Income of Charitable, etc., Organizations.

SEC. 511. IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME OF CHARITABLE, ETC., ORGANIZATIONS.

(a) Charitable, etc., Organizations Taxable at Corporation Rates.—

(1) Imposition of tax.—There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a normal tax and a surtax computed as provided in section 11. In making such computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income".

(2) Organizations subject to tax.—

(A) Organizations described in section 501(c)(2), (3), (5), and (6), and section 401(a).—The taxes imposed by paragraph (1) shall apply in the case of any organization (other than a church, a convention or association of churches, or a trust described in subsection (b)) which is exempt, except as provided in this part, from taxation under this subtitle by reason of section 401(a) or of paragraph (3), (5), or (6) of section 501(c). Such taxes shall also apply in the case of a corporation described in section 501(c)(2) if the income is payable to an organization which itself is subject to the taxes imposed by paragraph (1) or to a church or to a convention or association of churches.

(B) State colleges and universities.—The taxes imposed by paragraph (1) shall apply in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions. Such taxes shall also apply in the case of any corporation wholly owned by one or more such colleges or universities.

(b) Tax on Charitable, Etc., Trusts.—

(1) Imposition of tax.—There is hereby imposed for each taxable year on the unrelated business taxable income of every trust described in paragraph (2) a tax computed as provided in section 1. In making such computation for purposes of this section, the term "taxable income" as used in section 1 shall be read as "unrelated business income" as defined in section 512.

(2) Charitable, etc., trusts subject to tax.—The tax imposed by paragraph (1) shall apply in the case of any trust which is exempt, except as provided in this part, from taxation under this subtitle by reason of section 501(c)(3) or section 401(a) and which, if it were not for such exemption, would be subject to subchapter J

(sec. 641 and following, relating to estates, trusts, beneficiaries, and decedents).

(c) EFFECTIVE DATE.—The tax imposed by this section shall apply, in the case of a trust described in section 401(a), only for taxable years beginning after June 30, 1954.

§ 1.511–1 IMPOSITION AND RATES OF TAX.—Section 511(a) imposes a tax upon the unrelated business taxable income of certain organizations otherwise exempt from Federal income tax. Under section 511(a)(1), organizations described in section 511(a)(2)(A) and in paragraph (a) of section 1.511–2 and organizations described in section 511(a)(2)(B) are subject to normal tax and surtax at the corporate rates provided by section 11. Under section 511(b)(1), trusts described in section 511(b)(2) are subject to tax at the individual rates prescribed in section 1. The deduction for personal exemption provided in section 642(b) in the case of a trust taxable under subchapter J is not allowed in computing unrelated business taxable income.

§ 1.511–2 ORGANIZATIONS SUBJECT TO TAX.—(a)(1) The taxes imposed by section 511(a)(1) apply in the case of any organization (other than a church, a convention or association of churches, or a trust described in section 511(b)(2)) which is exempt (except as provided in sections 511 thruogh 515) from taxation under section 501(a) as an organization described in section 501(c)(3), (5), or (6), or section 401(a). A corporation described in section 501(c)(2) exempt from taxation under section 501(a) holding property for an organization which itself is subject to the tax or for a church or a convention or association of churches, is also subject to the tax imposed by section 511(a)(1).

(2) The taxes imposed by section 511(a) apply in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof or by any agency or instrumentality of any one or more governments or political subdivisions. Such taxes also apply in the case of any corporation wholly owned by one or more such colleges or universities. As here used, the word "government" includes any foreign government (to the extent not contrary to any treaty obligation of the United States) and all domestic governments (the United States and any of its Territories or possessions, any State, and the District of Columbia). Elementary and secondary schools operated by such governments are not subject to the tax on unrelated business income.

(3)(i) Churches and associations or conventions of churches are exempt from the tax imposed by section 511. The exemption is applicable only to an organization which itself is a church or an association or convention of churches. Subject to the provisions of subdivision (ii) of this subparagraph, religious organizations, including religious orders, if not themselves churches or associations or conventions of churches, and all other organizations which are organized or operated under church auspices, are subject to the tax imposed by section 511, whether or not they engage in religious educational, or charitable activities approved by a church.

(ii) The term "church" includes a religious order or a religious organization if such order or organization (*a*) is an integral part

of a church, and (*b*) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise. In determining whether a religious order or organization is an integral part of a church, consideration will be given to the degree to which it is connected with, and controlled by, such church. A religious order or organization shall be considered to be engaged in carrying out the functions of a church if its duties include the ministration of sacerdotal functions and the conduct of religious worship. If a religious order or organization is not an integral part of a church, or if such an order or organization is not authorized to carry out the functions of a church (ministration of sacerdotal functions and conduct of religious worship) then it is subject to the tax imposed by section 511 whether or not it engages in religious, educational, or charitable activities approved by a church. What constitutes the conduct of religious worship or the ministration of sacerdotal functions depends on the tenets and practices of a particular religious body constituting a church. If a religious order or organization can fully meet the requirements stated in this subdivision, exemption from the tax imposed by section 511 will apply to all its activities, including those which it conducts through a separate corporation (other than a corporation described in section 501(c)(2)) or other separate entity which it wholly owns and which is not operated for the primary purpose of carrying on a trade or business for profit. Such exemption from tax will also apply to activities conducted through a separate corporation (other than a corporation described in section 501(c)(2)) or other separate entity which is wholly owned by more than one religious order or organization, if all such orders or organizations fully meet the requirements stated in this subdivision and if such corporation or other entity is not operated for the primary purpose of carrying on a trade or business for profit.

(b) The taxes imposed by section 511(b) apply in the case of any trust which is exempt (except as provided in sections 511 through 515) from taxation under section 501(a) as an organization described in section 501(c)(3) or section 401(a) and which, if it were not for such exemption, would be subject to the provisions of subchapter J of chapter 1. In the case of a trust described in section 401(a), the tax imposed by section 511(b) and this section shall apply only for taxable years beginning after June 30, 1954. An organization which is considered as "trustee" of a stock bonus, pension, or profit-sharing plan described in section 401(a) (regardless of the form of such organization) is subject to the taxes imposed by section 511(b)(1) on its unrelated business taxable income. However, if such an orgainzation conducts a business which is a separate taxable entity on the basis of all the facts and circumstances, for example, as a corporation or an association taxable as a corporation, the business will be taxable as a feeder organization described in section 502.

§ 1.511–3 Provisions Generally Applicable to the Tax on Unrelated Business Income.—(a) *Assessment and collections.*—Since the taxes imposed by section 511 are taxes imposed by subtitle A of the Internal Revenue Code of 1954, all provisions of law and of the regulations applicable to the taxes imposed by subtitle A are applicable to the assessment and collection of the taxes imposed by

section 511. Organizations subject to the tax imposed by section 511(a)(1) are subject to the same provisions, including penalties, as are provided in the case of the income tax of other corporations. In the case of a trust subject to the tax imposed by section 511(b)(1), the fiduciaries for such trust are subject to the same provisions, including penalties, as are applicable to fiduciaries in the case of the income tax of other trusts. See section 6151, et seq., and the regulations prescribed thereunder, for provisions relating to payment of tax.

(b) *Returns.*—For requirements of filing annual returns with respect to unrelated business taxable income by organizations subject to the tax on such income, see section 6012, paragraph (e) of section 1.6012–2, and paragraph (a)(5) of section 1.6012–3.

(c) *Taxable years, method of accounting, etc.*—The taxable year (fiscal year or calendar year, as the case may be) of an organization shall be determined without regard to the fact that such organization may have been exempt from tax during any prior period. See sections 441, 446, and 7701, and the regulations thereunder. Similarly, in computing unrelated business taxable income, the determination of the taxable year for which an item of income or expense is taken into account shall be made under the provisions of sections 441, 446, 451, and 461, and the regulations thereunder, whether or not the item arose during a taxable year beginning before, on, or after the effective date of the provisions imposing a tax upon unrelated business taxable income. If a method for treating bad debts was selected in a return of income (other than an information return) for a previous taxable year, the taxpayer must follow such method in its returns under section 511, unless such method is changed in accordance with the provisions of section 1.166–1. A taxpayer which has not previously selected a method for treating bad debts may, in its first return under section 511, exercise the option granted in section 1.166–1.

(d) *Foreign tax credit.*—See section 515 for provisions applicable to the credit for foreign taxes provided in section 901.

§ 1.512(a) STATUTORY PROVISIONS; UNRELATED BUSINESS TAXABLE INCOME; DEFINITION.

SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

(a) DEFINITION.—The term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the exceptions, additions, and limitations provided in subsection (b). In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be its unrelated business taxable income derived from sources within the United States determined under subchapter N (sec. 861 and following, relating to tax based on income from sources within or without the United States).

§ 1.512(a)–1 DEFINITION; GENERAL RULE.—The unrelated business taxable income which is subject to the tax imposed by section 511 is the gross income, derived by any organization to which section 511 applies, from any unrelated trade or business regularly carried on by it, less the deductions allowed by chapter 1 of the Code which are directly connected with the carrying on of such trade or business,

subject to certain exceptions, additions, and limitations referred to below. In the case of an organization which regularly carries on two or more unrelated businesses, its unrelated business taxable income is the aggregate of its gross income from all such unrelated businesses, less the aggregate of the deductions allowed with respect to all such unrelated businesses. For provisions generally applicable to the unrelated business tax, see section 1.511–3, and for rules applicable to the determination of the adjusted basis of property, see paragraph (a) (2) of section 1.514(a)–1.

§ 1.512(b) STATUTORY PROVISIONS; UNRELATED BUSINESS TAXABLE INCOME; EXCEPTIONS, ADDITIONS, AND LIMITATIONS.

SEC. 512. UNRELATED BUSINESS TAXABLE INCOME. * * *

(b) EXCEPTIONS, ADDITIONS, AND LIMITATIONS.—The exceptions, additions, and limitations applicable in determining unrelated business taxable income are the following:

(1) There shall be excluded all dividends, interest, and annuities, and all deductions directly connected with such income.

(2) There shall be excluded all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

(3) There shall be excluded all rents from real property (including personal property leased with the real property), and all deductions direclty connected with such rents.

(4) Notwithstanding paragraph (3), in the case of a business lease (as defined in section 514) there shall be included, as an item of gross income derived from an unrelated trade or business, the amount ascertained under section 514(a)(1), and there shall be allowed, as a deduction, the amount ascertained under section 514(a)(2).

(5) There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than—

(A) Stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or

(B) Property held primarily for sale to customers in the ordinary course of the trade or business.

This paragraph shall not apply with respect to the cutting of timber which is considered, on the application of section 631, as a sale or exchange of such timber.

(6) The net operating loss deduction provided in section 172 shall be allowed, except that—

(A) The net operating loss for any taxable year, the amount of the net operating loss carryback or carryover to any taxable year, and the net operating loss deduction for any taxable year shall be determined under section 172 without taking into account any amount of income or deduction which is excluded under this part in computing the unrelated business taxable income; and

(B) The terms "preceding taxable year" and "preceding taxable years" as used in section 172 shall not include any taxable year for which the organization was not subject to the provisions of this part.

(7) There shall be excluded all income derived from research for (A) the United States, or any of its agencies or instrumentalities, or (B) any State or political subdivision thereof; and there shall be excluded all deductions directly connected with such income.

(8) In the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(9) In the case of an organization operated primarily for pur-

poses of carrying on fundamental research the results of which are freely available to the general public, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(10) In the case of any organization described in section 511(a), the deduction allowed by section 170 (relating to charitable, etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or business), but shall not exceed 5 percent of the unrelated business taxable income computed without the benefit of this paragraph.

(11) In the case of any trust described in section 511(b), the deduction allowed by section 170 (relating to charitable etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or business), and for such purpose a distribution made by the trust to a beneficiary described in section 170 shall be considered as a gift or contribution. The deduction allowed by this paragraph shall be allowed with the limitations prescribed in section 170(b)(1)(A) and (B) determined with reference to the unrelated business taxable income computed without the benefit of this paragraph (in lieu of with reference to adjusted gross income).

(12) There shall be allowed a specific deduction of $1,000.

§ 1.512(b)-1. EXCEPTIONS, ADDITIONS, AND LIMITATIONS.—Whether a particular item of income falls within any of the exceptions, additions, and limitations provided in section 512(b) shall be determined by all the facts and circumstances of each case. For example, if a payment termed "rent" by the parties is in fact a return of profits by a person operating the property for the benefit of the tax-exempt organization or is a share of the profits retained by such organization as a partner or a joint venturer, such payment is not within the exception for rent. The exceptions, additions, and limitations provided in section 512(b) are as follows:

(a) *Dividends, interest, and annuities.*—All dividends, interest, and annuities, and the deductions directly connected therewith, shall be excluded in computing unrelated business taxable income.

(b) *Royalties.*—Royalties, including overriding royalties, and all deductions directly connected with such income shall be excluded in computing unrelated business taxable income. Mineral royalties shall be excluded whether measured by production or by gross or taxable income from the mineral property. However, where an organization owns a working interest in a mineral property, and is not relieved of its share of the development costs by the terms of any agreement with an operator, income received from such an interest shall not be excluded. In-oil payments shall be treated in the same manner as royalty payments for the purpose of computing unrelated business taxable income.

(c) *Rents.*—(1) Rents from real property (including personal property leased with the real property) and the deduction directly connected therewith shall also be excluded in computing unrelated business taxable income, except that certain rents from, and certain deductions in connection with, a business lease (as defined in section 514(a)) shall be included in computing unrelated business taxable income. See sections 1.514(a)-1 and 1.514(a)-2.

(2) Payments for the use or occupancy of rooms or other space where 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 camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rentals from real estate. 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 service; whereas the furnishing of heat and light, the cleaning of public entrances, exists, 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 residence or living quarters in duplex or multiple housing units, of offices in an office building, etc., are generally rentals from real estate.

(d) *Gains and losses from the sale, etc., of property.*—There shall also be excluded from the computation of unrelated business taxable income gains or losses from the sale, exchange, or other disposition of property other than (1) stock in trade or other property of a kind which would properly be included in the inventory of the organization if on hand at the close of the taxable year, or (2) property held primarily for sale to customers in the ordinary course of the trade or business. This exclusion does not apply with respect to the cutting of timber which is considered, upon the application of section 631(a), as a sale or exchange of such timber. The exclusion under section 512(b)(5) applies with respect to gains and losses from involuntary conversions, casualties, etc.

(e) *Net operating losses.*—(1) The net operating loss deduction provided in section 172 shall be allowed in computing unrelated business taxable income. However, the net operating loss carryback or carryover (from a taxable year for which the taxpayer is subject to the provisions of section 511) shall be determined under section 172 without taking into account any amount of income or deduction which is not included under section 511 in computing unrelated business taxable income. For example, a loss attributable to an unrelated trade or business shall not be diminished by reason of the receipt of dividend income.

(2) For the purpose of computing the net operating loss deduction by section 172, any prior taxable year for which an organization was not subject to the provisions of section 511, or a corresponding provision of prior law, shall not be taken into account. Thus, if the organization was not subject to the provisions of section 511 or Supplement U of the 1939 Code for a preceding taxable year, the net operating loss is not a carryback to such preceding taxable year, and the net operating loss carryover to succeeding taxable years is not reduced by the taxable income for such preceding taxable year.

(3) A net operating loss carryback or carryover shall be allowed only from a taxable year for which the taxpayer is subject to the provisions of section 511, or a corresponding provision of prior law.

(4) In determining the span of years for which a net operating loss may be carried for purposes of section 172, taxable years in which an organization was not subject to the provisions of section 511 or a corresponding provision of prior law shall be taken into account.

Thus, for example, if an organization is subject to the provisions of section 511 for the taxable year 1955 and has a net operating loss for that year, the last taxable year to which any part thereof may be carried over is the year 1960 regardless of whether the organization is subject to the provisions of section 511 in any of the intervening taxable years.

(f) *Research.*—(1) Income derived from research for the United States or any of its agencies or instrumentalities or a State or political subdivision thereof, and all deductions directly connected with such income, shall be excluded in computing unrelated business taxable income.

(2) In the case of a college, university, or hospital, all income derived from research performed for any person and all deductions directly connected with such income, shall be excluded in computing unrelated business taxable income.

(3) In the case of an organization operated primarily for the purpose of carrying on fundamental research (as distinguished from applied research) the results of which are freely available to the general public, all income derived from research performed for any person and all deductions directly connected with such income shall be excluded in computing unrelated business taxable income.

(4) For the purpose of section 1.512(a)-1 and this section, the term "research" does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc. The term "fundamental research" does not include research carried on for the primary purpose of commercial or industrial application.

(g) *Charitable, etc., contributions.*—(1) In computing the unrelated business taxable income of an organization described in section 511 (a) (2) the deduction from gross income allowed by section 170 (relating to charitable contributions and gifts) shall be allowed, whether or not the contribution is directly connected with the carrying on of the trade or business. Section 512(b)(10) provides that this deduction shall not exceed 5 percent of the organization's unrelated business taxable income computed without regard to that deduction. The provisions of section 170(b)(2) are not applicable to contributions by the organizations described in section 511(a)(2).

(2) In computing the unrelated business taxable income of a trust described in section 511(b)(2), the deduction allowed by section 170 (relating to charitable contributions and gifts) shall be allowed whether or not the contribution is directly connected with the carrying on of the trade or business. The deduction is limited as provided in section 170(b)(1)(A) and (B), except that the amounts so allowed are determined on the basis of unrelated business taxable income computed without regard to this deduction (rather than on the basis of adjusted gross income). For purposes of this deduction, a distribution by a trust described in section 511(b)(2) made pursuant to the trust instrument to a beneficiary described in section 170 shall be treated in the same manner as gifts or contributions.

(3) The contribution, whether made by a trust or other exempt organization, must be paid to another organization to be allowable.

For example, a university described in section 501(c)(3) which is exempt from tax and which operates an unrelated business, shall be allowed a deduction, not in excess of 5 percent of its unrelated business taxable income, for gifts or contributions to another university described in section 501(c)(3) for educational work but shall not be allowed any deduction for amounts expended in administering its own educational program.

(h) *Specific deduction.*—In computing unrelated business taxable income a deduction from gross income of $1,000 is allowed.

§ 1.512(c) STATUTORY PROVISIONS; UNRELATED BUSINESS TAXABLE INCOME; SPECIAL RULES APPLICABLE TO PARTNERSHIPS.

SEC. 512. UNRELATED BUSINESS TAXABLE INCOME. * * *

(c) SPECIAL RULES APPLICABLE TO PARTNERSHIPS.—If a trade or business regularly carried on by a partnership of which an organization is a member is an unrelated trade or business with respect to such organization, such organization in computing its unrelated business taxable income shall, subject to the exceptions, additions, and limitations contained in subsection (b), include its share (whether or not distributed) of the gross income of the partnership from such unrelated trade or business and its share of the partnership deductions directly connected with such gross income. If the taxable year of the organization is different from that of the partnership, the amounts to be so included or deducted in computing the unrelated business taxable income shall be based upon the income and deductions of the partnership for any taxable year of the partnership ending within or with the taxable year of the organization.

§ 1.512(c)-1 SPECIAL RULES APPLICABLE TO PARTNERSHIPS; IN GENERAL.—In the event an organization to which section 511 applies is a member of a partnership regularly engaged in a trade or business which is an unrelated trade or business with respect to such organization, the organization shall include in computing its unrelated business taxable income so much of its share (whether or not distributed) of the partnership gross income as is derived from that unrelated business and its share of the deductions attributable thereto. For this purpose, both the gross income and the deductions shall be computed with the necessary adjustments for the exceptions, additions, and limitations referred to in section 512(b) and in section 1.512(b)-1. For example, if an exempt educational institution is a partner in a partnership which operates a factory and if such partnership also holds stock in a corporation, the exempt organization shall include in computing its unrelated business taxable income its share of the gross income from the operation of the factory, but not its share of any dividends received by the partnership from the corporation. If the taxable year of the organization differs from that of the partnership, the amounts included or deducted in computing unrelated business taxable income shall be based upon the income and deductions of the partnership for each taxable year of the partnership ending within or with the taxable year of the organization.

§ 1.513 STATUTORY PROVISIONS; UNRELATED TRADE OR BUSINESS.

SEC. 513. UNRELATED TRADE OR BUSINESS.

(a) GENERAL RULE.—The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially

related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511 (a)(2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)), except that such term does not include any trade or business—

(1) In which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) Which is carried on, in the case of an organization described in section 501(c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees; or

(3) Which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

(b) SPECIAL RULE FOR TRUSTS.—The term "unrelated trade or business" means, in the case of—

(1) A trust computing its unrelated business taxable income under section 512 for purposes of section 681; or

(2) A trust described in section 401(a) which is exempt from tax under section 501(a);

any trade or business regularly carried on by such trust or by a partnership of which it is a member.

(c) SPECIAL RULE FOR CERTAIN PUBLISHING BUSINESSES.—If a publishing business carried on by an organization during a taxable year beginning before January 1, 1953, is, without regard to this subsection, an unrelated trade or business, but before the beginning of the third succeeding taxable year the business is carried on by it (or by a successor who acquired such business in a liquidation which would have constituted a tax-free exchange under section 112(b)(6) of the Internal Revenue Code of 1939) in such manner that the conduct thereof is substantially related to the exercise or performance by such organization (or such successor) of its educational or other purpose or function described in section 501(c)(3), such publishing business shall not be considered, for the taxable year, as an unrelated trade or business.

§ 1.513–1 DEFINITION OF UNRELATED TRADE OR BUSINESS.—(a) *In general.*—(1) As used in section 512(a), the term "unrelated business taxable income" includes only income from an unrelated trade or business regularly carried on, and the term "trade or business" has the same meaning as it has in section 162.

(2) The income of an exempt organization is subject to the tax on unrelated business income only if two conditions are present with respect to such income. The first condition is that the income must be from a trade or business which is regularly carried on by the organization. The second condition is that the trade or business must not be substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501, or, in the case of an organization described in section 511(a)(2)(B) (governmental colleges, etc.) to the exercise or performance of any purpose or function described in section 501(c)(3). Whether or not an organization is subject to the tax imposed by section 511 shall be determined by the application of these tests to the particular circumstances involved in each individual case. For cer-

tain exceptions from the term "unrelated trade or business", see paragraph (b) of this section.

(3) A trade or business is regularly carried on when the activity is conducted with sufficient consistency to indicate a continuing purpose of the organization to derive some of its income from such activity. An activity may be regularly carried on even though its performance is infrequent or seasonal.

(4) Ordinarily, a trade or business is substantially related to the activities for which an organization is granted exemption if the principal purpose of such trade or business is to further (other than through the production of income) the purpose for which the organization is granted exemption. In the usual case the nature and size of the trade or business must be compared with the nature and extent of the activities for which the organization is granted exemption in order to determine whether the principal purpose of such trade or business is to further (other than through the production of income) the purpose for which the organization is granted exemption. For example, the operation of a wheat farm is substantially related to the exempt activity of an agricultural college if the wheat farm is operated as a part of the educational program of the college, and is not operated on a scale disproportionately large when compared with the educational program of the college. Similarly, a university radio station or press is considered a related trade or business if operated primarily as an integral part of the educational program of the university, but is considered an unrelated trade or business if operated in substantially the same manner as a commercial radio station or publishing house. A trade or business not otherwise related does not become substantially related to an organization's exempt purpose merely because incidental use is made of the trade or business in order to further the exempt purpose. For example, the manufacture and sale of a product by an exempt college would not become substantially related merely because students as part of their educational program perform clerical or bookkeeping functions in the business. In some cases, the business may be substantially related because it is a necessary part of the exempt activity. For example, in the case of an organization described in section 501(c)(3) and engaged in the rehabilitation of handicapped persons, the business of selling articles made by such persons as a part of their rehabilitation training would not be considered an unrelated business since such business is a necessary part of the rehabilitation program.

(b) *Exceptions.*—Section 513(a) specifically states that the term "unrelated trade or business" does not include—

(1) Any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) Any trade or business carried on by an organization described in section 501(c)(3) or by a governmental college or university described in section 511(a)(2)(B), primarily for the convenience of its members, students, patients, officers, or employees, or

(3) Any trade or business which consists of selling merchandise, substantially all of which has been received by the organization as gifts or contributions.

An example of the operation of the first of the exceptions mentioned above would be an exempt orphanage operating a retail store and selling to the general public, where substantially all the work in carrying on such business is performed for the organization by volunteers without compensation. An example of the second exception would be a laundry operated by a college for the purpose of laundering dormitory linens and the clothing of students. The third exception applies to so-called "thrift shops" operated by a tax-exempt organization where those desiring to benefit such organization contribute old clothes, books, furniture, etc., to be sold to the general public with the proceeds going to the exempt organization.

(c) *Special rule respecting publishing businesses.*—For a special rule with respect to publishing businesses carried on by an organization, see section 513(c).

§ 1.514(a) STATUTORY PROVISIONS; BUSINESS LEASES; BUSINESS LEASE RENTS AND DEDUCTIONS.

SEC. 514. BUSINESS LEASES.

(a) BUSINESS LEASE RENTS AND DEDUCTIONS.—In computing under section 512 the unrelated business taxable income for any taxable year—

(1) PERCENTAGE OF RENTS TAKEN INTO ACCOUNT.—There shall be included with respect to each business lease, as an item of gross income derived from an unrelated trade or business, an amount which is the same percentage (but not in excess of 100 percent) of the total rents derived during the taxable year under such lease as (A) the business lease indebtedness, at the close of the taxable year, with respect to the premises covered by such lease is of (B) the adjusted basis, at the close of the taxable year, of such premises.

(2) PERCENTAGE OF DEDUCTIONS TAKEN INTO ACCOUNT.—There shall be allowed with respect to each business lease, as a deduction to be taken into account in computing unrelated business taxable income, an amount determined by applying the percentage derived under paragraph (1) to the sum determined under paragraph (3).

(3) DEDUCTIONS ALLOWABLE.—The sum referred to in paragraph (2) is the sum of the following deductions allowable under this chapter:

(A) Taxes and other expenses paid or accrued during the taxable year on or with respect to the real property subject to the business lease.

(B) Interest paid of accrued during the taxable year on the business lease indebtedness.

(C) A reasonable allowance for exhaustion, wear and tear (including a reasonable allowance for obsolescense) of the real property subject to such lease.

Where only a portion of the real property is subject to the business lease, there shall be taken into account under subparagraphs (A), (B), and (C) only those amounts which are properly allocable to the premises covered by such lease.

§ 1.514(a)-1 BUSINESS LEASE RENTS.—(a) *In general.*—(1) *Rents includible in gross income.*—There shall be included with respect to each business lease, as an item of gross income derived from an unrelated trade or business, an amount which is the same percentage (but not in excess of 100 percent) of the total rents derived during the taxable year under such lease as—

(i) The amount of the business lease indebtedness at the close of the taxable year of the lessor tax-exempt organization, with respect to the premises covered by such lease, is of

(ii) The adjusted basis of such premises at the close of such taxable year.

For definition of business lease as a lease for a term of more than 5 years, and for rules for determining the computation of such 5-year term in certain specific situations, see section 1.514(b)-1. For definition of business lease indebtedness and allocation of business lease indebtedness where only a portion of the property is subject to a business lease, see section 1.514(c)-1.

(2) *Determination of basis.*—For purposes of the unrelated business income tax the basis (unadjusted) of property is determined under section 1012, and the adjusted basis of property is determined under section 1011. The determination of the adjusted basis of property is not affected by the fact that the organization was exempt from tax for prior taxable years. Proper adjustment must be made under section 1011 for the entire period since the acquisition of the property. Thus, adjustment must be made for depreciation for all prior taxable years whether or not the organization was exempt from tax for any of such years. Similarly, for taxable years during which the organization is subject to the tax on unrelated business taxable income the fact that only a portion of the deduction for depreciation is taken into account under section 514(a)(2) does not affect the amount of the adjustment for depreciation.

(b) *Examples.*—The application of this section may be illustrated by the following examples, in each of which it is assumed that the taxpayer makes its returns under section 511 on the basis of the calendar year, and that the lease is not substantially related to the purpose for which the organization is granted exemption from tax.

Example (1). Assume that a tax-exempt educational organization purchased property in 1942 for $600,000, using borrowed funds, and leased the building for a period of 20 years. Assume further that the adjusted basis of such building at the close of 1954 is $500,000 and that, at the close of 1954, $200,000 of the indebtedness incurred to acquire the property remains outstanding. Since the amount of the outstanding indebtedness is two-fifths of the adjusted basis of the building at the close of 1954, two-fifths of the gross rental received from the building during 1954 shall be included as an item of gross income in computing unrelated business taxable income. If, at the close of a subsequent taxable year, the outstanding indebtedness is $100,000 and the adjusted basis of the building is $400,000, one-fourth of the gross rental for such taxable year shall be included as an item of gross income in computing unrelated business taxable income for such taxable year.

Example (2). Assume that a tax-exempt organization owns a 4-story building, that in 1954 it borrows $100,000 which it uses to improve the whole building, and that it thereafter in 1954 rents the first and second floors of the building under 6-year leases at rentals of $4,000 a year. The third and fourth floors of the building are leased on a yearly basis during 1954. Assume, also, that the adjusted basis of the real property at the end of 1954 (after reflecting the expenditures for improving the building) is $200,000, allocable equally to each of the 4 stories. Under these facts, only one-half of the real property is subject to a business lease since only one-half is rented under a lease for more than five years. See section 1.514(b)-1. The percentage of the rent under such lease which is taken into account is determined by the ratio which the allocable part of the business lease indebtedness

bears to the allocable part of the adjusted basis of the real property, that is, the ratio which one-half of the $100,000 of business lease indebtedness outstanding at the close of 1954, or $50,000, bears to one-half of the adjusted basis of the business lease premises at the close of 1954, or $100,000. The percentage of rent which is business lease income for 1954 is, therefore, one-half (the ratio of $50,000 to $100,000) of $8,000, or $4,000, and this amount of $4,000 is considered an item of gross income derived from an unrelated trade or business.

§ 1.514(a)-2 BUSINESS LEASE DEDUCTIONS.—(a) The same percentage is used in determining both the portion of the rent and the portion of the deductions taken into account with respect to the business lease in computing unrelated business taxable income. See section 1.514 (a)-1 for the determination of such percentage. Such percentage is applicable only to the sum of the following deductions allowable under section 161:

(1) Taxes and other expenses paid or accrued during the taxable year upon or with respect to the real property subject to the business lease;

(2) Interest paid or accrued during the taxable year on the business lease indebtedness;

(3) A reasonable allowance for exhaustion, wear and tear (including a reasonable allowance for obsolescence) of the real property subject to such lease.

Where only a portion of the real property is subject to the business lease, there shall be taken into account only those amounts of the above-listed deductions which are properly allocable to the premises covered by such lease.

(b) The deductions allowable under section 514(a)(3) and under paragraph (a) of this section with respect to a business lease are not limited by the amount included in gross income with respect to the rent from such lease, but any excess of such deductions over such gross income shall be applied against other items of gross income in computing unrelated business taxable income taxable under section 511(a).

(c) The application of this section may be illustrated by the following example:

Example. Assume the same facts as those in example (1) in paragraph (b) of section 1.514(a)-1. Assume, also, that for 1954 the organization pays taxes of $4,000 on the property, interest of $6,000 on its business lease indebtedness, and that the depreciation allowable for 1954 under section 167 is $10,000. Under the facts set forth in such example (1) and in this example, the deductions to be taken into account for 1954 in computing unrelated business taxable income would be two-fifths of the total of the deductions of $20,000, that is, $8,000.

§ 1.514(b) STATUTORY PROVISIONS; BUSINESS LEASES; DEFINITION OF BUSINESS LEASE.

SEC. 514. BUSINESS LEASES. * * *

(b) DEFINITION OF BUSINESS LEASE.—

(1) GENERAL RULE.—For purposes of this section, the term "business lease" means a lease for a term of more than 5 years of real property by an organization (or by a partnership of which it is a member), if at the close of the lessor's taxable year there is a business lease indebtedness (as defined in subsection (c)) with respect to such property.

(2) SPECIAL RULES FOR APPLYING PARAGRAPH (1).—For purposes of paragraph (1)—

(A) In computing the term of a lease which contains an option for renewal or extension, the term of such lease shall be considered as including any period for which such option may be exercised; and the term of any lease made pursuant to an exercise of such option shall include the period during which the prior lease was in effect. If real property is acquired subject to a lease, the term of such lease shall be considered to begin on the date of such acquisition.

(B) If the property has been occupied by the same lessee for a total period of more than 5 years commencing not earlier than the date of acquisition of the property by the organization or trust (whether such occupancy is under one or more leases, renewals, extensions, or continuations thereof), the occupancy of such lessee shall be considered to be under a lease for a term of more than 5 years within the meaning of paragraph (1). However, subsection (a) shall apply in the case of a tenancy described in this subparagraph (and not within subparagraph (A)) only with despect to the sixth and succeeding years of occupancy by the same lessee. For purposes of this subparagraph, the term "same lessee' shall include any lessee of the property whose relationship with a lessee of the same property is such that losses in respect of sales or exchanges of property between the 2 lessees would be disallowed under section 267(a).

(3) EXCEPTIONS.—(A) No lease shall be considered a business lease if—

(i) Such lease is entered into primarily for purposes which are substantially related (aside from the need of such organization for income or funds or the use it makes of the rents derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501, or

(ii) The lease is of premises in a building primarily designed for occupancy, and occupied, by the organization.

(B) If a lease for more than 5 years to a tenant is for only a portion of the real property, and space in the real property is rented during the taxable year under a lease for not more than 5 years to any other tenant of the organization, leases of the real property for more than 5 years shall be considered as business leases during the taxable year only if—

(i) The rents derived from the real property during the taxable year under leases for more than 5 years (not including, as a lease for more than 5 years, an occupancy which is considered as such a lease by reason of paragraph (2)(B)) represent 50 percent or more of the total rents derived during the taxable year from the real property; or the area of the premises occupied under leases for more than 5 years (not including, as a lease for more than 5 years, an occupancy which is considered as such a lease by reason of paragraph (2)(B)) represents, at any time during the taxable year, 50 percent or more of the total area of the real property rented at such time; or

(ii) The rent derived from the real property during the taxable year from any tenant under a lease for more than 5 years (including as a lease for more than 5 years an occupancy which is considered as such a lease by reason of paragraph (2)(B)), or from a group of tenants (under such leases) who are either members of an affiliated group (as defined in section 1504) or partners, represents more than 10 percent of the total rents derived during the taxable year from such property; or the area of the premises occupied by any one such tenant, or by any such group of tenants, represents at any time during the taxable year more than

10 percent of the total area of the real property rented at such time.

In the application of clause (i), if during the last half of the term of a lease a new lease is made to take effect after the expiration of such lease the unexpired portion of such lease on the date of the second lease is made shall not be treated as a part of the term of the second lease.

§ 1.514(b)-1 DEFINITION OF BUSINESS LEASE.—(a) *In general.*—The term "business lease" means any lease, with certain exceptions discussed in paragraph (c) of this section, for a term of more than five years of real property by an organization subject to section 511 (or by a partnership of which it is a member) if at the close of the organization's taxable year there is a business lease indebtedness as defined in section 514(c) and section 1.514(c)-1 with respect to such property. For the purpose of section 514, the term "real property" and the term "premises" include personal property of the lessor tax-exempt organization leased by it to a lessee of its real estate if the lease of such personal property is made under, or in connection with, the lease of such real estate. For amounts of business lease rents and deductions to be included in computing unrelated business taxable income, see sections 1.514(a)-1 and 1.514(a)-2.

(b) *Special rules.*—(1) In computing the term of the lease, the period for which a lease may be renewed or extended by reason of an option contained therein shall be considered as part of the term. For example, a 3-year lease with an option for renewal for another such period is considered a lease for a term of six years. Another example is the case of a 1-year lease with option of renewal for another such term, where the parties at the end of each year renew the arrangement. In this case, during the fifth year (but not during the first four years), the lease falls within the 5-year rule, since the lease then involves five years and there is an option for the sixth year. In determining the term of the lease, an option for renewal of the lease is taken into account whether or not the exercise of the option depends upon conditions or contingencies.

(2) If the property is acquired subject to a lease, the term of such lease shall be considered to begin on the date of such acquisition. For example, if an exempt organization purchases, in whole or in part with borrowed funds, real property subject to a 10-year lease which has three years left to run, and such lease contains no right of renewal or extension, the lease shall be considered a 3-year lease and hence does not meet the definition of a business lease in section 514(b) and paragraph (a) of this section. However, if this lease contains an option to renew for a period of three years or more, it is a business lease.

(3) Under the provisions of section 514(b)(2)(B) a lease is considered as continuing for more than five years if the same lessee has occupied the premises for a total period of more than five years, whether the occupancy is under one or more leases, renewals, extensions, or continuations. Continued occupancy shall be considered to be by the same lessee if the occupants during the period are so related that losses in respect of sales or exchanges of property between them would be disallowed under section 267(a) of the 1954 Code. Such period shall be considered as commencing not earlier than the date

of the acquisition of the property by the tax-exempt organization or trust. This rule is applicable only in the sixth and succeeding years of such occupancy by the same lessee. See, however, paragraph (c) (3) of this section.

(c) *Exceptions.*—(1) A lease shall not be considered a business lease if such lease is entered into primarily for a purpose which is substantially related (aside from the need of such organization for income or funds, or the use it makes of the rents derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption. For example, where a tax-exempt hospital leases real property owned by it to an association of doctors for use as a clinic, the rents derived under such lease would not be included in computing unrelated business taxable income if the clinic is substantially related to the carrying on of hospital functions. See section 1.513–1 for principles applicable in determining whether there is a substantial relationship to the exempt purposes of an organization.

(2) A lease is not a business lease if the lease is of premises in a building primarily designed for occupancy and occupied by the tax-exempt organization.

(3) If a lease for more than five years to a tenant is for only a portion of the real property, and space in the real property is rented during the taxable year under a lease for not more than five years to any other tenant of the tax-exempt organization, all leases of the real property for more than five years shall be considered as business leases during the taxable year only if—

(i) The rents derived from the real property during the taxable year under leases for more than five years represent 50 percent or more of the total rents derived during the taxable year from the real property; or the area of the premises occupied under leases for more than five years represents, at any time during the taxable year, 50 percent or more of the total area of the real property rented at such time; or

(ii) The rent derived from the real property during the taxable year from any tenant under a lease for more than five years, or from a group of tenants (under such leases) who are either members of an affiliated group (as defined in section 1504) or are partners, represents more than 10 percent of the total rents derived during the taxable year from such property; or the area of the premises occupied by any one such tenant, or by any such group of tenants, represents at any time during the taxable year more than 10 percent of the total area of the real property rented at such time.

In determining whether 50 percent or more of the total rents are derived from leases for more than five years, or whether 50 percent or more of the total area is occupied under leases for more than five years—

(*a*) An occupancy which is considered to be a lease of more than five years solely by reason of the provisions of paragraph (b) (3) of this section shall not be treated as such a lease for purposes of subdivision (i) of this subparagraph, and

(*b*) An occupancy which is considered to be a lease of more than five years solely by reason of the provisions of paragraph (b) (3) of

this section shall be treated as such a lease for purposes of subdivision (ii) of this subparagraph, and

(*c*) If during the last half of the term of a lease a new lease is made to take effect after the expiration of such lease, the unexpired portion of the first lease will not be added to the second lease to determine whether such second lease is a lease for more than 5 years for purposes of subdivision (i) of this subparagraph.

(4) The application of subparagraph (3) of this paragraph may be illustrated by the following example:

Example. In 1954 an educational organization, which is on the calendar year basis, begins the erection of an 11-story apartment building using funds borrowed for that purpose, and immediately leases for a 10-year term the first floor to a real estate development company to sublet for stores and shops. As fast as the new apartments are completed, they are rented on an annual basis. At the end of 1959 all except the tenth and eleventh floors are rented. Those two floors are completed during 1960 and rented. Assume that for 1954 and each subsequent taxable year through 1959, and for the taxable year 1963, the gross rental for the first floor represents more than 10 percent of the total gross rents derived during the taxable year from the building. Under this set of facts the 10-year lease of the first floor would be considered to be a business lease for all except the taxable years 1961, 1962, and 1964.

§ 1.514(c) STATUTORY PROVISIONS; BUSINESS LEASES; BUSINESS LEASE INDEBTEDNESS.

SEC. 514. BUSINESS LEASES. * * *

(c) BUSINESS LEASE INDEBTEDNESS—

(1) GENERAL RULE.—The term "business lease indebtedness" means, with respect to any real property leased for a term of more than 5 years, the unpaid amount of—

(A) The indebtedness incurred by the lessor in acquiring or improving such property;

(B) The indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(C) The indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

(2) PROPERTY ACQUIRED SUBJECT TO MORTGAGE, ETC.—Where real property is acquired subject to a mortgage or other similar lien, the amount of the indebtedness secured by such mortgage or lien shall be considered (whether the acquisition was by gift, devise, or purchase) as an indebtedness of the lessor incurred in acquiring such property even though the lessor did not assume or agree to pay such indebtedness, except that where real property was acquired by gift, bequest, or devise before July 1, 1950, subject to a mortgage or other similar lien, the amount of such mortgage or other similar lien shall not be considered as an indebtedness of the lessor incurred in acquiring such property.

(3) CERTAIN PROPERTY ACQUIRED BY GIFT, ETC.—Where real property was acquired by gift, bequest, or devise before July 1, 1950, subject to a lease requiring improvements in such property on the happening of stated contingencies, indebtedness incurred in improving such property in accordance with the terms of such lease shall not be considered as an indebtedness for purposes of this subsection.

(4) CERTAIN CORPORATIONS DESCRIBED IN SECTION 501(c)(2).—In the case of a corporation described in section 501(c)(2), all of the stock of which was acquired before July 1, 1950, by an organization described in paragraph (3), (5), or (6) of section 501(c) (and more than one-third of such stock was acquired by such organization by gift or bequest), any indebtedness incurred by such corporation before July 1, 1950, and any indebtedness incurred by such corporation on or after such date in improving real property in accordance with the terms of a lease entered into before such date, shall not be considered as an indebtedness with respect to such corporation or such organization for purposes of this subsection.

(5) CERTAIN TRUSTS DESCRIBED IN SECTION 401(a).—In the case of a trust described in section 401(a), or in the case of a corporation described in section 501(c)(2) all of the stock of which was acquired prior to March 1, 1954, by a trust described in section 401(a), any indebtedness incurred by such trust or such corporation before March 1, 1954, in connection with real property which is leased before March 1, 1954, 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.

(6) BUSINESS LEASE ON PORTION OF PROPERTY.—In determining the amount of the business lease indebtedness where only a portion of the real property is subject to a business lease, proper allocation to the premises covered by such lease shall be made of the indebtedness incurred by the lessor with respect to the real property.

(7) SPECIAL RULE APPLICABLE TO TRUSTS DESCRIBED IN SECTION 401(a).—In the application of paragraph (1), if a trust described in section 401(a) forming part of a stock bonus, pension, or profit-sharing plan of an employer lends any money to another trust described in section 401(a) forming part of a stock bonus, pension, or profit-sharing plan of the same employer, such loan shall not be treated as an indebtedness of the borrowing trust, except to the extent that the loaning trust—

(A) Incurs any indebtedness in order to make such loan;

(B) Incurred indebtedness before the making of such loan which would not have been incurred but for the making of such loan; or

(C) 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.

§ 1.514(c)-1 BUSINESS LEASE INDEBTEDNESS.—(a) *Definition.*—The term "business lease indebtedness" means, with respect to any real property leased by a tax-exempt organization for a term of more than five years, the unpaid amount of—

(1) The indebtedness incurred by the lessor tax-exempt organization in acquiring or improving such property;

(2) The indebtedness incurred by the lessor tax-exempt organization prior to the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(3) The indebtedness incurred by the lessor tax-exempt organization subsequent to the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of the indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

See paragraph (i) of this section with respect to subsidiary corporations.

(b) *Examples.*—The rules of section 514(c) respecting business leases also cover certain cases where the leased property itself is not subject to an indebtedness. For example, they apply to cases such as the following:

Example (1). A university pledges some of its investment securities with a bank for a loan and uses the proceeds of such loan to purchase (either directly or through a subsidiary corporation) a building, which building is subject to a lease that then has more than five years to run. This would be an example of a business lease indebtedness incurred prior to the acquisition of the property which would not have been incurred but for such acquisition.

Example (2). If the building itself in example (1) in this paragraph is later mortgaged to raise funds to release the pledged securities, the lease would continue to be a business lease.

Example (3). If a scientific organization mortgages its laboratory building to replace working capital used in remodeling another one of its buildings or a building held by its subsidiary corporation, which other building is free of indebtedness and is subject to a lease that then has more than five years to run, the lease would be a business lease inasmuch as the indebtedness though incurred subsequent to the improvement of such property would not have been incurred but for such improvement, and the incurrence of the indebtedness was reasonably foreseeable when, to make such improvement, the organization reduced its working capital below the amount necessary to continue current operations.

(c) *Property acquired subject to lien.*—Where real property is acquired subject to a mortgage or similar lien, whether the acquisition by by gift, bequest, devise, or purchase, the amount of the indebtedness secured by such mortgage or lien is a business lease indebtedness (unless paragraph (d)(1) of this section applies) even though the lessor does not assume or agree to pay the indebtedness. For example, a university pays $100,000 for real estate valued at $300,000 and subject to a $200,000 mortgage. For the purpose of the tax on unrelated business taxable income the result is the same as if $200,000 of borrowed funds had been used to buy the property.

(d) *Certain property acquired by gifts, etc.*—(1) Where real property was acquired by gift, bequest, or devise, before July 1, 1950, subject to a mortgage or other similar lien, the amount of such mortgage or other similar lien shall not be considered as an indebtedness of the lessor tax-exempt organization incurred in acquiring such property. An indebtedness not otherwise covered by this exception is not brought within the exception by reason of a transfer of the property between a parent and its subsidiary corporation.

(2) Where real property was acquired by gift, bequest, or devise, before July 1, 1950, subject to a lease requiring improvements in such property upon the happening of stated contingencies, indebtedness incurred in improving such property in accordance with the terms of such lease shall not be considered as indebtedness described in section 514(c) and in this section. An indebtedness not otherwise covered by this exception is not brought within the exception by reason of

a transfer of the property between a parent and its subsidiary corporation.

(e) *Certain corporations described in section 501(c)(2).*—In the case of a title holding corporation described in section 501(c)(2), all of the stock of which was acquired before July 1, 1950, by an organization described in section 501(c)(3), (5), or (6) (and more than one-third of such stock was acquired by such organization by gift or bequest), any indebtedness incurred by such corporation before July 1, 1950, and any indebtedness incurred by such corporation on or after such date in improving real property in accordance with the terms of a lease entered into before such date, with respect to either such section 501(c)(2) corporation or such section 501(c)(3), (5), or (6) organization, shall not be considered an indebtedness described in section 514(c) and in this section.

(f) *Certain trusts described in section 401(a).*—In the case of a trust described in section 401(a), or in the case of a corporation described in section 501(c)(2) all of the stock of which was acquired before March 1, 1954, by such a trust, any indebtedness incurred by such trust or such corporation before such date, in connection with real property which is leased before such date, 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 described in section 514(c) and in this section.

(g) *Business lease on portion of property.*—Where only a portion of the real property is subject to a business lease, proper allocation of the indebtedness applicable to the whole property must be made to the premises covered by the lease. See example (2) of paragraph (b) of section 1.514(a)-1.

(h) *Special rule applicable to trusts described in section 401(a).*—If an employees' trust described in section 401(a) lends any money to another such employees' trust of the same employer, for the purpose of acquiring or improving real property, such loan will not be treated as an indebtedness of the borrowing trust except to the extent that the loaning trust—

(1) Incurs any indebtedness in order to make such loan;

(2) Incurred indebtedness before the making of such loan which would not have been incurred but for the making of such loan; or

(3) 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.

(i) *Subsidiary corporations.*—The provisions of section 514 are applicable whether or not a subsidiary corporation of the type described in section 501(c)(2) is availed of in making the business lease. For example, assume a parent organization borrows funds to purchase realty and sets up a separate section 501(c)(2) corporation as a subsidiary to hold the property. Such subsidiary corporation leases the property for a period of more than five years, collects the rents and pays over all of the income, less expenses to the parent organization, the parent organization being liable for the indebtedness. Under these assumed facts, the lease by the section 501(c)(2) subsidiary corporation would be a business lease with respect to such subsidiary corporation, and the rental income would be subject to the tax,

whether or not the subsidiary itself assumes the indebtedness and whether or not the property is subject to the indebtedness.

§ 1.514(d) STATUTORY PROVISIONS; BUSINESS LEASES; PERSONAL PROPERTY LEASED WITH REAL PROPERTY.

SEC. 514. BUSINESS LEASES. * * *

(d) PERSONAL PROPERTY LEASED WITH REAL PROPERTY.—For purposes of this section, the term "real property" and the term "premises" include personal property of the lessor leased by it to a lessee of its real estate if the lease of such personal property is made under, or in connection with, the lease of such real estate.

§ 1.515 STATUTORY PROVISIONS; TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.

SEC. 515. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.

The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax of an organization subject to the tax imposed by section 511 to the extent provided in section 901; and in the case of the tax imposed by section 511, the term "taxable income" as used in section 901 shall be read as "unrelated business taxable income".

FARMERS' COOPERATIVES

§ 1.521 STATUTORY PROVISIONS; EXEMPTION OF FARMERS' COOPERATIVES FROM TAX.

SEC. 521. EXEMPTION OF FARMERS' COOPERATIVES FROM TAX.

(a) EXEMPTION FROM TAX.—A farmers' cooperative organization described in subsection (b) (1) shall be exempt from taxation under this subtitle except as otherwise provided in section 522. Notwithstanding section 522, such an organization shall be considered an organization exempt from income taxes for purposes of any law which refers to organizations exempt from income taxes.

(b) APPLICABLE RULES—

(1) EXEMPT FARMERS' COOPERATIVES.—The farmers' cooperatives exempt from taxation to the extent provided in subsection (a) are farmers', fruit growers', or like associations organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

(2) ORGANIZATIONS HAVING CAPITAL STOCK.—Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association.

(3) ORGANIZATIONS MAINTAINING RESERVE.—Exemption shall not be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

(4) TRANSACTIONS WITH NONMEMBERS.—Exemption shall not be denied any such association which markets the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, or which purchases supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of all its purchases.

(5) BUSINESS FOR THE UNITED STATES.—Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this section.

§ 1.521–1 FARMERS' COOPERATIVE MARKETING AND PURCHASING ASSOCIATIONS; REQUIREMENTS FOR EXEMPTION UNDER SECTION 521.—(a)(1) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of either the quantity or the value of the products furnished by them, are exempt from income tax except as otherwise provided in section 522. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of either the quantity or the value of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Internal Revenue Code of 1954 and is not exempt. In other words, nonmember patrons must be treated the same as members insofar as the distribution of patronage dividends is concerned. Thus, if products are marketed for nonmember producers, the proceeds of the sale, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such proceeds result, whether or not such patrons are members of the association. In order to show its cooperative nature and to establish compliance with the requirement of the Code that the proceeds of sales, less necessary expenses, be turned back to all producers on the basis of either the quantity or the value of the products furnished by them, it is necessary for such an association to keep permanent records of the business done both with members and nonmembers. The Code does not require, however, that the association keep ledger accounts with each producer selling through the association. Any permanent records which show that the association was operating during the taxable year on a cooperative basis in the distribution of patronage dividends to all producers will suffice. While under the Code patronage dividends must be paid to all producers on the same basis, this requirement is complied with if an association, instead of paying patronage dividends to nonmember producers in cash, keeps permanent records from which the proportionate shares of the patronage dividends due to nonmember producers can be determined, and such shares are made applicable toward the purchase price of a share or stock or of a membership in the association.

(2) An association which has capital stock will not for such reason be denied exemption (i) if the dividend rate of such stock is fixed

at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and (ii) if substantially all of such stock (with the exception noted below) is owned by producers who market their products or purchase their supplies and equipment through the association. Any ownership of stock by others than such actual producers must be satisfactorily explained in the association's application for exemption. The association will be required to show that the ownership of its capital stock has been restricted as far as possible to such actual producers. If by statutory requirement all officers of an association must be shareholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a shareholder for any reason ceases to be a producer and the association is unable, because of a constitutional restriction or prohibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that under such circumstances a small amount of the outstanding capital stock is owned by shareholders who are no longer producers will not destroy the exemption. The restriction placed on the ownership of capital stock of an exempt cooperative association shall not apply to nonvoting preferred stock, provided the owners of such stock are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends.

(3) The accumulation and maintenance of a reserve required by State statute, or the accumulation and maintenance of a reasonable reserve or surplus for any necessary purpose, such as to provide for the erection of buildings and facilities required in business or for the purchase and installation of machinery and equipment or to retire indebtedness incurred for such purposes, will not destroy the exemption. An association will not be denied exemption because it markets the products of nonmembers, provided the value of the products marketed for nonmembers does not exceed the value of the products marketed for members. Anyone who shares in the profits of a farmers' cooperative marketing association, and is entitled to participate in the management of the association, must be regarded as a member of such association within the meaning of section 521.

(b) Cooperative associations engaged in the purchasing of supplies and equipment for farmers, fruit growers, livestock growers, dairymen, etc., and turning over such supplies and equipment to them at actual cost, plus the necessary operating expenses, are exempt. The term "supplies and equipment" as used in section 521 includes groceries and all other goods and merchandise used by farmers in the operation and maintenance of a farm or farmer's household. The provisions of paragraph (a) of this section relating to a reserve or surplus and to capital stock shall apply to associations coming under this paragraph. An association which purchases supplies and equipment for nonmembers will not for such reason be denied exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the value of the purchases made for nonmembers who are not producers does not exceed 15 percent of the value of all its purchases.

(c) In order to be exempt under either paragraph (a) or (b) of this section an association must establish that it has no taxable income for its own account other than that reflected in a reserve or surplus authorized in paragraph (a) of this section. An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements of the Internal Revenue Code of 1954. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under section 521 and this section. An association to be entitled to exemption must not only be organized but actually operated in the manner and for the purposes specified in section 521.

(d) Cooperative organizations engaged in occupations dissimilar from those of farmers, fruit growers, and the like, are not exempt.

(e) An organization is not exempt from taxation under this section merely because it claims that it complies with the requirements prescribed therein. In order to establish its exemption every organization claiming exemption under section 521 is required to file a Form 1028. The Form 1028, executed in accordance with the instructions on the form or issued therewith, should be filed with the district director for the internal revenue district in which is located the principal place of business or principal office of the oragnization. However, an organization which has been granted exemption under the provisions of the Internal Revenue Code of 1939 or prior law may rely on that ruling, unless affected by substantive changes in the 1954 Code or any changes in the character, purposes, or methods of operation of the organization, and it is not necessary in such case for the organization to request a new determination as to its exempt status.

§ 1.522 STATUTORY PROVISIONS; TAX ON FARMERS' COOPERATIVES.

SEC. 522. TAX ON FARMERS' COOPERATIVES.

(a) IMPOSITION OF TAX.—An organization exempt from taxation under section 521 shall be subject to the taxes imposed by section 11 or section 1201.

(b) COMPUTATION OF TAXABLE INCOME.—

(1) GENERAL RULE.—In computing the taxable income of such an organization there shall be allowed as deductions from gross income (in addition to other deductions allowable under this chapter)—

(A) Amounts paid as dividends during the taxable year on its capital stock, and

(B) Amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. Allocations made after the close of the taxable year and on or before the 15th day of the 9th month following the close of such year shall be considered as made on the last day of such taxable year to the extent the allocations are attributable to income derived before the close of such year.

(2) PATRONAGE DIVIDENDS, ETC.—Patronage dividends, refunds, and rebates to patrons with respect to their patronage in the same or preceding years (whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advise, or in some other manner that dis-

closes to each patron the dollar amount of such dividend, refund, or rebate) shall be taken into account in computing taxable income in the same manner as in the case of a cooperative organization not exempt under section 521. Such dividends, refunds, and rebates made after the close of the taxable year and on or before the 15th day of the 9th month following the close of such year shall be considered as made on the last day of such taxable year to the extent the dividends, refunds, or rebates, are attributable to patronage occurring before the close of such year.

§ 1.522–1 Tax Treatment of Farmers' Cooperative Marketing and Purchasing Associations Exempt Under Section 521.—(a) *In general.*—(1) Section 522 is applicable to farmers', fruit growers', or like associations organized and operated on a cooperative basis in the manner prescribed in section 521. Although such an association is subject to both normal tax and surtax, as in the case of corporations generally, certain special rules for the computation of taxable income are provided in section 522(b) and section 1.522–2. For the purpose of any law which refers to organizations exempt from income taxes such an association shall, however, be considered as an organization exempt under section 501. Thus, the provisions of section 243, providing a credit for dividends received from a domestic corporation subject to taxation, are not applicable to dividends received from a cooperative association subject to section 522. The provisions of section 1501, relating to consolidated returns, are likewise not applicable.

(2) Rules governing the manner in which amounts allocated as patronage dividends, refunds, or rebates are to be taken into account in computing the taxable income of such an association are set forth in section 1.522–3. For the tax treatment, as to patrons, of amounts received during the taxable year as patronage dividends, rebates, or refunds, see section 61 and section 1.61–5.

(b) *Meaning of terms.*—For purposes of sections 1.522–1 to 1.522–3, inclusive, sections 1.6044–1 and 1.61–5, the following terms shall have the meaning ascribed below:

(1) *Cooperative association.*—The term "cooperative association" includes any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons, except that the term does not include any cooperative or nonprofit corporation (including any cooperative or nonprofit corporation engaged in rural electrification) exempt from taxation under section 501(a) and described in section 501(c)(12) or (15) or any corporation subject to a tax imposed by subchapter L (relating to insurance companies).

(2) *Patron.*—The term "patron" includes any person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or a nonmember of the cooperative association, and whether an individual, a trust, estate, partnership, company, corporation, or cooperative association.

(3) *Allocation.*—The term "allocation" includes distributions made by a cooperative association to a patron in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, similar documents, or in any other manner whereby there is disclosed to a patron the dollar amount apportioned on the books of the association for the account of such patron. Thus, a mere credit to the account of a patron on the books of the

cooperative association, without disclosure to the patron, is not an allocation.

(4) *Patronage dividends, rebates, and refunds.*—The term "patronage dividend, rebate, or refund" includes any amount allocated by a cooperative association, to the account of a patron on the basis of the business done with or for such patron. The following are not patronage dividends, rebates, or refunds:

(i) Amounts distributed in redemption of capital stock, or in redemption or satisfaction of certificates of indebtedness, revolving fund certificates, retain certificates, letters of advice, or other similar documents;

(ii) Amounts allocated (whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, refund or rebate) by the association for products of members or other patrons to the extent such amounts are fixed without reference to the earnings of the cooperative association. For this purpose, the term "earnings" includes the excess of amounts retained (or assessed) by the association to cover expenses or other items over the amount of such expenses or other items.

(c) *Examples.*—The application of paragraph (b) of this section may be illustrated by the following examples:

Example (1). Cooperative A, a marketing association operating on a pooling basis, receives the products of patron W on January 5, 1954. On the same day Cooperative A advances to W 45 cents per unit for the products so delivered and allocates to him a "retain certificate" having a face value calculated at the rate of 5 cents per unit. During the operation of the pool, and before substantially all the products in the pool are disposed of, Cooperative A advances to W an additional 40 cents per unit, the amount being determined by reference to the market price of the products sold and the anticipated price of the unsold products. At the close of the pool on November 10, 1954, Cooperative A determines the excess of its receipts over the sum of its expenses and its previous advances to patrons, and allocates to W an additional 3 cents per unit and shares of the capital stock of A having an aggregate of face value calculated at the rate of 2 cents per unit.

The amount of patronage dividends, rebates, or refunds allocated to W during 1954 amount to 5 cents per unit, consisting of the aggregate of the following per-unit allocations: The amount of cash distribution (3 cents), and the face value of the capital stock of A (2 cents), which are fixed with reference to the earnings of A. The amount of the two distributions in cash (85 cents) and the face amount of the "retain certificate" (5 cents), which are fixed without reference to the earnings of A, do not constitute patronage dividends, rebates, or refunds.

Example (2). Cooperative B, a marketing association operating on a pooling basis, receives the products of patron X on March 5, 1954. On the same day Cooperative B pays to X $1.00 per unit for such products, this amount being determined by reference to the market price of the product when received, and issues to him a participation

certificate having no face value but which entitles X on the close of the pool to the proceeds derived from the sale of his products less the previous payment of $1.00 and the expenses and other charges attributable to such products. On March 5, 1957, Cooperative B, having sold the products in the pool, having deducted the previous payments for such products, and having determined the expenses and other charges of the pool, redeems the participation certificate of X in cash for 10 cents per unit. The allocation made to X during 1957, amounting to 10 cents per unit, is a patronage dividend, rebate, or refund. Neither the payment to X in 1954 of $1.00 nor the issuance to him of the participation certificate in that year constitutes a patronage dividend, rebate, or refund within the meaning of this section.

Example (3). Cooperative C, a purchasing association, obtains supplies for patron Y on May 1, 1954, and receives in return therefor $100. On February 1, 1955, Cooperative C, having determined the excess of its receipts over its costs and expenses, allocates to Y a cash distribution of $1.00 and a revolving fund certificate of a face amount of $1.00. The amount of patronage dividends, rebates, or refunds allocated to Y for 1955 is $2.00, the aggregate of the cash distribution of $1.00, and the face amount, $1.00, of the revolving fund certificate.

Example (4). Cooperative D, a service association, sells the products of members on a fee basis. It receives the products of patron Z under an agreement not to pool his products with those of other members, to sell his products, and to deliver to him the proceeds of the sale. Patron Z makes payments to Cooperative D during 1954 aggregating $75 for service rendered him by Cooperative D during that year. On May 15, 1955, Cooperative D, having determined the excess of its receipts over its costs and expenses, allocates to Z a cash distribution of $2.00. Such amount is a patronage dividend, rebate, or refund allocated by Cooperative D during 1955.

(d) *Returns of exempt cooperative associations.*—For requirements of annual returns by exempt cooperative associations, see sections 6012 and 6072 (d) and paragraph (f) of section 1.6012–2.

§ 1.522–2 Manner of Taxation of Cooperative Associations Subject to Section 522.—(a) *In general.*—Farmers', fruit growers', or like associations, organized and operated in compliance with the requirements of section 521 and section 1.521–1 shall be subject to the taxes imposed by section 11 or section 1201, except that there shall be allowed as deductions from gross income, in addition to the other deductions allowable under chapter 1, certain special deductions provided in section 522(b)(1)(A) and paragraph (c) of this section, and section 522(b)(1)(B) and paragraph (d) of this section. Amounts allocated as patronage dividends, refunds, or rebates, whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated, with respect to patronage for the taxable year or for preceding taxable years, shall be taken into account in the manner provided in section 522 and in section 1.522–3.

(b) *Cooperative association exempt from tax before January 1, 1952.*—(1) For the purpose of determining the method of accounting under section 446 in the case of a cooperative association which was exempt from tax for taxable years beginning prior to January 1, 1952, the method of accounting, recognized under sections 41, 42, and 43 of the Internal Revenue Code of 1939 and the regulations prescribed thereunder and utilized in the return of such association for its last taxable year to which the Internal Revenue Code of 1939 was applicable, shall be deemed to constitute the method of accounting regularly employed by the cooperative association. Any change from this method may be made only if permission is obtained from the Commissioner to change to another recognized method in accordance with section 446 and the regulations thereunder.

(2) In any case where inventories are an income-producing factor, see sections 471 and 472 and the regulations thereunder. The elective method of inventorying goods provided in section 472 may be adopted by the cooperative association for any taxable year beginning after December 31, 1953, in accordance with the requirements of section 472 and the regulations thereunder. However, in order to use such method for such a taxable year the cooperative association (unless it has used such method for a taxable year beginning after 1951 and before 1954 pursuant to an election exercised as provided in section 39.22(d)–3 of Regulations 118) must exercise the election provided in section 472 and the regulations thereunder, even if it may have utilized such method for accounting purposes for taxable years beginning before January 1, 1952.

(3) The following rules shall be applicable in computing the net operating loss deduction provided in section 172: No net operating loss carryover shall be allowed from a taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt from tax under section 101(12) of the 1939 Code. In the case of a taxable year beginning prior to January 1, 1952, for which the association was not exempt under section 101(12) of the 1939 Code, and of any taxable year beginning after December 31, 1951, the amount of the net operating loss carryback or carryover from such year shall not be reduced by reference to the income of any taxable year beginning prior to January 1, 1952, for which the association was exempt from tax under section 101(12) of the 1939 Code. However, any taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt under section 101(12) of the 1939 Code shall be taken into account in determining the period for which a net operating loss may be carried back or carried over, as the case may be.

(4) The adjustments to the cost or other basis provided in sections 1011 and 1016 and the regulations thereunder are applicable for the entire period since the acquisition of the property. Thus, proper adjustment to basis must be made under section 1016 for depreciation, obsolescence, amortization, and depletion for all taxable years beginning prior to January 1, 1952, although the cooperative association was exempt from tax under section 521 or corresponding provisions of prior law for such years. However, no adjustment for percentage or discovery depletion is to be made for any year during which the association was exempt from tax. If a cooperative association has

made a proper election in accordance with section 1020 and the regulations prescribed thereunder with respect to a taxable year beginning before 1952 in which the association was not exempt from tax, the adjustment to basis for depreciation for such years shall be limited in accordance with the provisions of section 1016(a)(2).

(5) In the case of tax exempt and partially taxable bonds purchased at a premium and subject to amortization under section 171, proper adjustment to basis must be made to reflect amortization with respect to such premium from the date of acquisition of the bond. (For principles governing the method of computation, see the example in paragraph (b) of section 1.1016–9, relating to mutual savings banks, building and loan associations, and cooperative banks.) The basis of a fully taxable bond purchased at a premium shall be adjusted from the date of the election to amortize such premium in accordance with the provisions of section 171 except that no adjustment shall be allowable for such portion of the premium attributable to the period prior to the election.

(6) In the case of a mortgage acquired at a premium where the principal of such mortgage is payable in installments, adjustments to the basis for the premium must be made for all taxable years (whether or not the association was exempt from tax under section 521 during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period of payments of the mortgage loans of such association. For the purpose of this adjustment, the term "premium" includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage is the cost including buying commissions, attorneys' fees or brokerage fees, but such value does not include amounts paid for accrued interest.

(c) *Deduction for dividends paid.*—There is allowable as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 521 and section 1.521–1, amounts paid as dividends during the taxable year upon the capital stock of the cooperative association. For the purpose of the preceding sentence, the term "capital stock" includes common stock (whether voting or nonvoting), preferred stock, or any other form of capital represented by capital retain certificates, revolving fund certificates, letters of advice, or other evidence of a proprietary interest in a cooperative association. Such deduction is applicable only to the taxable year in which the dividends are actually or constructively paid to the holder of capital stock or other proprietary interest of the cooperative association. If a dividend is paid by check and the check bearing a date within the taxable year is deposited in the mail, in a cover properly stamped and addressed to the shareholder at his last known address, at such time that in the ordinary handling of the mails the check would be received by such holder within the taxable year, a presumption arises that the dividend was paid to such holder in such year. The determination of whether a dividend has been paid to such holder by the corporation during its taxable year is in no way dependent upon the method of accounting regularly employed by the corporation in keeping its books. For further rules as to the deter-

mination of the right to a deduction for dividends paid, under certain specific circumstances, see section 561 and the regulations thereunder.

(d) *Deduction for amounts allocated from income not derived from patronage.*—There is allowable as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 521 and § 1.521–1 amounts allocated during the taxable year to partons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether such amounts are paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. For this purpose, allocations made after the close of the taxable year and on or before the 15th day of the ninth month following the close of the taxable year shall be considered as made on the last day of such taxable year to the extent that such allocations are attributable to income derived during the taxable year or during years prior to the taxable year. As used in this paragraph, the term "income not derived from patronage" means incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment in securities, from the sale or exchange of capital assets, constitutes income not derived from patronage. Business done with the United States shall constitute income not derived from patronage. In order that the deduction for income not derived from patronage may be applicable, it is necessary that the amount sought to be deducted be allocated on a patronage basis in proportion, insofar as is practicable, to the amount of business done by or for patrons during the period to which such income is attributable. Thus, if capital gains are realized from the sale or exchange of capital assets acquired and disposed of during the taxable year, income realized from such gains must be allocated to patrons of such year in proportion to the amount of business done by such patrons during the taxable year. Similarly, if capital gains are realized by the association from the sale or exchange of capital assets held for a period of more than one taxable year income realized from such gains must be allocated, in proportion insofar as is practicable, to the patrons of the taxable years during which the asset was owned by the association, and to the amount of business done by such patrons during such taxable years.

§ 1.522–3 Patronage Dividends, Rebates, or Refunds; Treatment as to Cooperative Associations Entitled to Tax Treatment Under Section 522.—(a) *General rule.*—Patronage dividends, refunds, or rebates, allocated by a cooperative association entitled to tax treatment under section 522 to a patron shall be taken into account in computing the gross income of such association for the taxable year, as an increase in its other cost of goods sold in the case of an association marketing products for patrons, or as a reduction in its gross receipts, in the case of an association purchasing supplies and equipment or performing services for patrons, as the case may be, if:

(1) The allocation is made in fulfillment and satisfaction of a valid obligaion of such association to the patron, which obligation was in existence prior to the receipt by the cooperative association of the amount allocated, and

(2) The allocation is made on or before the 15th day of the ninth month following the close of the taxable year in which the amounts allocated were received by the cooperative association.

For the purpose of subparagraph (1) of this paragraph, amounts allocated by a cooperative association entitled to tax treatment under section 522 will be deemed allocated in fulfillment and satisfaction of a valid enforceable obligation, if made pursuant to provisions of the by-laws, articles of incorporation, or other contract, whereby the association is obligated to make such allocation after the retention of "reasonable reserves" and after payment of dividends on capital stock or other proprietary capital interests. Notwithstanding the provisions of subparagraphs (1) and (2) of this paragraph, amounts allocated as patronage dividends, refunds, or rebates during the taxable year, on or before the 15th day of the ninth month following the close of such year, with respect to patronage for years preceding the taxable year, shall be taken into account as an increase in its other cost of goods sold, or as a reduction in gross receipts, for the taxable year, as the case may be, where retention as "reasonable reserves" of the amounts so allocated beyond the year in which earned was proper in accordance with the provisions of section 521 and where the allocation is made to the patron on a patronage basis in proportion insofar as is practicable, to the amount of business done by such patrons during the taxable year or years in which the retained amounts were received by the cooperative association.

(b) *Examples.*—This section may be illustrated by the following examples:

Example (1). E, a cooperative association entitled to tax treatment under section 522, organized without capital stock, is engaged in the business of marketing products for its patrons on a non-pool basis. The by-laws of Cooperative E provide that there shall be allocated to patrons as patronage dividends within a reasonable time following the close of the year all of the gross returns from sales, less expenses of operation for the year and amounts retained as "reasonable reserves" necessary to the operation of Cooperative E. At the close of the taxable year, 1954, it is determined that from the gross returns from sales less operating expenses and all taxes for such year $5,000 is to be retained as "reasonable reserves" for various necessary purposes of Cooperative E. It is assumed that the retention of such amount is proper in accordance with the provisions of section 521. Such $5,000 is apportioned on the books of Cooperative E to patrons of 1954 on a patronage basis, or permanent records are kept from which an apportionment to such patrons can be made. On March 1, 1955, pursuant to the terms of the by-laws, $200,000, the balance of the gross returns for the taxable year, is allocated to patrons of 1954 on the basis of patronage. $100,000 of such $200,000 is allocated in cash. The remaining $100,000 is allocated in "retain certificates", bearing no interest and redeemable in the discretion of the Board of Directors of Cooperative E.

There may be added to the cost of goods sold by Cooperative E for 1954, $200,000 ($100,000 in cash, $100,000 in retain certificates), the total amount allocated as patronage dividends, rebates, or refunds in fulfillment and satisfaction of the obligation of the by-laws, on

March 1, 1955, before the 15th day of the ninth month following the close of 1954. There may not be added to the cost of goods sold by Cooperative E for 1954, $5,000, the amount retained as reserves apportioned on the books, but not allocated as patronage dividends, rebates, or refunds.

Example (2). The facts are the same as example (1), it additionally appearing that at the close of 1955 it is determined by Cooperative E to allocate as cash patronage dividends, rebates, or refunds to patrons of 1954, $5,000, the amount retained as "reasonable reserves" for 1954 in accordance with the provisions of section 521. On March 1, 1956, such amount is allocated.

There may be added to the cost of goods sold by Cooperative E for 1955, $5,000, the amount allocated with respect to patronage of a preceding year, 1954, properly maintained as a reserve under section 521.

SHIPOWNERS' PROTECTION AND INDEMNITY ASSOCIATIONS

§ 1.526 STATUTORY PROVISIONS; SHIPOWNERS' PROTECTION AND INDEMNITY ASSOCIATIONS.

SEC. 526. SHIPOWNERS' PROTECTION AND INDEMNITY ASSOCIATIONS.

There shall not be included in gross income the receipts of shipowners' mutual protection and indemnity associations not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder; but such corporations shall be subject as other persons to the tax on their taxable income from interest, dividends, and rents.

INCOME TAX RETURNS

§ 1.6012 STATUTORY PROVISIONS; PERSONS REQUIRED TO MAKE RETURNS OF INCOME; GENERAL.

SEC. 6012. PERSONS REQUIRED TO MAKE RETURNS OF INCOME.

(a) GENERAL RULE.—Returns with respect to income taxes under subtitle A shall be made by the following:

(1) Every individual having for the taxable year a gross income of $600 or more (except that any individual who has attained the age of 65 before the close of his taxable year shall be required to make a return only if he has for the taxable year a gross income of $1,200 or more);

(2) Every corporation subject to taxation under subtitle A;

(3) Every estate the gross income of which for the taxable year is $600 or more;

(4) Every trust having for the taxable year any taxable income, or having gross income of $600 or over, regardless of the amount of taxable income; and

(5) Every estate or trust of which any beneficiary is a nonresident alien;

except that subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Secretary or his delegate, nonresident alien individuals subject to the tax imposed by section 871 and foreign corporations subject to the tax imposed by section 881 may be exempted from the requirement of making returns under this section.

(b) RETURNS MADE BY FIDUCIARIES AND RECEIVERS.

(1) RETURNS OF DECEDENTS.—If an individual is deceased, the return of such individual required under subsection (a) shall be made by his executor, administrator, or other person charged with the property of such decedent.

(2) PERSONS UNDER A DISABILITY.—If an individual is unable to make a return required under subsection (a) or section 6015 (a), the return of such individual shall be made by a duly authorized

agent, his committee, guardian, fiduciary or other person charged with the care of the person or property of such individual. The preceding sentence shall not apply in the case of a receiver appointed by authority of law in possession of only a part of the property of an individual.

(3) RECEIVERS, TRUSTEES AND ASSIGNEES FOR CORPORATIONS.—In a case where a receiver, trustee in bankrupcty, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

(4) RETURNS OF ESTATES AND TRUSTS.—Returns of an estate or a trust shall be made by the fiduciary thereof.

(5) JOINT FIDUCIARIES.—Under such regulations as the Secretary or his delegate may prescribe, a return made by one of two or more joint fiduciaries shall be sufficient compliance with the requirements of this section. A return made pursuant to this paragraph shall contain a statement that the fiduciary has sufficient knowledge of the affairs of the person for whom the return is made to enable him to make the return, and that the return is, to the best of his knowledge and belief, true and correct.

(c) CONSOLIDATED RETURNS.—For provisions relating to consolidated returns by affiliated corporations, see chapter 6.

§ 1.6012–2 CORPORATIONS REQUIRED TO MAKE RETURNS OF INCOME.* * *

(e) *Charitable and other organizations with unrelated business income.*—Every organization, described in section 501(c)(2), (3), (5), and (6), which is otherwise exempt from tax under section 501 (a), and which is subject to the tax imposed on unrelated business taxable income by section 511(a)(1), shall make a return on Form 990–T for each taxable year if it has gross income, included in computing unrelated business taxable income for such taxable year, of $1,000 or more. A return on Form 990–T shall also be made for each taxable year by every governmental college or university and by every corporation wholly owned by such a college or university, which is subject to the tax on unrelated business taxable income and which has gross income, included in computing unrelated business taxable income for such taxable year, of $1,000 or more. The filing of a return of unrelated business income does not relieve the organization of the duty of filing other required returns.

(f) *Farmers' cooperatives.*—Farmers' cooperative organizations described in section 521 are required to make a return of income whether or not such organizations are, under section 522, subject to the taxes imposed by section 11 or section 1201. The return shall be made on Form 990–C.

§ 1.6012–3 RETURNS BY FIDUCIARIES.—(a) *For estates and trusts.* * * *

(5) *Trusts with unrelated business income.*—Every fiduciary for a trust, described in section 501(c)(3), or section 401(a), which is otherwise exempt from tax under section 501(a), and which is subject to the tax imposed on unrelated business taxable income by section 511(b)(1), shall make a return on Form 990–T for each taxable year

if the trust has gross income, included in computing unrelated business taxable income for such taxable year, of $1,000 or more. The filing of a return of unrelated business income does not relieve the fiduciary of such trust from the duty of filing other required returns.

INFORMATION RETURNS

§ 1.6033 STATUTORY PROVISIONS; RETURNS BY EXEMPT ORGANIZATIONS.

SEC. 6033. RETURNS BY EXEMPT ORGANIZATIONS.

(a) GENERAL.—Every organization, except as hereinafter provided, 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 for the purpose of carrying out the provisions of subtitle A as the Secretary or his delegate may by forms or regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations, as the Secretary or his delegate may from time to time prescribe, except that, in the discretion of the Secretary or his delegate, an organization described in section 401(a) may be relieved from stating in its return any information which is reported in returns filed by the employer which established such organization. No such annual return need be filed under this subsection by any organization exempt from taxation under the provisions of section 501(a)—

(1) Which is a religious organization described in section 501(c)(3); or

(2) Which is an educational organization described in section 501(c)(3), if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; or

(3) Which is a charitable organization, or an organization for the prevention of cruelty to children or animals, described in section 501(c)(3), if such organization is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or is primarily supported by contributions of the general public; or

(4) Which is an organization described in section 501(c)(3), if such organization is operated, supervised, or controlled by or in connection with a religious organization described in paragraph (1); or

(5) Which is an organization described in section 501(c)(8); or

(6) Which is an organization described in section 501(c)(1), if such organizations is a corporation wholly owned by the United States or any agency or instrumentality thereof, or a wholly-owned subsidiary of such a corporation.

(b) CERTAIN ORGANIZATIONS DESCRIBED IN SECTION 501(c)(3).—Every organization described in section 501(c)(3) which is subject to the requirements of subsection (a) shall furnish annually information, at such time and in such manner as the Secretary or his delegate may by forms or regulations prescribe, setting forth—

(1) Its gross income for the year,

(2) Its expenses attributable to such income and incurred within the year,

(3) Its disbursements out of income within the year for the purposes for which it is exempt,

(4) Its accumulation of income within the year,

(5) Its aggregate accumulations of income at the beginning of the year,

(6) Its disbursements out of principal in the current and prior years for the purposes for which it is exempt, and

(7) A balance sheet showing its assets, liabilities, and net worth as of the beginning of such year.

(c) CROSS REFERENCE.—For provisions relating to statements, etc., regarding exempt status of organizations, see section 6001.

§ 1.6033–1 RETURNS BY EXEMPT ORGANIZATIONS.—(a) *In general.*—(1) Except as provided in section 6033(a) and paragraph (g) of this section, every organization exempt from taxation under section 501(a) shall file an annual return of information specifically stating its items of gross income, receipts and disbursements, and such other information as may be prescribed in the instructions issued with respect to the return. Such information return shall be filed annually regardless of the amount or source of the income or receipts of the organization. Exempt as provided in paragraph (d) of this section, such return shall be filed annually regardless of whether such organization is chartered by, or affiliated or associated with, any central, parent, or other organization.

(2) Every organization exempt from taxation under section 501(a), and required to file a return under section 6033 and this section, other than those described in sections 401(a), 501(c)(3), and 501(d), shall file its annual return on Form 990.

(3) Every employees' trust described in section 401(a) which is exempt from taxation under section 501(a) shall file an annual return on Form 990–P. The return shall include the information required by paragraph (b)(5)(ii) of section 1.401–1. The trust must also file the information required by section 1.404(a)–2, unless the employer has notified the trustee that he has or will timely file such information. If the trustee has received such notification from the employer, then the trust must file a copy thereof with its return and the other information required by the return.

(4)(i) Every organization described in section 501(c)(3), which is exempt from taxation under section 501(a), and which is required to file a return under section 6033 and this section, shall file its annual return on Form 990–A.

(ii) In addition to the information required by subparagraph (1) of this paragraph, there shall also be furnished on Form 990–A, in the manner prescribed in the instructions issued with respect to the return, the information required by section 6033(b). See section 6104 and the regulations thereunder for publicity of information required by section 6033(b).

(5)(i) Every religious or apostolic association or corporation described in section 501(d) which is exempt from taxation under section 501(a) shall file a return on Form 1065 for each taxable year, stating specifically the items of gross income and deductions, and its taxable income. There shall be attached to the return as a part thereof a statement showing the name and address of each member of the association or corporation and the amount of his distributive share of the taxable income of the association or corporation for such year.

(ii) If the taxable year of any member is different from the taxable year of the association or corporation, the distributive share of the taxable income of the association or corporation to be included in the gross income of the member for his taxable year shall be based upon the taxable income of the association or corporation for its taxable year ending with or within the taxable year of the member.

(b) *Accounting period for filing return.*—A return on Form 990, Form 990–A, or Form 990–P shall be on the basis of the established annual accounting period of the organization. Where the organiza-

tion has no such established accounting period, such return shall be on the basis of the calendar year.

(c) *Returns when exempt status not established.*—An information return on Form 990–A is not required to be filed by an organization claiming an exempt status under section 501(a) prior to the establishment by the organization of such exempt status under section 501(a) and section 1.501(a)–1. If the date for filing an income tax return and paying the tax occurs before the tax-exempt status of the organization has been established, the organization is required to file the return and pay the tax. However, see sections 6081 and 6161 and the regulations thereunder for extensions of time for filing the return and paying the tax. Upon establishment of its exempt status, the organization may file a claim for a refund of income taxes paid for the period for which its exempt status is established.

(d) *Group returns.*—(1) A central, parent, or like organization (referred to in this paragraph as "central organization"), exempt under section 501(a) and described in section 501(c), although required to file a separate annual return for itself under section 6033 and paragraph (a) of this section, may file annually, in addition to such separate annual return, a group return on Form 990 or Form 990–A as may be appropriate (see paragraph (a) of this section). Such group return may be filed for two or more of the local organizations, chapters, or the like (referred to in this paragraph as "local organizations") which are (i) chartered by, or affiliated or associated with, such central organization at the close of its annual accounting period, (ii) subject to the general supervision of, and examination by, the central organization, and (iii) exempt from taxation under section 501(a) and described by the same provision of section 501(c) as the central organization.

(2) (i) The filing of the group return shall be in lieu of the filing of a separate return 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 made and filed, with the central organization, their statements, 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. Such an authorization by a local organization shall be made annually, under the penalties of perjury, and shall be signed by a duly authorized officer of the local organization in his official capacity and shall contain the following statement, or a statement of like import: "I hereby declare under the penalties of perjury that this authorization (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true, correct and complete and made in good faith for the taxable year stated." Such authorizations and statements shall be permanently retained by the central organization.

(ii) 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, and 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

for an accounting period ending on or after December 31, 1957, the central organization shall notify each district director 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 each schedule described in this subdivision shall constitute notice as required by the preceding sentence.

(3) The group return shall be on the basis of the established annual accounting period of the central organization. Where such central organization has no established annual accounting period, such return shall be on the basis of the calendar year. The same income, receipts, and disbursements of a local organization shall not be included in more than one group return.

(4) The group return shall be filed in accordance with these regulations and the instructions issued with respect to Form 990 or Form 990–A, whichever is appropriate, and shall be considered the return of each local organization included therein. The tax-exempt status of a local organization must be established before a group return including the local organization will be considered as the return of the local organization. See section 1.501(a)–1 for requirements for establishing a tax-exempt status.

(e) *Time and place for filing.*—The annual return of information on Form 990, 990–A, or 990–P shall be filed on or before the fifteenth day of the fifth calendar month following the close of the period for which the return is required to be filed. The annual return on Form 1065 required to be filed by a religious or apostolic association or corporation shall be filed on or before the fifteenth day of the fourth month following the close of the taxable year for which the return is required to be filed. Each such return shall be filed with the district director for the internal revenue district in which the principal place of business or principal office of the organization is located.

(f) *Penalties.*—For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207.

(g) *Organizations not required to file annual returns.*—(1) (i) Annual returns on Form 990–A are not required to be filed by an organization described in section 501(c)(3) which has established its right to exemption from taxation under section 501(a) and which is—

(*a*) Organized and operated exclusively for religious purposes;

(*b*) Operated, supervised, or controlled by or in connection with an organization which is organized and operated exclusively for religious purposes;

(*c*) An educational organization which normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; or

(*d*) A charitable organization, or an organization for the prevention of cruelty to children or animals, which is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or which is primarily supported by contributions of the general public.

(ii) An educational organization which normally maintains and has a regular faculty, curriculum, and student body and meets the conditions of subdivision (i)(*c*) of this subparagraph, which relieve it from the requirement of filing annual returns, shall not be considered as having thereafter failed to continue meeting such conditions if it is temporarily compelled to curtail or discontinue its normal and regular activities during the existence of abnormal circumstances and conditions.

(iii) An organization organized and operated exclusively for charitable purposes or for the prevention of cruelty to children or animals is not "primarily supported by contributions of the general public" for any accounting period if more than 50 percent of its income and receipts for such period is not actually derived from voluntary contributions and gifts made by the general public, as distinguished from a few contributors or donors or from related or associated persons. For purposes of this subdivision, the words "related or associated persons" refer to persons of a particular group who are connected with or are interested in the activities of the organization, such as founders, incorporators, shareholders, members, fiduciaries, officers, employees, or the like, or who are connected with such persons by family or business relationships.

(2) The annual return on Form 990 need not be filed by—

(i) A fraternal beneficiary society, order, or association, described in section 501(c)(8), or

(ii) An organization described in section 501(c)(1) if it is a corporation wholly owned by the United States or any agency or instrumentality thereof, or is a wholly owned subsidiary of such a corporation,

which has established its exemption from tax under section 501(a).

(3) The provisions of section 6033(a) relieving certain specified types of organizations exempt from tax under section 501(a) from filing annual returns do not abridge or impair in any way the powers and authority of district directors provided for in other provisions of the Code and in the regulations thereunder to require the filing of such returns by such organizations. See section 6001 and section 1.6001–1.

(h) *Records, statements, and other returns of tax-exempt organizations.*—(1) An organization which has esablished its right to exemption from tax under section 501(a) and has also established that it is not required to file annually the return of information on Form 990 or Form 990–A shall immediately notify in writing the district director for the internal revenue district in which its principal office is located of any changes in its character, operations, or purpose for which it was originally created.

(2) Every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the district director for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of subchapter F of chapter 1 (section 501 and following) and of section 6033. See section 6001 and section 1.6001–1 with respect to the authority of the district director to require such additional information and with respect to the permanent books of account or records to be kept by such organizations.

(3) An organization which has established its right to exemption from tax under section 501(a), including an organization which is relieved under section 6033 and this section from filing annual returns of information, is not, however, relieved from the duty of filing other returns of information. See, for example, sections 6041 and 6051 and the regulations thereunder.

(i) *Unrelated business tax returns.*—In addition to the foregoing requirements of this section, certain organizations otherwise exempt from tax under section 501(a) and described in section 501(c)(2), (3), (5), or (6) or section 401(a) which are subject to tax on unrelated business taxable income are also required to file returns on Form 990–T. See paragraph (e) of section 1.6012–2 and paragraph (a)(5) of section 1.6012–3 for requirements with respect to such returns.

PAR. 2. Paragraph (e) of section 1.401–1 of the Income Tax Regulations (26 CFR 1.401–1(e)), as prescribed by Treasury Decision 6203 (21 F. R. 7269), approved September 24, 1956, [C. B. 1956–2, 219] is amended to read as follows:

(e) *Determination of exemptions and returns.*—(1) An employees' trust may request a determination letter as to its qualification under section 401 and exemption under section 501. For the procedure for obtaining such a determination letter see paragraph (1) of section 601.201 of this chapter (Statement of Procedural Rules).

(2) A trust which qualifies under section 401(a) and which is exempt under section 501(a) must file a return in accordance with section 6033 and the regulations thereunder. See section 1.6033–1. In case such a trust realizes any unrelated business taxable income, as defined in section 512, such trust is also required to file a return with respect to such income. See section 1.6012–3.

(Paragraph 2 of 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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved July 2, 1958.

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

(Filed by the Division of the Federal Register on July 8, 1958, 8:50 a. m., and published in the issue of the Federal Register for July 9, 1958, 23 F. R. 5192.)

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26 CFR 1.501(a)–1: Exemption from taxation. Rev. Rul. 58–617
(Also Section 6033; 1.6033–1.)

Rulings and determinations letters granting exemption from Federal income tax to an organization described in section 501(a) of the Internal Revenue Code of 1954, to which contributions are deductible by donors in computing their taxable income in the manner and to the extent provided by section 170 of the Code, are effective only so long as there are no material changes in the character of the organization, the purposes for which it was organized, or its methods of operation. The District Director of Internal Revenue for the district in

which the organization is located *must be* advised immediately of any such changes in order that a determination may be made as to the effect the changes may have upon the exempt status of the organization. See generally sections 1.501(a)–1 and 1.6033–1 of the Income Tax Regulations. Failure to comply with this requirement may result in serious consequences to the organization for the reason that the ruling or determination letter holding the organization exempt may be revoked retroactively to the date of the changes affecting its exempt status, depending upon the circumstances involved, and subject to the limitations on retroactivity of revocation found in section 503 of the Code.

Procedures for the public disclosure of certain information relating to organizations which have been held to be exempt from income tax under section 501(a) of the Internal Revenue Code of 1954, and the corresponding provisions of prior revenue laws. See Rev. Proc. 58–20, page 1134.

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26 CFR 1.501(c)(2)–1: Corporations organized to hold title to property for exempt organizations. Rev. Rul. 58–566

A corporation will not be considered organized as a holding company within the meaning of section 501(c)(2) of the Internal Revenue Code of 1954 where it has broad powers and business purposes far beyond the scope necessary to a holding company. Furthermore, where part of its income is used to reduce indebtedness on property which will ultimately revert to private individuals, it will not be considered as being operated for exempt purposes.

Advice has been requested whether a corporation holding title to property for the benefit of a tax exempt charitable organization may, under the circumstances indicated below, be entitled to exemption from Federal income tax as an organization described in section 501(c)(2) of the Internal Revenue Code of 1954.

The instant organization was incorporated under state law with authority, inter alia, to acquire real and personal property; to construct, conduct, and operate buildings of all kinds for the accommodation of the public and of individuals, whether or not such buildings were the property of the organization; to conduct a general real estate business; to buy, sell, deal and trade in mortgages on or interest in real estate; and to acquire, deal in, pledge and dispose of shares of the capital stock, other securities, obligations and evidences of indebtedness issued by any corporations, syndicates, associations, firms, trusts or persons, public or private.

The corporation entered into an agreement for the lease of land for a period of 20 years with a stipulated rental therefor. As additional rent the corporation also agreed to pay all rates, taxes, assessments, etc., coming due on the land during the period of the lease and upon any building or improvements that the corporation might make thereon. Upon expiration or termination of the lease, title to any buildings and improvements which the organization may erect upon the demised land, including any fixtures, equipment and ma-

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chinery attached to and connected with the operation and maintenance of such buildings and improvements, are to pass to and vest in the lessor without cost or charge whatsoever to the lessor, and free and clear of encumbrances.

The organization then acquired a loan and entered into a contract with a builder for the erection of a building on the land acquired by lease. The building was erected. At the same time, the builder purchased all the interest of the lessor holding title to the land upon which the building was erected. The builder also purchased all the stock of the instant corporation. Shortly thereafter, the builder donated his stock in the organization to an incorporated charity bearing his name.

Profit and loss statements for the first several years of operation show that annual income from building rentals was used to defray fixed charges including ground rent, real estate taxes, interest on mortgage, amortization of finance charges and for operating expenses including legal expenses, payroll taxes, licenses and fees, salaries, insurance, and so forth.

Section 501(c)(2) of the Code describes one type of an organization exempt from tax as provided by section 501(a) as a corporation organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under section 501(a) of the Code.

From the foregoing, it is readily seen that the organization, here under consideration, was incorporated with broad powers and business purposes far beyond the scope of those necessary to a holding company. The events surrounding the organization and its operations indicate that it was not the intent that its income, less expenses, be turned over to a charitable organization in view of the intention to reduce indebtedness on property which will ultimately revert to private individuals, *i. e.*, in this case to the lessor building contractor.

In view of the foregoing, it is held that the instant organization was not organized for purposes specified in section 501(c)(2) of the Code since its broad powers and business purposes are far beyond the scope necessary to a holding company. Furthermore, since part of its income is used to reduce indebtedness on property which will ultimately revert to private individuals it is not operated for exempt purposes. Accordingly, the organization is not exempt from Federal income tax under the provisions of section 501(c)(2) of the Code.

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26 CFR 1.501(c)(7)–1: Social clubs. Rev. Rul. 58–501

Where a social club, qualified for tax exemption under section 501(c)(7) of the Internal Revenue Code of 1954, finds it impracticable to continue to conduct its exempt activities and, as a result, sells its property and liquidates, such sale is incidental to its exempt purposes and the club is still to be considered as operated exclusively for pleasure, recreation and similar purposes up through the date of the sale and distribution of the liquidated assets to its active members.

Advice has been requested whether a tax exempt social club which is unable to continue its exempt activities will be deprived of its

exemption because a profit was realized on the sale of all the club's property upon liquidation.

A club was incorporated, as a corporation without stock, under the laws of the state in which it was located, for the purpose of operating a golf club exclusively on a nonprofit basis for the pleasure and recreation of its members. The club membership was composed of two groups, the regular members, who held certificates of indebtedness in the Club's property and a small number of associate members, who were proposed by and approved of in the same manner as the regular members, but who were not to share in the distribution of the assets of the club. As the years progressed, it became apparent that the club was in peril due to the urbanization of the immediate surrounding area. Among the problems faced by the club were increased real estate assessments; rearrangement of its golf course made necessary by the city's street-building activities; and the imminent possibility of further condemnation of additional golf property for the widening of a boulevard which would render the club facilities useless for club purposes. Several offers were received from builders who desired to use the property for residential development and finally, on recommendation of the board of directors, prospective purchasers were invited to submit bids. After negotiations, an offer for purchase of the property was accepted and a contract of sale was executed. The price was payable in part upon execution of the contract, in part upon closing date, and the balance was secured by a purchase money mortgage at four and one-half percent interest payable in three years. After an agreed date there were no club activities except to collect interest on notes and to defend the club from claims of past members. A committee had been appointed, while the sale was still being negotiated, to find a new location for the club, but no adequate facilities were found and no serious action was taken in this respect. The personal property was also sold. Shortly after the sale of the property, the club passed a resolution to dissolve and commenced distribution of the proceeds to the certificate holders, who were entitled to the amounts. The mortgage was paid in full at maturity.

To qualify for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954, a social club must be organized and operated exclusively for pleasure, recreation and other nonprofit purposes and no part of its net earnings may inure to the benefit of any private shareholder. Section 1.501(c)(7)–1(b) of the Income Tax Regulations states that an incidental sale of property will not deprive the club of its exemption. It has also been held that sales of property at a profit will not cause a social club to lose its exemption provided the sale is incidental to the club's purpose. See *Santee Club* v. *White*, 87 Fed. (2d) 5; *Anderson Country Club* v. *Commissioner*, 2 T. C. 1238 acquiescence, C. B. 1944, 2; *Koon Kreek Club* v. *Thomas*, 108 Fed. (2d) 616.

In determining whether the transaction in the present case is an incidental sale or a sale primarily for profit, it is necessary to examine the circumstances under which the sale was made and determine the primary purpose of the sale. The extensive urbanization of the area surrounding the club, the increased taxes and expenses occasioned thereby, the probable condemnation of a large section of the land and continued trespasses all indicate that the further contin-

uance of the club would not be possible. Therefore, the sale of the club property was for the purpose of facilitating its dissolution and not primarily for a profit. In G. C. M. 19465, C. B. 1938–1, 172, it is held that a social club does not lose its exemption by reason of the sale at a profit of its club properties to avoid financial burden. The sale of the property and the distribution of its assets are important transactions in the dissolution of a club and, as such, these activities do not form a basis on which to deprive the club of its exemption. This transaction was obviously a singular event in the club's history and to facilitate the dissolution does not convert a social club into a real estate business. The sale was incidental to the club's purpose.

The fact that a portion of the profit resulting from the sale was distributed to the members does not cause the club to lose its exemption. Every social and recreational group has a prospect of eventually being disbanded and dissolved. Therefore, the fact that the assets of a club will, upon dissolution, be paid to members or shareholders is not alone sufficient to make the organization liable to render income tax returns. See S. M. 2710, C. B. III–2, 230 (1924), and *Mill Lane Club Inc.* v. *Commissioner*, 23 T. C. 433, acquiescence C. B. 1955–1, 5.

Another aspect of this case is whether the holding of the mortgage note and the collection of interest were something more than a mere incident to the sale and liquidation, that is, whether it became a profit making venture for the club which would cause the club to lose its exemption. The receipt of interest on its purchase money mortgage did not deprive the taxpayer of its exempt status. The method of settlement on this sale of land was as practical and reasonable a method of payment as could be expected and it resulted in the fastest possible liquidation without depriving the taxpayer of a just price by the necessity of demanding full payment in cash. As long as no repeated extensions of the mortgage note were granted and there being no other evidence to show an investment purpose, the settlement under the facts herein stated is considered an ordinary and reasonable method of settlement and an integral part of the sale. As such, it does not affect the taxpayer's exempt status.

As to the possibility of considering this as a sale for profit rather than a sale for liquidation because of the fact that an effort was made to locate a new site, the taxpayer would not lose its tax status because the conversion of property to other property better suited to serve the operations of a club is a valid purpose within the contemplation of the Code. I. T. 3302, C. B. 1939–2, 105.

Accordingly, it is held that where a social club, qualified for tax exemption under section 501(c)(7) of the Code, finds it impracticable to continue to conduct its exempt activities and, as a result, sells its property and liquidates, such sale is incidental to its exempt purposes. The club is still to be considered as operated exclusively for pleasure, recreation, and similar purposes up through the date of the sale and distribution of the liquidated assets to its active members. The profit from the sale by the club of all its property in conjunction with the termination of its activities and liquidation does not deprive the club of the exemption provided by section 501(c)(7) of the Code.

Rev. Rul. 58–588

An organization formed by several individuals to operate a health, recreational, and social club but whose predominant activity is the selling of services for profit to an unlimited number of so-called "members," who have no voice in the management of the club and whose only rights are to the use of the club's facilities upon the payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization formed by several individuals for the purpose of operating a health, recreational, and social club may be exempt from Federal income tax as a social club, within the meaning of section 501(c)(7) of the Internal Revenue Code of 1954, under the circumstances set forth below.

The instant organization was incorporated as a nonprofit membership corporation without capital stock. Its purposes are to operate a health, recreational and social club, including a clubhouse, restaurant, gymnasium, baths, and recreational facilities. Its bylaws provide for two classes of memberships, active and associate. The current membership consists of 25 active members and approximately 25,000 associate members. The active members have exclusive voting rights. The associate members have only the right to use the club facilities. The organization is managed and controlled by a board of directors elected from and by the active members. The officers of the organization are elected from among the board of directors. The board of directors functions as a membership committee, and any one of them may exercise the functions of the committee for the purpose of receiving applications for associate membership. In addition, any member of the membership committee may summarily revoke an associate membership at his discretion without assigning any reason therefor. Under the bylaws such revocation is effective immediately and without recourse.

The club leases its clubhouse which contains such facilities as Turkish and Russian baths, steam rooms, a roof solarium, swimming pools, a gymnasium, ball courts, a dormitory, club rooms, lounges, a restaurant, a barbershop, and a beauty salon. The club itself operates all these facilities with the exception of the restaurant and barbershop. These are leased to two of the active members under a concession arrangement calling for the payment to the club of a specified percentage of the gross receipts of the concession.

Five of the active members are full-time employees of the club and constitute a majority of the board of directors and of the membership committee. These five members have complete control over membership in the club and, under the articles of incorporation and the bylaws, have authority to fix and determine the use and disposition of club funds and, in general, to direct all club business. The charges for the use of the various facilities and services provided by the club are fixed by and in the discretion of the directors. Each member also pays nominal yearly dues.

The club's income is derived from membership dues, rent from concessions, and fees for services provided in the operation of club facilities. Disbursements are made for salaries and wages, rent, supplies, equipment and miscellaneous operating expenses. Less than

one-half of one percent of the income is attributable to active members and guests, the remainder being derived from associate members.

Section 501(c) of the Internal Revenue Code of 1954 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 provides 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). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

On the basis of the information presented, it is concluded that the club in the instant case is operated in the personal interest of a few individuals; that social features are not a material purpose of the club but are subordinate and merely incidental to the active furtherance of a predominant purpose to engage in the business of selling services for profit to an unlimited number of individuals termed "associate members;" that "associate" membership is not a true membership but is merely a guise under which virtually unlimited numbers of individuals may utilize the club facilities; and that income from associate members is in reality income from transactions with the general public.

Accordingly, it is held that the instant organization is not a social club as contemplated by the law and regulations and, consequently is not entitled to exemption from Federal income tax under section 501(a) of the Code as an organization described in section 501(c)(7) of the Code. See Rev. Rul. 58–589, below.

Rev. Rul. 58–589

> Criteria or tests for determining whether an organization qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(7) of the Code.

Advice has been requested concerning the criteria or tests to be met in determining whether a social club can qualify for exemption from Federal income tax under the provisions of section 501(a) of the Internal Revenue Code of 1954.

Section 501(c) of the Code describes certain organizations exempt from 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.

In making a determination whether an organization comes within the provisions of section 501(c)(7) of the Code, all facts pertaining to its form of organization, method of operation and activities should be considered. An organization must establish (1) that it is a club both organized and operated exclusively for pleasure, recreation and other nonprofitable purposes and (2) that no part of its net earnings inures to the benefit of any private shareholder or individual. To meet the first requirement, there must be an established membership of individuals, personal contacts and fellowship. A commingling of the members must play a material part in the life of the organization. See G. C. M. 23688, C. B. 1943, 283.

Section 1.501(c)(7)-1 of the Income Tax Regulations relating to the exemption of social clubs under section 501(a) of the Internal Revenue Code of 1954 reads 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 recreational 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). *Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business* and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption [Italics supplied.]

It is clear under the foregoing regulations that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, etc., may not be considered as being organized and operated exclusively for pleasure, recreation or social purposes. It is equally clear that activities by a social club such as the solicitation by advertisements or otherwise of public patronage of its facilities may be adverse to the establishment of an exempt status.

Therefore, to qualify for income tax exemption, a social club should not advertise its facilities for nonmember patronage since this would be prima facie evidence it was engaging in business. Likewise a social club should not engage in any type of business activity for profit which is designed to increase or which could result in an increase in net earnings inuring to the benefit of any shareholder or individual. Net earnings may inure to members in such forms as an increase in services offered by the club without a corresponding increase in dues or other fees paid for club support or as an increase in the club's assets which would be distributable to members upon the dissolution of the club.

However, this is not to say that a club will necessarily lose its exemption if it derives income from transactions with other than its bona fide members and their guests. A club will not be denied exemption merely because it receives income from the general public, that is, persons other than members and their bona fide guests, or because the general public on occasion is permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and it may not be said that income therefrom is inuring to members. This is generally true where the receipts from nonmembers are no more than enough to pay their share of the expense. *Barstow Rodeo and Riding Club, Inc.* v. *Commissioner*, Tax Court Memorandum Opinion entered November 30, 1953. Where, however, a club makes its facilities open to the general public and the purpose is to increase its funds for enlarging its club facilities or for otherwise benefitting its members, it is evident that it is not operating as an exempt social club within the intendment of section 501(c)(7) of the Code. *Jockey Club* v. *Helvering*, 76 Fed. (2d) 597; *Aviation Club of Utah* v. *Commissioner*, 162 Fed. (2d) 984. Compare *West Side Tennis Club* v. *Commissioner*, 111 Fed. (2d) 6, certiorari denied, 311 U. S. 674.

Similarly, where a club engages in income producing transactions which are not a part of the club purposes, exemption will not be denied because of incidental, trivial or nonrecurrent activities such as sales of property no longer adapted to club purposes. *Santee Club* v. *White*, 87 Fed. (2d) 5. But in order to retain exemption a club must not enter into outside activities with the purpose of deriving profit. Section 1.501(c)(7)-1 of the Income Tax Regulations and *Santee Club* v. *White*, *supra*. If such income producing activities are other than incidental, trivial or nonrecurrent, it will be considered that they are designed to produce income and will defeat exemption. *West Side Tennis Club* v. *Commissioner*, *supra; Mah Jongg League, Inc.* v. *United States*, 75 Fed. Supp. 769.

The fact that an organization believes that it falls within the scope of this Revenue Ruling does not relieve it from the requirement that it file, 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, an application on Form 1025, Exemption Application. See see section 1.501(a)-1 of the Income Tax Regulations.

See Revenue Ruling 56-334, C. B. 1956-2, 831, as to the status of an exempt social club for purpose of the excise tax on club dues imposed by section 4241 of the Code.

SECTION 502.—FEEDER ORGANIZATIONS

26 CFR 1.502: Statutory provisions; feeder organizations.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

SECTION 503.—REQUIREMENTS FOR EXEMPTION

26 CFR 1.503(a): Statutory provisions; requirements for exemption; denial of exemption to organizations engaged in prohibited transactions.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

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26 CFR 1.503(c)–1: Prohibited transactions. Rev. Rul. 58–526

The exempt trust forming a part of an employees' qualified pension plan of a subsidiary corporation shall not be considered as engaging in a prohibited transaction merely because trust funds are invested in debentures of the parent corporation which, although not secured by the pledge of any collateral, are subject to the usual provisions with respect to default of either principal or interest ordinarily set forth in an indenture under which corporate debentures are isued.

Advice has been requested whether a trust forming part of an employees' qualified pension plan of a subsidiary corporation may be considered as engaging in a prohibited transaction when the trust funds are invested in unsecured debentures of the parent corporation.

The *S* corporation has established a noncontributory pension plan on behalf of its employees. The plan was held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 and the trust forming a part thereof was entitled to exemption under section 501(a) of the Code. All of the amounts contributed to the trust were made by the *S* corporation.

Subsequent to the establishment of the pension plan and trust, the *P* corporation acquired approximately 65 percent of the outstanding shares of stock of the *S* corporation. The *S* corporation thus became a subsidiary of the *P* corporation.

The *P* corporation issued 20-year interest-bearing debentures which were a direct obligation of the *P* corporation and, although not secured by the pledge of any collateral, were subject to the usual provisions with respect to default of either principal or interest ordinarily set forth in an indenture under which corporate debentures are issued. Some of these debentures were purchased by the exempt employees' trust established by the *S* corporation.

Section 501 (a) of the Code provides, in part, that an organization described in section 401(a) shall be exempt from taxation unless such exemption is denied under section 503 of the Code.

Section 503 of the Code provides, in subsection (a)(1) thereof, that an organization described in section 401(a) shall be denied exemption from taxation if it engages in a prohibited transaction. Subsection (c) of section 503 defines the term "prohibited transaction" to mean, in part, any transaction in which an organization subject to the provisions of this section lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to the creator of a trust, a person who has made a substantial contribution to such trust, or a corporation controlled by such creator or person through the ownership of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or of the total value

of shares of all classes of stock of the corporation. In the instant case, the *P* corporation, which issued the debentures purchased by the exempt employees' pension trust, is the parent corporation and, therefore, is not controlled by the subsidiary which established the trust, nor is it the grantor of the trust.

Accordingly, it is held that the exempt trust forming a part of an employees' qualified pension plan of a subsidiary corporation shall not be considered as engaging in a prohibited transaction merely because trust funds are used to purchase debentures of the parent corporation which, although not secured by the pledge of any collateral, are subject to the usual provisions with respect to default of either principal or interest ordinarily set forth in an indenture under which corporate debentures are issued.

SECTION 504.—DENIAL OF EXEMPTION

26 CFR 1.504: Statutory provisions; denial of exemption.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

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26 CFR 1.504–1: Denial of exemption. Rev. Rul. 58–535

Contributions to an organization exempt from Federal income tax under section 501(c)(3) for the Internal Revenue Code of 1954 are not considered as income to the organization for the purpose of applying the provisions of section 504 of the Code. Consequently, distributions made by the organization for its stated tax-exempt purposes are first applied against current income before being charged against contributions received during the taxable year or against contributed capital on hand at the beginning of the year.

Advice has been requested whether contributions to an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 will be considered as income for the purpose of applying the provisions of section 504 of the Code, and whether distributions which are made by the organization for its stated tax-exempt purposes should be applied first to the reduction of income or to the donations received.

Section 504 of the Internal Revenue Code of 1954 provides, in substance, that any organization described in section 501(c)(3) of the Code to which section 503 of the Code is applicable shall be denied exemption under section 501 of the Code for the taxable year if amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year are unreasonable in amount or duration in order to carry out the charitable, educational or other purpose or function constituting the basis for such organization's exemption under section 501(c)(3).

Section 1.504–1(c) of the Income Tax Regulations states that for the purpose of section 504 of the Internal Revenue Code of 1954 the term "income" means gains, profits, and income determined under the principles applicable in determining the earnings or profits of a corporation. The amount accumulated out of income during the taxable year or any prior taxable year shall be determined under the principles

applicable in determining the accumulated earnings or profits of a corporation.

Contributions, as such, are not considered to be "income" within the meaning of that term as used in the Internal Revenue Code for purposes of section 504. In view of the provisions contained in section 504 of the Code, denying exemption in the case of certain organizations that are accumulating income, and the regulations which interpret that section, contributions made to an organization which otherwise qualifies for exemption under section 501(c)(3) of the Code may be disregarded for the purpose of determining whether amounts accumulated out of income are unreasonable.

Since contributions received by an organization exempt from Federal income tax under section 501(c)(3) of the Code constitute contributed or donated capital, unless the facts in a particular case indicate otherwise, distributions made by the organization for its stated tax-exempt purposes are properly shown as a reduction of current income before such distributions are charged against contributions received during the taxable year or against contributed capital on hand at the beginning of the year.

In view of the foregoing, it is held that contributions to an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 are not considered to be income to the organization for the purpose of applying the provisions of section 504 of the Code. Consequently, distributions made by the organization for its stated tax-exempt purposes are first applied against current income before being charged against contributions received during the taxable year or against contributed capital on hand at the beginning of the year.

PART II.—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

SECTION 511.—IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME OF CHARITABLE, ETC., ORGANIZATIONS

26 CFR. 1.511: Statutory provisions; imposition of tax on unrelated business income of charitable, etc., organizations.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

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26 CFR 1.511–1: Impositions and rates of tax. (Also Sections 512, 513; 1.512(a)–1, 1.513–1.) Rev. Rul. 58–502

An association, formed to promote and conserve the best interests and true spirit of a game, which has been held to be exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code of 1954, is not subject to the unrelated business income tax imposed by section 511 of the Code on income derived from the operation of championship tournaments, the grant of radio and television broadcasting rights, and the sale of publications relating to the rules of the game.

Advice has been requested whether an organization exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code of 1954 will be subject to the unrelated business income tax imposed by section 511 of the Code on income derived from the operation of championship tournaments, the grant of radio and television rights, etc.

The organization in the instant case was formed for the purpose of promoting and conserving the best interests and true spirit of a game as embodied in its traditions. Its membership is composed of regularly organized clubs throughout the United States. The organization is empowered to prescribe and enforce the rules and tests governing amateur standing and the rules for the playing of the game, and to hold each year championship tournaments and such other events as may from time to time be arranged. It acts as an authoritative national body in the arbitration of controversies and in the final determination of all questions which may arise relating to the game in this country. In addition to dues which it receives from its membership, the organization derives its income from the championship tournaments which it sponsors, the grant of radio and television broadcasting rights, and from the sale of booklets on the rules of the game. The income derived from the grant of radio and television broadcasting rights is relatively insignificant in amount.

Section 511 of the Internal Revenue Code of 1954 imposes a tax on the unrelated business taxable income of certain organizations exempt from tax under section 501(c) of the Code. The term "unrelated business taxable income" as defined in section 512 of the Code means, with certain exceptions, additions, and limitations, the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business. Section 513 of the Code defines the term "unrelated trade or business," in the case of any organization subject to the tax imposed by section 511 of the Code, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the functions constituting the basis for its exemption under section 501 of the Code.

Under section 513 of the Code and section 1.513–1 of the Income Tax Regulations, a trade or business regularly carried on is not considered to be substantially related to the activities for which an organization is granted exemption if the income therefrom is disproportionate in amount when considered in connection with the size and extent of the tax-exempt activities, or if its primary purpose is the production of income, or if it is operated in the same manner as a commercial business.

Where an organization is engaged in activities which are substantially related to the carrying out of the purposes for which the organization was granted exemption, the income derived therefrom should not be taxed as unrelated business income. The activities performed by the organization in the instant case, the sponsorship of championship tournaments, the sale of publications relating to rules, etc., are considered to be a means whereby the primary purpose of the organization is achieved. They are directly related to

the purpose for which the organization was granted exemption. The grant of radio and television rights is considered to be incidental to the purposes for which the organization was granted exemption and the income derived therefrom is not disproportionate in amount when compared with the size and extent of its tax-exempt activities.

In view of the foregoing, it is held that income derived from the operation of championship tournaments, the sale of publications relating to rules, etc., and the grant of radio and television broadcasting rights by an association formed to promote and conserve the best interests of a game and which has been held to be exempt from Federal income tax under section 501 (c) (6) of the Code, is considered not to be subject to the unrelated business income tax imposed by section 511 of the Code.

Income derived by a trust from operation of orchards and farms by employees of a charitable trust and tenants under a lease. See Rev. Rul. 58–482, below.

SECTION 512.—UNRELATED BUSINESS TAXABLE INCOME

26 CFR 1.512(a): Statutory provisions; unrelated business taxable income; definition.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

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26 CFR 1.512(a)–1: Definition; general rule.

Income derived by a trust from operation of orchards and farms by employees of a charitable trust and tenants under a lease. See Rev. Rul. 58–482, below.

Income derived from the operation of championship tournaments, radio and television rights, and the sale of rule books. See Rev. Rul. 58–502, page 271.

SECTION 513.—UNRELATED TRADE OR BUSINESS

26 CFR 1.513: Statutory provisions; unrelated trade or business.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

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26 CFR 1.513–1: Definition of unrelated trade or business. Rev. Rul. 58–482

(Also Sections 511, 512; 1.511–1, 1.512(a)–1.)

The operation of orchards and farms by the employees of a charitable trust under the supervision of the trustees is a profit-making enterprise not related to the charitable purposes of the trust and,

therefore, constitutes an unrelated trade or business within the meaning of section 513 of the Internal Revenue Code of 1954. The income derived therefrom is taxable as unrelated business taxable income as defined in section 512 of the Code. However, farm income derived by the trust from a tenant under a lease, under the terms of which the trust is neither a joint venture nor a partner, is not unrelated business taxable income within the meaning of section 512 of the Code.

Advice has been requested whether the operation of orchards and farms by employees of a charitable trust under the circumstances set forth below constitutes an unrelated trade or business within the purview of section 513 of the Internal Revenue Code of 1954.

Under the last will and testament of the testator, his residuary estate was left to certain trustees to be administered as a charitable trust to provide for and protect the various stipulated charitable bequests therein. Included among the trust properties are farms and orchards.

One portion of the orchards and farms is operated by employees of the trust, under direct supervision of the trustees. Their work consists of harvesting crops raised on the land and storing, marketing, and processing juices and preserves derived from such crops. The remaining portion of the orchards and farms has been leased by the trust to a tenant who plants the crops and cares for and harvests them. The trust receives a share of the gross products raised by the tenant. All operating expenses with respect to this portion of the orchards and farms are borne by the tenant. The tenant occupies this property under the terms of a lease which gives him exclusive possession of the property and under which the trust is neither a joint venture nor a partner.

Section 511 of the Internal Revenue Code of 1954 imposes a tax on the unrelated business taxable income of certain organizations, otherwise exempt from tax under section 501(c)(3), that are engaged in an unrelated trade or business. The term "unrelated business taxable income" as defined in section 512 of the Code means, with certain exceptions, additions and limitations, the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business. Section 512 provides specifically that the term "unrelated business taxable income" does not include rents from real property. Section 513 of the 1954 Code defines the term "unrelated trade or business," in the case of any organization subject to the tax imposed by section 511 of the Code, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 of the Code.

In the instant case, it is apparent that the farms and orchards operated by the estate, although they constitute a part of the property received in the original inventory of the trust, are operated as profit-making enterprises in the same manner as a commercial operation and are not considered related to the charitable purpose of the trust other than through the use made of the profits derived therefrom. See Rev. Rul. 55-676, C. B. 1955-2,266.

Accordingly, it is held that the operation of the orchard and farms by the employees under the supervision of the trustees of the trust is a profit-making enterprise which constitutes an unrelated trade or business as defined in section 513. The income derived therefrom is taxable as unrelated business taxable income under section 511 of the Code. It is further held that the proceeds derived by the trust from the lease constitute rents and are not unrelated business taxable income within the meaning of section 512 of the Code.

Operation of championship tournaments, the grant of radio and television broadcasting rights, and the sale of rule books. See Rev. Rul. 58–502, page 271.

SECTION 514.—BUSINESS LEASES

26 CFR 1.514(a): Statutory provisions; business leases; business lease rents and deductions.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

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26 CFR 1.514(b)–1: Definition of business lease. Rev. Rul. 58–547

A lease, the parties to which are both exempt from tax under section 501(c)(3) of the Internal Revenue Code of 1954 and which otherwise constitutes a business lease within the meaning of section 514 of the Code, will not be considered as substantially related to the charitable, educational, etc., purposes of the lessor solely because the lessee is likewise an exempt organization.

Advice has been requested whether a lease between a charitable foundation as lessor and a nursery school as lessee, both exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, will come within the exception to the definition of the term "business lease" provided for in section 514(b)(3)(A)(i) of the Code, notwithstanding that the lease would otherwise constitute a business lease within the meaning of section 514 of the Code.

The foundation, in the instant case, built a school building according to the designs requested by the nursery school. Upon its completion the building was leased for a period of ten years to the nursery school at a certain stipulated monthly rental. At the close of the current taxable year, there was a balance due on a construction loan obtained by the foundation for completion of the school building.

Section 511(a) of the Code imposes a tax on unrelated business taxable income of certain charitable, etc., organizations, otherwise exempt from tax under section 501(c)(3) of the Code. Such unrelated business taxable income includes income from a business lease as defined in section 514 of the Code.

Unrelated business taxable income, as defined by section 512(a) of the Code, means the gross income derived by any organization

from any unrelated trade or business carried on by it, less the allowed deductions which are directly connected with such trade or business, both computed with certain exceptions, additions, and limitations.

With certain exceptions, section 513(a) of the Code defines the term "unrelated trade or business" as meaning, in the case of any organization subject to tax under section 511 of the Code, any trade or business the conduct of which is not substantially related to the exercise by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 of the Code.

Section 514 of the Code states that the term "business lease" means a lease of real property for a term of more than five years by an organization if, at the close of the lessor's taxable year, there is a business lease indebtedness with respect to such real property. A business lease indebtedness is defined, with respect to any real property leased for a term of more than five years, as the unpaid amount of (1) the indebtedness incurred by the lessor in acquiring or improving such property; (2) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and (3) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

However, section 514(b)(3)(A)(i) provides that a lease shall not be considered a business lease if it is entered into primarily for purposes which are substantially related (aside from the need or use made of the rentals derived) to the exercise or performance of the charitable, educational, or other purpose or function constituting the basis for exemption of the lessor organization.

The lease of property under ordinary commercial arrangements does not constitute the exercise of an educational or charitable function in and of itself. Only when it is shown that the lease is for purposes substantially related to the exempt functions of the lessor does the above exception apply. The fact that the lessee may be an exempt educational organization does not cause the rental of space thereto to become a related activity on the part of the lessor who may be organized in part for educational purposes.

Therefore, the lease entered into between the exempt organization and the nursery school for a period of ten years, with respect to which there is a business lease indebtedness, is a business lease within the meaning of section 514(b)(1) of the Code for each year at the close of which an unpaid amount of the indebtedness incurred exists.

Accordingly, it is held that a lease, the parties to which are both exempt from tax under section 501(c)(3) of the Internal Revenue Code of 1954 and which otherwise constitutes a business lease within the meaning of section 514 of the Code, will not be considered as substantially related to the charitable, educational, etc., purposes of the lessor solely because the lessee is likewise an exempt organization.

PART III.—FARMERS' COOPERATIVES

SECTION 521.—EXEMPTION OF FARMERS' COOPERATIVES FROM TAX

26 CFR 1.521: Statutory provisions; exemption of farmers' cooperatives from tax.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

26 CFR 1.521–1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521. Rev. Rul. 58–483

Where a feed dealer furnishes poultry to a grower and the grower agrees to properly feed and care for the poultry and to turn it over to the dealer for marketing through a farmers' cooperative association, both the feed dealer and the grower are patrons of the cooperative association and they qualify as producers for purposes of section 521 of the Internal Revenue Code of 1954 to the extent of their respective interests in the poultry marketed. Such course of dealing will not of itself affect the cooperative association's status as an organization exempt from Federal income taxation under section 521 of the Code, provided that its activities otherwise conform to the requirements for exemption specified in that section.

Advice has been requested whether a farmers' cooperative association, by marketing poultry supplied by feed dealers in the circumstances described below, will thereby affect its status as an organization exempt from Federal income taxation under section 521 of the Internal Revenue Code of 1954.

The cooperative association was incorporated for the purpose of processing and marketing poultry for members and other producers on a cooperative basis. It deals with all patrons on the same basis with respect to charges for services and payment of patronage dividends. It markets a considerable amount of poultry for feed dealers which is raised by poultry growers (farmers) in the area.

Pursuant to written or oral contract, the feed dealers furnish poultry to growers. The growers agree to properly feed and care for the poultry so supplied. The feed dealers also supply the growers with all fuel, feeds, medicines, and other necessary supplies, the cost of which is deducted from the price received from the sale of the poultry. After deduction of the cost of the supplies, the net profit from the poultry sales is divided between the feed dealers and the growers.

Although the feed dealers, rather than the growers, normally enter into the marketing agreements with the cooperative association concerning poultry grown in the instant circumstances, all patronage dividends with respect thereto, with the dealers' consents, are credited to the account of the growers involved. Since the dealers generally give such consent and since the cooperative association's bylaws pro-

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vide that any patron who has accumulated sufficient credits of patronage dividends to pay for a share of common stock may become a member, most of the growers are members of such cooperative association. Furthermore, most of the feed dealers are also members thereof.

Section 521 of the Code provides, in part, for the exemption from Federal income taxation of farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of marketing the products of members or other producers and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of either the quantity or the value of the products furnished by them.

In determining whether the cooperative association is fulfilling the requirements specified in section 521 of the Code so that it may maintain its exemption, it is necessary to ascertain whether the feed dealers qualify as producers and patrons to the extent of their interest in the poultry marketed in the situation referred to and whether the growers so qualify.

Under the terms of the contracts between the feed dealers and the growers, it appears that the parties are tenants in common with respect to the poultry involved, so that each has an undivided interest in such poultry subject to his control. Compare *Underhill* v. *Allis-Chalmers Mfg. Co.* 15 Fed. (2d) 181; *Minneapolis Iron Store Company* v. *William Branum*, 162 N. W. 543; *Dickey* v. *Waldo*, 56 N. W. 608. Since each grower has a property right in such poultry, each feed dealer, in marketing it, acts as agent for the grower to the extent of the grower's interest therein. Accordingly, it is clear that to the extent of the grower's interest in the poultry marketed, he is a producer for purposes of section 521 of the Code and a patron of the cooperative association. It is equally clear that each feed dealer is a patron in his own right as to his interest in the poultry which he markets and that the feed dealer is a producer for purposes of the cited Code section. Compare *Farmers Co-operative Creamery* v. *Commissioner*, 21 B. T. A. 265, nonacquiescence published in C. B. X-2, 86 (1931), withdrawn for the year 1925 and acquiescence substituted therefor for that year only, C. B. 1957-2, 4.

Accordingly, it is concluded that the feed dealers in question qualify as producers and patrons of the instant cooperative to the extent of their interest in the poultry marketed through the cooperative. Therefore, it is held that the marketing of poultry for the feed dealers will not affect the cooperative's exempt status, provided it continues to meet the requirements for exemption prescribed by section 521 of the Internal Revenue Code of 1954.

SECTION 522.—TAX ON FARMERS' COOPERATIVES

26 CFR 1.522: Statutory provisions; tax on farmers' cooperatives.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

SUBCHAPTER G.—CORPORATIONS USED TO AVOID INCOME TAX ON SHAREHOLDERS

PART II.—PERSONAL HOLDING COMPANIES

SECTION 541.—IMPOSITION OF PERSONAL HOLDING COMPANY TAX

26 CFR 1.541: Statutory provisions: imposition of personal holding company tax. (Also Sections 551, 561; 1.551, 1.561.) T. D. 6308 [1]

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

Regulations prescribed under parts II, III, and IV of subchapter G of chapter I 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 November 16, 1956, notice of proposed rule making regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954 (except as otherwise provided) under parts II, III, and IV of subchapter G of chapter 1 of the Internal Revenue Code of 1954, was published in the Federal Register (21 F. R. 8920). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, regulations are hereby adopted. The regulations supersede paragraphs 11, 12, and 13 of Treasury Decision 6118 (Temporary Rules (26 CFR 1954)), approved December 30, 1954 [C. B. 1955–1, 698].

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[1] The publication of this Treasury Decision in 23 F. R. 6976, dated September 10, 1958, contains (1) instructions for modifying the notice of proposed rulemaking published in 21 F. R. 8920, dated November 16, 1956, 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.

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AUTHORITY: §§ 1.541 to 1.565–6, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

PERSONAL HOLDING COMPANIES

§ 1.541 STATUTORY PROVISIONS; IMPOSITION OF PERSONAL HOLDING COMPANY TAX.

SEC. 541. IMPOSITION OF PERSONAL HOLDING COMPANY TAX.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the undistributed personal holding company income (as defined in section 545) of every personal holding company (as defined in section 542) a personal holding company tax equal to the sum of—

(1) 75 percent of the undistributed personal holding company income not in excess of $2,000, plus

(2) 85 percent of the undistributed personal holding company income in excess of $2.000.

§ 1.541–1 IMPOSITION OF TAX.—(a) Section 541 imposes a graduated tax upon corporations classified as personal holding companies under section 542. This tax, if applicable, is in addition to the tax imposed upon corporations generally under section 11. Unless specifically excepted under section 542(c) the tax applies to domestic and foreign corporations and, to the extent provided by section 542(b), to an affiliated group of corporations filing a consolidated return. Corporations classified as personal holding companies are exempt from the accumulated earnings tax imposed under section 531 but are not exempt from other income taxes imposed upon corporations, generally, under any other provisions of the Code. Unlike the accumulated earnings tax imposed under section 531, the personal holding company tax imposed by section 541 applies to all personal holding companies as defined in section 542, whether or not they were formed or availed of to avoid income tax upon shareholders. See section 6501(f) and § 301.6501(f)–1 of the Regulations on Procedure and Administration (Part 301 of this chapter) with respect to the period of limitation on assessment of personal holding company tax upon failure to file a schedule of personal holding company income.

(b) A foreign corporation, whether resident or nonresident, which is classified as a personal holding company is subject to the tax imposed under section 541 with respect to its income from sources within the United States, even though such income is not fixed or determinable annual or periodical income specified in section 881. A foreign corporation is not classified as a personal holding company subject to tax under section 541 if it is a foreign personal holding company as defined in section 552 or if it meets the requirements of the exception provided in section 542(c)(10).

§ 1.542 Statutory Provisions; Definition of Personal Holding Company.

SEC. 542. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) General Rule.—For purposes of this subtitle, the term "personal holding company" means any corporation (other than a corporation described in subsection (c)) if—

(1) Gross income requirement.—At least 80 percent of its gross income for the taxable year is personal holding company income as defined in section 543, and

(2) Stock ownership requirement.—At any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals. For purposes of this paragraph, an organization described in section 503(b) or a portion of a trust permanently set aside or to be used exclusively for the purposes described in section 642(c) or a corresponding provision of a prior income tax law shall be considered an individual. The preceding sentence shall not apply in the case of an organization or trust organized or created before July 1, 1950, if at all times on or after July 1, 1950, and before the close of the taxable year such organization or trust has owned all of the common stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation, but only if such organization or trust is not denied exemption under section 504 or an unlimited charitable deduction is not denied under section 681(c) and, for this purpose—

(A) All income of the corporation which is available for distribution as dividends to its shareholders at the close of any taxable year shall be deemed to have been distributed at the close of such year whether or not any portion of such income was in fact distributed; and

(B) Section 504(a)(1) and section 681(c)(1) shall also not apply to income attributable to property of a decedent dying before January 1, 1951, which was transferred during his lifetime to a trust or property that was transferred under his will to such trust.

(b) Corporations Filing Consolidated Returns.—

(1) General rule.—In the case of an affiliated group of corporations filing or required to file a consolidated return under section 1501 for any taxable year, the gross income requirement of subsection (a)(1) of this section shall, except as provided in paragraphs (2) and (3) be applied for such year with respect to the consolidated gross income and the consolidated personal holding company income of the affiliated group. No member of such an affiliated group shall be considered to meet such gross income requirement unless the affiliated group meets such requirement.

(2) Ineligible affiliated group.—Paragraph (1) shall not apply to an affiliated group of corporations, other than an affiliated group of railroad corporations the common parent of which would be eligible to file a consolidated return under section 141 of the Internal Revenue Code of 1939 prior to its amendment by the Revenue Act of 1942, if—

(A) Any member of the affiliated group of corporations (including the common parent corporation) derived 10 percent or more of its gross income for the taxable year from sources outside the affiliated group, and

(B) 80 percent or more of the amount described in subparagraph (A) consists of personal holding company income (as defined in section 543).

For purposes of this paragraph, section 543 shall be applied as if the amount described in subparagraph (A) were the gross income of the corporation.

(3) Excluded corporations.—Paragraph (1) shall not apply to an affiliated group of corporations if any member of the affiliated group (including the common parent corporation) is a corporation

excluded from the definition of personal holding company under subsection (c).

(4) CERTAIN DIVIDEND INCOME RECEIVED BY A COMMON PARENT.—In applying paragraph (2)(A) and (B), personal holding company income and gross income shall not include dividends received by a common parent corporation from another corporation if—

(A) The common parent corporation owns, directly or indirectly, more than 50 percent of the outstanding voting stock of such other corporation, and

(B) Such other corporation is not a personal holding company for the taxable year in which the dividends are paid.

(c) EXCEPTIONS.—The term "personal holding company" as defined in subsection (a) does not include—

(1) A corporation exempt from tax under subchapter F (sec. 501 and following);

(2) A bank as defined in section 581;

(3) A life insurance company;

(4) A surety company;

(5) A foreign personal holding company as defined in section 552;

(6) A licensed personal finance company under State supervision, 80 percent or more of the gross income of which is lawful interest received from loans made to individuals in accordance with the provisions of applicable State law if at least 60 percent of such gross income is lawful interest—

(A) Received from individuals each of whose indebtedness to such company did not at any time during the taxable year exceed in principal amount the limit prescribed for small loans by such law (or, if there is no such limit, $500), and

(B) Not payable in advance or compounded and computed only on unpaid balances, and if the loans to a person, who is a shareholder in such company during the taxable year by or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by the members of his family as defined in section 544(a)(2)), outstanding at any time during such year do not exceed $5,000 in principal amount;

(7) A lending company, not otherwise excepted by this subsection, authorized to engage in the small loan business under one or more State statutes, providing for the direct regulation of such business, 80 percent or more of the gross income of which is lawful interest, discount or other authorized charges—

(A) Received from loans maturing in not more than 36 months made to individuals in accordance with the provisions of applicable State law, and

(B) Which do not, in the case of any individual loan, exceed in the aggregate an amount equal to simple interest at the rate of 3 percent per month not payable in advance and computed only on unpaid balances, if at least 60 percent of the gross income is lawful interest, discount or other authorized charges received from individuals each of whose indebtedness to such company did not at any time during the taxable year exceed in principal amount the limit prescribed for small loans by such law (or, if there is no such limit, $500), and if the deductions allowed to such company under section 162 (relating to trade or business expenses), other than for compensation for personal services rendered by shareholders (including members of the shareholder's family as described in section 544(a)(2)) constitute 15 percent or more of its gross income, and the loans to a person, who is a shareholder in such company during the taxable year by or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by the members of his family as defined in section 544(a)(2)), outstanding at any time during such year do not exceed $5,000 in principal amount;

(8) A loan or investment corporation, a substantial part of the business of which consists of receiving funds not subject to check

and evidenced by installment or fully paid certificates of indebtedness or investment, and making loans and discounts, and the loans to a person who is a shareholder in such corporation during such taxable year by or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by the members of his family as defined in section 544(a)(2)) outstanding at any time during such year do not exceed $5,000 in principal amount;

(9) A finance company, actively and regularly engaged in the business of purchasing or discounting accounts or notes receivable or installment obligations, or making loans secured by any of the foregoing or by tangible personal property, at least 80 percent of the gross income of which is derived from such business in accordance with the provisions of applicable State law or does not constitute personal holding company income as defined in section 543, if 60 percent of the gross income is derived from one or more of the following classes of transactions—

(A) Purchasing or discounting accounts or notes receivable, or installment obligations evidenced or secured by contracts of conditional sale, chattel mortgages, or chattel lease agreements, arising out of the sale of goods or services in the course of the transferor's trade or business;

(B) Making loans, maturing in not more than 36 months, to, and for the business purposes of, persons engaged in trade or business, secured by—

(i) Accounts or notes receivable, or installment obligations, described in subparagraph (A);

(ii) Warehouse receipts, bills of lading, trust receipts, chattel mortgages, bailments, or factor's liens, covering or evidencing the borrower's inventories;

(iii) A chattel mortgage on property used in the borrower's trade or business;

except loans to any single borrower which for more than 90 days in the taxable year of the company exceed 15 percent of the average funds employed by the company during such taxable year;

(C) Making loans, in accordance with the provisions of applicable State law, secured by chattel mortgages on tangible personal property, the original amount of each of which is not less than the limit referred to in, or prescribed by, paragraph (6)(A), and the aggregate principal amount of which owing by any one borrower to the company at any time during the taxable year of the company does not exceed $5,000; and

(D) If 30 percent or more of the gross income of the company is derived from one or more of the classes of transactions described in subparagraphs (A), (B), and (C), purchasing, discounting, or lending upon the security of, installment obligations of individuals where the transferor or borrower acquired such obligations either in transactions of the classes described in subparagraphs (A) and (C) or as a result of loans made by such transferor or borrower in accordance with the provisions of subparagraphs (A) and (B) of paragraph (6) or of subparagraphs (A) and (B) of paragraph (7) of this subsection, if the funds so supplied at all times bear an agreed ratio to the unpaid balance of the assigned installment obligations, and documents evidencing such obligations are held by the company;

provided that the deductions allowable under section 162 (relating to trade or business expenses), other than compensation for personal services rendered by shareholders (including members of the shareholders family as described in section 544(a)(2)), constitute 15 percent or more of the gross income, and that loans to a person who is a shareholder in such company during such taxable year or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by members of his family as defined in section 544(a)(2)), out-

standing at any time during such year do not exceed $5,000 in principal amount;

(10) A foreign corporation if—

(A) Its gross income from sources within the United States for the period specified in section 861(a)(2)(B) is less than 50 percent of its total gross income from all sources, and

(B) All of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals whether directly or indirectly through other foreign corporations.

[Sec. 542 as amended by sec. 3, Pub. Law 385 (84th Cong.). Sec. 3, Pub. Law 385, added the last sentence of sec. 542 (a) (2), effective with respect to taxable years beginning after December 31, 1954]

§ 1.542–1 GENERAL RULE.—A personal holding company is any corporation (other than one specifically excepted under section 542(c)) which, for the taxable year, meets—

(a) The gross income requirement specified in section 542(a)(1) and § 1.542–2, and

(b) The stock ownership requirement specified in section 542 (a)(2) and § 1.542–3.

Both requirements must be satisfied with respect to each taxable year.

§ 1.542–2 GROSS INCOME REQUIREMENT.—To meet the gross income requirement it is necessary that at least 80 percent of the total gross income of the corporation for the taxable year be personal holding company income as defined in section 543 and §§ 1.53–1 and 1.543–2. For the definition of "gross income" see section 61 and §§ 1.61–1 through 1.61–14. Under such provisions gross income is not necessarily synonymous with gross receipts. Further, in the case of transactions in stocks and securities and in commodities transactions, gross income for personal holding company tax purposes shall include only the excess of gains over losses from such transactions. See section 543(b), paragraph (b)(5) and (6) of § 1.543–1, and § 1.543–2.

§ 1.542–3 STOCK OWNERSHIP REQUIREMENT.—(a) *General rule.*—To meet the stock ownership requirement, it is necessary that at sometime during the last half of the taxable year more than 50 percent in value of the outstanding stock of the corporation be owned, directly or indirectly, by or for not more than 5 individuals. Any organization or trust to which subparagraph (1) of this paragraph applies shall be considered as one individual for purposes of this stock ownership requirement subject, however, to the exception in subparagraph (2) which is applicable only to taxable years beginning after December 31, 1954. Thus, if an organization or trust which is considered as an individual, owns 51 percent in value of the outstanding stock of the corporation at any time during the last half of the taxable year, the stock ownership requirement will be met by ownership of the required percentage by one individual. See section 544 and § 1.544–1 through § 1.544–7 for the determination of stock ownership.

(1) AN ORGANIZATION OR TRUST CONSIDERED AS AN INDIVIDUAL.—Any of the following organizations or trusts shall be considered as an individual:

(i) An organization to which section 503 applies, namely, any organization described in section 501(c)(3) (relating to charitable, etc., organizations) or section 401(a) (relating to employees' pension trust, etc.) other than an organization excepted from the application of sec-

tion 503 by paragraphs (1) to (5) of section 503(b). Therefore, a religious organization (other than a trust) excepted under section 503(b)(1) is not considered an individual for purposes of the stock ownership requirement of section 542(a)(2).

(ii) A portion of a trust permanently set aside or to be used exclusively for the purposes described in section 642(c), relating to amounts set aside for charitable purposes, or described in a corresponding provision of the prior income tax law (such as section 162(a), Internal Revenue Code of 1939).

(2) *Exception.* For taxable years beginning after December 31, 1954, an organization or trust to which subparagraph (1) applies shall not be considered an individual if all of the following conditions are met:

(i) It was organized or created before July 1, 1950,

(ii) At all times on or after July 1, 1950, and before the close of the taxable year, it owned all of the common stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation, and

(iii) (*a*) For the taxable year it is not denied exemption under section 504(a) or the unlimited charitable deduction under section 681(c). In determining whether, for the purpose of section 542(a)(2), exemption is not denied under section 504(a) or the unlimited charitable deduction is not denied under section 681(c) all the income of the corporation which is available for distribution as dividends to its shareholders shall be deemed to have been distributed at the close of the taxable year whether or not any portion of such income was in fact distributed. If the amounts described in section 504(a) or section 681(c), increased by the income of the corporation deemed distributed pursuant to the preceding sentence, would be sufficient to deny exemption or the unlimited charitable deduction, the organization or trust will be considered to be an individual for the purpose of section 542(a)(2). For the purpose of this subdivision the restrictions in sections 504(a)(1) and 681(c)(1) against unreasonable accumulations will not apply to income attributable to property of a decedent dying before January 1, 1951, which was transferred during his lifetime to a trust or property that was transferred under his will to such trust.

(*b*) *Example.* This subparagraph is illustrated by the following example. The X Charitable Foundation (an organization described in section 501(c)(3) to which section 503 is applicable) has owned all of the stock of the Y Corporation since Y's organization in 1949. Both X and Y are calendar year corporations. At the end of the year 1955, X has accumulated $100,000 out of income and has actually paid out only $75,000 of this amount, leaving a balance of $25,000 on December 31, 1955. X was not denied an exemption under section 504(a) for the year 1955. Y, during the calendar year 1955, has $400,000 taxable income of which $200,000 is available for distribution as dividends at the end of the year. X will be considered to have accumulated out of income during the calendar year 1955 the amount of $225,000 for the purpose of determining whether it would have been denied an exemption under section 504(a)(1). If X would have been denied an exemption under section 504(a)(1) by reason of having been deemed to have accumulated $225,000, the

stock ownership requirement of section 542(a)(2) and this section will have been satisfied. If Y Corporation also satisfies the gross income requirement of section 542(a)(1) and § 1.542–2 it will be a personal holding company.

(b) *Changes in stock outstanding.*—It is necessary to consider any change in the stock outstanding during the last half of the taxable year, whether in the number of shares or classes of stock, or in the ownership thereof. Stock subscribed and paid for will be considered as stock outstanding, whether or not such stock is evidenced by issued certificates. Treasury stock shall not be considered as stock outstanding.

(c) *Value of stock outstanding.*—The value of the stock outstanding shall be determined in the light of all the circumstances. The value may be determined upon the basis of the company's net worth, earning and dividend paying capacity, appreciation of assets, together with such other factors as have a bearing upon the value of the stock. If the value of the stock is greatly at variance with that reflected by the corporate books, the evidence of such value should be filed with the return. In any case where there are two or more classes of stock outstanding, the total value of all the stock should be allocated among the different classes according to the relative value of each class.

(d) *Applicability of rules.*—The rules stated in this section are equally applicable in determining the stock ownership requirement specified in section 543(a)(5), relating to personal service contracts, and in section 543(a)(6), relating to the use of corporation property by a shareholder. The stock ownership requirement specified in these sections relates, however, to the stock outstanding at any time during the entire taxable year and not merely during the last half thereof.

§ 1.542–4 Corporations Filing Consolidated Returns.—(a) *General rule.*—A consolidated return under section 1501 shall determine the application of the personal holding company tax to the group and to any member thereof on the basis of the consolidated gross income and consolidated personal holding company income of the group, as determined under the regulations prescribed pursuant to section 1502 (relating to consolidated returns); however, this rule shall not apply to either (1) an ineligible affiliated group as defined in section 542(b)(2) and paragraph (b) of this section, or (2) an affiliated group of corporations a member of which is excluded from the definition of a personal holding company under section 542(c) and paragraph (c) of this section. Thus, in the latter two instances the gross income requirement provided in section 542(a)(1) and § 1.542–2 shall apply to each individual member of the affiliated group of corporations.

(b) *Ineligible affiliated group.*—(1) Except for certain affiliated railroad corporations, as provided in subparagraph (2) of this paragraph, an affiliated group of corporations is an ineligible affiliated group and therefore may not use its consolidated gross income and consolidated personal holding company income to determine the liability of the group or any member thereof for personal holding company tax (as provided in paragraph (a) of this section), if (i) any member of such group, including the common parent, derived gross

income from sources outside the affiliated group for the taxable year in an amount equal to 10 percent or more of its gross income from all sources for that year and (ii) 80 percent or more of the gross income from sources outside the affiliated groups consists of personal holding company income as defined in section 543 and §§ 1.543–1 and 1.543–2. For purposes of subdivision (i) of this subparagraph gross income shall not include certain dividend income received by a common parent from a corporation not a member of the affiliated group which qualifies under section 542(b)(4) and paragraph (d) of this section. See particularly the examples contained in paragraph (d)(2) of this section. Intercorporate dividends received by members of the affiliated group (including the common parent) are to be included in the gross income from all sources for purposes of the test in subdivision (i) of this subparagraph. For purposes of subdivision (ii) of this subparagraph, section 543 and § 1.543–1(a) shall be applied as if the amount of gross income derived from sources outside the affiliated group by a corporation which is a member of such group is the gross income of such corporation.

(2) An affiliated group of railroad corporations shall not be considered to be an ineligible affiliated group, notwithstanding any other provisions of section 542(b)(2) and this paragraph, if the common parent of such group would be eligible to file a consolidated return under section 141 of the Internal Revenue Code of 1939 prior to its amendment by the Revenue Act of 1942.

(3) See section 562(d) and § 1.562–3 for dividends paid deductions in the case of a distribution by a member of an ineligible affiliated group.

(4) The determination of whether an affiliated group of corporations is an ineligible group under section 542(b)(2) and this paragraph, may be illustrated by the following examples:

Example (1). Corporations X, Y, and Z constitute an affiliated group of corporations which files a consolidated return for the calendar year 1954; Corporations Y and Z are wholly-owned subsidiaries of Corporation X and derive no gross income from sources outside the affiliated group; Corporation X, the common parent, has gross income in the amount of $250,000 for the taxable year 1954. $200,000 of such gross income consists of dividends received from Corporations Y and Z. The remaining $50,000 was derived from sources outside the affiliated group, $40,000 of which represents personal holding company income as defined in section 543. The $50,000 included in the gross income of Corporation X and derived from sources outside the affiliated group is more than 10 percent of X's gross income ($50,000/250,000) and the $40,000 which represents personal holding company income is 80 percent of $50,000 (the amount considered to be the gross income of CorporationX). Accordingly, Corporations X, Y, and Z would be an ineligible affiliated group and the gross income requirement under section 542(a)(1) and § 1.542–2 would be applied to each corporation individually.

Example (2). If, in the above example, only $30,000 of the $50,000 derived from sources outside the affiliated group by Corporation X represented personal holding company income, this group of affiliated corporations would not be an ineligible affiliated group. Although

the $50,000 representing the gross income of Corporation X from sources outside the affiliated group is more than 10 percent of its total gross income, the amount of $30,000 representing personal holding company income is not 80 percent or more of the amount considered to be gross income for the purpose of this test. Under section 542(b)(2) and subparagraph (1) of this paragraph both the gross income and the personal holding company income requirements must be satisfied in determining that an affiliated group constitutes an ineligible group. Since both of these requirements have not been satisfied in this example this group of affiliated corporations would not be an ineligible group.

(c) *Excluded corporations.*—The general rule for determining liability of an affiliated group under paragraph (a) of this section shall not apply if any member thereof is a corporation which is excluded under section 542(c), from the definition of a personal holding company.

(d) *Certain dividend income received by a common parent.*—(1) Dividends received by the common parent of an affiliated group from a corporation which is not a member of the affiliated group shall not be included in gross income or personal holding company income, for the purpose of the test under section 542(b)(2), (i) if such common parent owned, directly or indirectly, more than 50 percent of the outstanding voting stock of the dividend paying corporation at the time such common parent became entitled to the dividend and (ii) if the dividend paying corporation is not a personal holding company for the taxable year in which the dividends are paid. Thus, if the tests in subdivision (i) and (ii) of this subparagraph are met, the dividend income received by the common parent from such other corporation will not be considered gross income for purposes of the test in section 542(b)(2)(A) (paragraph (b) of this section), that is, either to determine gross income from sources outside the affiliated group or to determine gross income from all sources.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). Corporation X is the common parent of Corporation Y and Corporation Z and together they constitute an affiliated group which files a consolidated return under section 1501. Corporation Y and Corporation Z derived no income from sources outside the affiliated group. Corporation X, the common parent, had gross income of $100,000 for the calendar year 1954 of which amount $20,000 represented a dividend received from Corporation W, and $4,000 represented interest from Corporation T. The remaining gross income of X, $76,000, was received from Corporations Y and Z. Corporation X, for its entire taxable year, owned 60 percent of the voting stock of Corporation W which was not a personal holding company for the calendar year 1954. For the purpose of the gross income and personal holding company income test under section 542(b)(2) and paragraph (b) of this section, the $20,000 dividend received from Corporation W would not be included in the gross income or personal holding company income of Corporation X. The affiliated group would not be an ineligible group under section 542(b)(2) because 10 percent or more of its gross income was not from sources outside the affiliated group as required by section 542(b)(2)(A). Inasmuch as the $20,000 divi-

dend from Corporation W is not included in the gross income of Corporation X for purposes of section 542(b)(2) Corporation X only has $4,000 gross income from sources outside the affiliated group which is only 5 percent of its gross income from all sources, $80,000.

Example (2). If, in example (1), Corporation X owned 50 percent or less of the voting stock of Corporation W at the time X became entitled to the dividend, or if Corporation W had been a personal holding company for the taxable year in which the dividends were paid, the $20,000 dividends received by Corporation X would be included in gross income and personal holding company income of Corporation X for the purpose of the test under section 542(b)(2) and paragraph (b) of this section. Thus, the affiliated group would be an ineligible affiliated group under section 542(b)(2) because 24 percent of its gross income was from sources outside the affiliated group ($24,000/$100,000) and 100 percent of this $24,000 was personal holding company income.

§ 1.543 STATUTORY PROVISIONS; DEFINITION OF PERSONAL HOLDING COMPANY INCOME.

SEC. 543. PERSONAL HOLDING COMPANY INCOME.

(a) GENERAL RULE.—For purposes of this subtitle, the term "personal holding company income" means the portion of the gross income which consists of:

(1) DIVIDENDS, ETC.—Dividends, interest, royalties (other than mineral, oil, or gas royalties), and annuities. This paragraph shall not apply to interest constituting rent as defined in paragraph (7) or to interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act, 1936.

(2) STOCK AND SECURITIES TRANSACTIONS.—Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

(3) COMMODITIES TRANSACTIONS.—Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This paragraph shall not apply to gains by a producer, processor, merchant, or handler of the commodity which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others.

(4) ESTATES AND TRUSTS.—Amounts includible in computing the taxable income of the corporation under part I of subchapter J, (sec. 641 and following, relating to estates, trusts, and beneficiaries); and gains from the sale or other disposition of any interest in an estate or trust.

(5) PERSONAL SERVICE CONTRACTS.—

(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

(B) Amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(6) USE OF CORPORATION PROPERTY BY SHAREHOLDER.—Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the cor-

poration in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has personal holding company income for the taxable year, computed without regard to this paragraph and paragraph (7), in excess of 10 percent of its gross income.

(7) RENTS.—Rents, unless constituting 50 percent or more of the gross income. For purposes of this paragraph, the term "rents" means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but does not include amounts constituting personal holding company income under paragraph (6).

(8) MINERAL, OIL, OR GAS ROYALTIES.—Mineral, oil, or gas royalties, unless—

(A) Such royalties constitute 50 percent or more of the gross income, and

(B) The deductions allowable under section 162 (relating to trade or business expenses) other than compensation for personal services rendered by the shareholders, constitute 15 percent or more of the gross income.

(b) LIMITATION ON GROSS INCOME IN CERTAIN TRANSACTIONS.—For purposes of this part—

(1) Gross income and personal holding company income determined with respect to transactions described in section 543(a)(2) (relating to gains from stock and security transactions) shall include only the excess of gains over losses from such transactions, and

(2) Gross income and personal holding company income determined with respect to transactions described in section 543(a)(3) (relating to gains from commodity transactions) shall include only the excess of gains over losses from such transactions.

(c) GROSS INCOME OF INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.—In the case of an insurance company other than life or mutual, the term "gross income" as used in this part means the gross income, as defined in section 832(b)(1), increased by the amount of losses incurred, as defined in section 832(b)(5), and the amount of expenses incurred, as defined in section 832(b)(6), and decreased by the amount deductible under section 832(c)(7) (relating to tax-free interest).

§ 1.543–1 PERSONAL HOLDING COMPANY INCOME.—(a) *General rule.*—The term "personal holding company income" means the portion of the gross income which consists of the classes of gross income described in paragraph (b) of this section. See section 543(b) and § 1.543–2 for special limitations on gross income and personal holding company income in cases of gains from stocks', securities', and commodities' transactions.

(b) *Definitions.*—(1) *Dividends.*—The term "dividends" includes dividends as defined in section 316 and amounts required to be included in gross income under section 551 and §§ 1.551–1—1.551–2 (relating to foreign personal holding company income taxed to United States shareholders).

(2) *Interest.*—The term "interest" means any amounts, includible in gross income, received for the use of money loaned. However, (i) interest which constitutes "rent" shall not be classified as interest but shall be classified as "rents" (see subparagraph (10) of this paragraph) and (ii) interest on amounts set aside in a reserve fund under

section 511 or 607 of the Merchant Marine Act, 1936 (46 U. S. C. 1161 or 1177), shall not be included in personal holding company income.

(3) *Royalties (other than mineral, oil, or gas royalties).*—The term "royalties" (other than mineral, oil, or gas royalties) includes amounts received for the privilege of using patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property. It does not, however, include rents. For rules relating to rents see section 543 (a) (7) and subparagraph (10) of this paragraph. For rules relating to mineral, oil, or gas royalties, see section 543(a)(8) and subparagraph (11) of this paragraph.

(4) *Annuities.*—The term "annuities" includes annuities only to the extent includible in the computation of gross income. See section 72 and §§ 1.72–1—1.72–14 for rules relating to the inclusion of annuities in gross income.

(5) *Gains from the sale or exchange of stock or securities.*—(i) Except in the case of regular dealers in stocks or securities as provided in subdivision (ii) of this subparagraph, gross income and personal holding company income include the amount by which the gains exceed the losses from the sale or exchange of stock or securities. See section 543(b)(1) and § 1.543–2 for provisions relating to this limitation. For this purpose, there shall be taken into account all those gains includible in gross income (including gains from liquidating dividends and other distributions from capital) and all those losses deductible from gross income which are considered under chapter 1 of the Internal Revenue Code of 1954 to be gains or losses from the sale or exchange of stock or securities. The term "stock or securities" as used in section 543(a)(2) and this subparagraph includes shares or certificates of stock, stock rights or warrants, or interest in any corporation (including any joint stock company, insurance company, association, or other organization classified as a corporation by the Internal Revenue Code of 1954), certificates of interest or participation in any profit-sharing agreement, or in any oil, gas or other mineral property, or lease, collateral trust certificates, voting trust certificates, bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, obligations issued by or behalf of a State, Territory, or political subdivision thereof.

(ii) In the case of "regular dealers in stock or securities" there shall not be included gains or losses derived from the sale or exchange of stock or securities made in the normal course of business. The term "regular dealer in stock or securities" means a corporation with an established place of business regularly engaged in the purchase of stock or securities and their resale to customers. However, such corporations shall not be considered as regular dealers with respect to stock or securities which are held for investment. See section 1236 and § 1.236–1.

(6) *Gains from futures transactions in commodities.*—Gross income and personal holding company income include the amount by which the gains exceed the losses from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. See § 1.543–2 for provisions relating to this limitation. In general, for the purpose of determining such excess, there are included all gains and losses on futures contracts which are speculative. However, for

the purpose of determining such excess, there shall not be included gains or losses from cash transactions, or gains or losses by a producer, processor, merchant, or handler of the commodity, which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others. See section 1233 and § 1.1233–1.

(7) *Estates and trusts.*—Under section 543(a)(4) personal holding company income includes amounts includible in computing the taxable income of the corporation under part I of subchapter J (relating to estates, trusts, and beneficiaries); and any gain derived by the corporation from the sale or other disposition of any interest in an estate or trust.

(8) *Personal service contracts.*—(i) Under section 543(a)(5) amounts received under a contract under which the corporation is to furnish personal services, as well as amounts received from the sale or other disposition of such contract, shall be included as personal holding company income if—

(*a*) Some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

(*b*) At any time during the taxable year 25 percent or more in value of the outsanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services. For this purpose, the value of the outstanding stock shall be determined in accordance with the rules set forth in § 1.542–3. It should be noted that the stock ownership requirement of section 543(a)(5) and this subparagraph relates to the stock ownership at any time during the taxable year. For rules relating to the determination of stock ownership, see section 544 and §§ 1.544–1—1.544–7.

(ii) If the contract, in addition to requiring the performance of services by a 25-percent stockholder who is designated or who could be designated (as specified in section 543(a)(5) and subdivision (i) of this subparagraph), requires the performance of services by other persons which are important and essential, then only that portion of the amount received under such contract which is attributable to the personal services of the 25-percent stockholder shall constitute personal holding company income. Incidental personal services of other persons employed by the corporation to facilitate the performance of the services by the 25-percent stockholder, however, shall not constitute important or essential services. Under section 482 gross income, deductions, credits, or allowances between or among organizations, trades, or businesses may be allocated if it is determined that allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses.

(iii) The application of section 543(a)(5) and this subparagraph may be illustrated by the following examples:

Example (1). A, whose profession is that of an actor, owns all of the outstanding capital stock of the M Corporation. The M Corporation entered into a contract with A under which A was to perform personal services for the person or persons whom the M Cor-

poration might designate, in consideration of which A was to receive $10,000 a year from the M Corporation. The M Corporation entered into a contract with the O Corporation in which A was designated to perform personal services for the O Corporation in consideration of which the O Corporation was to pay the M Corporation $500,000 a year. The $500,000 received by the M Corporation from the O Corporation constitutes personal holding company income.

Example (2). Assume the same facts as in example (1), except that, in addition to A's contract with the M Corporation, B, whose profession is that of a dancer and C, whose profession is that of a singer, were also under contract to the M Corporation to perform personal services for the person or persons whom the M Corporation might designate, in consideration of which they were each to receive $25,000 a year from the M Corporation. Neither B nor C were stockholders of the M Corporation. The contract entered into by the M Corporation with the O Corporation, in addition to designating that A was to perform personal services for the O Corporation, designated that B and C were also to perform personal services for the O Corporation. Although the O Corporation particularly desired the services of A for an entertainment program it planned, it also desired the services of B and C, who were prominent in their fields, to provide a good supporting cast for the program. The services of B and C required under the contract are determined to be important and essential; therefore, only that portion of the $500,000 received by the M Corporation which is attributable to the personal services of A constitutes personal holding company income. The same result would obtain although the dancer and the singer required by the contract were not designated by name but the contract gave the M Corporation discretion to select and provide the services of a singer and a dancer for the program and such services were provided.

Example (3). The N Corporation is engaged in engineering. Its entire outstanding capital stock is owned by four individuals. The N Corporation entered into a contract with the R Corporation to perform engineering services in consideration of which the R Corporation was to pay the N Corporation $50,000. The individual who was to perform the services was not designated (by name or by description) in the contract and no one but the N Corporation had the right to designate (by name or by description) such individual. The $50,000 received by the N Corporation from the R Corporation does not constitute personal holding company income.

(9) *Compensation for use of property.*—Under section 543(a)(6) amounts received as compensation for the use of, or right to use, property of the corporation shall be included as personal holding company income if, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned directly or indirectly, by or for an individual entitled to the use of the property. Thus, if a shareholder who meets the stock ownership requirements of section 543(a)(6) and this subparagraph uses, or has the right to use a yacht, residence or other property owned by the corporation, the compensation to the corporation for such use, or right to use, the property constitutes personal holding company income. This is true even though the shareholder may acquire the use of, or the right to use, the property by means of a sublease or under any other

arrangement involving parties other than the corporation and the shareholder. However, if the personal holding company income of the corporation (after excluding any such income described in section 543(a)(6) and this subparagraph, relating to compensation for use of property, and after excluding any such income described in section 543(a)(7) and subparagraph (10) of this paragraph, relating to rents) is not more than 10 percent of its gross income, compensation for the use of property shall not constitute personal holding company income. For the purpose of applying section 543(a)(6) and this subparagraph, the value of the outsanding stock shall be determined in accordance with the rules set forth in § 1.542–3. It should be noted that the stock ownership requirement of section 543(a)(6) and this subparagraph relates to the stock outstanding at any time during the entire taxable year. For rules relating to the determination of stock ownership, see section 544 and §§ 1.544–1—1.544–7.

(10) *Rents (including interest constituting rents).*—Rents which are to be included as personal holding company income consist of compensation (however designated) for the use, or right to use, property of the corporation. The term "rents" does not include amounts includible in personal holding company income under section 543(a)(6) and subparagraph (9) of this paragraph. The amounts considered as rents include charter fees, etc., for the use of, or the right to use, property, as well as interest on debts owed to the corporation (to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of the corporation's trade or business was sold or exchanged by the corporation). However, if the amount of the rents includible under section 543(a)(7) and this subparagraph constitutes 50 percent or more of the gross income of the corporation, such rents shall not be considered to be personal holding company income.

(11) *Mineral, oil, or gas royalties.*—(i) The income from mineral, oil, or gas royalties is to be included as personal holding company income, unless (*a*) the aggregate amount of such royalties constitutes 50 percent or more of the gross income of the corporation for the taxable year and (*b*) the aggregate amount of deductions allowable under section 162 (other than compensation for personal services rendered by the shareholders of the corporation) equals 15 percent or more of the gross income of the corporation for the taxable year.

(ii) The term "mineral, oil, or gas royalties" means all royalties, including production payments and overriding royalties, received from any interest in mineral, oil, or gas properties. The term "mineral" includes those minerals which are included within the meaning of the term "minerals" in the regulations under section 611.

(iii) The first sentence of subdivision (ii) of this subparagraph shall apply to overriding royalties received from the sublessee by the operating company which orginally leased and developed the natural resource property in respect of which such overriding royalties are paid, and to mineral, oil, or gas production payments, only with respect to amounts received after September 30, 1958.

§ 1.543–2 Limitation on Gross Income and Personal Holding Company Income in Transactions Involving Stocks, Securities and Commodities.—(a) Under section 543(b)(1) the gains which are to be included in gross income, and in personal holding company income

with respect to transactions described in section 543(a)(2) and § 1.543–1(b)(5), shall be the net gains from the sale or exchange of stock or securities. If there is an excess of losses over gains from such transactions, such excess (or net loss) shall not be used to reduce gross income or personal holding company income for purposes of the personal holding company tax. Similarly, under section 543(b)(2) the gains which are to be included in gross income, and in personal holding company income with respect to transactions described in section 543(a)(3) and § 1.543–1(b)(6), shall be the net gains from commodity transactions which reflect personal holding company income. Any excess of losses over gains from such transactions (resulting in a net loss) shall not be used to reduce gross income or personal holding company income. The capital loss carryover under section 1212 shall not be taken into account.

(b) The application of section 543(b) may be illustrated by the following examples:

Example (1). The P Corporation, not a regular dealer in stocks and securities, received rentals of $250,000 for its property from a 25 percent shareholder, and also had gains of $50,000 during the taxable year from the sale of stocks and securities. It also had losses on the sale of stocks and securities in the amount of $30,000. Accordingly, P Corporation had gross income during the taxable year of $270,000 ($250,000 plus $20,000 net gain from the sales of stocks and securities). It had personal holding company income of $20,000. (The rentals of $250,000 would not be personal holding company income under section 543(a)(6) since the personal holding company income of the corporation, $20,000 (after excluding any such income described in section 543(a)(6)), is not more than 10 percent of its gross income.)

Example (2). The R Corporation, not a regular dealer in stocks or securities, realized total gains during the taxable year of $900,000 from commodity futures transactions and $200,000 from the sales of stocks and securities. It also sustained total losses of $1,000,000 on such commodity futures transactions, resulting in a net gain for the taxable year of $100,000. None of the commodity futures transactions are hedging or other types of futures transactions excluded from the application of section 543(a)(3). No part of the loss on commodity futures transactions is to be taken into account in determining personal holding company income and gross income for personal holding company tax purposes for the taxable year. The full amount of the $200,000 in gains from the sales of stocks and securities is to be included in personal holding company income and in gross income for personal holding company tax purposes for the taxable year.

§ 1.544 Statutory Provisions; Rules for Determining Stock Ownership.

SEC. 544. RULES FOR DETERMINING STOCK OWNERSHIP.

(a) Constructive Ownership.—For purposes of determining whether a corporation is a personal holding company, insofar as such determination is based on stock ownership under section 542(a)(2), section 543(a)(5), or section 543(a)(6)—

(1) Stock not owned by individual.—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) FAMILY AND PARTNERSHIP.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For purposes of this paragraph, the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(3) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) APPLICATION OF FAMILY-PARTNERSHIP AND OPTION RULES.—Paragraphs (2) and (3) shall be applied—

(A) For purposes of the stock ownership requirement provided in section 542(a)(2), if, but only if, the effect is to make the corporation a personal holding company;

(B) For purposes of section 543(a)(5) (relating to personal service contracts), or of section 543(a)(6) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such paragraph as personal holding company income.

(5) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

(6) OPTION RULE IN LIEU OF FAMILY AND PARTNERSHIP RULE.—If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

(b) CONVERTIBLE SECURITIES.—Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

(1) For purposes of the stock ownership requirement provided in section 542(a)(2), but only if the effect of the inclusion of all such securities is to make the corporation a personal holding company;

(2) For purposes of section 543(a)(5) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income; and

(3) For purposes of section 543(a)(6) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income.

The requirement in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included.

§ 1.544–1 CONSTRUCTIVE OWNERSHIP.—(a) Rules relating to the constructive ownership of stock are provided by section 544 for the purpose of determining whether the stock ownership requirements of the following sections are satisfied:

(1) Section 542(a)(2), relating to ownership of stock by five or fewer individuals;

(2) Section 543(a)(5), relating to personal holding company income derived from personal service contracts;

(3) Section 543(a)(6), relating to personal holding company income derived from property used by shareholders.

(b) Section 544 provides four general rules with respect to constructive ownership. These rules are:

(1) Constructive ownership by reason of indirect ownership. See section 544(a)(1) and § 1.544–2.

(2) Constructive ownership by reason of family and partnership ownership. See section 544(a)(2), (4), (5), and (6) and §§ 1.544–3, 1.544–6, and 1.544–7.

(3) Constructive ownership by reason of ownership of options. See section 544(a)(3), (4), (5), and (6), and §§ 1.544–4, 1.544–6, and 1.544–7.

(4) Constructive ownership by reason of ownership of convertible securities. See section 544(b) and § 1.544–5. Each of the rules referred to in subparagraphs (2), (3), and (4) of this paragraph is applicable only if it has the effect of satisfying the stock ownership requirement of the section to which applicable; that is, when applied to section 542(a)(2), its effect is to make the corporation a personal holding company, or when applied to section 543(a)(5) or section 543(a)(6), its effect is to make the amounts described in such provisions includible as personal holding company income.

(c) All forms and classes of stock, however denominated, which represent the interests of shareholders, members, or beneficiaries in the corporation shall be taken into consideration in applying the constructive ownership rules of section 544.

(d) For rules applicable in treating constructive ownership, determined by one application of section 544, as actual ownership for purposes of a second application of section 544, see section 544(a)(5) and §1.544–6.

§ 1.544–2 Constructive Ownership by Reason of Indirect Ownership.—The following example illustrates the application of section 544(a)(1), relating to constructive ownership by reason of indirect ownership:

Example. A and B, two individuals, are the exclusive and equal beneficiaries of a trust or estate which owns the entire capital stock of the M Corporation. The M Corporation in turn owns the entire capital stock of the N Corporation. Under such circumstances the entire capital stock of both the M Corporation and the N Corporation shall be considered as being owned equally by A and B as the individuals owning the beneficial interest therein.

§ 1.544–3 Constructive Ownership by Reason of Family and Partnership Ownership.—(a) The following example illustrates the application of section 544(a)(2), relating to constructive ownership by reason of family and partnership ownership.

Example. The M Corporation at some time during the last half of the taxable year, had 1,800 shares of outstanding stock, 450 of which were held by various individuals having no relationship to one another and none of whom were partners, and the remaining 1,350 were held by 51 shareholders as follows:

Relationships	Shares		Shares		Shares		Shares		Shares	
An individual	A	100	B	20	C	20	D	20	E	20
His father	AF	10	BF	10	CF	10	DF	10	EF	10
His wife	AW	10	BW	40	CW	40	DW	40	EW	40
His brother	AB	10	BB	10	CB	10	DB	10	EB	10
His son	AS	10	BS	40	CS	40	DS	40	ES	40
His daughter by former marriage (son's half-sister).	ASHS	10	BSHS	40	CSHS	40	DSHS	40	ESHS	40
His brother's wife	ABW	10	BBW	10	CBW	10	DBW	160	EBW	10
His wife's father	AWF	10	BWF	10	CWF	110	DWF	10	EWF	10
His wife's brother	AWB	10	BWB	10	CWB	10	DWB	10	EWB	10
His wife's brother's wife	AWBW	10	BWBW	10	CWBW	10	DWBW	10	EWBW	110
Individual's partner	AP	10								

By applying the statutory rule provided in section 544(a)(2) five individuals own more than 50 percent of the outstanding stock as follows:

A (including AF, AW, AB, AS, ASHS, AP)	160
B (including BF, BW, BB, BS, BSHS)	160
CW (including C, CS, CWF, CWB)	220
DB (including D, DF, DBW)	220
EWB (including EW, EWF, EWBW)	170
Total, or more than 50 percent	910

Individual A represents the obvious case where the head of the family owns the bulk of the family stock and naturally is the head of the group. A's partner owns 10 shares of the stock. Individual B represents the case where he is still head of the group because of the ownership of stock by his immediate family. Individuals C and D represent cases where the individuals fall in groups headed in C's case by his wife and in D's case by his brother because of the preponderance of holdings on the part of relatives by marriage. Individual E represents the case where the preponderant holdings of others eliminate that individual from the group.

(b) For the restriction on the applicability of the family and partnership ownership rules, see paragraph (b) of § 1.544–1. For rules relating to constructive ownership as actual ownership, see § 1.544–6.

§ 1.544–4 Options.—The shares of stock which may be acquired by reason of an option shall be considered to be constructively owned by the individual having the option to acquire such stock. For example: If C, an individual, on March 1, 1955, purchases an option, or otherwise comes into possession of an option, to acquire 100 shares of the capital stock of M Corporation, such 100 shares of stock shall be considered to be constructively owned by C as if C had actually acquired the stock on that date. If C has an option on an option (or one of a series of options) to acquire such stock, he shall also be considered to have constructive ownership of the stock which may be acquired by reason of the option (or the series of options). Under such circumstances, C shall be considered to have acquired constructive ownership of the stock on the date he acquired his option. For the restriction on the applicability of the rule of this section, see § 1.544–1(b).

§ 1.544–5 Convertible Securities.—Under section 544(b) outstanding securities of a corporation such as bonds, debentures, or other

corporate obligations, convertible into stock of the corporation (whether or not convertible during the taxable year) shall be considered as outstanding stock of the corporation. The consideration of convertible securities as outstanding stock is subject to the exception that, if some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be considered as outstanding stock although the others are not so considered, but no convertible securities shall be considered as outstanding stock unless all outstanding securities having a prior conversion date are also so considered. For example, if outstanding securities are convertible in 1954, 1955 and 1956, those convertible in 1954 can be properly considered as outstanding stock without so considering those convertible in 1955 or 1956, and those convertible in 1954 and 1955 can be properly considered as outstanding stock without so considering those convertible in 1956. However, the securities convertible in 1955 could not be properly considered as outstanding stock without so considering those convertible in 1954 and the securities convertible in 1956 could not be properly considered as outstanding stock without so considering those convertible in 1954 and 1955. For the restriction on the applicability of the rule of this section, see § 1.544–1(b).

§ 1.544–6 CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—(a) *General rules.*—(1) Stock constructively owned by a person by reason of the application of the rule provided in section 544(a)(1), relating to stock not owned by an individual, shall be considered as actually owned by such person for the purpose of again applying such rule or of applying the family and partnership rule provided in section 544(a)(2), in order to make another person the constructive owner of such stock, and

(2) Stock constructively owned by a person by reason of the application of the option rule provided in section 544(a)(3) shall be considered as actually owned by such person for the purpose of applying either the rule provided in section 544(a)(1), relating to stock not owned by an individual, or the family and partnership rule provided in section 544(a)(2) in order to make another person the constructive owner of such stock, but

(3) Stock constructively owned by an individual by reason of the application of the family and partnership rule provided in section 544(a)(2) shall not be considered as actually owned by such individual for the purpose of again applying such rule in order to make another individual the constructive owner of such stock.

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

Example (1). A's wife, AW, owns all the stock of the M Corporation, which in turn owns all the stock of the O Corporation. The O Corporation in turn owns all the stock of the P Corporation. Under the rule provided in section 544(a)(1), relating to stock not owned by an individual, the stock in the P Corporation owned by the O Corporation is considered to be owned constructively by the M Corporation, the sole shareholder of the O Corporation. Such constructive ownership of the stock of the M Corporation is considered as actual ownership for the purpose of again applying such rule in order to

make AW, the sole shareholder of the M Corporation, the constructive owner of the stock of the P Corporation. Similarly, the constructive ownership of the stock by AW is considered as actual ownership for the purpose of applying the family and partnership rule provided in section 544(a)(2) in order to make A the constructive owner of the stock of the P Corporation, if such application is necessary for any of the purposes set forth in § 1.544–1(b). But the stock thus constructively owned by A may not be considered as actual ownership for the purpose of again applying the family and partnership rule in order to make another member of A's family, for example, A's father, the constructive owner of the stock of the P Corporation.

Example (2). B, an individual, owns all the stock of the R Corporation which has an option to acquire all the stock of the S Corporation, owned by C, an individual, who is not related to B. Under the option rule provided in section 544(a)(3) the R Corporation may be considered as owning constructively the stock of the S Corporation owned by C. Such constructive ownership of the stock by the R Corporation is considered as actual ownership for the purpose of applying the rule provided in section 544(a)(1), relating to stock not owned by an individual, in order to make B, the sole shareholder of the R Corporation, the constructive owner of the stock of the S Corporation. The stock thus constructively owned by B by reason of the application of the rule provided in section 544(a)(1) likewise is considered as actual ownership for the purpose, if necessary, of applying the family and partnership rule provided in section 544(a)(2), in order to make another member of B's family, for example, B's wife, BW, the constructive owner of the stock of the S Corporation. However, the family and partnership rule could not again be applied so as to make still another individual the constructive owner of the stock of the S Corporation, that is, the stock constructively owned by BW could not be considered as actually owned by her in order to make BW's father the constructive owner of such stock by a second application of the family and partnership rule.

§ 1.544–7 Option Rule in Lieu of Family and Partnership Rule.—(a) If, in determining the ownership of stock, such stock may be considered as constructively owned by an individual by an application of either the family and partnership rule (section 544(a)(2)) or the option rule (section 544(a)(3)), such stock shall be considered as owned constructively by the individual by reason of the application of the option rule.

(b) The application of this section may be illustrated by the following example:

Example. Two brothers, A and B, each own 10 percent of the stock of the M Corporation, and A's wife, AW, also owns 10 percent of the stock of such corporation. AW's husband, A, has an option to acquire the stock owned by her at any time. It becomes necessary, for one of the purposes stated in section 544(a)(4), to determine the stock ownership of B in the M Corporation. If the family and partnership rule were the only rule that applied in the case, B would be considered, under that rule, as owning 20 percent of the stock of the M Corporation, namely, his own stock plus the stock owned by his brother. In that event, B could not be considered as owning the stock held by AW

since (1) AW is not a member of B's family and (2) the constructive ownership of such stock by A through the application of the family and partnership rule in his case is not considered as actual ownership so as to make B the constructive owner by a second application of the same rule with respect to the ownership of the stock. However, there is more than the family and partnership rule involved in this example. As the holder of an option upon the stock, A may be considered the constructive owner of his wife's stock by the application of the option rule and without reference to the family relationship between A and AW. If A is considered as owning the stock of his wife by application of the option rule, then such constructive ownership by A is regarded as actual ownership for the purpose of applying the family and partnership rule so as to make another member of A's family, for example, B, the constructive owner of the stock. Hence, since A may be considered as owning his wife's stock by applying either the family-partnership rule or the option rule, the provisions of section 544(a)(6) apply and accordingly A must be considered the constructive owner of his wife's stock under the option rule rather than the family-partnership rule. B thus becomes the constructive owner of 30 percent of the stock of the M Corporation, namely, his own 10 percent, A's 10 percent, and AW's 10 percent constructively owned by A as the holder of an option on the stock.

§ 1.545 STATUTORY PROVISIONS; UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME.

SEC. 545. UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME.

(a) DEFINITION.—For purposes of this part, the term "undistributed personal holding company income" means the taxable income of a personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction as defined in section 561.

(b) ADJUSTMENTS TO TAXABLE INCOME.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

(1) TAXES.—There shall be allowed as a deduction Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940) and income, war profits and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 164(b)(6)), accrued during the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law. A taxpayer which, for each taxable year in which it was subject to the tax imposed by section 500 of the Internal Revenue Code of 1939, deducted Federal income and excess profits taxes when paid for the purpose of computing subchapter A net income under such Code, shall deduct taxes under this paragraph when paid, unless the taxpayer elects, in its return for a taxable year ending after June 30, 1954, to deduct the taxes described in this paragraph when accrued. Such an election shall be irrevocable and shall apply to the taxable year for which the election is made and to all subsequent taxable years.

(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions provided under section 170 shall be allowed but with the limitations in section 170(b)(1)(A) and (B) (in lieu of the limitation in section 170(b)(2)). For purposes of this paragraph, the term "adjusted gross income" when used in section 170(b)(1) means the taxable income computed with the adjustments provided

in section 170(b)(2) and without the deduction of the amount disallowed under paragraph (8) of this subsection.

(3) SPECIAL DEDUCTIONS DISALLOWED.—The special deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) NET OPERATING LOSS.—The net operating loss deduction provided in section 172 shall not be allowed, but there shall be allowed as a deduction the amount of the net operating loss (as defined in section 172(c)) for the preceding taxable year.

(5) LONG-TERM CAPITAL GAINS.—There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—

(A) The taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

(B) Such taxes computed for such year without including such excess in taxable income.

(6) BANK AFFILIATES.—There shall be allowed the deduction described in section 601 (relating to bank affiliates).

(7) PAYMENT OF INDEBTEDNESS INCURRED PRIOR TO JANUARY 1, 1934.—There shall be allowed as a deduction amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred before January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness.

(8) EXPENSES AND DEPRECIATION APPLICABLE TO PROPERTY OF THE TAXPAYER.—The aggregate of the deductions allowed under section 162 (relating to trade or business expenses) and section 167 (relating to depreciation), which are allocable to the operation and maintenance of property owned or operated by the corporation, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Secretary or his delegate) to the satisfaction of the Secretary or his delegate—

(A) That the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(B) That the property was held in the course of a business carried on bona fide for profit; and

(C) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(9) AMOUNT OF A LIEN IN FAVOR OF THE UNITED STATES.—There shall be allowed as a deduction the amount, not to exceed the taxable income of the taxpayer, of any lien in favor of the United States (notice of which has been filed as provided in section 6323(a)(1), (2), or (3)) to which the taxpayer is subject at the close of the taxable year. The sum of the amounts deducted under this paragraph with respect to any lien shall, for the purposes of this section, be added to the taxable income of the taxpayer for the taxable year in which such lien is satisfied or released. Where an amount is added to the taxable income of a corporation by reason of the preceding sentence of this paragraph, the shareholders of the corporation may, pursuant to regulations prescribed by the Secretary or his delegate, elect to compute the income tax with respect to such dividends as are attributable to such amount as though they were received ratably over the period the lien was in effect.

§ 1.545–1 DEFINITION.—(a) Undistributed personal holding company income is the amount which is subject to the personal holding company tax imposed under section 541. Undistributed personal holding company income is the taxable income of the corporation adjusted in the manner described in section 545(b) and § 1.545–2, less

the deduction for dividends paid. See sections 561–565 and §§ 1.561–1, 1.565–6, relating to the dividends paid deduction.

(b) For purposes of the imposition of the personal holding company tax on a foreign corporation, resident or nonresident, which files or causes to be filed a return, the undistributed personal holding company income shall be computed on the basis of the taxable income form sources within the United States, and such income shall be adjusted in accordance with the principles of section 545(b) and § 1.545–2. For purposes of the imposition of such tax on a foreign corporation, resident or nonresident, which files no return, the undistributed personal holding company income shall be computed on the basis of the gross income from sources within the United States without allowance of any deductions.

§ 1.545–2 ADJUSTMENTS TO TAXABLE INCOME.—(a) *Taxes.*—(1) *General rule.*—(i) In computing undistributed personal holding company income for any taxable year, there shall be allowed as a deduction the amount by which Federal income and excess profits taxes accrued during the taxable year exceed the credit provided by section 33 (relating to taxes of foreign countries and possessions of the United States), and the income, war profits, and excess profits taxes of foreign countries and possessions of the United States accrued during the taxable year (to the extent provided by subparagraph (3) of this paragraph), except that no deduction shall be allowed for (*a*) the accumulated earnings tax imposed by section 531 (or a corresponding section of a prior law), (*b*) the personal holding company tax imposed by section 541 (or a corresponding section of a pior law), and (*c*) the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939, for taxable years beginning after December 31, 1940. The deduction is for taxes for the taxable year, determined under the accrual method of accounting, regardless of whether the corporation uses an accrual method of accounting, the cash receipts and disbursement method, or any other allowable method of accounting. In computing the amount of taxes accrued, an unpaid tax which is being contested is not considered accrued until the contest is resolved.

(ii) However, the taxpayer shall deduct taxes paid, rather than taxes accrued, if it used that method with respect to Federal taxes for each taxable year for which it was subject to the tax imposed by section 500 of the Internal Revenue Code of 1939, unless an election is made under subparagraph (2) of this paragraph to deduct taxes accrued.

(2) *Election by taxpayer which deducted taxes paid.*—(i) If the corporation was subject to the personal holding company tax imposed by section 500 of the Internal Revenue Code of 1939 and, for the purpose of that tax, deducted Federal taxes paid rather than such taxes accrued for each taxable year for which it was subject to such taxes, the corporation may elect for any taxable year ending after June 30, 1954, to deduct taxes accrued, including taxes of foreign countries and of possessions of the United States, rather than taxes paid, for the purposes of the tax imposed by section 541 of the Internal Revenue Code of 1954. The election shall be made by deducting such taxes accrued on Schedule PH, Form 1120, to be filed with

the return. The schedule shall, in addition, contain a statement that the corporation has made such election and shall set forth the year to which such election was first applicable. The deduction of taxes accrued in the year of election precludes the deduction of taxes paid during such year. The election, if made, shall be irrevocable and the deduction for taxes accrued shall be allowed for the year of election and for all subsequent taxable years.

(ii) Pursuant to section 7851(a)(1)(C), the election provided for in subdivision (i) of this subparagraph may be made with respect to a taxable year ending after June 30, 1954, even though such taxable year is subject to the Internal Revenue Code of 1939.

(3) *Taxes of foreign countries and United States possessions.*—In computing undistributed personal holding company income for any taxable year, a deduction is allowed for income, war profits and excess profits taxes accrued (or paid, if required under subparagraph (1)(ii) of this paragraph) during such taxable year to foreign countries or possessions of the United States if the taxpayer chooses the benefits of section 901 for such taxable year. The credit for such taxes provided by section 901 is not allowed against the personal holding company tax imposed by section 541. See section 901(a).

(b) *Charitable contributions.*—(1) Section 545(b)(2) provides that, in computing the undistributed personal holding company income of a corporation, the deduction for charitable contributions by a corporation shall be computed with the limitations of section 170(b)(1)(A) and (B) (relating to charitable contributions by individuals) instead of the limitation in section 170(b)(2) (relating to charitable contributions by corporations).

(2) Although the limitations of section 170(b)(1)(A) and (B) are 10 and 20 percent, respectively, of the individual's adjusted gross income, the limitations are applied for purposes of section 545(b)(2) by using 10 and 20 percent, respectively, of the corporation's taxable income as adjusted for purposes of section 170(b)(2) (that is, the same amount of taxable income to which the 5 percent limitation applied). However, a further adjustment for this purpose is that the taxable income shall also be computed without the deduction of the amount disallowed under section 545(b)(8) (relating to expenses and depreciation applicable to property of the taxpayer.

(3) See the regulations under section 170(b)(1)(A) and (B) with respect to the charitable contributions to which the 10 percent limitation is applicable and the charitable contributions to which the 20 percent limitation is applicable.

(4) In some cases, a deduction in excess of the 5 percent limitation may be allowed for one taxable year under section 545(b)(2) for purposes of the personal holding company tax only, and may also be allowed as a deduction in computing taxable income for a subsequent taxable year under the carryover provisions of section 170(b)(2). To the extent that the charitable contributions carried over from a previous year have already been deducted for purposes of the personal holding company tax in the year when the charitable contributions were made, they may not be deducted again as part of the contribution carryover deduction for purposes of the personal holding company tax for a subsequent year. However, this adjustment is only for purposes of the personal holding company tax,

and the carryover in such case is allowable in computing taxable income for purposes of the corporation normal tax and surtax.

(c) *Special deductions disallowed.*—Part VIII of subchapter B of chapter 1 allows corporations, in computing taxable income, special deductions for such matters as partially tax-exempt interest, certain dividends received, dividends paid on certain preferred stock of public utilities, organizational expenses, etc. See section 241. Such special deductions, except the deduction provided by section 248 (relating to organizational expenses) shall be disallowed in computing undistributed personal holding company income.

(d) *Net operating loss.*—The net operating loss deduction provided in section 172 is not allowed for purposes of the computation of undistributed personal holding company income; however, there is allowed as a deduction for such purposes the amount of the net operating loss (as defined in section 172(c)) for the preceding taxable year.

(e) *Long-term capital gains.*—(1) There is allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes attributable to such excess, as provided in section 545(b)(5).

(2) Section 631(c) (relating to gain or loss in the case of disposal of coal) shall have no application.

(f) *Bank affiliates.*—There is allowed the deduction provided by section 601 in the case of bank affiliates (as defined in section 2 of the Banking Act of 1933; 12 U. S. C. 221a(c)).

(g) *Payment of indebtedness incurred prior to January 1, 1934.*—(1) *General rule.*—In computing undistributed personal holding company income, section 545(b)(7) provides that there shall be allowed as a deduction amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred before January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness.

(2) *Indebtedness.*—The term "indebtedness" means an obligation absolute and not contingent, to pay on demand or within a given time, in cash or other medium, a fixed amount. The term "indebtedness" does not include the obligation of a corporation on its capital stock. The indebtedness must have been incurred (or, if incurred by assumption, assumed) by the taxpayer before January 1, 1934. An indebtedness evidenced by bonds, notes, or other obligations issued by a corporation is ordinarily incurred as of the date such obligations are issued and the amount of such indebtedness is the amount represented by the face value of the obligations. In the case of refunding, renewal, or other change in the form of an indebtedness, the giving of a new promise to pay by the taxpayer will not have the effect of changing the date the indebtedness was incurred.

(3) *Amounts used or irrevocably set aside.*—The deduction is allowable, in any taxable year, only for amounts used or irrevocably set aside in that year. The use or irrevocable setting aside must be to effect the extinguishment or discharge of indebtedness. In the case of refunding, renewal, or other change in the form of an indebtedness, the mere giving of a new promise to pay by the taxpayer will not result in an allowable deduction. If amounts are set aside in one year, no deduction is allowable for such amounts for a later year in which

actually paid. As long as all other conditions are satisfied, the aggregate amount allowable as a deduction for any taxable year includes all amounts (from whatever source) used and all amounts (from whatever source) irrevocably set aside, irrespective of whether in cash or other medium. Double deductions shall not be allowed.

(4) *Reasonableness of the amounts with reference to the size and terms of the indebtedness.*—(i) The reasonableness of the amounts used or irrevocably set aside must be determined by reference to the size and terms of the particular indebtedness. Hence, all the facts and circumstances with respect to the nature, scope, conditions, amount, maturity, and other terms of the particular indebtedness must be shown in each case.

(ii) Ordinarily an amount used to pay or retire an indebtedness, in whole or in part, at or prior to the maturity and in accordance with the terms thereof will be considered reasonable, and may be allowable as a deduction for the year in which so used. However, if an amount has been set aside in a prior year for payment or retirement of the same indebtedness, the amount so set aside shall not be allowed as a deduction in the year of the payment.

(iii) All amounts irrevocably set aside for the payment or retirement of an indebtedness in accordance with and pursuant to the terms of the obligation, for example, the annual contribution to trustees required by the provisions of a mandatory sinking fund agreement, will be considered as complying with the requirement of reasonableness. To be considered reasonable, it is not necessary that the plan of retirement provide for a retroactive setting aside of amounts for years prior to that in which the plan is adopted. However, if a voluntary plan was adopted before 1934, no adjustment is allowable in respect of the amounts set aside in the years prior to 1934.

(5) *Burden of proof.*—The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, the taxpayer must furnish the information required by the return, and such other information as the district director may require in substantiation of the deduction claimed.

(6) *Allowance to a successor corporation.*—For allowance of deduction for pre-1934 indebtedness to a successor corporation, see section 381(c)(15).

(h) *Expenses and depreciation applicable to property of the taxpayer.*—(1) In computing undistributed personal holding company income in the case of a personal holding company which owns or operates property, section 545(b)(8) provides a specific limitation with respect to the allowance of deductions for trade or business expenses and depreciation allocable to the operation or maintenance of such property. Under this limitation, these deductions shall not be allowed in an amount in excess of the aggregate amount of the rent or other compensation received for the use of, or the right to use, the property, unless it is established to the satisfaction of the Commissioner—

(i) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(ii) That the property was held in the course of a business carried on bona fide for profit; and

(iii) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(2) The burden of proof will rest upon the taxpayer to sustain the deduction claimed. If, in computing undistributed personal holding company income, a personal holding company claims deductions for expenses and depreciation allocable to the operation and maintenance of property owned or operated by the company, in an aggregate amount in excess of the rent or other compensation received for the use of, or the right to use, the property, it shall attach to its income tax return a statement setting forth its claim for allowance of the additional deductions, together with a complete statement of the facts and circumstances pertinent to its claim and the arguments on which it relies. Such statement shall set forth:

(i) A description of the property;

(ii) The cost or other basis to the corporation and the nature and value of the consideration paid for the property;

(iii) The name and address of the person from whom the property was acquired and the date the property was acquired;

(iv) The name and address of the person to whom the property is leased or rented, or the person permitted to use the property, and the number of shares of stock, if any, held by such person and the members of his family;

(v) The nature and gross amount of the rent or other compensation received for the use of, or the right to use, the property during the taxable year and for each of the five preceding years and the amount of the expenses incurred with respect to, and the depreciation sustained on, the property for such years;

(vi) Evidence that the rent or other compensation was the highest obtainable or, if none was received, a statement of the reasons therefor;

(vii) A copy of the contract, lease or rental agreement;

(viii) The purpose for which the property was used;

(ix) The business, carried on by the corporation, with respect to which the property was held and the gross income, expenses, and taxable income derived from the conduct of such business for the taxable year and for each of the five preceding years;

(x) A statement of any reasons which existed for expectation that the operation of the property would be profitable, or a statement of the necessity for the use of the property in the business of the corporation, and the reasons why the property was acquired; and

(xi) Any other information pertinent to the taxpayer's claim.

(i) *Amount of a lien in favor of the United States.*—(1) If notices of lien are filed in the manner provided in section 6323(a)(1), (2), or (3), the amount of the liability to the United States outstanding at the close of the taxable year, and secured by such liens which are in effect at that time, shall be allowed as a deduction in computing undistributed personal holding company income. However, the amount of such deduction which may be allowed for any taxable year shall not exceed the taxable income (as adjusted for purposes of determining the undistributed personal holding company income, but without regard to the deduction under section 545(b)(9)) for such year. The fact that the amount of, or any

part of, the outstanding obligation to the United States was deducted for one taxable year does not prevent its deduction for a subsequent taxable year to the extent the obligation is still outstanding at the close of the subsequent taxable year and is secured by a lien, notice of which has been filed.

(2) Subparagraph (1) may be illustrated by the following example:

Example. If the taxpayer (on the calendar year basis) is subject to a lien (notice of which has been properly filed) in the amount of $500,000 at the close of the calendar year 1954 and has taxable income of $400,000 for such taxable year, the deduction allowable by reason of the lien for the calendar year 1954 is $400,000. If, at the close of the taxable year ended December 31, 1955, the taxpayer is still subject to the same lien of $500,000 and it has taxable income of $450,000, a deduction is allowed by reason of such lien in the amount of $450,000.

(3) When the obligation secured by the lien in favor of the United States has been satisfied or released, the sum of the amounts which have been allowed as deductions under section 545(b)(9) in respect of such obligation shall be restored to taxable income for the year in which such lien is satisfied or released. If only a part of the obligation secured by the lien has been satisfied, the sum of the amounts which have been allowed as deductions under section 545(b)(9) in respect of such part shall be included in taxable income for the year of the satisfaction for the purpose of determining undistributed personal holding company income. It should be noted, however, that only the sum of the amounts which have been allowed as deductions under section 545(b)(9) and subparagraph (i) of this paragraph shall be included in taxable income. Thus, any amounts which were allowed as deductions under section 504(e) of the Internal Revenue Code of 1939 shall not be included as taxable income for any taxable year under section 545(b)(9) and subparagraph (i) of this paragraph.

(4) The application of subparagraph (3) of this paragraph may be illustrated by the following example:

Example. Assume the same facts as in the example in subparagraph (2) of this paragraph, and assume further that the corporation has $100,000 taxable income both for 1956 (before including the $400,000 described below) and for 1957. In 1956, the corporation pays $200,000 of the obligation, thereby reducing its liability from $500,000 to $300,000. In such case, $400,000 is included in taxable income in computing its undistributed personal holding company income for 1956, that is, the sum of the $200,000 deduction for 1954 and the $200,000 deduction for 1955 in respect of the liability which is paid in 1956. In 1957, property of the corporation is discharged from the lien by reason of the fact that the value of the remaining property of the corporation exceeds double the outstanding liability. (See section 6325(b)(1).) Since this was not a release or satisfaction of the lien, no amount is added to taxable income for 1957 with respect to the property discharged from the lien. In 1958, the remaining property is released from the lien by reason of a bond being accepted under section 6325(a)(2). There is added to taxable in-

come in computing undistributed personal holding company income for 1958, $850,000, that is, the sum of the deductions allowed for 1954, 1955, 1956, and 1957 in respect of the $300,000 liability, the lien for which was released in 1958. This amount of $850,000, is computed as follows:

Year	Outstanding liability	Taxable income	Deduction as limited by taxable income	Amount attributable to part payment of $200,000 in 1956	Amount attributable to release of lien in 1958
1954	$500,000	$400,000	$400,000	$200,000	$200,000
1955	500,000	450,000	450,000	200,000	250,000
1956	300,000	500,000	300,000	----------	300,000
1957	300,000	100,000	100,000	----------	100,000
Total	----------	----------	----------	----------	850,000

(5) (i) If an amount has been included in undistributed personal holding company income of the personal holding company by reason of section 545(b) (9), any shareholder of the company may elect to compute his income tax with respect to such of his dividends as are attributable to such amount as though such dividends were received ratably over the period the lien was in effect.

(ii) For purposes of section 545(b) (9), the dividends paid during the taxable year of the personal holding company (computed as of the close of such year) shall be deemed attributable first to undistributed personal holding company income by reason of section 545(b) (9) (computed as of the close of the taxable year of the personal holding company). If the period over which the lien was in effect consists of several taxable years of the personal holding company, the dividend deemed received for any taxable year shall be deemed received on the last day of such taxable year of the personal holding company.

(iii) Such election shall be made in a statement showing the amount of the deduction under section 545(b) (9) for each taxable year of the period in which the lien was in effect, the amount of such deduction, if any, which was added to undistributed personal holding company income in a later year or years as a result of partial satisfaction or release of such lien, and the details thereof, the taxable year or years to which such dividends are allocable, and a computation of tax, on the basis of the election, for all taxable years affected by such ratable allocation of the dividends. Further, the statement shall show the district director's office in which the returns, for the years to which the dividends are allocable, were filed, the kind of returns which were filed (separate returns or joint returns), and the name and address under which the returns were filed. The statement shall be attached to the shareholder's return for the taxable year for which the dividend would be reported but for such election.

(iv) The operation of subparagraph (5) may be illustrated as follows: If, in the example under subparagraph (4), shareholder A owns 75 percent in value of the outstanding stock of the personal holding company, and receives a dividend of $540,000 from such

company during 1958 (the total dividend distribution being $720,000) he may elect to compute his income tax with respect to the $540,000 in dividends for 1958 as if he had received $127,058.82 of such dividends for 1954 $200,000/850,000 of $540,000), $158,823.53 of such dividends for 1955 ($250,000/850,000 of $540,000), $190,588.23 of such dividends for 1956 ($300,000/850,000 of $540,000), and $63,529.41 of such dividends for 1957 ($100,000/850,000 of $540,000). Accordingly, the tax computed for 1958 with respect to such dividends shall be the aggregate of the taxes attributable to such amounts had they been distributed in the respective years.

§ 1.546 STATUTORY PROVISIONS; INCOME NOT PLACED ON ANNUAL BASIS.

SEC. 546. INCOME NOT PLACED ON ANNUAL BASIS.

Section 443 (b) (relating to computation of tax on change of annual accounting period) shall not apply in the computation of the personal holding company tax imposed by section 541.

§ 1.547 STATUTORY PROVISIONS; DEDUCTION FOR DEFICIENCY DIVIDENDS.

SEC. 547. DEDUCTION FOR DEFICIENCY DIVIDENDS.

(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.

(b) RULES FOR APPLICATION OF SECTION.—(1) ALLOWANCE OF DEDUCTION.—The deficiency dividend deduction shall be allowed as of the date the claim for the deficiency dividend deduction is filed.

(2) CREDIT OR REFUND.—If the allowance of a deficiency dividend deduction results in an overpayment of personal holding tax company tax for any taxable year, credit or refund with respect to such overpayment shall be made as if on the date of the determination 2 years remained before the expiration of the period of limitation on the filing of claim for refund for the taxable year to which the overpayment relates. No interest shall be allowed on a credit or refund arising from the application of this section.

(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.

(d) DEFICIENCY DIVIDENDS.—

(1) DEFINITION.—For purposes of this section, the term "deficiency dividends" means the amount of the dividends paid by the corporation on or after the date of the determination and before filing claim under subsection (e), which would have been includible in the computation of the deduction for dividends paid under section 561 for the taxable year with respect to which the liability for personal holding company tax exists, if distributed during such taxable year. No dividends shall be considered as deficiency dividends for purposes of subsection (a) unless distributed within 90 days after the determination.

(2) EFFECT ON DIVIDENDS PAID DEDUCTION.—

(A) FOR TAXABLE YEAR IN WHICH PAID.—Deficiency dividends paid in any taxable year (to the extent of the portion thereof taken into account under subsection (a) in determining personal holding company tax) shall not be included in the amount of dividends paid for such year for purposes of computing the dividends paid deduction for such year and succeeding years.

(B) FOR PRIOR TAXABLE YEAR.—Deficiency dividends paid in any taxable year (to the extent of the portion thereof taken into account under subsection (a) in determining personal holding company tax) shall not be allowed for purposes of section 563 (b) in the computation of the dividends paid deduction for the taxable year preceding the taxable year in which paid.

(e) CLAIM REQUIRED.—No deficiency dividend deduction shall be allowed under subsection (a) unless (under regulations prescribed by the Secretary or his delegate) claim therefor is filed within 120 days after the determination.

(f) SUSPENSION OF STATUTE OF LIMITATIONS AND STAY OF COLLECTION.—

(1) SUSPENSION OF RUNNING OF STATUTE.—If the corporation files a claim, as provided in subsection (e), the running of the statute of limitations provided in section 6501 on the making of assessments, and the bringing of distraint or a proceeding in court for collection, in respect of the deficiency and all interest, additional amounts, or assessable penalties, shall be suspended for a period of 2 years after the date of the determination.

(2) STAY OF COLLECTION.—In the case of any deficiency with respect to the tax imposed by section 541 established by a determination under this section—

(A) The collection of the deficiency and all interest, additional amounts, and assessable penalties shall, except in cases of jeopardy, be stayed until the expiration of 120 days after the date of the determination, and

(B) If claim for deficiency dividend deduction is filed under subsection (e), the collection of such part of the deficiency as is not reduced by the deduction for deficiency dividends provided in subsection (a) shall be stayed until the date the claim is disallowed (in whole or in part), and if disallowed in part collection shall be made only with respect to the part disallowed.

No distraint or proceeding in court shall be begun for the collection of an amount the collection of which is stayed under subparagraph (A) or (B) during the period for which the collection of such amount is stayed.

(g) DEDUCTION DENIED IN CASE OF FRAUD, ETC.—No deficiency dividend deduction shall be allowed under subsection (a) if the determination contains a finding that any part of the deficiency is due to fraud with intent to evade tax, or to wilful failure to file an income tax return within the time prescribed by law or prescribed by the Secretary or his delegate in pursuance of law.

(h) EFFECTIVE DATE.—Subsections (a) through (f), inclusive, shall apply only with respect to determinations made more than 90 days after the date of enactment of this title. If the taxable year with respect to which the deficiency is asserted began before January 1, 1954, the term "deficiency dividend" includes only amounts which would have been includible in the computation under the Internal Revenue Code of 1939 of the basic surtax credit for such taxable year. Subsection (g) shall apply only if the taxable year with respect to which the deficiency is asserted begins after December 31, 1953.

§ 1.547–1 GENERAL RULE.—Section 547 provides a method under which, by virtue of dividend distributions, a corporation may be relieved from the payment of a deficiency in the personal holding company tax imposed by section 541 (or by a corresponding provision of a prior income tax law), or may be entitled to a credit or refund of a part or all of any such deficiency which has been paid. The method provided by section 547 is to allow an additional

deduction for a dividend distribution (which meets the requirements of this section) in computing undistributed personal holding company income for the taxable year for which a deficiency in personal holding company tax is determined. The additional deduction for deficiency dividends will not, however, be allowed for the purpose of determining interest, additional amounts, or assessable penalties, computed with respect to the personal holding company tax prior to the allowance of the additional deduction for deficiency dividends. Such amounts remain payable as if section 547 had not been enacted.

§ 1.547–2 REQUIREMENTS FOR DEFICIENCY DIVIDENDS.—(a) *In general.*—There are certain requirements which must be fulfilled before a deduction is allowed for a deficiency dividend under section 547 and this section. These are—

(1) The taxpayer's liability for personal holding company tax shall be determined only in the manner provided in section 547(c) and § 1.547–2(b)(1).

(2) The deficiency dividend shall be paid by the corporation on, or within 90 days after, the date of such determination and prior to the filing of a claim under section 547(e) and § 1.547–2(b)(2) for deduction for deficiency dividends. This claim must be filed within 120 days after such determination.

(3) The deficiency dividend must be of such a nature as would have permitted its inclusion in the computation of a deduction for dividends paid under section 561 for the taxable year with respect to which the liability for personal holding company tax exists, if it had been distributed during such year. See section 562 and §§ 1.562–1—1.562–3. In this connection, it should be noted that under section 316(b)(2), the term "dividend" means (in addition to the usual meaning under section 316(a)) any distribution of property (whether or not a dividend as defined in section 316(a)) made by a corporation to its shareholders, to the extent of its undistributed personal holding company income (determined under section 545 and §§ 1.545–1 and 1.545–2 without regard to section 316(b)(2)) for the taxable year in respect of which the distribution is made.

(b) *Special rules.*—(1) *Nature and details of determination.*—(i) A determination of a taxpayer's liability for personal holding company tax shall, for the purposes of section 547, be established in the manner specified in section 547(c) and this subparagraph.

(ii) The date of determination by a decision of the Tax Court of the United States is the date upon which such decision becomes final, as prescribed in section 7481.

(iii) The date upon which a judgment of a court becomes final, which is the date of the determination in such cases, must be determined upon the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for taking an appeal, if no such appeal is duly taken within such time; and a judgment of the United States Court of Claims becomes final upon the expiration of the time allowed for filing a petition for certiorari if no such petition is duly filed within such time.

(iv) The date of determination by a closing agreement, made under section 7121, is the date such agreement is approved by the Commissioner.

(v) A determination under section 547(c)(3) may be made by an agreement signed by the district director or such other official to whom authority to sign the agreement is delegated, and by or on behalf of the taxpayer. The agreement shall set forth the total amount of the liability for personal holding company tax for the taxable year or years. The date of the determination is the date such agreement is signed by the district director or such other official to whom authority to sign the agreement is delegated.

(2) *Claim for deduction.*—(i) *Contents of claim.*—A claim for deduction for a deficiency dividend shall be made in duplicate, with the requisite declaration, on Form 976 and shall contain the following information:

(*a*) The name and address of the corporation;

(*b*) The place and date of incorporation;

(*c*) The amount of the deficiency determined with respect to the tax imposed by section 541 (or a corresponding provision of a prior income tax law) and the taxable year or years involved; the amount of the unpaid deficiency or, if the deficiency has been paid in whole or in part, the date of payment and the amount thereof; a statement as to how the deficiency was established, if unpaid; or if paid in whole or in part, how it was established that any portion of the amount paid was a deficiency at the time when paid and, in either case whether it was by an agreement under section 547(c)(3), by a closing agreement under section 7121, or by a decision of the Tax Court or court judgment and the date thereof; if established by a final judgment in a suit against the United States for refund, the date of payment of the deficiency, the date the claim for refund was filed, and the date the suit was brought; if established by a Tax Court decision or court judgment, a copy thereof shall be attached, together with an explanation of how the decision became final; if established by an agreement under section 547(c)(3), a copy of such agreement shall be attached;

(*d*) The amount and date of payment of the dividend with respect to which the claim for the deduction for deficiency dividends is filed.

(*e*) A statement setting forth the various classes of stock outstanding, the name and address of each shareholder, the class and number of shares held by each on the date of payment of the dividend with respect to which the claim is filed, and the amount of such dividend paid to each shareholder;

(*f*) The amount claimed as a deduction for deficiency dividends; and

(*g*) Such other information as may be required by the claim form.

(ii) *Filing of claim and corporate resolution.*—The claim in duplicate together with a certified copy of the resolution of the board of directors or other authority, authorizing the payment of the dividend with respect to which the claim is filed, shall be filed with the district director of internal revenue for the district in which the return is filed.

(iii) *Carryover of deficiency dividends paid by 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), the distributor or transferor corporation shall be entitled to

a deduction fo any deficiency dividends (as defined in section 547(d)) paid by the acquiring corporation with respect to such distributor or transferor corporation. See section 381(c)(17).

§ 1.547–3 Claim for Credit or Refund.—(a) If a deficiency in personal holding company tax is asserted for any taxable year, and the corporation has paid any portion of such asserted deficiency, it is entitled to a credit or refund of such payment to the extent that such payment constitutes an overpayment as the result of a deduction for a deficiency dividend as provided in section 547 and §§ 1.547–1—1.547–7. It should be noted that a "determination" under section 547(c) and § 1.547–2(b)(1), of taxpayer's liability for personal holding company tax may take place subsequent to the time the deficiency was paid. To secure credit or refund of such overpayment, the taxpayer must file a claim on Form 843 in addition to the claim for the deduction for deficiency dividends required under section 547(e) and § 1.547–2(b)(2).

(b) No interest shall be allowed on such credit or refund.

(c) Such credit or refund will be allowed as if, on the date of the determination under section 547(c) and § 1.547–2(b)(1), two years remained before the expiration of the period of limitation on the filing of claim for refund for the taxable year to which the overpayment relates.

§ 1.547–4 Effect on Dividends Paid Deduction.—The deficiency dividends deduction shall be allowed as of the date the claim is filed. No duplication of deductions with respect to any deficiency dividends is permitted. If a corporation claims and receives the benefit of the provisions of section 547 (or the corresponding section 506 of the Internal Revenue Code of 1939, or section 407 of the Revenue Act of 1938), based upon a distribution of deficiency dividends, that distribution does not become a part of the dividends paid deduction under section 561. Likewise, it will not be made the basis of a dividends paid deduction under section 561 by reason of the application of section 563(b), relating to dividends paid after the close of the taxable year and on or before the 15th day of the third month following the close of such taxable year.

§ 1.547–5 Deduction Denied in Case of Fraud or Wilful Failure to File Timely Return.—No deduction for deficiency dividends shall be allowed under section 547(a) if the determination contains a finding that any part of the deficiency is due to fraud with intent to evade tax, or to wilful failure to file an income tax return within the time prescribed by law or prescribed by the Secretary or his delegate in pursuance of law. See § 1.547–7 for effective date.

§ 1.547–6 Suspension of Statute of Limitations and Stay of Collection.—(a) *Statute of limitations.*—If the corporation files a claim for a deduction for deficiency dividends under section 547(e) and § 1.547–2(b)(2), the running of the statute of limitations upon assessment, distraint, and collection in court in respect of the deficiency, and all interest, additional amounts, or assessable penalties, shall be suspended for a period of two years after the date of the determination under section 547(c) and § 1.547–2(b)(1).

(b) *Stay of collection.*—If a deficiency in personal holding company tax is established by a determination under section 547(c) and

§ 1.547–2(b)(1), collection by distraint or court proceeding (except in case of jeopardy), of the deficiency and all interest, additional amounts, and assessable penalties, shall be stayed for a period of 120 days after the date of such determination, and, to the extent any part of such deficiency remains after deduction for deficiency dividends, for an additional period until the date the claim is disallowed. After such claim is allowed or rejected, either in whole or in part, the amount of the deficiency which was not eliminated by the application of section 547, together with interest, additional amounts and assessable penalties, will be assessed and collected in the usual manner.

§ 1.547–7 EFFECTIVE DATE.—The deduction for deficiency dividends, in computing personal holding company tax for any taxable year, is allowable only with respect to determinations under section 547(c) made after November 14, 1954 (the date falling 90 days after the date of enactment of the Internal Revenue Code of 1954). If the taxable year with respect to which the deficiency is asserted began before January 1, 1954, the deficiency dividends deduction shall include only the amounts which would have been includible in the computation of the basic surtax credit for such taxable year under the Internal Revenue Code of 1939. Section 547(g), relating to the denial of a deficiency dividends deduction if the determination contains a finding that any part of the deficiency is due to fraud, etc., shall apply only if the taxable year with respect to which the deficiency is asserted begins after December 31, 1953.

FOREIGN PERSONAL HOLDING COMPANIES

§ 1.551 STATUTORY PROVISIONS; FOREIGN PERSONAL HOLDING COMPANY INCOME TAXED TO UNITED STATES SHAREHOLDERS.

SEC. 551. FOREIGN PERSONAL HOLDING COMPANY INCOME TAXED TO UNITED STATES SHAREHOLDERS.

(a) GENERAL RULE.—The undistributed foreign personal holding company income of a foreign personal holding company shall be included in the gross income of the citizens or residents of the United States, domestic corporations, domestic partnerships, and estates or trusts (other than estates or trusts the gross income of which under this subtitle includes only income from sources within the United States), who are shareholders in such foreign personal holding company (hereinafter called "United States shareholders") in the manner and to the extent set forth in this part.

(b) AMOUNT INCLUDED IN GROSS INCOME.—Each United States shareholder, who was a shareholder on the day in the taxable year of the company which was the last day on which a United States group (as defined in section 552(a)(2)) existed with respect to the company, shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the company ends, the amount he would have received as a dividend if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(c) DEDUCTION FOR OBLIGATIONS OF UNITED STATES AND ITS INSTRUMENTALITIES.—Each United States shareholder shall take into account in determining his income tax his proportionate share of partially tax-exempt interest on obligations described in section 35 or 242 which is included in the gross income of the company otherwise than by the application of the provisions of section 555 (b) (relating to the inclusion in the gross income of a foreign personal holding company of its

distributive share of the undistributed foreign personal holding company income of another foreign personal holding company in which it is a shareholder). If the foreign personal holding company elects under section 171 to amortize the premiums on such obligations, for purposes of the preceding sentence each United States shareholder's proportionate share of such interest received by the foreign personal holding company shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 171 as is attributable to such share.

(d) INFORMATION IN RETURN.—Every United States shareholder who is required under subsection (b) to include in his gross income any amount with respect to the undistributed foreign personal holding company income of a foreign personal holding company and who, on the last day on which a United States group existed with respect to the company, owned 5 percent or more in value of the outstanding stock of such company, shall set forth in his return in complete detail the gross income, deductions and credits, taxable income, foreign personal holding company, and undistributed foreign personal holding company income of such company.

(e) EFFECT ON CAPITAL ACCOUNT OF FOREIGN PERSONAL HOLDING COMPANY.—An amount which bears the same ratio to the undistributed foreign personal holding company income of the foreign personal holding company for its taxable year as the portion of such taxable year up to and including the last day on which a United States group existed with respect to the company bears to the entire taxable year, shall, for the purpose of determining the effect of distributions in subsequent taxable years by the corporation, be considered as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend, directly or indirectly, in the gross income of United States shareholders.

(f) BASIS OF STOCK IN HANDS OF SHAREHOLDERS.—The amount required to be included in the gross income of a United States shareholder under subsection (b) shall, for the purpose of adjusting the basis of his stock with respect to which the distribution would have been made (if it had been made), be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in the last determination of the shareholder's tax liability, made before the expiration of 6 years after the date prescribed by law for filing the return.

(g) CROSS REFERENCES.—(1) For basis of stock or securities in a foreign personal holding company acquired from a decedent, see section 1014(b)(5).

(2) For period of limitation on assessment and collection without assessment, in case of failure to include in gross income the amount properly includible therein under subsection (b), see section 6501.

(3) For treatment of gain on liquidation of certain foreign personal holding companies, see section 342.

§ 1.551–1 GENERAL RULE.—Part III of subchapter G of chapter 1 of the Internal Revenue Code of 1954 (sections 551–557) does not impose a tax on foreign personal holding companies. The undistributed foreign personal holding company income of such companies, however, must be included in the manner and to the extent set forth in section 551, in the gross income of their "United States shareholders," that is, the shareholders who are individual citizens or residents of the United States, domestic corporations, domestic partnerships, and estates or trusts other than estates or trusts the gross income of which under subtitle A includes only income from sources within the United States.

§ 1.551-2 AMOUNT INCLUDED IN GROSS INCOME.—(a) The undistributed foreign personal holding company income is included only in the gross income of the United States shareholders who were shareholders in the company on the last day of its taxable year on which a United States group (as defined in section 552(a)(2)) existed with respect to the company. Such United States shareholders, accordingly, are determined by the stock holdings as of such specified time. This rule applies to every United States shareholder who was a shareholder in the company at the specified time regardless of whether the United States shareholder is included within the United States group. For example, a domestic corporation which is a United States shareholder at the specified time must return its distributive share in the undistributed foreign personal holding company income even though the domestic corporation cannot be included within the United States group since, under section 554, the stock it owns in the foreign corporation is considered as being owned proportionately by its shareholders for the purpose of determining whether the foreign corporation is a foreign personal holding company.

(b) The United States shareholders must include in their gross income their distributive shares of that proportion of the undistributed foreign personal holding company income for the taxable year of the company which is equal in ratio to that which the portion of the taxable year up to and including the last day on which the United States group with respect to the company existed bears to the entire taxable year. Thus, if the last day in the taxable year on which the required United States group existed was also the end of the taxable year, the portion of the taxable year up to and including such last day would be equal to 100 percent and, in such case, the United States shareholders would be required to return their distributive shares in the entire undistributed foreign personal holding company income. But if the last day on which the required United States group existed was September 30, and the taxable year was a calendar year, the portion of the taxable year up to and including such last day would be equal to nine-twelfths and, in that case, the United States shareholders would be required to return their distributive shares in only nine-twelfths of the undistributed foreign personal holding company income.

(c) The amount which each United States shareholder must return is that amount which he would have received as a dividend if the above-specified portion of the undistributed foreign personal holding company income had in fact been distributed by the foreign personal holding company as a dividend on the last day of its taxable year on which the required United States group existed. Such amount is determined, therefore, by the interest of the United States shareholder in the foreign personal holding company, that is, by the number of shares of stock owned by the United States shareholder and the relative rights of his class of stock, if there are several classes of stock outstanding. Thus, if a foreign personal holding company has both common and preferred stock outstanding and the preferred shareholders are entitled to a specified dividend before any distribution may be made to the common shareholders, then the assured distribution of the stated portion of the undistributed foreign personal holding company income must first be treated as a payment of

the specified dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

(d) The assumed distribution of the required portion of the undistributed foreign personal holding company income must be returned as dividend income by the United States shareholders for their respective taxable years in which or with which the taxable year of the foreign personal holding company ends. For example, if the M Corporation, whose taxable year is the calendar year, is a foreign personal holding company for 1954 and if A, one of its United States shareholders, makes returns on a calendar year basis, while B, another United States shareholder, makes returns on the basis of a fiscal year ending November 30, A must return his assumed dividend as income for the taxable year 1954 and B must return his distributive share as income for the fiscal year ending November 30, 1955. In applying this rule, the date as of which the United States group last existed with respect to the company is immaterial. Thus, in the foregoing example, if September 30, 1954, was the last day on which the United States group with respect to the M Corporation existed, B would still be required to return his assumed dividend as income for the fiscal year ending November 30, 1955, even though September 30, 1954, the date as of which the distribution is assumed to have been made, does not fall within such fiscal year.

(e) For the treatment of gain on the sale of certain stock, see section 306(f) and § 1.306–3(h).

§ 1.551–3 Deduction for Obligations of the United States and its Instrumentalities.—(a) Each United States shareholder required to return his distributive share of undistributed foreign personal holding company income for any taxable year shall take into account in computing the credit against tax under section 35, or the deduction under section 242, whichever is allowable to such shareholder, his proportionate share of whatever interest on obligations of the United States or its instrumentalities (as specified in sections 35 or 242, as the case may be) may be included in the gross income of the company for such taxable year, with the exception of any such interest as may be so included by reason of the application of the provisions of section 555. For reduction of credit for such interest on account of amortizable bond premium, see section 171 and the regulations thereunder.

(b) The rule set forth in paragraph (a) of this section may be illustrated by the following example:

Example. The M Corporation is a foreign personal holding company which owns all the stock of the N Corporation, another foreign personal holding company. Both companies receive interest on obligations of the United States or its instrumentalities as specified in section 35. In determining the amount of the credit allowable under section 35 (if the shareholder is an individual) or the deduction allowable under section 242 (if the shareholder is a corporation), the United States shareholder of the M Corporation would be entitled to a credit or a deduction, as the case may be, only for his proportionate share of the interest received by that company and not for any part of the interest received by the N Corporation, regardless of whether the interest received by the N Corporation is included in the gross income

of the M Corporation as an actual dividend or as a constructive dividend under section 555.

§ 1.551–4 INFORMATION IN RETURN.—The information required by section 551(d) in the returns of certain United States shareholders relates only to the taxable year of a foreign personal holding company for which any part of such corporation's undistributed foreign personal holding company income must be included in gross income by the United States shareholder of whom the information is required. The information shall be submitted as a part of the income tax return in the form of a statement attached to the return.

§ 1.551–5 EFFECT ON CAPITAL ACCOUNT OF FOREIGN PERSONAL HOLDING COMPANY AND BASIS OF STOCK IN HANDS OF SHAREHOLDERS.—(a) Sections 551(e) and 551(f) are designed to prevent double taxation with respect to the undistributed foreign personal holding company income.

(b) The application of sections 551(e) and 551(f) may be illustrated by the following examples:

Example (1). The M Corporation is a foreign personal holding company. Seventy-five percent in value of its capital stock is owned by A, a citizen of the United States, and the remainder, or 25 percent, of its stock is owned by B, a nonresident alien individual. For the calendar year 1954 the M Corporation has an undistributed foreign personal holding company income of $100,000. A is required to include $75,000 of such income in gross income as a dividend in his return for the calendar year 1954. The $100,000 is treated as paid-in surplus or as a contribution to the capital of the M Corporation and its accumulated earnings and profits as of the close of the calendar year 1954 are correspondingly reduced. If after treating such $100,000 as paid-in surplus or as a contribution to capital, the M Corporation has no accumulated earnings and profits at the close of 1954, and if for the calendar year 1955, the M Corporation had no earnings and profits, but distributed $40,000, the amount so distributed would be a nontaxable distribution and would not be included in the gross income of either A or B for the calendar year 1955. If, however, after treating the $100,000 as paid-in surplus or as a contribution to capital, the M Corporation had accumulated earnings and profits of $100,000 at the close of 1954, the facts otherwise being the same, the distributions in 1955 would be taxable to A as a dividend, and the taxability of such distributions to B would depend upon the application of section 861(a)(2), relating to the treatment of dividends from a foreign corporation as income from sources within or without the United States.

Example (2). In example (1) assume the basis of A's stock to be $300,000. If A includes in gross income in his return for the calendar year 1954, $75,000 as a dividend from the M Corporation, the basis of his stock would be $375,000. After the nontaxable distribution of $30,000 to A by the M Corporation in 1955 (75 percent of the $40,000 distribution) the basis of A's stock, assuming no other changes, would be $345,000. If A failed to include the $75,000 as a dividend in gross income in his return for 1954 and his failure was not discovered until after the 6-year period of limitations had expired, the application of the rule would not increase the basis of

A's stock. The subsequent nontaxable distribution of $30,000 to A in 1955 would reduce his basis of $300,000 to $270,000, thus tending to compensate for his failure to include the amount of $75,000 as a dividend in his gross income for 1954. If the undistributed foreign personal holding company income of the M Corporation is readjusted within the statutory period of limitations, thus increasing or decreasing the amount A would have to include in his gross income, proper adjustment is required to be made to the basis of A's stock on account of such readjustment.

§ 1.552 STATUTORY PROVISIONS; DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY.

SEC. 552. DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY.

(a) GENERAL RULE.—For purposes of this subtitle, the term "foreign personal holding company" means any foreign corporation if—

(1) GROSS INCOME REQUIREMENT.—At least 60 percent of its gross income (as defined in section 555(a)) for the taxable year is foreign personal holding company income as defined in section 553; but if the corporation is a foreign personal holding company with respect to any taxable year ending after August 26, 1937, then, for each subsequent taxable year, the minimum percentage shall be 50 percent in lieu of 60 percent, until a taxable year during the whole of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 50 percent of the gross income is foreign personal holding company income. For purposes of this paragraph, there shall be included in the gross income the amount includible therein as a dividend by reason of the application of section 555(c)(2); and

(2) STOCK OWNERSHIP REQUIREMENT.—At any time during the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States, hereinafter called "United States group."

(b) EXCEPTIONS.—The term "foreign personal holding company" does not include—

(1) A corporation exempt from tax under subchapter F (sec. 501 and following); and

(2) A corporation organized and doing business under the banking and credit laws of a foreign country if it is established (annually or at other periodic intervals) to the satisfaction of the Secretary or his delegate that such corporation is not formed or availed of for the purpose of evading or avoiding United States income taxes which would otherwise be imposed upon its shareholders. If the Secretary or his delegate is satisfied that such corporation is not so formed or availed of, he shall issue to such corporation annually or at other periodic intervals a certification that the corporation is not a foreign personal holding company.

Each United States shareholder of a foreign corporation which would, except for the provisions of paragraph (2), be a foreign personal holding company, shall attach to and file with his income tax return for the taxable year a copy of the certification by the Secretary or his delegate made pursuant to paragraph (2). Such copy shall be filed with the taxpayer's return for the taxable year if he has been a shareholder of such corporation for any part of such year.

§ 1.552-1 DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY.—(a) A foreign personal holding company is any foreign corporation, other than a corporation exempt from taxation under subchapter F (section 501 and following) and other than certain banking institutions which satisfy the requirements of section 552(b)(2) and § 1.552-4(b) which for the taxable year meets (1) the gross income

requirement specified in section 552(a)(1); and (2) the stock ownership requirement specified in section 552(a)(2). Both requirements must be satisfied with respect to each taxable year.

(b) A foreign corporation which comes within the classification of a foreign personal holding company is not subject to taxation either under section 531 or section 541. See sections 532(b)(2) and 542(c)(5). The fact that a foreign corporation is a foreign personal holding company does not relieve the corporation from liability for the taxes imposed generally upon foreign corporations, such as the taxes imposed by sections 881 and 882, since such taxes apply regardless of the classification of the foreign corporation as a foreign personal holding company.

§ 1.552–2 Gross Income Requirement.—(a) To meet the gross income requirement, it is necessary that either of the following percentages of gross income of the corporation for the taxable year (including the additions to gross income provided in section 555(b) as required by section 555(c)(2)) be foreign personal holding company income as defined in section 553:

(1) 60 percent or more; or

(2) 50 percent or more if the foreign corporation has been classified as a foreign personal holding company for any taxable year ending after August 26, 1937, unless—

(i) A taxable year has intervened since the last taxable year for which it was so classified, during no part of which the stock ownership requirement specified in section 552(a)(2) exists; or

(ii) Three consecutive years have intervened since the last taxable year for which it was so classified, during each of which its foreign personal holding company income was less than 50 percent of its gross income.

(b) In determining whether the foreign personal holding company income is equal to the required percentage of the total gross income, the determination must not be made upon the basis of gross receipts, since gross income is not synonymous with gross receipts. For meaning of gross income in this part, see section 555 and § 1.555–1.

§ 1.552–3 Stock Ownership Requirement.—(a) To meet the stock ownership requirement, it is necessary that at sometime in the taxable year more than 50 percent in value of the outstanding stock of the foreign corporation be owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States, herein referred to as "United States group." For the purpose of the requirement under section 552(a)(2), section 554 provides that the ownership of the stock must be determined under the rules prescribed by section 544 (relating to rules for determining stock ownership in the case of personal holding companies generally). Accordingly, section 544 and §§ 1.544–1—1.544–7 are applicable for purposes of section 552(a)(2) and this section as if each reference in section 544 and §§ 1.544–1—1.544–7 to a personal holding company or to part II (sections 541–547) of subchapter G of the 1954 Code was a reference to a foreign personal holding company or to part III (sections 551–557) of subchapter G of the 1954 Code, as the case may be.

(b) It is necessary to consider any change in the stock outstanding during the taxable year, whether in the number of shares or classes of

stock, or in the ownership thereof, since a corporation comes within the classification if the statutory conditions with respect to stock ownership are present at any time during the taxable year.

(c) In determining whether the statutory conditions with respect to stock ownership are present at any time during the taxable year, the phrase "in value" shall, in the light of all the circumstances, be deemed the value of the corporate stock outstanding at such time (not including treasury stock). This value may be determined upon the basis of the company's net worth, earning and dividend paying capacity, appreciation of assets, together with such other factors as have a bearing upon the value of the stock. If the value of the stock which is used is greatly at variance with that reflected by the corporate books, the evidence of such value should be filed with the return. In any case where there are two or more classes of stock outstanding, the total value of all the stock should be allocated among the different classes according to the relative value of each class therein.

§ 1.552–4 CERTAIN EXCLUDED BANKS.—(a) A corporation is excluded from the definition of "foreign personal holding company" if it is organized and doing business under the banking and credit laws of a foreign country and if it establishes to the satisfaction of the Commissioner that it was not formed or availed of for the purpose of evading or avoiding United States income taxes which would otherwise be imposed on its shareholders. If this is established, the Commissioner, or such other official to whom authority may be delegated, will certify, by letter to the corporation, that it is not a foreign personal holding company.

(b) An application for certification under section 552(b)(2) shall be made in writing to the Commissioner of Internal Revenue, Washington 25, D. C., Attention: Director of International Operations. A separate application shall be filed for each taxable year for which certification is requested and the application shall be accompanied by a completed Form 958 for the taxable year. See section 6035. The following information shall be set forth in, or submitted with, the application:

(1) A complete reference to the banking or credit laws of the foreign country under which the corporation operates;

(2) A statement as to the extent of the corporation's business in receiving deposits and making loans and discounts and similar banking and credit operations;

(3) A statement as to the extent of the operations of the corporation other than such banking and credit operations;

(4) A statement as to whether the banking and credit operations of the corporation are customary for it;

(5) A statement setting forth the degree and manner of supervision exercised over it by the foreign government under its banking and credit laws; a copy (in English) of the corporation's last annual financial statement, as submitted to the Government authority having jurisdiction over it, shall be submitted with the application;

(6) A statement setting forth the business reasons of the corporation for not distributing the amount which would be its un-

distributed foreign personal holding company income if the corporation were not excluded under section 552 (b);

(7) A statement setting forth the extent of the corporation's profits which must be retained as reserves under the foreign law;

(8) A statement setting forth the date or dates when the corporation reasonably expects to distribute its undistributed foreign personal holding company income for the taxable year;

(9) A statement setting forth the name and address of each of the individuals described in section 552 (a) (2), the extent of their stock ownership in the corporation, and the amount of distributions or other payments to such stockholders including, but not limited to, dividends, compensation, interest, and rents; and

(10) Any other facts or information the corporation may wish to submit to show that it was not formed or availed of for the purpose of evading or avoiding United States income taxes which would otherwise be imposed on its shareholders.

The corporation shall also furnish such other information requested as necessary by the Director of International Operations. The application for certification, together with the information required by this paragraph, should be filed within 60 days after the close of the taxable year of the corporation or within 60 days after the date of publication of these regulations in the Federal Register, whichever is later. However, if the corporation is unable, for good cause, to submit the application for certification within such 60-day period, additional time may be granted by the Director of International Operations upon receipt of a request from the corporation setting forth the reasons for such request.

§ 1.552–5 UNITED STATES SHAREHOLDER OF EXCLUDED BANK.—A copy of the certification issued to an excluded bank under section 552 (b) (2) and § 1.552–4 shall be filed with, and made a part of, the income tax return for the taxable year of each United States shareholder of such foreign corporation, if he has been a shareholder of such corporation for any part of such year. If the certificate has not been issued at the time the return of the United States shareholder is filed, the shareholder shall compute the tax on his return by treating the bank as a foreign personal holding company. If a certificate is issued after the return is filed, the United States shareholder may file a claim for refund or an amended return, and shall attach thereto a copy of the certification.

§ 1.553 STATUTORY PROVISIONS; FOREIGN PERSONAL HOLDING COMPANY INCOME.—

SEC. 553. FOREIGN PERSONAL HOLDING COMPANY INCOME.

For purposes of this subtitle, the term "foreign personal holding company income" means the portion of the gross income, determined for purposes of section 552, which consists of personal holding company income, as defined in section 543, except that all interest, whether or not treated as rent, and all royalties, whether or not mineral, oil, or gas royalties, shall constitute "foreign personal holding company income".

§ 1.553–1 FOREIGN PERSONAL HOLDING COMPANY INCOME.—Foreign personal holding company income shall consist of the items defined under section 543 and §§ 1.543–1 and 1.543–2, relating to personal holding company income, with the following exceptions:

(a) The entire amount received as "interest", whether or not treated as rent, shall be considered to be foreign personal holding company income. Thus, the exception in the second sentence of section 543(a)(1) and § 1.543–1(b)(2) (relating to interest treated as rent under section 543(a)(7) and § 1.543–1(b)(10)), is inapplicable for the purpose of determining foreign personal holding company income. Similarly, section 543(a)(7) and § 1.543–1(b)(10) are applied for this purpose without regard to the interest described in that section.

(b)(1) The entire amount received as "royalties", whether or not mineral, oil, or gas royalties, shall be considered to be foreign personal holding company income. Thus, subparagraphs (A) and (B) of section 543(a)(8) and subdivisions (*a*) and (*b*) of § 1.543–1(b)(11)(i) are inapplicable for the purpose of determining foreign personal holding company income.

(2) In computing foreign personal holding company income, the first sentence of paragraph (b)(11)(ii) of § 1.543–1 shall apply to overriding royalties received from the sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid, and to mineral, oil, or gas production payments, only with respect to amounts received after September 30, 1958.

§ 1.554 STATUTORY PROVISIONS; STOCK OWNERSHIP.

SEC. 554. STOCK OWNERSHIP.

For purposes of determining whether a foreign corporation is a foreign personal holding company, insofar as such determination is based on stock ownership, the rules provided in section 544 shall be applicable as if any reference in such section to a personal holding company was a reference to a foreign personal holding company and as if any reference in such section to a provision of part II (relating to personal holding companies) was a reference to the corresponding provision of this part.

§ 1.554–1 STOCK OWNERSHIP.—For regulations under section 554, see § 1.552–3.

§ 1.555 STATUTORY PROVISION; GROSS INCOME OF FOREIGN PERSONAL HOLDING COMPANIES.

SEC. 555. GROSS INCOME OF FOREIGN PERSONAL HOLDING COMPANIES.

(a) GENERAL RULE.—For purposes of this part the term "gross income" means, with respect to a foreign corporation, gross income computed (without regard to the provisions of subchapter N (sec. 861 and following)) as if the foreign corporation were a domestic corporation which is a personal holding company.

(b) ADDITIONS TO GROSS INCOME.—In the case of a foreign personal holding company (whether or not a United States group, as defined in section 552(a)(2), existed with respect to such company on the last day of its taxable year) which was a shareholder in another foreign personal holding company on the day in the taxable year of the second company which was the last day on which a United States group existed with respect to the second company, there shall be included, as a dividend, in the gross income of the first company, for the taxable year in which or with which the taxable year of the second company ends, the amount the first company would have received as a dividend if on such last day there had been distributed by the second company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the sec-

ond company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

(c) APPLICATION OF SUBSECTION (b).—The rule provided in subsection (b)—

(1) Shall be applied in the case of a foreign personal holding company for the purpose of determining its undistributed foreign personal holding company income which, or a part of which, is to be included in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies;

(2) Shall be applied in the case of every foreign corporation with respect to which a United States group exists on some day of its taxable year, for the purpose of determining whether such corporation meets the gross income requirements of section 552(a)(1).

§ 1.555–1 GENERAL RULE.—The gross income of a foreign corporation which is a foreign personal holding company is computed the same as if the foreign corporation were a domestic corporation which is a personal holding company. See section 542(a)(1) and § 1.542–2. The gross income of a foreign personal holding company thus includes income from all sources, whether within or without the United States, which is not specifically excluded from gross income under any other provisions of the Code. For example, the gross income of a foreign personal holding company includes all income from sources outside the United States even though the foreign personal holding company is a foreign corporation not engaged in trade or business within the United States.

§ 1.555–2 ADDITIONS TO GROSS INCOME.—(a) If, for any taxable year—

(1) A foreign corporation meets the stock ownership requirement specified in section 552(a)(2) and § 1.552–3, regardless of whatever day in its taxable year is the last day on which the required United States group exists, and

(2) Such foreign corporation is a shareholder in a foreign personal holding company on any day of a taxable year of the second company which ends with or within the taxable year of the first company and such day is the last day in the taxable year of the second company in which the United States group exists with respect to the second company, then for the purpose of—

(i) Determining whether the first company meets the specified gross income requirement so as to come within the classification of a foreign personal holding company, and

(ii) Determining the undistributed foreign personal holding company income of the first company which (in the event the first company is a foreign personal holding company) is to be included, in whole or in part, in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies:

there shall be included as a dividend in the gross income of the first company for the taxable year in which or with which the taxable year of the second company ends, the amount the first company would have received as a dividend, if on the last day referred to in subparagraph (2) of this paragraph there had been distributed by the second company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company in-

come of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year. The foregoing rules apply to any chain of foreign corporations regardless of the number of corporations included in the chain.

(b) The application of section 555(b) may be illustrated by the following examples:

Example (1). The X Corporation is a foreign corporation whose stock is owned by A, a United States citizen. The X Corporation owns the entire stock of the Y Corporation, another foreign corporation. The taxable year of the X Corporation is the calander year and the taxable year of the Y Corporation is the fiscal year ending June 30. For the fiscal year ending June 30, 1955, more than the required percentage of the Y Corporation's gross income consists of foreign personal holding company income and no part of the earnings for such year is distributed as dividends. On the basis of these facts the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1955. The X Corporation meets the stock ownership requirement and constitutes a foreign personal holding company for 1955, if it also meets the gross income requirement. For the purpose of determining whether the X Corporation meets the gross income requirement, the entire undistributed foreign personal holding company income of the Y Corporation for the fiscal year ending June 30, 1955, must be included as a dividend in the gross income of the X Corporation for 1955, since—

(1) The X Corporation was a shareholder in the Y Corporation on a day (June 30, 1955) in the taxable year of the Y Corporation ending with or within the taxable year of the X Corporation, which day was the last day in the taxable year of the Y Corporation on which the United States group required with respect to the Y Corporation existed,

(2) Such last day was also the end of the Y Corporation's taxable year so that the portion of the taxable year of the Y Corporation up to and including such last day is equal to 100 percent of the taxable year of the Y Corporation, and, therefore, the portion of the undistributed foreign personal holding company income of the Y Corporation includible in the gross income of its shareholders is likewise equal to 100 percent, and

(3) The X Corporation being the sole shareholder of the Y Corporation must include such portion in its gross income for 1955, the taxable year in which or with which the taxable year of the Y Corporation ends. If, after the inclusion of the presumptive dividend in its gross income, the X Corporation is a foreign personal holding company for 1955, then the undistributed foreign personal holding company income of the Y Corporation must also be included as a dividend in the gross income of the X Corporation in determining its undistributed foreign personal holding company income which is to be included in the gross income of A, the sole shareholder in the X Corporation. On the other hand, if, after including such presumptive dividend, the X Corporation does not constitute a foreign personal holding company, the undistributed foreign personal hold-

ing company income of the Y Corporation is not includible in the gross income of the X Corporation.

Example (2). The X Corporation referred to in example (1) sold the stock in the Y Corporation to other interests on September 30, 1955, so that after that date no United States group existed with respect to the Y Corporation. For the fiscal year ending June 30, 1956, more than the required percentage of the gross income of the Y Corporation consists of foreign personal holding company income. The taxable income of the Y Corporation for such fiscal year amounts to $1,000,000, of which $900,000 is distributed in dividends after September 30, 1955. The undistributed foreign personal holding company income of the Y Corporation for such fiscal year amounts to $100,000. Upon the basis of these facts the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1956, since at one time in such fiscal year, or from July 1 to and including September 30, 1955, it meets the stock ownership requirement, and the gross income requirement is also satisfied. In determining whether the X Corporation constitutes a foreign personal holding company for 1956, a portion of the undistributed foreign personal holding company income of the Y Corporation for the fiscal year ending June 30, 1956 ($^3/_{12}$ of $100,000, or $25,000), must be included as a dividend in the gross income of the X Corporation, since—

(1) The X Corporation was a shareholder in the Y Corporation on September 30, 1955, or on a day in the taxable year of the Y Corporation ending with or within the taxable year of the X Corporation which day was the last day in the Y Corporation's taxable year on which the United States group required with respect to the Y Corporation existed.

(2) The portion of the taxable year of the Y Corporation up to and including such day is three-twelfths of the entire taxable year of the Y Corporation and, therefore, the portion of the undistributed foreign personal holding company income of the Y Corporation includible in the gross income of its shareholders also is equal to three-twelfths, and

(3) The X Corporation, being the sole shareholder of the Y Corporation at the time the United States group with respect to the Y Corporation last existed, must include all of such portion in its gross income for 1956, the taxable year of the X Corporation in which or with which the taxable year of the Y Corporation ends.

It is to be observed that three-twelfths of the undistributed foreign personal holding company income of the Y Corporation for the entire taxable year and not the earnings realized by the Y Corporation up to and including September 30, 1955, the last day on which the United States group with respect to the Y Corporation existed, must be included in the gross income of the X Corporation.

Example (3). The X Corporation referred to in example (1) sold the stock in the Y Corporation to other interests on September 30, 1955, so that after that date a different United States group existed with respect to the Y Corporation. Assuming that the Y Corporation is a foreign personal holding company for the fiscal year ending

June 30, 1956, no part of the undistributed foreign personal holding company income of the Y Corporation for such fiscal year would, in this instance, be includible in the gross income of the X Corporation for the year 1956, in determining whether the X Corporation is a foreign personal holding company for that year. In such case, the undistributed foreign personal holding company income of the Y Corporation is includible in the gross income of the other foreign personal holding companies, if any, and of the United States shareholders who are shareholders in the Y Corporation the day after September 30, 1955, which was the last day in the taxable year of the Y Corporation on which the United States group with respect to the Y Corporation existed. If, however, the X Corporation sells 90 percent of its stock in the Y Corporation and thus is a minority shareholder in the Y Corporation on the last day of the taxable year of the Y Corporation on which the United States group with respect to the Y Corporation exists, the portion of the undistributed foreign personal holding company income allocable to the minority interest of the X Corporation would be includible in the gross income of the X Corporation, even though on such last day the United States group is not the same with respect to both corporations.

Example (4). If the Y Corporation in example (1) owns all of the stock of the Z Corporation, another foreign corporation, there would be a chain of three foreign corporations. In such case, assuming that the Z Corporation is a foreign personal holding company for a taxable year ending with or within the taxable year of the Y Corporation, the undistributed foreign personal holding company income of the Z Corporation would be included in the gross income of the Y Corporation for the purpose of determining whether the Y Corporation comes within the classification of a foreign personal holding company. If, after the inclusion of such presumptive dividend, the Y Corporation is a foreign personal holding company, the undistributed foreign personal holding company income of the Z Corporation would be included in the gross income of the Y Corporation in determining the undistributed foreign personal holding company income of the Y Corporation which is includible in the gross income of its shareholder, the X Corporation. The same process would be repeated with respect to determining whether the X Corporation is a foreign personal holding company and in determining its undistributed foreign personal holding company income. If all three corporations are foreign personal holding companies, the undistributed foreign personal holding company income of each would, in this manner, be reflected as a dividend in the gross income of A, the ultimate beneficial shareholder of the chain. In the event that after the inclusion of the undistributed foreign personal holding company income of the Z Corporation in the gross income of the Y Corporation, the Y Corporation is not a foreign personal holding company, then no part of the income of either the Z Corporation or the Y Corporation would be includible in the gross income of the X Corporation. In that event, whether the X Corporation is a foreign personal holding company, and its undistributed foreign personal holding company income, would be determined independently of the income of the Y Corporation and the Z Corporation.

§ 1.556 Statutory Provisions; Undistributed Foreign Personal Holding Company Income.

SEC. 556. UNDISTRIBUTED FOREIGN PERSONAL HOLDING COMPANY INCOME.

(a) Definition.—For purposes of this part, the term "undistributed foreign personal holding company income" means the taxable income of a foreign personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561).

(b) Adjustments to Taxable Income.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

(1) Taxes.—There shall be allowed as a deduction Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940) and income, war profits, and excess-profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 164(b)(6)), accrued during the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law. A taxpayer which, for each taxable year in which it was subject to the provisions of supplement P of the Internal Revenue Code of 1939, deducted Federal income and excess profits taxes when paid for the purpose of computing undistributed supplement P net income under such code, shall deduct taxes under this paragraph when paid, unless the corporation elects, under regulations prescribed by the Secretary or his delegate, after the date of enactment of this title to deduct the taxes described in this paragraph when accrued. Such election shall be irrevocable and shall apply to the taxable year for which the election is made and to all subsequent taxable years.

(2) Charitable contributions.—The deduction for charitable contributions provided under section 170 shall be allowed, but with the limitation in section 170(b)(1)(A) and (B) (in lieu of the limitation in section 170(b)(2)). For purposes of this paragraph, the term "adjusted gross income" when used in section 170(b)(1) means the taxable income computed with the adjustments provided in section 170(b)(2) and without the deduction of the amounts disallowed under paragraphs (5) and (6) of this subsection or the inclusion in gross income of the amounts includible therein as dividends by reason of the application of the provisions of section 555(b) (relating to the inclusion in gross income of a foreign personal holding company of its distributive share of the undistributed foreign personal holding company income of another company in which it is a shareholder).

(3) Special deductions disallowed.—The special deductions for corporations provided in part VIII (except sections 242 and 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) Net operating loss.—The net operating loss deduction provided in section 172 shall not be allowed, but there shall be allowed as a deduction the amount of the net operating loss (as defined in section 172(c)) for the preceding taxable year .

(5) Expenses and depreciation applicable to property of the taxpayer.—The aggregate of the deductions allowed under section 162 (relating to trade or business expenses) and section 167 (relating to depreciation) which are allocable to the operation and maintenance of property owned or operated by the company, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Sec-

retary or his delegate) to the satisfaction of the Secretary or his delegate—

(A) That the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(B) That the property was held in the course of a business carried on bona fide for profit; and

(C) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(6) TAXES AND CONTRIBUTIONS TO PENSION TRUSTS.—The deductions provided in section 164(e) (relating to taxes of a shareholder paid by the corporation) and in section 404 (relating to pension, etc., trusts) shall not be allowed.

§ 1.556–1 DEFINITION.—Undistributed foreign personal holding company income is the amount which is to be included in the gross income of the United States shareholders under section 551(b) and § 1.551–2. Undistributed foreign personal holding company income is the taxable income of the foreign personal holding company, as defined in section 63(a) (computed without regard to subchapter N), and adjusted in the manner described in section 556(b) and § 1.556–2, less the deduction for dividends paid (§§ 1.561–1.565). See § 1.556–3 for an illustration of the computation of undistributed foreign personal holding company income.

§ 1.556–2 ADJUSTMENTS TO TAXABLE INCOME.—(a) *Taxes.*—(1) *General rule.*—(i) In computing undistributed foreign personal holding company income for any taxable year, there shall be allowed as a deduction the Federal income and excess profits taxes accrued during the taxable year except that no deduction shall be allowed for (*a*) the accumulated earnings tax imposed by section 531 (or a corresponding section of a prior law), (*b*) the personal holding company tax imposed by section 541 (or a corresponding section of a prior law), and (*c*) the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939, for taxable years beginning after December 31, 1940. The deduction is for taxes for the taxable year, determined under the accrual method of accounting regardless of whether the corporation uses an accrual method of accounting, the cash receipts and disbursements method, or any other allowable method of accounting. In computing the amount of taxes accrued, an unpaid tax which is being contested is not considered accrued until the contest is resolved.

(ii) However, the corporation shall deduct taxes paid, rather than taxes accrued, if it used that method with respect to Federal taxes for each taxable year for which it was subject to the provisions of supplement P of the Internal Revenue Code of 1939, unless an election is made under subparagraph (2) of this paragraph to deduct taxes accrued.

(2) *Election by corporation which deducted taxes paid.*—(i) If the corporation was subject to supplement P of the Internal Revenue Code of 1939, and, for the purpose of computing undistributed supplement P net income under such Code, deducted Federal taxes paid, rather than such taxes accrued, for each taxable year for which it was subject to supplement P of the 1939 Code, the corporation may elect for any taxable year ending after August 16, 1954, to deduct taxes

accrued, rather than taxes paid, for the purpose of computing its undistributed foreign personal holding company income. The election shall be made by deducting such taxes accrued in the return (Form 958) required to be filed for such taxable year. The return shall, in addition, contain a statement that the corporation has made such election and shall set forth the year to which such election was first applicable. The deduction of taxes accrued in the year of election precludes the deduction of taxes paid during such year. The election, if made, shall be irrevocable and the deduction for taxes accrued shall be allowed for the year of election and for all subsequent taxable years. See section 6035 and the regulations thereunder for rules relative to the filing of returns of officers, directors, and shareholders of foreign personal holding companies.

(ii) Pursuant to section 7851(a)(1)(C), the election provided for in subdivision (i) of this subparagraph may be made with respect to a taxable year ending after August 16, 1954, even though such taxable year is subject to the Internal Revenue Code of 1939.

(3) *Taxes of foreign countries and United States possessions.*—In computing taxable income, a foreign personal holding company is allowed a deduction under section 164 for income, war profits, and excess-profits taxes paid or accrued during the taxable year to foreign countries or possessions of the United States, but is not allowed the foreign tax credit under section 901. Therefore, in computing undistributed foreign personal holding company income for any taxable year, no adjustment under section 556(b)(1) is allowed for such taxes.

(b) *Charitable contributions.*—(1) Section 556(b)(2) provides that, in computing the undistributed foreign personal holding company income of a corporation, the deduction for charitable contributions by a corporation shall be computed with the limitations of section 170(b)(1)(A) and (B) (relating to charitable contributions by individuals) instead of the limitation in section 170(b)(2) (relating to charitable contributions by corporations).

(2) Although the limitations of section 170(b)(1)(A) and (B) are 10 and 20 percent, respectively, of the individual's adjusted gross income, the limitations are applied for purposes of section 556(b)(2) by using 10 and 20 percent, respectively, of the corporation's taxable income as adjusted for purposes of section 170(b)(2) (that is, the same amount of taxable income to which the 5 percent limitation applied). However, a further adjustment for this purpose is that the taxable income shall also be computed without the deduction of the amount disallowed under section 556(b)(5) (relating to expenses and depreciation applicable to property of the taxpayer), and section 556(b)(6) (relating to taxes and contributions to pension trusts), and without the inclusion of the amounts includible as dividends under section 555(b) (relating to the inclusion in gross income of a foreign personal holding company of its distributive share of the undistributed foreign personal holding company income of another company in which it is a shareholder).

(3) See the regulations under section 170(b)(1)(A) and (B) with respect to the charitable contributions to which the 10 percent limitation is applicable and the charitable contributions to which the 20 percent limitation is applicable.

(4) In some cases, a deduction in excess of the 5 percent limitation may be allowed for one taxable year under section 556(b)(2) for purposes of computing the undistributed foreign personal holding company income only, and may also be allowed as a deduction in computing taxable income for a subsequent taxable year under the carryover provisions of section 170(b)(2). To the extent that the charitable contributions carried over from a previous year have already been deducted for purposes of determining undistributed foreign personal holding company income in the year when the charitable contributions were made, they may not be deducted again as part of the contribution carryover deduction, for purposes of determining undistributed foreign personal holding company income for a subsequent year. However, this adjustment is only for purposes of computing the undistributed foreign personal holding company income, and the carryover in such case is allowable in computing taxable income.

(c) *Special deductions disallowed.*—Part VIII of subchapter B of chapter 1 allows corporations special deductions in computing taxable income for such matters as partially tax-exempt interest, certain dividends received, dividends paid on certain preferred stock of public utilities, organizational expenses, etc. See section 241. Such special deductions, except the deduction provided by section 242 (relating to partially tax-exempt interest) and the deduction provided by section 248 (relating to organizational expenses), shall be disallowed in computing undistributed foreign personal holding company income.

(d) *Net operating loss.*—The net operating loss deductions provided in section 172 is not allowed for purposes of the computation of undistributed foreign personal holding company income; however, there is allowed as a deduction for such purposes the amount of the net operating loss (as defined in section 172 (c)) for the preceding taxable year.

(e) *Expenses and depreciation applicable to property of the corporation.*—(1) Section 556(b)(5) provides a specific limitation in computing undistributed foreign personal holding company income, with respect to the allowance of deductions for trade or business expenses and depreciation which are allocable to the operation and maintenance of property owned or operated by a foreign personal holding company. Under this limitation these deductions shall not be allowed in excess of the aggregate amount of the rent or other compensation received for the use of, or the right to use, the property, unless it is established to the satisfaction of the Commissioner—

(i) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(ii) That the property was held in the course of a business carried on bona fide for profit; and

(iii) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(2) The burden of proof will rest upon the taxpayer to sustain the deduction claimed. If a United States shareholder, in computing his distributive share of undistributed foreign personal holding company income to be included in gross income in his individual return (see section 551, and §§ 1.551–1 and 1.551–2), claims deduc-

tions for expenses and depreciation allocable to the operation and maintenance of property owned or operated by the company, in an aggregate amount in excess of the rent or other compensation received for the use of, or the right to use, the property, he shall attach to his income tax return a statement setting forth his claim for allowance of the additional deductions, together with a complete statement of the facts and circumstances pertinent to his claim and the arguments on which he relies. Such statement shall set forth:

(i) A description of the property;

(ii) The cost or other basis to the corporation and the nature and value of the consideration paid for the property;

(iii) The name and address of the person from whom the property was acquired and the date the property was acquired;

(iv) The name and address of the person to whom the property is leased or rented, or the person permitted to use the property, and the number of shares of stock, if any, held by such person and the members of his family;

(v) The nature and gross amount of the rent or other compensation received for the use of, or the right to use, the property during the taxable year and for each of the five preceding years and the amount of the expenses incurred with respect to, and the depreciation sustained on, the property for such years;

(vi) Evidence that the rent or other compensation was the highest obtainable, or, if none was received, a statement of the reasons therefor;

(vii) A copy of the contract, lease or rental agreement;

(viii) The purpose for which the property was used;

(ix) The business carried on by the corporation with respect to which the property was held and the gross income, expenses, and taxable income derived from the conduct of such business for the taxable year and for each of the five preceding years;

(x) A statement of any reasons which existed for expectation that the operation of the property would be profitable, or a statement of the necessity for the use of the property in the business of the corporation, and the reasons why the property was acquired; and

(xi) Any other information pertinent to the taxpayer's claim.

(f) *Taxes and contributions to pension trusts.*—Section 164(e) provides for deduction by a corporation for taxes of a shareholder paid by it; section 404 provides for deduction by an employer for its contributions to an employees' trust, etc. For the purpose of computing undistributed foreign personal holding company income, neither of these deductions is allowable.

§ 1.556–3 Illustration of Computation of Undistributed Foreign Personal Holding Company Income.—The method of computation of the undistributed foreign personal holding company income may be illustrated by the following example:

Example. (a) The following facts exist with respect to the M Corporation, a foreign personal holding company, for the calendar year 1954:

(1) The gross income of the corporation as defined in section 555 amounts to $300,000, of which $85,000 represents its distributive share of the undistributed foreign personal holding company income of another foreign personal holding company in which it is shareholder,

$200,000 consists of dividends, $10,000 consists of fully taxable interest, and the remainder ($5,000) consists of rent received from the principal shareholder of the corporation for the use of property owned by the corporation.

(2) The expenses of the corporation amount to $85,000, of which $75,000 is allocable to the maintenance and operation of the property used by the principal shareholder and $10,000 consists of ordinary and necessary office expenses allowable as a deduction. The claim for deduction for the expenses of, and depreciation on, the rented property in excess of the rent received for its use is not established as provided in section 556 (b) (5). The yearly depreciation on the rented property amounts to $30,000.

(3) Federal income tax witheld at the source on the income of the corporation from sources within the United States amounts to $59,125.

(4) No gain from the sale or exchange of stock or securities is realized during the taxable year, but losses in the amount of $10,000 are sustained from the sale of stock or securities which constitute capital assets. Such losses are not allowed as a deduction in any amount. See section 1211(a).

(5) Contributions, payment of which is made to or for the use of donees described in section 170(b)(1)(A) for the purposes therein specified, amount to $15,000, of which $5,000 is deductible in computing taxable income under section 63.

(6) Dividends paid by the corporation to its shareholders during the taxable year amount to $50,000.

(b) The taxable income of the corporation (including the distributive share of the undistributed foreign personal holding company income of the other foreign personal holding company) is $180,000, computed as follows (assuming for the purposes of this example only that the expenses of, and depreciation on, the rental property are deductible under sections 162 and 167):

INCOME (Section 61)

Dividends		$200,000
Interest		10,000
Rent		5,000
Gross income as defined in section 61		215,000
Add:		
Distributive share of undistributed income of the other foreign personal holding company (considered as a dividend)		85,000
Gross income as defined in section 555		300,000

DEDUCTIONS (Section 161)

Expenses allocable to operation of the rented property	$75,000	
Depreciation of the rented property	30,000	
Ordinary and necessary expenses (office)	10,000	
Contributions (within the 5 percent limitation specified in section 170(b)(2))	5,000	
		120,000
Taxable income for purposes of computing undistributed foreign personal holding company income		180,000

(c) The undistributed foreign personal holding company income of the corporation is $160,875, computed as follows:

Taxable income for purposes of computing undistributed foreign personal holding company income		$180,000
Add (see section 556(b)):		
Contributions deductible in computing taxable income under section 63	$5,000	
Excess property expenses and depreciation over amount of rent received for use of property ($105,000–$5,000)	100,000	
	105,000	
Deduct (see section 556(b)):		
Federal income taxes	$59,125	
Contributions (within the percentage limitations specified in section 170(b)(1)(A) and (B), determined under the rules provided in section 556(b)(2))	15,000	
	74,125	
Net additions under section 556(b)		30,875
Taxable income, as adjusted under section 556(b)		210,875
Less:		
Deduction for dividends paid (see section 561)		50,000
Undistributed foreign personal holding company income		160,875

§ 1.557 Statutory Provisions; Income Not Placed on Annual Basis.

SEC. 557. INCOME NOT PLACED ON ANNUAL BASIS.

Section 443(b) (relating to computation of tax on change of annual accounting period) shall not apply in the computation of the undistributed foreign personal holding company income under section 556.

DEDUCTIONS FOR DIVIDENDS PAID

§ 1.561 Statutory Provisions; Definition of Deduction for Dividends Paid.

SEC. 561. DEFINITION OF DEDUCTION FOR DIVIDENDS PAID.

(a) General Rule.—The deduction for dividends paid shall be the sum of—

(1) The dividends paid during the taxable year,

(2) The consent dividends for the taxable year (determined under section 565), and

(3) In the case of a personal holding company, the dividend carryover described in section 564.

(b) Special Rules Applicable.—In determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) and section 563 (relating to dividends paid after the close of the taxable year) shall be applicable.

§ 1.561–1 Deduction for Dividends Paid.—(a) The deduction for dividends paid is applicable in determining accumulated taxable income under section 535, undistributed personal holding company income under section 545, undistributed foreign personal holding company income under section 556, and investment company taxable income under section 852. The deduction for dividends paid includes—

(1) The dividends paid during the taxable year;

(2) The consent dividends for the taxable year, determined as provided in section 565; and

(3) In the case of a personal holding company, the dividend carryover computed as provided in section 564.

(b) For dividends for which the dividends paid deduction is allowable, see section 562 and § 1.562–1. As to when dividends are considered paid, see § 1.561–2.

§ 1.561–2 WHEN DIVIDENDS ARE CONSIDERED PAID.—(a) *In general.*—(1) A dividend will be considered as paid when it is received by the shareholder. A deduction for dividends paid during the taxable year will not be permitted unless the shareholder receives the dividend during the taxable year for which the deduction is claimed. See section 563 for special rule with respect to dividends paid after the close of the taxable year.

(2) If a dividend is paid by check and the check bearing a date within the taxale year is deposited in the mails, in a cover properly stamped and addressed to the shareholder at his last known address, at such time that in the ordinary handling of the mails the check would be received by the shareholder within the taxable year, a presumption arises that the dividend was paid to the shareholder in such year.

(3) The payment of a dividend during the taxable year to the authorized agent of the shareholder will be deemed payment of the dividend to the shareholder during such year.

(4) If a corporation, instead of paying the dividend directly to the shareholder, credits the account of the shareholder on the books of the corporation with the amount of the dividend, the deduction for a dividend paid will not be permitted unless it be shown to the satisfaction of the Commissioner that such crediting constituted payment of the dividend to the shareholder within the taxable year.

(5) A deduction will not be permitted for the amount of a dividend credited during the taxable year upon an obligation of the shareholder to the corporation unless it is shown to the satisfaction of the Commissioner that such crediting constituted payment of the dividend to the shareholder within the taxable year.

(6) If the dividend is payable in obligations of the corporation, they should be entered or registered in the taxable year on the books of the corporation, in the name of the shareholder (or his nominee or transferee), and, in the case of obligations payable to bearer, should be received in the taxable year by the shareholder (or his nominee or transferee) to constitute payment of the dividend within the taxable year.

(7) In the case of a dividend from which the tax has been deducted and withheld as required by chapter 3 of the Internal Revenue Code of 1954 (sections 1441–1443) the dividend is considered as paid when such deducting and withholding occur.

(b) *Methods of accounting.*—The determination of whether a dividend has been paid to the shareholder by the corporation during its taxable year is in no way dependent upon the method of accounting regularly employed by the corporation in keeping its books or upon the method of accounting upon the basis of which the taxable income of the corporation is computed.

(c) *Records.*—Every corporation claiming a deduction for dividends paid shall keep such permanent records as are necessary (1) to establish that the dividends with respect to which such deduction is

claimed were actually paid during the taxable year and (2) to supply the information required to be filed with the income tax return of the corporation. Such corporation shall file with its return (i) a copy of the dividend resolution; and (ii) a concise statement of the pertinent facts relating to the payment of the dividend, clearly specifying (*a*) the medium of payment and (*b*) if not paid in money, the fair market value and adjusted basis (or face value, if paid in its own obligations) on the date of distribution of the property distributed and the manner in which such fair market value and adjusted basis were determined. Canceled dividend checks and receipts obtained from shareholders acknowledging payment of dividends paid otherwise than by check need not be filed with the return but shall be kept by the corporation as a part of its records.

§ 1.562 STATUTORY PROVISIONS; RULES APPLICABLE IN DETERMINING DIVIDENDS ELIGIBLE FOR DIVIDENDS PAID DEDUCTION.

SEC. 562. RULES APPLICABLE IN DETERMINING DIVIDENDS ELIGIBLE FOR DIVIDENDS PAID DEDUCTION.

(a) GENERAL RULE.—For purposes of this part, the term "dividend" shall, except as otherwise provided in this section, include only dividends described in section 316 (relating to definition of dividends for purposes of corporate distributions).

(b) DISTRIBUTIONS IN LIQUIDATION.—In the case of amounts distributed in liquidation, the part of such distribution which is properly chargeable to earnings and profits accumulated after February 28, 1913, shall be treated as a dividend for purposes of computing the dividends paid deduction. In the case of a complete liquidation occurring within 24 months after the adoption of a plan of liquidation, any distribution within such period pursuant to such plan shall, to the extent of the earnings and profits (computed without regard to capital losses) of the corporation for the taxable year in which such distribution is made, be treated as a dividend for purposes of computing the dividends paid deduction.

(c) PREFERENTIAL DIVIDENDS.—The amount of any distribution shall not be considered as a dividend for purposes of computing the dividends paid deduction, unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

(d) DISTRIBUTIONS BY A MEMBER OF AN AFFILIATED GROUP.—In the case where a corporation which is a member of an affiliated group of corporations filing or required to file a consolidated return for a taxable year is required to file a separate personal holding company schedule for such taxable year, a distribution by such corporation to another member of the affiliated group shall be considered as a dividend for purposes of computing the dividends paid deduction if such distribution would constitute a dividend under the other provisions of this section to a recipient which is not a member of an affiliated group.

§ 1.562–1 DIVIDENDS FOR WHICH THE DIVIDENDS PAID DEDUCTION IS ALLOWABLE.—(a) *General rule.*—Except as otherwise provided in section 562(b) and (d), the term "dividend", for purposes of determining dividends eligible for the dividends paid deduction, refers only a a dividend described in section 316 (relating to definition of dividends for purposes of corporate distributions). No distribution however, which is preferential within the meaning of section 562(c) and § 1562–2 shall be eligible for the dividends paid deduction. Further, for purposes of the dividends paid deduction, the term "dividend" does not include a distribution in liquidation unless the distribution quali-

fies under section 562(b) and paragraph (b) of this section. If a dividend is paid in property (other than money) the amount of the dividend paid deduction with respect to such property shall be the adjusted basis of the property in the hands of the distributing corporation at the time of the distribution. See paragraph (c) of this section for a special rule for personal holding companies. Also see section 563 for special rules with respect to dividends paid after the close of the taxable year.

(b) *Distributions in liquidation.*—(1) *Distributions in liquidation for which the dividends paid deduction is allowable.*—In the case of amounts distributed in liquidation section 562(b) makes an exception to the general rule that a deduction for dividends paid is permitted only with respect to dividends described in section 316. In order to qualify under that exception, the distribution must be one either in complete or partial liquidation of a corporation pursuant to sections 331, 332, or 333. As provided by section 346(a), for the purposes of section 562(b), a partial liquidation includes a redemption of stock to which section 302 applies. Amounts distributed in liquidation in a transaction which is preceded, or followed, by a transfer to another corporation of all or part of the assets of the liquidating corporation, may not be eligible for the dividends paid deduction.

(2) *Amount of dividends paid deduction allowable.*—(i) *General rule.*—In the case of distributions in liquidation with respect to which a deduction for dividends paid is permissible under subparagraph (1) of this paragraph, the amount of the deduction is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated after February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for the purposes of this subparagraph, includes not only amounts representing the par or stated value of the stock with respect to which the liquidation distribution is made, but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated after February 28, 1913. Thus, if there is a deficit in earnings and profits on the first day of a taxable year, and the earnings and profits for such taxable year do not exceed such deficit, no dividends paid deduction would be allowed for such taxable year with respect to a distribution in liquidation; if the earnings and profits for such taxable year exceed the deficit in earnings and profits which existed on the first day of such taxable year, then a dividends paid deduction would be allowable to the extent of such excess.

(ii) *Special rule.*—Section 562(b) provides that in the case of a complete liquidation occurring within 24 months after the adoption of a plan of liquidation the amount of the deduction is equal to the earnings and profits for each taxable year in which distributions are made. Thus, if there is a distribution in liquidation pursuant to

section 333, or a distribution in complete liquidation pursuant to sections 331(a)(1) or 332 which occurs within a 24-month period after the adoption of a plan of liquidation, a dividends paid deduction will be allowable to the extent of the current earnings and profits for the taxable year or years even though there was a deficit in earnings and profits on the first day of such taxable year or years. In computing the earnings and profits for the taxable year in which the distributions are made, computation shall be made with the inclusion of capital gains and without any deduction for capital losses.

(iii) *Examples.*—The application of subparagraph (2) of this paragraph may be illustrated by the following examples:

Example (1). The Y Corporation, which makes its income tax returns on the calendar year basis, was organized on January 1, 1910, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. The preferred stock was to receive annual dividends of $7 per share and $100 per share on complete liquidation of the corporation in priority to any payments on common stock, and was to participate equally with the common stock in either instance after the common stock had received a similar amount. However, the preferred stock was redeemable in whole or in part at the option of the board of directors at any time at $106 per share plus its proportion of the earnings of the company at the time of such redemption. In 1910 the preferred stock was issued at $106 per share, for a total of $106,000, and the common stock was issued, at $100 per share, for a total of $200,000. On July 15, 1954, the company had a paid-in surplus of $6,000, consisting of the premium received on the preferred stock; earnings or profits of $30,000 accumulated prior to March 1, 1913; and earnings or profits accumulated since February 28, 1913, of $75,000. On July 15, 1954, the option with respect to the preferred stock was exercised and the entire amount of such stock was redeemed at $141 per share or a total of $141,000 in a transaction upon which gain or loss to the distributees resulting from the exchange was determined and recognized under section 302(a). The amount of the distribution allocable to capital account was $116,000 ($100,000 attributable to par value, $6,000 attributable to paid-in surplus, and $10,000 attributable to earnings or profits accumulated prior to March 1, 1913). The remainder, $25,000 ($141,000, the amount of the distribution, less $116,000, the amount allocable to capital account) is properly chargeable to the earnings or profits accumulated since February 28, 1913, and is deductible as dividends paid.

Example (2). The M Corporation, a calendar year taxpayer, is completely liquidated on November 1, 1955, pursuant to a plan of liquidation adopted April 1, 1955. On January 1, 1955, the M Corporation has a deficit in earnings and profits of $100,000. During the period January 1, 1955 to the date of liquidation, November 1, 1955, it has earnings and profits of $10,000. The M Corporation is entitled to a dividends paid deduction in the amount of $10,000 as a result of its distribution in complete liquidation on November 1, 1955.

Example (3). The N Corporation, a calendar year taxpayer, is completely liquidated on July 1, 1958, pursuant to a plan of liquida-

tion adopted February 1, 1955. No distributions in liquidation were made pursuant to the plan of liquidation adopted February 1, 1955, until the distribution in complete liquidation on July 1, 1958. On January 1, 1958, N Corporation had a deficit in earnings and profits of $30,000. During the period January 1, 1958, to the date of liquidation, on July 1, 1958, the N Corporation has earnings and profits of $5,000. The N Corporation is not entitled to any deduction for dividends paid as a result of the distribution in complete liquidation on July 1, 1958. If the earnings and profits for the period January 1, 1958 to July 1, 1958, had been $32,000, the N Corporation would have been entitled to a deduction for dividends paid in the amount of $2,000.

(c) *Special rule for personal holding companies.*—Section 316 (b)(2) provides that in the case of a corporation which, under the law applicable to the taxable year in which a distribution is made, is a personal holding company, the term "dividend" (in addition to the general meaning set forth in section 316(a)) also means a distribution to its shareholders to the extent of the corporation's undistributed personal holding company income (determined under section 545 without regard to such distributions) for the taxable year in which the distribution was made. See § 1.316–1(b).

§ 1.562–2 PREFERENTIAL DIVIDENDS.—(a) Section 562(c) imposes a limitation upon the general rule that a corporation is entitled to a deduction for dividends paid with respect to all dividends which it actually pays during the taxable year. Before a corporation may be entitled to any such deduction with respect to a distribution regardless of the medium in which the distribution is made, every shareholder of the class of stock with respect to which the distribution is made must be treated the same as every other shareholder of that class, and no class of stock may be treated otherwise than in accordance with its dividend rights as a class. The limitation imposed by section 562(c) is unqualified, except in the case of an actual distribution made in connection with a consent distribution (see section 565), if the entire distribution composed of such actual distribution and consent distribution is not preferential. The existence of a preference is sufficient to prohibit the deduction regardless of the fact (1) that such preference is authorized by all the shareholders of the corporation or (2) that the part of the distribution received by the shareholder benefited by the preference is taxable to him as a dividend. A corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class. Nor will a corporation be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock. A preference exists if any rights to preference inherent in any class of stock are violated. The disallowance, where any preference in fact exists, extends to the entire amount of the distribution and not merely to a part of such distribution. As used in

this section, the term "distribution" includes a dividend as defined in subchapter C of chapter 1 and a distribution in liquidation referred to in section 562(b).

(b) The application of the provisions of section 562(c) may be illustrated by the following examples:

Example (1). A, B, C, and D are the owners of all the shares of class A common stock in the M Corporation, which makes its income tax returns on a calendar year basis. With the consent of all the shareholders, the M Corporation on July 15, 1954, declared a dividend of $5 a share payable in cash on August 1, 1954, to A. On September 15, 1954, it declared a dividend of $5 a share payable in cash on October 1, 1954, to B, C, and D. No allowance for dividends paid for the taxable year 1954 is permitted to the M Corporation with respect to any part of the dividends paid on August 1, 1954, and October 1, 1954.

Example (2). The N Corporation, which makes its income tax returns on the calendar year basis, has a capital of $100,000 (consisting of 1,000 shares of common stock of a par value of $100) and earnings or profits accumulated after February 28, 1913, in the amount of $50,000. In the year 1954, the N Corporation distributes $7,500 in cancellation of 50 shares of the stock owned by three of the four shareholders of the corporation. No deduction for dividends paid is permissible under section 562(c) and paragraph (a) of this section with respect to such distribution.

Example (3). The P Corporation has two classes of stock outstanding, 10 shares of cumulative preferred, owned by E, entitled to $5 per share and on which no dividends have been paid for two years, and 10 shares of common, owned by F. On December 31, 1954, the corporation distributes a dividend of $125, $50 to E, and $75 to F. The corporation is entitled to no deduction for any part of such dividend paid, since there has been a preference to F. If, however, the corporation had distributed $100 to E and $25 to F, it would have been entitled to include $125 as a dividend paid deduction.

§ 1.562–3 Distributions by a Member of an Affiliated Group.—A personal holding company which files or is required to file a consolidated return with other members of an affiliated group may be required to file a separate personal holding company schedule by reason of the limitations and exceptions provided in section 542(b) and § 1.542–4. Section 562(d) provides that in such case the dividends paid deduction shall be allowed to the personal holding company, with respect to a distribution made to any member of the affiliated group, if such distribution would constitute a dividend if it were made to a shareholder which is not a member of the affiliated group.

§ 1.563 Statutory Provisions; Rules Relating to Dividends Paid After Close of Taxable Year.

SEC. 563. RULES RELATING TO DIVIDENDS PAID AFTER CLOSE OF TAXABLE YEAR.

(a) Accumulated Earnings Tax.—In the determination of the dividends paid deduction for purposes of the accumulated earnings tax imposed by section 531, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the

close of such taxable year shall be considered as paid during such taxable year.

(b) PERSONAL HOLDING COMPANY TAX.—In the determination of the dividends paid deduction for purposes of the personal holding company tax imposed by section 541, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall, to the extent the taxpayer elects in its return for the taxable year, be considered as paid during such taxable year. The amount allowed as a dividend by reason of the application of this subsection with respect to any taxable year shall not exceed either—

(1) The undistributed personal holding company income of the corporation for the taxable year, computed without regard to this subsection, or

(2) 10 percent of the sum of the dividends paid during the taxable year, computed without regard to this subsection.

(c) DIVIDENDS CONSIDERED AS PAID ON LAST DAY OF TAXABLE YEAR. For the purpose of applying section 562(a), with respect to distributions under subsection (a) or (b) of this section, a distribution made after the close of a taxable year and on or before the 15th day of the third month following the close of the taxable year shall be considered as made on the last day of such taxable year.

§ 1.563–1 ACCUMULATED EARNINGS TAX.—In the determination of the dividends paid deduction for purposes of the accumulated earnings tax imposed by section 531, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall be considered as paid during such taxable year, and shall not be included in the computation of the dividends paid deduction for the year of payment. However, the rule provided in section 563(a) is not applicable to dividends paid during the first two and one-half months of the first taxable year of the corporation subject to tax under chapter 1 of the Internal Revenue Code of 1954.

§ 1.563–2 PERSONAL HOLDING COMPANY TAX.—In the case of a personal holding company subject to the provisions of section 541 dividends paid after the close of the taxable year and before the 15th day of the third month thereafter shall be included in the computation of the dividends paid deduction for the taxable year only if the taxpayer so elects in its return for such taxable year. The election shall be made by including such dividends in computing its dividends paid deduction. The amount of such dividends which may be included in computing the dividends paid deduction for the taxable year shall not exceed either—

(a) The undistributed personal holding company income of the corporation for the taxable year, computed without regard to this section, or

(b) 10 percent of the sum of the dividends paid during the taxable year (not including consent dividends), computed without regard to this section. In computing the amount of the dividends paid deduction allowable for any taxable year, the amount allowed by reason of section 563(b) for any preceding taxable year is considered a dividend paid in such preceding taxable year and not in the year of actual distribution. Thus, a double deduction is not allowable.

§ 1.563–3 DIVIDENDS CONSIDERED AS PAID ON LAST DAY OF TAXABLE YEAR.—(a) *General rule.*—Where a distribution made after the close of the taxable year is considered as paid during such taxable

year, for purposes of applying section 562(a) the distribution shall be considered as made on the last day of such taxable year.

(b) *Personal holding company tax.*—In the case of a corporation which under the law applicable to the taxable year in respect of which a distribution is made under section 563(b) and § 1.563–2 is a personal holding company under the law applicable to such taxable year, section 316(b)(2) provides that the term dividend means (in addition to the general rule under section 316(a)) any distribution to the extent of the corporation's undistributed personal holding company income (determined under section 545 without regard to distributions under section 316(b)(2)) for such year. See § 1.316–1(b).

(c) *Dividends paid on or before December 15, 1955.*—Public Law 74 (84th Congress) approved June 15, 1955, repealed sections 452 and 462 of the Internal Revenue Code of 1954, relating to prepaid income and reserve for estimated expenses. Under section 4(c)(4) of Public Law 74, dividends paid after the 15th day of the third month following the close of the taxable year and on or before December 15, 1955, may be treated as having been paid on the last day of the taxable year for purposes of the accumulated earnings tax or the personal holding company tax and in the case of regulated investment companies, but only to the extent that such dividends are attributable to an increase in taxable income for the taxable year by reason of the repeal of sections 452 and 462. See paragraph (b) of § 1.9000–8, relating to treatment of certain dividends, prescribed pursuant to section 4(c)(4) of the Act of June 15, 1955 (Public Law 74, 84th Congress, 69 Stat. 136).

§ 1.564 Statutory Provisions; Dividend Carryover.

SEC. 564 DIVIDEND CARRYOVER.

(a) General Rule.—For purposes of computing the dividends paid deduction under section 561, in the case of a personal holding company the dividend carryover for any taxable year shall be the dividend carryover to such taxable year, computed as provided in subsection (b), from the two preceeding taxable years.

(b) Computation of Dividend Carryover.—The dividend carryover to the taxable year shall be determined as follows:

(1) For each of the 2 preceding taxable years there shall be determined the taxable income computed with the adjustments provided in section 545 (whether or not the taxpayer was a personal holding company for either of such preceding taxable years), and there shall also be determined for each such year the deduction for dividends paid during such year as provided in section 561 (but determined without regard to the dividend carryover to such year).

(2) There shall be determined for each such taxable year whether there is an excess of such taxable income over such deduction for dividends paid or an excess of such deduction for dividends paid over such taxable income, and the amount of each such excess.

(3) If there is an excess of such deductions for dividends paid over such taxable income for the first preceding taxable year, such excess shall be allowed as a dividend carryover to the taxable year.

(4) If there is an excess of such deduction for dividends paid over such taxable income for the second preceding taxable year, such excess shall be reduced by the amount determined in paragraph (5), and the remainder of such excess shall be allowed as a dividend carryover to the taxable year.

(5) The amount of the reduction specified in paragraph (4) shall be the amount of the excess of the taxable income, if any, for the

first preceding taxable year over such deduction for dividends paid, if any, for the first preceding taxable year.

(c) DETERMINATION OF DIVIDEND CARRYOVER FROM TAXABLE YEARS TO WHICH THIS SUBTITLE DOES NOT APPLY.—In a case where the first or second preceding taxable year began before the taxpayer's first taxable year under this subtitle, the amount of the dividend carryover to taxable years to which this subtitle applies shall be determined under the provisions of the Internal Revenue Code of 1939.

§ 1.564–1 DIVIDEND CARRYOVER.—(a) *General rule.*—The dividend carryover from the two preceding years, allowable only to personal holding companies, is includible in the dividends paid deduction under section 561. It is computed as follows:

(1) If, for each of the preceding two years, the deduction for dividends paid under section 561 (determined without regard to the dividend carryover to each such year) exceeds the taxable income (adjusted as provided in section 545 for purposes of determining undistributed personal holding company income) then the dividend carryover to the taxable year is the sum of both such excess amounts.

(2) If the deduction for dividends paid under section 561 for the second preceding year (determined without regard to the dividend carryover to such year) exceeds the taxable income for such year (adjusted as provided in section 545), and if the taxable income for the first preceding year (as so adjusted) exceeds the dividends paid deduction for such first preceding year (as so determined), then the dividend carryover to the taxable year shall be such excess amount for the second preceding year, less such excess amount for the first preceding year.

(3) If for the first preceding year the deduction for dividends paid under section 561 (determined without regard to the dividend carryover to such year) exceeds the taxable income (adjusted as provided in section 545) for such year, and such excess is not present in the second preceding year, then the dividend carryover to the taxable year shall be such excess amount for the first preceding year.

(b) *Dividend carryover from year in which taxpayer was not a personal holding company.*—In computing the dividend carryover, the taxable income as adjusted under section 545 of any preceding taxable year shall be determined as if the corporation was, under the law applicable to such taxable year, a personal holding company.

(c) *Dividend carryover from year in which taxpayer was subject to 1939 Code.*—In a case where the first or the second preceding taxable year began before the taxpayer's first taxable year under the Internal Revenue Code of 1954, the amount of the dividend carryover shall be determined under the Internal Revenue Code of 1939.

(d) *Statement to be filed with return.*—Every corporation claiming a dividend carryover for any taxable year shall file with its return for such year a concise statement setting forth the amount of the dividend carryover claimed and all material and pertinent facts relative thereto, including a detailed schedule showing the computation of the dividend carryover claimed.

(e) *Computation of dividend carryover.*—The computation of the dividend carryover may be illustrated by the following examples:

Example (1). The X Corporation, which files its income tax returns on the calendar year basis, has taxable income, adjusted as

required by section 545, in the amount of $110,000 and has a dividends paid deduction of $150,000 for the year 1954. For 1955, its taxable income, adjusted as required by section 545, is $200,000 and its dividends paid deduction is $300,000. The dividend carryover to the year 1956 is $140,000, computed as follows:

Dividends paid deduction for 1954	$150,000	
Taxable income for 1954	110,000	
Dividend carryover from 1954		$40,000
Dividends paid deduction for 1955	$300,000	
Taxable income for 1955	200,000	
Dividend carryover from 1955		100,000
Dividend carryover for two preceding taxable years, allowable as a deduction for the year 1956		140,000

Example (2). The Y Corporation, which files its income tax returns on the calendar year basis, has taxable income, adjusted as required by section 545, in the amount of $100,000 and has a dividends paid deduction of $150,000 for the year 1954. For 1955, its taxable income, adjusted as required by section 545, is $200,000 and its dividends paid deduction is $170,000. The dividend carryover to the year 1956 is $20,000 computed as follows:

Dividends paid deduction for 1954	$150,000	
Taxable income for 1954	100,000	
Dividend carryover from 1954		$50,000
Taxable income for 1955	$200,000	
Dividends paid deduction for 1955	170,000	
Excess of taxable income over dividends paid deduction		30,000
Dividend carryover for second preceding taxable year, allowable as a deduction for the year 1956		20,000

§ 1.565 Statutory Provisions; Consent Dividends.

SEC. 565. CONSENT DIVIDENDS.

(a) General Rule.—If any person owns consent stock (as defined in subsection (f) (1)) in a corporation on the last day of the taxable year of such corporation, and such person agrees, in a consent filed with the return of such corporation in accordance with regulations prescribed by the Secretary or his delegate, to treat as a dividend the amount specified in such consent, the amount so specified shall, except as provided in subsection (b), constitute a consent dividend for purposes of section 561 (relating to the deduction for dividends paid).

(b) Limitations.—A consent dividend shall not include—

(1) An amount specified in a consent which, if distributed in money, would constitute, or be part of, a distribution which would be disqualified for purposes of the dividends paid deduction under section 562(c) (relating to preferential dividends), or

(2) An amount specified in a consent which would not constitute a dividend (as defined in section 316) if the total amounts specified in consents filed by the corporation had been distributed in money to shareholders on the last day of the taxable year of such corporation.

(c) Effect of Consent.—The amount of a consent dividend shall be considered, for purposes of this title—

(1) As distributed in money by the corporation to the shareholder on the last day of the taxable year of the corporation, and

(2) As contributed to the capital of the corporation by the shareholder on such day.

(d) CONSENT DIVIDENDS AND OTHER DISTRIBUTIONS.—If a distribution by a corporation consists in part of consent dividends and in part of money or other property, the entire amount specified in the consents and the amount of such money or other property shall be considered together for purposes of applying this title.

(e) NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.—In the case of a consent dividend which, if paid in money would be subject to the provisions of section 1441 (relating to withholding of tax on nonresident aliens) or section 1442 (relating to withholding of tax on foreign corporations), this section shall not apply unless the consent is accompanied by money, or such other medium of payment as the Secretary or his delegate may by regulations authorize, in an amount equal to the amount that would be required to be deducted and withheld under sections 1441 or 1442 if the consent dividend had been, on the last day of the taxable year of the corporation, paid to the shareholder in money as a dividend. The amount accompanying the consent shall be credited against the tax imposed by this subtitle on the shareholder.

(f) DEFINITIONS.—

(1) CONSENT STOCK.—Consent stock, for purposes of this section, means the class or classes of stock entitled, after the payment of preferred dividends, to a share in the distribution (other than in complete or partial liquidation) within the taxable year of all the remaining earnings and profits, which share constitutes the same proportion of such distribution regardless of the amount of such distribution.

(2) PREFERRED DIVIDENDS.—Preferred dividends, for purposes of this section, means a distribution (other than in complete or partial liquidation), limited in amount, which must be made on any class of stock before a further distribution (other than in complete or partial liquidation) of earnings and profits may be made within the taxable year.

§ 1.565–1 GENERAL RULE.—(a) The dividends paid deduction, as defined in section 561, includes the consent dividends for the taxable year. A consent dividend is a hypothetical distribution (as distinguished from an actual distribution) which any person, who owns consent stock on the last day of the taxable year of the corporation, agrees to treat as a dividend, subject to the limitations in section 565(b) and § 1.565–2. The amount of the distribution must be specified by such person in a consent (or consent) filed at the time and in the manner specified in paragraph (b) of this section.

(b) *Making the filing of consents.*—(1) A consent shall be made on Form 972 in accordance with this section and the instructions on the form issued therewith. It may be made only by or on behalf of a person who was the actual owner on the last day of the corporation's taxable year of any class of consent stock, that is, the person who would have been required to include in gross income any dividends on such stock actually distributed on the last day of such year. Form 972 shall contain or be verified by a written declaration that it is made under the penalties of perjury. In the consent such person must agree to include in his gross income for his taxable year in which or with which the taxable year of the corporation ends a specific amount as a taxable dividend.

(2) See § 1.565–2 for rules as to when all or a portion of the amount so specified will be disregarded for tax purposes.

(3) A consent may be filed at any time not later than the due date of the corporation's income tax return for the taxable year for which the dividends paid deduction is claimed. With such return, and not

later than the due date thereof, the corporation must file Forms 972 duly executed by each consenting shareholder, and a return on Form 973 showing by classes the stock outstanding on the first and last days of the taxable year, the dividend rights of such stock, distributions made during the taxable year to shareholders, and giving all the other information required by the form. Form 973 shall contain or be verified by a written declaration that it is made under the penalties of perjury.

(c) *Taxability of amounts specified in consents.*—(1) Once a shareholder's consent is filed, the full amount specified therein shall be included in his gross income as a taxable dividend, except as otherwise provided in section 565(b) and § 1.565–2. Where the shareholder is taxable on a dividend only if received from sources within the United States, the amount specified in the consent of such shareholder shall be treated as a dividend from such sources in the same manner as if the dividend had been paid in money to the shareholder on the last day of the corporation's taxable year. See paragraph (b) of this section, relating to the making and filing of consents, and section 565(e) and § 1.565–5, with respect to the payment requirements in the case of nonresident aliens and foreign corporations.

(2) Except as provided in section 565(b) and § 1.565–2, the ground upon which a consent dividends deduction is denied the corporation does not affect the taxability of a shareholder whose consent has been filed for the amount specified in his consent. Thus, he is taxable on the full amount so specified even though a consent dividends deduction may be denied the corporation or may be of less value to it because, for example, (i) it is determined that it is not a corporation subject to part I, II, or III of subchapter G of chapter 1 of the Internal Revenue Code of 1954, (ii) although subject to part II of subchapter G of the 1954 Code, its taxable income (as adjusted under section 545(b) and § 1.545–2) is less than the total of the consent dividends, or (iii) in the case of nonresident aliens or foreign corporations, payment has not been made as required by section 565(e) and § 1.565–5.

§ 1.565–2 LIMITATIONS.—(a) Amounts specified in consents are not treated as consent dividends to the extent that they would constitute a preferential dividend, or would not constitute a dividend (as defined in section 316), if distributed in money to shareholders on the last day of the taxable year of the corporation. If any portion of an amount specified in a consent is not treated as a consent dividend under section 565(b) and this section, it is disregarded for all tax purposes. For example, it is not taxable to the consenting shareholder, and § 1.565–1(c) is not applicable to such portion of the amount specified in the consent.

(b)(1) A preferential distribution is an actual distribution, or a consent distribution, or a combination of the two, which involves a preference to one or more shares of stock as compared with other shares of the same class or to one class of stock as compared with any other class of stock. See section 562(c) and § 1.562–2.

(2) The application of section 565(b)(1) may be illustrated by the following examples:

Example (1). The X Corporation, which makes its income tax returns on the calendar year basis, has 200 shares of stock outstand-

ing, owned by A and B in equal amounts. On December 15, 1954, the corporation distributes $600 to B and $100 to A. As a part of the same distribution, A executes a consent to include $500 in his gross income as a taxable dividend, though such amount is not distributed to him. The X Corporation, assuming the other requirements of section 565 have been complied with, is entitled to a consent dividends deduction of $500. Although the consent dividend is deemed to have been paid on December 31, 1954, the last day of the taxable year of the corporation, they constitute a single nonpreferential distribution of $1,200.

Example (2). The Y Corporation, which makes its income tax returns on the calendar year basis, has one class of consent stock outstanding, owned in equal amounts by A, B, and C. On December 15, 1954, the corporation makes a distribution in cash of $5,000 each to A and B, and $3,000 to C. The distribution is preferential. If A and B each receive a distribution in cash of $5,000 and C consents to include $3,000 in gross income as a taxable dividend, the combined actual and consent distribution is preferential. Similarly, if no one receives a distribution in cash, but A and B each consents to include $5,000 as a taxable dividend in gross income and C agrees to include only $3,000, the consent distribution is preferential.

Example (3). The Z Corporation, which makes its income tax returns on the calendar year basis, has only two classes of stock outstanding, each class being consent stock and consisting of 500 shares. Class A, with a par value of $40 per share, is entitled to two-thirds of any distribution of earnings and profits. Class B, with a par value of $20 per share, is entitled to one-third of any distribution of earnings and profits. On December 15, 1954, there is distributed on the class B stock $2 per share, or $1,000, and shareholders of the class A stock consent to include in gross income amounts equal to $2 per share, or $1,000. The distribution is preferential, inasmuch as the class B stock has received more than its pro rata share of the combined amounts of the actual distributions and the consent distributions.

(c) (1) An additional limitation under section 565(b) is that the amounts specified in consents which may be treated as consent dividends cannot exceed the amounts which would constitute a dividend (as defined in section 316) if the corporation had distributed the total specified amounts in money to shareholders on the last day of the taxable year of the corporation. If only a portion of such total would constitute a dividend, then only a corresponding portion of each specified amount is treated as a consent dividend.

(2) The application of section 565(b)(2) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, owned in equal amounts by A and B. It makes no distributions during the taxable year 1954. Its earnings and profits for the calendar year 1954 amount to $8,000, there being at the beginning of such year no accumulated earnings or profits. A and B execute proper consents to include $5,000 each in their gross income as a dividend received by them on December 31, 1954. The sum of the amounts specified in the consents executed by A and B is $10,000, but if $10,000 had actually been distributed by the X Corporation on December 31, 1954, only

$8,000 would have constituted a dividend under section 316(a). The amount which could be considered as consent dividends in computing the dividends paid deduction for purposes of the accumulated earnings tax is limited to $8,000, or $4,000 of the $5,000 specified in each consent. The remaining $1,000 in each consent is disregarded for all tax purposes. In the case of a personal holding company, the amount which could be considered as consent dividends in computing the dividends paid deduction for purposes of the personal holding company tax is $10,000 (assuming that the undistributed personal holding company income, determined without regard to distributions under section 316(b)(2), is equal to at least that amount). In that event, A and B would each include $5,000 in gross income as a dividend received on December 31, 1954.

§ 1.565–3 Effect of Consent.—(a) The amount of the consent dividend shall be considered, for all purposes of the Internal Revenue Code of 1954, as if it were distributed in money by the corporation to the shareholder on the last day of the taxable year of the corporation, received by the shareholder on such day, and immediately contributed by the shareholder as paid-in capital to the corporation on such day. Thus, the amount of the consent dividend will be treated by the shareholder as a dividend. The shareholder will be entitled to the dividends received credit under section 34 and the exclusion under section 116, or to the dividends received deduction under section 243, with respect to such consent dividend. The basis of the shareholder's consent stock in a corporation will be increased by the amount thus treated in his hands as a dividend which he is considered as having contributed to the corporation as paid-in capital. The amount of the consent dividend will also be treated as a dividend received from sources within the United States in the same manner as if the dividend had been paid in money to the shareholders. Among other effects of the consent dividend, the earnings and profits of the corporation will be decreased by the amount of the consent dividends. Moreover, if the shareholder is a corporation, its accumulated earnings and profits will be increased by the amount of the consent dividend with respect to which it makes a consent.

(b) The application of section 565(c) to a corporate shareholder may be illustrated by the following examples:

Example (1). The A Corporation has one shareholder, the B Corporation, whose consent to include $10,000 in its gross income for the calendar year 1954 has been duly made and filed. The earnings and profits of the A Corporation for the calendar year 1954 amount to only $8,000, there being at the beginning of such year no accumulated earnings or profits. If A Corporation was a personal holding company for 1954 and had undistributed personal holding company income for that year of $10,000 or more (determined without regard to distributions under section 316(b)(2)), the B Corporation must include $10,000 in its gross income as a taxable dividend. On the other hand, if A was not a personal holding company for 1954, the B Corporation must include in its gross income $8,000 as a taxable dividend.

Example (2). Assume the B Corporation to have begun the year 1954 with $5,000 accumulated earnings and profits, to have made no distributions during the year, and to have had neither profit nor loss

from operations during the year 1954. If the A Corporation was a personal holding company for 1954, the amount of $10,000 included in the income of the B Corporation shall be considered as earnings and profits for the year 1954 and the earnings and profits of B Corporation at the close of such year will include both the $5,000 accumulated earnings and profits and the $10,000 included in income. But if A Corporation was not a personal holding company for 1954, the amount of $8,000 included in the income of the B Corporation shall be considered as earnings and profits for the year 1954 and the earnings and profits of B Corporation at the close of such year will include both the $5,000 accumulated earnings and profits and the $8,000 included in income.

§ 1.565–4 CONSENT DIVIDENDS AND OTHER DISTRIBUTIONS.—Section 565(d) provides a rule applicable where a distribution is made in part in consent dividends and in part in money or other property. With respect to such a distribution the entire amount specified in the consents and the amount of such money or other property shall be considered together. Thus, if as a part of the same distribution consents are filed by some of the shareholders and cash is distributed to other shareholders, for example, those who may be unwilling to sign consents, the total amount of the cash and the amounts specified in the consents will be viewed as a single distribution to determine the tax effects of such distribution. For example, the total of such amounts must be considered to determine whether the distribution (including the amounts specified in the consents) is preferential and whether any part of such distribution would not be dividends if the total amounts specified in the consents were distributed in cash. See paragraph (b) (2) of § 1.565–2 for examples illustrating the treatment of distributions which consist in part of consent dividends and in part of other property.

§ 1.565–5 NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.—In the event that any consent filed by the corporation is made by a shareholder to whom the payment of a dividend in cash on the last day of the taxable year of the corporation would have made it necessary for the corporation to deduct and withhold any amount as a tax under section 1441 or section 1442, such consent, when filed by the corporation, must be accompanied by payment of the amount which would have been required to be deducted and withheld if the amount specified in such consent had, on the last day of the corporation's taxable year, been paid to the shareholder in cash as a dividend. Such payment must be in one of the following forms:

(a) Cash;
(b) United States postal money order;
(c) Certified check drawn on a domestic bank, provided that the law of the place where the bank is located does not permit the certification to be rescinded prior to presentation;
(d) A cashier's check of a domestic bank, or
(e) A draft on a domestic bank or a foreign bank maintaining a United States agency or branch and payable in United States funds.

The amount of such payment shall be credited against the tax imposed on the shareholder.

§ 1.565–6 DEFINITIONS.—(a) *Consent stock.*—(1) The term "consent stock" includes what is generally known as common stock. It also includes participating preferred stock, the participation rights of which are unlimited.

(2) The definition of consent stock may be illustrated by the following example:

Example. If in the case of the X Corporation there is only one class of stock outstanding, it would all be consent stock. If, on the other hand, there were two classes of stock, class A and class B, and class A was entitled to 6 percent before any distribution could be made on class B, but class B was entitled to everything distributed after class A had received its 6 percent, only class B stock would be consent stock. Similarly, if class A, after receiving its 6 percent, was to participate equally or in some fixed proportion with class B until it had received a second 6 percent, after which class B alone was entitled to any further distributions, only class B stock would be consent stock. The same result would follow if the order of preferences were class A 6 percent, then class B 6 percent, then class A a second 6 percent, either alone or in conjunction with class B, then class B the remainder. If, however, class A stock is entitled to ultimate participation without limit as to amount, then it, too, may be consent stock. For example, if class A is to receive 3 percent and then share equally or in some fixed proportion with class B in the remainder of the earnings or profits distributed, both class A stock and class B stock are consent stock.

(b) *Preferred dividends.*—(1) The term "preferred dividends" includes all fixed amounts (whether determined by percentage of par value, a stated return expressed in a certain number of dollars per share, or otherwise) the distribution of which on any class of stock is a condition precedent to a further distribution of earnings or profits (not including a distribution in partial or complete liquidation). A distribution, though expressed in terms of a fixed amount, is not a preferred dividend, however, unless it is preferred over a subsequent distribution within the taxable year upon some class or classes of stock other than one on which it is payable.

(2) The definition of preferred dividends may be illustrated by the following example:

Example. If, in the case of the X Corporation, there are only two classes of stock outstanding, class A and class B, and class A is entitled to a distribution of 6 percent of par, after which the balance of the earnings and profits are distributable on class B exclusively, class A's 6 percent is a preferred dividend. If the order of preferences is class A $6 per share, class B $6 per share, then class A and class B in fixed proportions until class A receives $3 more per share, then class B the remainder, all of class A's $9 per share and $6 per share of the amount distributable on class B are preferred dividends. The amount which class B is entitled to receive in conjunction with the payment to class A of its last $3 per share is not a preferred dividend, because the payment of such amount is preferred over no subsequent distribution except one made on class B itself. Finally, if a distribution must be $6 on class A, $6 on class B, then on class A and class B

share and share alike, the distribution on class A of $6 and the distribution on class B of $6 are both preferred dividends.

RUSSELL C. HARRINGTON,
Commissioner.

Approved September 3, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

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SECTION 542.—DEFINITION OF PERSONAL HOLDING COMPANY

(Also Section 543.) Rev. Rul. 58-357

For the purpose of determining whether a finance company is excepted, under the provisions of section 542(c)(9) of the Internal Revenue Code of 1954, from classification as a personal holding company, that portion of interest charged by the company which is usurious, although includible in gross income as interest, may not be taken into account in determining whether 80 percent of its gross income is derived from the finance business in accordance with the provisions of applicable State law. If 80 percent or more of the company's gross income, other than usurious interest, is derived from the finance business in accordance with the provisions of applicable State law, the company will be excepted from classification as a personal holding company, provided it meets the other tests of section 542(c)(9) of the Code.

Advice has been requested whether interest which is usurious may be taken into account in determining whether in the application of section 542(c)(9) of the Internal Revenue Code of 1954, 80 percent of the gross income of a finance company is derived from the finance business under the applicable State law.

A corporation, all of its outstanding stock being owned by two individuals, operates as a finance company. The major portion of the company's income consists of finance charges on loans made to persons engaged in a trade or business. Sixty percent of its gross income is derived from loans which mature in less than 36 months and are secured by chattel mortgages or conditional sales contracts. Loans to any single borrower for more than 90 days in a taxable year do not exceed 15 percent of the average funds employed by the company during the year. Business expenses properly deductible for Federal income tax purposes exceed 15 percent of the corporation's gross income. The corporation has not made loans exceeding $5,000 in principal during any taxable year to any person who is a shareholder in the corporation. The State in which the corporation conducts its business does not specifically regulate the operations of finance companies which grant loans in excess of $500. The lending of money by other than small loan companies in such State is governed by general statutory provisions regarding interest. Such statute provides that if any person contracts to receive a greater amount of interest than seven percent upon any contract, verbal or written, such person shall forfeit the whole of said interest so contracted to be received and shall be entitled only to recover the principal sum due to such person. Because of the high risk involved in many of the

loans made by the corporation, finance charges made in many cases exceed the rate of interest provided by State statute.

Section 542(c) of the Code provides, in part, as follows:

> (c) EXCEPTIONS.—The term "personal holding company" * * * does not include—
>
> * * * * * * *
>
> (9) a finance company, actively and regularly engaged in the business of purchasing or discounting accounts or notes receivable or installment obligations, or making loans secured by any of the foregoing or by tangible personal property, at least 80 percent of the gross income of which is derived from such business in accordance with the provisions of applicable State law * * *.

Section 543 (a) of the Code includes interest in the term "personal holding company income," for Federal income tax purposes.

The term "interest" is used in section 543(a) of the Code in a broad sense; hence, it includes, in the case of a finance company, the charges for making the loan regardless of how such charges are designated. Finance or service charges imposed on borrowers by a finance company which do not warrant a separable charge in addition to that for the use of borrowed money constitute "interest" within the meaning of section 543 (a) (1) of the Code in determining personal holding company income. See Rev. Rul. 57–540, C. B. 1957–2, 318.

Under the law of the State in which the instant corporation operates, the only consequence of a contract for more than the lawful rate of interest is that the borrower, if other than a corporation, could interpose the defense of usury to an action on the loan. If the borrower successfully avoids payment by pleading usury, there is no question of usurious interest income to the corporation, since there will be no such income realized. If the borrower fails to interpose this defense, the lender may recover not only his principal but also the entire amount of interest charged.

Usury may be defined as contracting for or reserving something in excess of the amount allowed by law for the loan or forbearance of money. A usurer is one who lends money at a rate of interest greater than that established by law. An usurious contract is one which stipulates for the payment of more than lawful interest, for the use of money, or forbearance of a debt. The term "usurious interest," unless restricted by the terms of the statute or constitution in which it is used, means unlawful interest; and, so, unless the statutory or constitutional provision is to the effect that all interest charged above a specified rate is usurious, in which case usurious interest within the meaning of the statute is the excess over what may be lawfully charged, statutory and constitutional provisions relating to usurious interest have reference to the entire interest contracted for. Unlawful interest is a premium or compensation paid or stipulated to be paid for the use of money borrowed beyond the rate of interest established by law. Illegal interest is defined as a term synonymous with and meaning "usury." 91 Corpus Juris Secundum, Usury, section 1.

The term "illegal," in its common acceptance, signifies that which is contrary to the principles of law, as distinguished from the rules of procedure, and carries with it the idea that something is not only contrary to law, but contains some element of moral turpitude; but it does not necessarily imply a crime. It has been defined as meaning

contrary to law, not authorized by law, illicit, unlawful; that which lacks authority of, or support from, law. The term has been held equivalent to, or synonymous with "unfair" and "unlawful." See 42 Corpus Juris Secundum, Illegal.

Based on the foregoing definitions, it is evident that a premium or compensation paid or stipulated to be paid for the use of money borrowed beyond the rate of interest established by law is usury or illegal interest. It is equally apparent that such a transaction is unlawful whether or not the borrower elects to inject the plea of usury.

Accordingly, it is held that for the purpose of determining whether a finance company is excepted under the provisions of section 542(c)(9) of the Code, from classification as a personal holding company, that portion of interest charged by the company which is usurious, although includible in gross income as interest, may not be taken into account in determining whether 80 percent of its gross income is derived from the finance business in accordance with the provisions of applicable State law. If 80 percent or more of the company's gross income, other than usurious interest, is derived from the finance business in accordance with the provisions of applicable State law, the company will be excepted from classification as a personal holding company, provided it meets the other tests of section 542(c)(9) of the Code.

(Also Section 7701.) Rev. Rul. 58-556
(Also Part II, Section 503; Regulations 118, Section 39.503(a)-1.)

An incorporated nonprofit foundation, not exempt from Federal income tax, which has no capital stock but which issued certificates of membership to its three directors who hold no beneficial interest in the property of the corporation, does not meet the stock ownership requirement of a personal holding company prescribed by section 542(a)(2) of the Internal Revenue Code of 1954. Such organization is, therefore, not a personal holding company for Federal income tax purposes.

Advice has been requested whether a nonprofit foundation, which is prohibited by the laws of the State in which it was incorporated from issuing capital stock, but which has outstanding membership certificates issued to its three directors who have no beneficial interest in the property of the foundation, satisfies the stock ownership requirements of a personal holding company for Federal income tax purposes.

The *M* foundation was incorporated under the Indiana General Not for Profit Corporation Act, Acts 1935, Ch. 157, Section 1, p. 557, as a nonprofit organization for the promotion of educational, literary, scientific, religious and charitable purposes. The foundation has been held not to be exempt from Federal income tax because the amounts accumulated out of income are unreasonable within the meaning of section 504 of the Internal Revenue Code of 1954. The foundation, even though incorporated, is prohibited from issuing capital stock but it has issued certificates of membership, all of which are held by three directors who are permitted to receive only a reasonable salary for personal services actually rendered. The articles of incorpora-

tion provide that there shall be only three directors at any time. Any person who is elected as a director also becomes a member. No other person can become a member. The holder of a certificate of membership, which expires with the expiration of his term as director, is not vested with any equity interest in the property of the corporation. Upon being succeeded as a director by another person, he becomes completely separated from the corporation. Upon liquidation of the corporation, any moneys and property remaining after the payment of certain designated amounts revert to the State.

All funds received by the corporation, other than dividends, interest, and gains from the sale of capital assets, were received from one of the directors of the corporation or from corporations which he owns or controls, directly or indirectly, through stock ownership Since more than 80 percent of the gross income of the corporation for the year here involved represents dividends received and since the corporation has been held not to be exempt from Federal income tax, the corporation meets the gross income requirement of a personal holding company.

The relevant portions of the Indiana General Not for Profit Corporation Act, *supra*, as disclosed in Burns' Indiana Statutes, Vol. 6, Part 1, 1933, 1948 Replacement, are shown below, as follows:

25–513. MEMBERS—CLASSES OF MEMBERS—LIMITATIONS OF ACTIONS.—No corporation organized or reorganized under this act shall have any capital stock, or pay any dividends, but any corporation organized or reorganized under this act may have as many classes of members with such relative rights, privileges, duties, liabilities, limitations and restrictions as may be provided for in its articles of incorporation not inconsistent with the provisions of this act. Any member may advance or loan money to the corporation. Any such member may have any such money so advanced or loaned by him to the corporation returned or repaid to him at such times and under such conditions as the corporation and such member may determine and agree upon, but no such member shall receive more than the principal sum of any moneys so loaned or advanced, together with simple interest at a rate not to exceed six (6) percent per annum. * * *

* * * * * * *

25–519. EARNINGS.—No member of any corporation organized or reorganized under this act shall have or receive any earnings from such corporation, except that a member may be an officer, director, or employee of such corporation, in which event such member may receive fair and reasonable compensation for his services as such officer, director, or employee * * *.

* * * * * * *

25–532. DISSOLUTION PROCEEDINGS—SOLVENT AND INSOLVENT CORPORATIONS.—(a) Any solvent corporation (or any insolvent corporation with written consent of all its creditors) may proceed to effect the dissolution of such corporation as follows:

* * * * * * *

(2) * * * Any moneys or property remaining after all amounts designated in this section shall have been paid, shall escheat to the State of Indiana, * * * by the payment thereof to the treasurer of state, who shall issue his receipt to the corporation. * * *.

* * * * * * *

25–538. MISREPRESENTATIONS—PENALTIES.—Any person or persons who knowingly shall make any misrepresentations to the secretary of state in articles of incorporation, articles of amendments, articles of dissolution, annual reports, or in any other manner whatsoever, shall be deemed guilty of a misdemeanor and fined in any amount not exceeding five hundred dollars ($500) and may be imprisoned for not more than six (6) months.

Section 542(a)(2) of the Code provides that a corporation meets the stock ownership requirement of a personal holding company if

at any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. Section 1.544–1 of the regulations relating to rules for determining stock ownership in a personal holding company provides that all forms and classes of stock, however denominated, which represent the interests of shareholders, members, or beneficiaries in the corporation shall be taken into consideration. Under section 7701(a)(7) of the Code, the term "stock" includes shares in an association, joint-stock company, or insurance company. Section 7701(a)(8) of the Code provides that the term "shareholder" includes a member in an association, joint-stock company, or insurance company.

In the instant case, membership in the corporation is evidenced by a certificate which does not vest the holder with any equity property interest in the corporation. A certificate-holder possesses nothing which he can sell, give or bequeath to another. Upon being succeeded as a director by another person, he becomes completely separated from the corporation. Furthermore, a member is prohibited by State law from receiving dividends or otherwise sharing in the earnings of the corporation. Therefore, these certificates of membership have none of the characteristics of capital stock, and the interests of the members in the foundation are not beneficial because these members are not legally entitled to receive any profits or distributions from the foundation. In the absence of a showing that there is such a beneficial interest, it is concluded that there is no stock ownership as contemplated in section 542.

Accordingly, on the basis of the foregoing facts, it is held that an incorporated nonprofit foundation, not exempt from Federal income tax, which has no capital stock but which issued certificates of membership to its three directors who hold no beneficial interest in the property of the corporation, does not meet the stock ownership requirement of a personal holding company prescribed by section 542(a)(2) of the Code. Such organization is, therefore, not a personal holding company for Federal income tax purposes.

SECTION 543.—PERSONAL HOLDING COMPANY INCOME

Usurious interest as personal holding company income. See Rev. Rul. 58–357, page 353.

PART III.—FOREIGN PERSONAL HOLDING COMPANIES

SECTION 551.—FOREIGN PERSONAL HOLDING COMPANY INCOME TAXED TO UNITED STATES SHAREHOLDERS

26 CFR 1.551: Statutory provisions; foreign personal holding company income taxed to United States shareholders.

Regulations under the Internal Revenue Code of 1954. See T. D. 6308, page 279.

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PART IV.—DEDUCTION FOR DIVIDENDS PAID

SECTION 561.—DEFINITION OF DEDUCTION FOR DIVIDENDS PAID

26 CFR 1.561: Statutory provisions; definition of deduction for dividends paid.

Regulations under the Internal Revenue Code of 1954. See T. D. 6308, page 279.

SUBCHAPTER H.—BANKING INSTITUTIONS

PART I.—RULES OF GENERAL APPLICATION TO BANKING INSTITUTIONS

SECTION 581.—DEFINITION OF BANK

26 CFR 1.581–1: Tax on banks. Rev. Rul. 58–605
(Also Section 584; 1.584–1.)

A corporation engaged in the insurance business with fiduciary powers similar to those permitted to national banks, under section 11(k) of the Federal Reserve Act, does not qualify as a bank for purposes of section 581 of the Internal Revenue Code of 1954 if it is not subject to the supervision of the state banking authorities. Accordingly, any collective investment fund which it may maintain will not qualify as a common trust fund under section 584 of the Code.

Advice has been requested whether an insurance company which, under state law, may exercise certain fiduciary powers, qualifies as a "bank" for purposes of section 581 of the Internal Revenue Code of 1954 and, hence, may maintain a collective investment fund which qualifies as a common trust fund under section 584 of the Code.

The taxpayer is a corporation which is permitted under state law to act as a title insurance, abstract and trust company. Under state law it may act as a trustee, receiver, guardian, executor, or administrator and may generally exercise fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, 12 U. S. C. 248(k). The corporation is, however, properly classified under state law as an insurance company and is subject to examination and supervision of the state insurance commission rather than the state banking commission.

Section 581 of the Code provides as follows:

For purposes of sections 582 and 584, the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act (38 Stat. 262; 12 U. S. C. 248(k), and which is subject by law to supervision and examination by State, Territorial, or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

Section 584 of the Code provides in part as follows:

(a) DEFINITIONS.—For purposes of this subtitle, the term "common trust fund" means a fund maintained by a bank—

(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and

(2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks.

In the instant case, the corporation is properly classified under state law as an insurance company and, as such, it is not subject by law to supervision and examination by any "State, Territorial, or Federal authority having supervision over banking institutions." Accordingly, it is held that such company is not a "bank" as that term is defined in section 581 of the Code. Therefore, any investment fund which it may maintain will not qualify as a common trust fund under section 584 of the Code.

SECTION 584.—COMMON TRUST FUNDS

26 CFR 1.584-1. Common trust funds.

Maintenance of a Collective investment fund by an insurance company. See Rev. Rul. 58-605, page 358.

SUBCHAPTER I.—NATURAL RESOURCES

PART I.—DEDUCTIONS

SECTION 615.—EXPLORATION EXPENDITURES

Rev. Rul. 58-358

In the case of expenditures paid or incurred during the taxable year and prior to the development stage of the mine for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral, a taxpayer is not precluded from capitalizing any portion of such exploration expenditures which would otherwise be allowable as a deduction or treated as a deferred expense under section 615 of the Internal Revenue Code of 1954.

Advice has been requested whether exploration expenditures paid or incurred in connection with the mining of ore or other minerals, permitted to be expensed or deferred under section 615 of the Code, may instead be capitalized.

Section 615 of the Internal Revenue Code of 1954, relating to exploration expenditures, is substantially identical to section 23(ff) of the 1939 Code, which was added to the 1939 Code by the Revenue Act of 1951. Subsection (a) of section 615 provides in part that "in the case of expenditures paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent or quality of any deposit of ore or other mineral, and paid or incurred before the beginning of the development stage of the mine or deposit, there shall be allowed as a deduction in computing taxable income so much of such expenditures as does not exceed $100,000. This

section shall apply only with respect to the amount of such expenditures which, but for this section, would not be allowable as a deduction for the taxable year."

Subsection (b) of section 615 provides that a taxpayer may elect in accordance with prescribed regulations to treat as deferred expenses any portion of the amount deductible for the taxable year under subsection (a) and such portion shall be deductible on a ratable basis as the units of produced ores or minerals discovered or explored by reason of such expenditures are sold.

Under subsection (c) of section 615, there is a four-year limitation upon the application of subsection (a) and (b). Thus, if in any four years preceding the taxable year, the taxpayer (or certain transferors of the taxpayer) has been allowed a deduction for, or has elected to defer, such expenditures under section 615 (a) or (b) of the 1954 Code, or section 23(ff) of the 1939 Code, no further deduction or deferral is allowable under section 615.

Prior to 1951 any expenditure paid or incurred to ascertain the existence, location, extent or quality of any deposit of ore or other mineral was generally not deductible as an expense but was required to be capitalized. Section 23(ff), the predecessor of section 615, which was applicable to taxable years subject to the 1939 Code, for the first time permitted a taxpayer to deduct currently or defer exploration expenditures.

The purposes and justification for the change in law as it pertains to exploration expenditures is contained in part in both S. Report No. 781, 82nd Cong., C. B. 1951–2, 458, at 503 and the Joint Committee Staff Summary of Provisions of the Revenue Act of 1951, C. B. 1951–2, 287, at 319. The Senate Report states, "Any taxpayer may treat such expenditures made in any 4 years, up to $75,000 per year, as deductible in either of these ways; after he has done this for 4 years, additional expenditures for exploration must be capitalized as under present law."

In neither the Code provisions nor the regulations thereunder is it indicated that the expensing of exploratory expenses is mandatory, or that the mere failure to take a deduction for exploration expenditures is binding on the taxpayer for that year. Rather it appears from the legislative history of section 23(ff) that the provisions of the section are permissive, thus allowing a taxpayer the choice of deducting the expense currently. This viewpoint seems to be supported by the inference drawn from the example set forth in the Supplemental Report on S. Report No. 781, Part 2, 82nd Cong., C. B. 1951–2, 545, at 589, which states, "Thus, for example, if a taxpayer who makes his return on a calendar year basis takes a deduction under the subsection in each of the years 1952, 1953, 1954, and 1956, he will not be entitled to any deduction under the subsection for 1957, or any other subsequent taxable year." The inference drawn from the example is that the taxpayer did not choose to take a deduction in 1955.

In the light of the legislative history of section 23(ff), indicating that the primary purpose of this section was to stimulate exploration for mineral deposits, it is reasonable to conclude that the intent was to liberalize the tax treatment of exploration expenditures.

Accordingly, in the case of expenditures paid or incurred during the taxable year and prior to the development stage of the mine for

the purpose of ascertaining the existence, location, extent or quality of any deposit of ore or other mineral, a taxpayer is not precluded from capitalizing any portion of such exploration expenditures which would otherwise be allowable as a deduction or treated as a deferred expense under section 615 of the Internal Revenue Code of 1954.

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. Rev. Rul. 58–579

A taxpayer who acquires by contract the right to cut, remove and sell timber from the land of another for the account of the landowner, but not the right to cut the timber for sale on his own account or for use in his trade or business, is not the holder of "a contract right to cut" such timber within the meaning of section 631(a) of the Internal Revenue Code of 1954, nor is the taxpayer entitled to the treatment provided by section 631(b) of the Code, relative to a disposal by the owner.

Advice has been requested regarding the treatment for Federal income tax purposes of proceeds received by a taxpayer under a certain contract relating to timber.

By written instrument, *M* company, the owner of timberlands, authorized the taxpayer, an individual, for a period of one year, to enter its lands and to cut and remove therefrom specified timber and to deliver such cut timber in the form of saw logs and cordwood to a sawmill to be designated by the taxpayer in writing to the landowner prior to milling. It was provided that the sawmill so designated was to pay direct to *M* company stated amounts per unit for the saw logs and cordwood delivered to such mill. The agreement provided for the conduct of logging operations in a safe and prudent manner. Any dispute regarding the manner of conducting logging operations was to be resolved in accordance with the judgment of *M* company and the agreement was terminable at the option of *M* company for the violation of any of its terms. The taxpayer was ascribed the status of independent contractor. Any right or interest acquired under the agreement by the taxpayer was made assignable, after first obtaining the written consent of *M* company.

By separate agreement, subsequently entered into by the taxpayer and *X* lumber company, of which the agreement between the taxpayer and *M* company was made a part, *X* lumber company undertook to and did cut and remove the timber of *M* company in such a manner as to comply in every way with the taxpayer's agreement with *M* company, delivered the timber in the form of saw logs and cordwood to its mill, and paid therefor direct to *M* company the amount specified in the taxpayer's agreement with *M* company. In addition, *X* lumber company also paid to taxpayer a specified amount per unit for the saw logs and cordwood cut and delivered by *X* lumber

company to its mill, pursuant to the terms of its separate agreement with the taxpayer.

The question raised is whether the amount received by the taxpayer under his separate agreement with *X* lumber company is taxable to him as ordinary income or whether such amount may be accorded capital gain treatment under the provisions of sections 631(a) or 631(b) of the Internal Revenue Code of 1954.

Section 631(a) of the Code provides in part that "* * * If the taxpayer so elects on his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) during such year by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than six months before the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. * * *"

Section 1.631–1(b)(1) of the Income Tax Regulations provides that in order to have a "contract right to cut timber" within the meaning of section 631(a), a taxpayer must have a right to sell the timber cut under the contract on his own account or to use such cut timber in his trade or business.

Section 631(b) of the Code provides in part that "In the case of the disposal of timber held for more than six months before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. * * * For purposes of this subsection, the term 'owner' means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber."

Section 1.631–2(e)(2) of the regulations provides that the provisions of section 631(b) of the Code apply to an owner of timber; that an owner of timber means any person who owns an interest in timber, including a sub-lessor and a holder of a contract to cut timber, and that such owner of timber must have a right to cut timber for sale on his own account or for use in his trade or business in order to own an interest in timber within the meaning of section 631(b) of the Code.

The right acquired by the taxpayer from *M* company, the owner of the timberlands, with respect to the timber standing thereon, is the right to cut, remove and sell such timber for the account of *M* company. Such right is not a right to sell the timber cut under the contract on taxpayer's own account or to use such cut timber in his trade or business. Therefore, the taxpayer is not the holder of "a contract right to cut timber" within the meaning of section 631(a) of the Code and the regulations thereunder and is not entitled to the election granted therein.

Similarly, since such right is not the right to cut timber for sale on the taxpayer's own account or for use in his trade or business, but only for the account or use of another, the taxpayer is not entitled to the treatment provided by section 631(b) of the Code and the regulations

thereunder. Consequently, the taxpayer is not entitled to the capital gain treatment provided by that section.

In essence the two agreements evidence but one single transaction whereby *M* company secured the services of the taxpayer to dispose of its timber for its own account in consideration of the amount, over and above that specified and paid by *X* lumber company direct to *M* company, which was agreed upon between the taxpayer and *X* lumber company.

In view of the foregoing, it is held that the amount received by the taxpayer constitutes ordinary income in the nature of a selling commission for disposing of the timber for the account of *M* company.

SUBCHAPTER J.—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

Subpart A.—General Rules for Taxation of Estates and Trusts

SECTION 642.—SPECIAL RULES FOR CREDITS AND DEDUCTIONS

26 CFR 1.642 (g)–1: Disallowance of double deductions; in general. Rev. Rul. 58–484

> The phrase "finally allowed," for the purposes of section 1.642(g)–1 of the Income Tax Regulations, may be construed as referring to an estate tax return in which the deduction in question has been allowed and with respect to which the statute of limitations on assessment has expired, or in which for any other reason, such as a closing agreement, an assessment of a deficiency resulting from disallowance of the deduction is prohibited.

The Internal Revenue Service has been requested to clarify the significance to be attributed to the words "finally allowed" as contained in section 1.642(g)–1 of the Income Tax Regulations, pertaining to the treatment of certain estate administration expenses, as deductions on the estate income-tax return or on the estate-tax return.

During a prior taxable year, the executor of an estate filed an estate tax return claiming deductions thereon for certain administration expenses as provided by section 2053(a)(2) of the Internal Revenue Code of 1954. Thereafter, within the period of limitations for the assessment of estate taxes, the executor notified the appropriate District Director of Internal Revenue that it wished to have the administration expense deductions deleted from the estate-tax return in order to claim such deductions on the estate's income-tax return. In compliance with section 1.642(g)–1 of the regulations, the executor filed a statement that the amounts had not been allowed as deductions from the gross estate under sections 2053 or 2054 of the Code (relating to expenses and losses during administration) and waiving all right to have the items allowed as deductions from the gross estate under such sections.

The specific issue in the instant case is whether the request for change was timely in view of the specific language of section 1.642(g)–1 of the regulations, as follows:

> * * * Allowance of a deduction in computing an estate's taxable income is not precluded by claiming a deduction in the estate-tax return, so long as the estate-tax deduction is not *finally allowed* and the statement is filed. [Italics supplied.]

Revenue Ruling 240, C. B. 1953–2, 79, holds that even though deductions were claimed in an estate-tax return, the estate was not precluded from deducting such amounts for income-tax purposes where, at the time the statement and waiver were filed, the amounts had not been allowed as deductions for estate-tax purposes and the taxpayer made it clear that the same amounts were not currently being claimed as deductions on the estate-tax return.

For Federal tax purposes, a deduction is technically finally allowed when there is no question of its validity and/or when the statutory period within which to question such validity has expired. In this respect, section 6501 of the Code provides the statutory period of time within which, in the absence of fraud, willful attempt to evade tax, failure to file a return, or extension by agreement, the amount of any tax must be assessed or thereafter be barred from assessment. Likewise, with respect to a taxpayer, section 6511 of the Code provides that claims for credit or refund of an overpayment of any tax shall be made within certain statutory periods depending on the circumstances and the item on which the claim is based. An additional method of finalizing tax liability or allowance is provided by the use of the closing agreement, Form 866, Agreement as to Final Determination of Tax Liability, or Form 906, Closing Agreement as to Final Determination Covering Specific Matters, as authorized by section 7121 of the Code. See *Aetna Life Insurance Co.* v. *Robert O. Eaton*, 43 Fed. (2d) 711, Ct. D. 225, C. B. IX–2, 263 (1930).

The facts of the instant case indicate that the executor requested the deletion of the administration expense deduction from the estate tax return prior to the expiration of the statutory period of limitation for the assessment of estate taxes. Under the rationale of the foregoing discussion, such request was timely and is allowable under section 1.642(g)–1 of the regulations.

However, in a situation of this type, particularly where the request is made in the closing days of the period of limitations for assessment of estate tax, the executor should also file a Form 890, Estate Tax Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment, with respect to the deficiency which will result from deletion of the deduction on the estate tax return. This form should be filed at the time he files the above-mentioned documents required by section 1.642(g)–1 of the regulations.

Accordingly, it is held that the phrase "finally allowed," for the purposes of section 1.642(g)–1 of the regulations, may be construed as referring to an estate tax return in which the deduction in question has been allowed and with respect to which the statute of limitations on assessment has expired, or in which for any other reason, such as a closing agreement, an assessment of a deficiency resulting from disallowance of the deduction is prohibited.

SECTION 643.—DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D

26 CFR 1.643(a)-3: Capital gains and losses.

Treatment of the total distributions under a qualified employees' profit sharing trust paid on account of the employee-grantor's death. See Rev. Rul. 58-423, page 151.

Subpart E.—Grantors and Others Treated as Substantial Owners

SECTION 673.—REVERSIONARY INTERESTS

26 CFR 1.673(a)-1: Reversionary interests; income payable to beneficiaries other than certain charitable organizations; general rule. Rev. Rul. 58-567

The grantor of a trust is not considered to be the owner of a portion of the trust, for the purposes of section 673 of the Internal Revenue Code of 1954, merely because a reversionary interest in such portion passes to his estate in the event of his death prior to the expiration of ten years, where his estate cannot possess or enjoy the property until the expiration of ten years.

The grantor of a trust will be held taxable on the income of that portion of a trust attributable to property added to the original trust corpus after the creation of the trust at a time which may reasonably be expected to be within ten years of its termination date.

Advice has been requested whether a grantor of a trust will be considered the owner of a portion of such trust, under section 673 of the Internal Revenue Code of 1954, and thereby realize taxable income under the circumstances described below.

The taxpayer, aged 71 years, established an irrevocable trust and transferred securities thereto. Under the terms of the trust indenture, the trust is to terminate upon the death of the grantor or the expiration of ten years and one month whichever event shall last occur. The trust indenture further provides that the net income of the trust is to be paid to *M*, one of the grantor's sons, or, should *M* predecease the grantor leaving issue, to his issue, until the grantor's death or the expiration of the trust period, whichever event shall first occur. Should *M* predecease the grantor leaving no issue, or from and after the death of *M*'s last surviving issue, the trust net income is to be paid from time to time to other living children of the grantor, or from time to time to their living issue, until the expiration of the trust period. In the event that the grantor dies before the ten-year and one-month period expires, the trust net income is to be paid to *M* and other living children of the grantor from time to time (or from time to time to their living issue) until the expiration of the ten-year and one-month period and the trust principal is not to be distributed as part of the grantor's estate until such time has expired. The grantor may transfer additional securities or property to the trust from time to time.

Section 673 of the Code provides, in part, as follows:

(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if, as of the inception of that portion of the trust, the interest will

or may reasonably be expected to take effect in possession or enjoyment within 10 years commencing with the date of the transfer of that portion of the trust.

Revenue Ruling 56–601, C. B. 1956–2, 458, holds that the grantor of a trust, having a reversionary interest in the corpus which will revert to his estate at his death, will not be taxable on the income under section 673(a) of the Code if his life expectancy, according to appropriate United States life and actuarial tables, is more than ten years at the date of the transfer. However, the grantor will be held taxable on income attributable to property added to the principal of the trust after the date of its creation and within ten years prior to its termination date, measured by the grantor's life expectancy on the date the additions are made.

Based on United States Life Table 38 of the United States Life Tables and Actuarial Tables 1939–1941, (United States Department of Commerce, Bureau of Census, (1946) page 80) the life expectancy of an individual 71 years of age is 9.45 years.

In the instant case, based on the life expectancy of the grantor, the ownership of the reversionary interest in the trust principal may pass to his estate within the ten-year period. However, in such event, the estate cannot either "possess or enjoy" the property constituting the trust corpus inasmuch as such property will continue in the possession of the trustee and be enjoyed by the grantor's children pursuant to the terms of the trust indenture, until the expiration of ten years and one month. Should the grantor add securities or property to the trust corpus more than one month after the creation of the trust, he will be held taxable on the income from the additions inasmuch as such portion of the corpus will or may reasonably be expected to revert to his estate prior to the expiration of ten years. See Rev. Rul. 56–601, *supra*.

Accordingly, it is held that the grantor of a trust is not considered to be the owner of a portion of the trust, for the purposes of section 673 of the Code, merely because a reversionary interest in such portion passes to his estate in the event of his death prior to the expiration of ten years, where his estate cannot possess or enjoy the property until the expiration of ten years.

The grantor of a trust will be held taxable on the income of that portion of a trust attributable to property added to the original trust corpus after the creation of the trust at a time which may reasonably be expected to be within ten years of its termination date.

PART II.—INCOME IN RESPECT OF DECEDENTS

SECTION 691.—RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS

26 CFR 1.691(a)–1: Income in respect of a decedent. Rev. Rul. 58–436

(Also Sections 61, 102, 1014, 2032; 1.61–4, 1.102–1, 1.1014–1, 20.2032–1

Livestock and farm crops (harvested or unharvested, raised by a decedent prior to his death or received from tenants as rent for farm lands, held for sale or for feeding purposes) which a decedent, who had reported his income on the cash method of accounting, owned at

the time of his death, constitute items of property or inventory and not rights to, or items of, income in respect of a decedent.

For estate tax purposes, the appreciation in the value of cattle and other property after the decedent's death and during the alternate valuation period is not property earned or accrued and, therefore, no part of the appreciated value of the property is "excluded property", but is includible in the gross estate at the fair market value on the applicable valuation date.

Advice has been requested as to the treatment, for Federal income tax purposes, of the value of unsold livestock and farm crops which a decedent, who reported his income on the cash method of accounting, owned at the time of his death and the effect, for estate tax purposes, of the gain or appreciation in the value of the cattle which were sold during the alternate valuation period.

The decedent, at the time of his death, owned livestock and various farm crops. Some of these crops had been raised by the decedent prior to his death and some were received from tenants as rent for farm lands. A portion of the crops was harvested and a portion of the crops and livestock was in various stages of growth. The decedent was holding some of the livestock and crops for sale at a time when the market price was more desirable, and some of the crops were held for feeding purposes.

After the decedent's death, the executor of the estate elected to use the alternate valuation date provided by section 2032 of the Internal Revenue Code of 1954. The livestock appreciated in value due to an increase in weight and price per pound from the date of the decedent's death to eleven months later when they were sold by the executor.

Section 691(a)(1) of the Code provides as follows:

(1) GENERAL RULE.—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

In *Estate of Tom L. Burnett* v. *Commissioner*, 2 T. C. 897, acquiescence C. B. 1944, 4, the court distinguished ownership of livestock or farm crops (harvested or unharvested) from rights to receive items of income. This decision also acknowledged that where the property had not been sold or exchanged by the decedent prior to his death, and no one was indebted to the decedent for the fair market value of any part of the property, the mere ownership of the property did not represent gross income accrued to the decedent. The principles of this case, although decided prior to the enactment of section 691 of the 1954 Code (and prior to the time its counterpart section 126 of the Internal Revenue Code of 1939 became effective), are still applicable.

The problem of income in respect of a decedent concerns items of income and not items of property or inventory. Thus, where the decedent has disposed of his livestock and farm crops, whether by sale or by some other arrangement which technically did not amount to a sale but which had put his property beyond his dominion and control, so that at the date of his death he was entitled only to receive the agreed proceeds from such property, such proceeds constitute items of income in respect of a decedent. This was essentially the situation in *Commissioner* v. *Rose J. Linde*, 213 Fed. (2d) 1, certiorari denied 348 U. S. 871. In that case, the decedent (a grape grower) had turned his grapes over to a cooperative marketing association, of which he and other growers were members, for processing and sale and at the time of his death was merely possessed of a right to his share of the net proceeds from the "pooled" crops.

Section 1.61–4 of the Income Tax Regulations (relating to the gross income of farmers) provides in part, "Crop shares (whether or not considered rent under State law) shall be included in gross income as of the year in which the crop shares are reduced to money or the equivalent of money." The decedent, having owned crops received from tenants as rent for farm lands at the time of his death, did not own a right to receive income, but merely held an asset which he had an election to convert into money or its equivalent, or possibly use in its present form. There was nothing owing the decedent with respect to the crop shares.

Where an executor of an estate elects the alternate valuation method provided under section 2032 of the Code, all property interests existing at the date of the decedent's death which form a part of his gross estate constitute the property to be valued as of one year after the date of the decedent's death or as of the intermediate dates prescribed in section 2032 of the Code. Such property is referred to as "included property." These property interests remain "included property" for the purpose of valuing the gross estate under the alternate valuation method even though they change in form during the alternate valuation period by being actually received, or disposed of, in whole or in part, by the estate. "Excluded property" is composed of property earned or accrued (whether received ornot) after the decedent's death and during the alternate valuation period with respect to any property interest existing at the date of death, which does not represent "included property" itself or the receipt thereof. See section 20.2032–1(d) of the Estate Tax Regulations.

The regulations require that there be excluded from the gross estate only property earned or accrued during the alternate valuation period. The "excluded property" is measured by the amount of income which is earned or accrued after the decedent's death and prior to the alternate valuation date. While income earned or accrued (such as rents, interest, and dividends) subsequent to the date of the decedent's death and during the alternate valuation period is to be excluded from the gross estate under section 2032 and the regulations issued thereunder, it is clear that the value of property under the alternate valuation provision includes any increase in value resulting from gain or appreciation in value of such property during the one-year

period following the decedent's death. In this connection, see the example in the Senate Report No. 1240 (section 202(a) of the Revenue Act of 1935), 74th Cong. 1st Session, C. B. 1939–1, (Part 2), 651, at page 664, in which the appreciation in the value of real estate and foreign bonds and the depreciation in the value of stocks and bonds, occurring during the year after death, are shown at the values of these assets as of one year after the date of the decedent's death or as of the date of sale, distribution, or other disposition of such assets.

In applying the alternate valuation method, the cattle sold by the executor in the instant case are includible in the decedent's gross estate at the sale price and no part of the sale price is regarded as "excluded property." There is no taxable gain on the sale of the cattle by the executor.

Accordingly, for Federal income tax purposes, it is held that livestock and farm crops (harvested or unharvested, raised by a decedent prior to his death or received from tenants as rent for farm lands, held for sale or for feeding purposes) which a decedent, who had reported his income on the cash method of accounting, owned at the time of his death, constitute items of property or inventory and not rights to, or items of, income in respect of a decedent.

For Federal estate tax purposes, it is held that the gain or appreciation in the value of cattle sold by the executor during the alternate valuation period is not property earned or accrued and, therefore, no part of the increase in value of such property is "excluded property," but is "included property" within the meaning of the regulations issued pursuant to section 2032. The date or dates on which the grain, hay, or other feed on hand (at the date of death) were fed to the cattle, during the year following the decedent's death, establishes the time of disposition of such property. Therefore, it is held that the grain, hay, or other feed on hand at the date of death, which were consumed by the cattle prior to their sale, are "included property" and they must be valued for estate tax purposes on the basis of their values at the date or dates of disposition thereof.

Section 2053(a)(2) of the Code provides that a deduction may be allowed against the decedent's gross estate for administration expenses as are allowed by the laws of the jurisdiction under which the estate is being administered. This provision is interpreted by the regulations as including expenses necessarily incurred in preserving and caring for property during the administration of the estate where it is impossible to effect immediate distribution of such property to the beneficiaries. In the instant case, the expenses incurred in feeding and caring for the cattle were a necessary incident of liquidation of the animals in order to effect distribution thereof to the beneficiaries. Accordingly, it is held that the value as of the alternate valuation date of feed on hand at the date of death and the cost of labor, feed, and supplies, purchased after such date and prior to the alternate valuation date used in feeding and caring for the cattle prior to their sale constitute administration expenses which are deductible in determining the taxable estate of the decedent for Federal estate tax purposes.

26 CFR 1.691(c)-2: Estates and trusts. (Also Section 454; 1.454-1.) (Also Part II, Sections 42, 126(c); Regulations 118, Sections 39.42-6, 39.126(c)-1.) Rev. Rul. 58-435

Federal income tax consequences of the election by the executor of an estate, making returns on the cash receipts and disbursements method, to treat, as income received in the taxable year 1956, interest (increment in value) on Series E United States savings bonds, not finally matured, owned by the estate, that accrued (as earned) thereon in such year and previously, where such bonds had been (1) purchased by the decedent with her funds and registered in her name alone, (2) purchased by her with her funds and registered in her name and the name of her husband in the alternative as coowners, and (3) purchased by her husband with his funds and registered in his name and her name in the alternative as coowners, and he predeceased her.

Advice has been requested regarding the proper treatment, for Federal income tax purposes, to the estate of a decedent, of interest (increment in value) on Series E United States savings bonds, not finally matured, owned by the estate, if the executor thereof, making returns on the cash receipts and disbursements method, elects, under section 454(a) of the Internal Revenue Code of 1954, to treat such interest as income received when it accrues (as earned increases in their redemption values), where the bonds had been (1) purchased by the decedent with her own funds and registered in her name alone, (2) purchased by the decedent with her own funds and registered in her name and the name of her husband in the alternative as coowners, and (3) purchased by her husband with his own funds and registered in his name and her name in the alternative as coowners, and he predeceased her.

The decedent, who died in 1955, was the sole beneficiary under the will of her husband, who died in 1954. They were not domiciled in a state having community property laws. Among the assets of her estate were the above-described savings bonds. She and her husband had filed their Federal income tax returns on the cash receipts and disbursements method, as did also the executor of his estate; and neither the decedent, her husband, nor the executor of his estate had reported as income, for Federal income tax purposes, any of the interest (increment in value) on the bonds that had accrued (as earned) thereon prior to their acquisition by her estate upon her death. However, the executor of her estate, although also making Federal income tax returns for it on the cash receipts and disbursements method, reported as income, in its return for the calendar taxable year 1956, the interest (increment in value) that had accrued (as earned) on all the bonds from the dates of their purchase to the end of that year, by electing, under section 454(a) of the Code, to treat such interest as income received in that year. Immediately after the close of the year 1956, the executor of her estate, pursuant to her will, transferred the bonds to himself as trustee of a trust. He is making returns for the trust on the cash receipts and disbursements method and will report the interest (increment in value) on the bonds, accruing (as earned) after their acquisition by the trust, as income in the taxable year in which they are finally redeemed, or

they finally mature, whichever is earlier, rather than report such interest annually, as it accrues (as earned), by election under section 454(a) of the Code.

Section 22(d) of the Second Liberty Bond Act, as amended by the Public Debt Act of 1941, C. B. 1941–1, 546, provides that with respect to such savings bonds, "For purposes of taxation any increment in value represented by the difference between the price paid and the redemption value received (whether at or before maturity) for savings bonds * * * shall be considered as interest." As set forth in Revenue Ruling 55–278, C. B. 1955–1, 471, at 473, "such interest (increment in value) does not accrue ratably between the dates on which the redemption values increase, but, as outlined in Revenue Ruling 54–143, C. B. 1954–1, 12, 13, the increments occur (become earned) only in specific (fixed) amounts at the end of certain periods.".

Under section 454(a), of the Code, if, in the case of a taxpayer owning Series E United States savings bonds, the increase in their redemption price occurring in the taxable year does not (under the method of accounting used in computing his taxable income) constitute income to him in such year, he may elect, in his return for that year, to treat such increase as income received therein, provided he also treats as income received therein any increase in their redemption value after he acquired them that occurred prior to such year. The election shall apply to all obligations owned by him at the beginning of such year and thereafter acquired by him which were issued at a discount and are redeemable for fixed amounts increasing at stated intervals. Also, the election shall be binding on the taxpayer for all subsequent taxable years, unless upon his application the Commissioner of Internal Revenue or his delegate permits him, subject to such conditions as the Commissioner or his delegate deems necessary, to change to a different method.

I. T. 2958, C. B. XV–1, 120 (1936), holds that the interest (increment in value) on United States savings bonds of the type here involved should be reported, by taxpayers who regularly make their Federal income tax returns on the cash receipts and disbursements basis, as income for the taxable year of their redemption at or before maturity. But, if such bonds are not actually redeemed at their final maturity, the interest (increment in value) thereon is includible, on such basis, in gross income for the taxable year in which they finally matured. Section 454(c) of the Code, relating to Series E United States savings bonds held by a taxpayer at (original) maturity in which he thereafter retains his investment, provides that the increase in their redemption value (to the extent not previously includible in gross income) in excess of the amount paid for them shall be includible in gross income in the taxable year in which the continuing obligations are finally redeemed, or in the taxable year of their final maturity, whichever is earlier. Section 454(c) does not apply in the case of any taxable year for which the taxpayer's taxable income is computed under an accrual method of accounting or for which an election made by him under section 454(a) applies.

Section 691(a)(1) of the Code provides, in effect, that the amount of all items of gross income in respect of a decedent which are not properly includible for the taxable year in which falls the date of his death or a prior period (including the amount of all items of gross

income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of the taxpayer that acquires the right to receive the amount.

Section 691(c)(1) of the Code provides, in effect, that a person, estate, or trust that includes an amount in gross income under section 691(a)(1) of the Code shall be allowed, for the same taxable year, as a deduction, the portion of the Federal estate tax on the decedent's estate attributable to the inclusion therein of the net value of the right to receive such amount. The method of computing the amount of the deduction allowable under section 691(c)(1) of the Code is prescribed in paragraph (2) of section 691(c) of the Code.

Where a taxpayer purchases entirely with his own funds Series E United States savings bonds and has them registered in his name and that of another individual in the alternative as coowners, such a coownership does not constitute a tenancy by the entirety, tenancy in common, joint tenancy, or ownership similar to a joint bank account. This was pointed out in Revenue Ruling 55–278, *supra*, in connection with the determination of the proper value, for Federal gift tax purposes, with respect to the gift by a taxpayer of his coownership in such savings bonds, which he had purchased entirely with his own funds, to the other coowner. As also set forth in that ruling, the taxpayer acquired full beneficial ownership of the bonds at the time he thus purchased them; such beneficial ownership would not be extinguished during the taxpayer's lifetime until (1) he surrenders the bonds to the other coowner and gratuitously permits him to obtain redemption thereof and retain the proceeds, or (2) the bonds are reissued in the other coowner's name alone; and, in the meantime, for all practical purposes, the latter has at most only the hope or expectancy that either event (1) or (2), might occur. In fact, in many cases, the latter is not even aware that he has been named such a coowner. Therefore, it has been held that, where such savings bonds are registered in the names of two natural persons in the alternative as coowners, the interest (increment in value) earned thereon is income, for Federal income tax purposes, of the coowner whose funds were used to purchase the bonds; and, that, if the purchase price was furnished in part by each, the interest (increment in value) on the bonds is income of each in proportion to his or her respective contribution to the purchase price. See I. T. 3301, C. B. 1939–2, 75. Revenue Ruling 54–143, *supra*, consistently holds that, where such a savings bond registered in the names of two natural persons in the alternative as coowners was purchased entirely with the funds of one of the coowners, all the interest (increment in value) earned thereon is his income, even though he gratuitously permits the other coowner to redeem the bond and retain as hers the entire proceeds.

In view of the foregoing, it is held that the action of the instant executor of the estate of the deceased wife in electing to report all the interest (increment in value) on all the Series E United States savings bonds owned by such estate in the taxable year 1956, that accrued (as earned) therein and previously since they were purchased, as income received therein is proper. In other words, the interest (increment in value) that accrued (as earned) before the wife died on the bonds

which she had purchased entirely with her own funds and of which she was full beneficial owner, whether registered in her name alone or in her name and the name of her husband in the alternative as coowners and also the interest (increment in value) that accrued (as earned) before she died but after her husband died on the bonds which he purchased entirely with his own funds, registered in his name and her name in the alternative as coowners and of which she became the sole (beneficial and registered) owner upon his death, is gross income in respect of the decedent (wife) under section 691(a)(1) of the Code. Compare Revenue Ruling 55–356, C. B. 1955–1, 673. The interest (increment in value) that accrued (as earned) before the husband died on the bonds which he had purchased entirely with his own funds and of which he was full beneficial owner, although registered in his name and the name of his wife in the alternative as coowners, is gross income in respect of a prior decedent, under section 691(a)(1) of the Code, and the interest (increment in value) that accrued (as earned) on all the bonds after their acquisition by the estate of the wife upon her death and before their transfer to the trust pursuant to her will is income of the estate, under the general definition of gross income for Federal income tax purposes in section 61(a) of the Code.

A trust established pursuant to the will of a decedent is a separate and distinct taxable entity from her estate, even though the same individual or trust company is executor of the estate and trustee of the trust. Therefore, the election under section 454(a) of the Code, which the instant executor of the wife's estate made to treat the interest (increment in value) accrued (as earned) on Series E United savings bonds owned by it, as income received, is not binding on the trust, although he is its trustee. Accordingly, it is also held that the contemplated action of the trustee of the trust of reporting the interest (increment in value) accruing (as earned) on the bonds after their acquisition by the trust as income in the taxable year in which they are finally redeemed, or they finally mature, whichever is earlier, will be proper, *i.e.*, in the absence of an election under section 454(a) of the Code, by him as trustee of the trust, to treat the increases in the redemption values of the bonds occurring in each taxable year after their acquisition by the trust as income therein received.

It is further held that, under section 691(c)(1) of the Code, because of the inclusion in gross income, in the Federal income tax return of the estate of the decedent (wife) for the taxable year 1956, of (1) the interest (increment in value) on the bonds purchased by her with her own funds and registered in her name alone, from the dates of purchase to the date of her death; (2) the interest (increment in value) on the bonds purchased by her with her own funds and registered in her name and the name of her husband in the alternative as coowners, from the dates of purchase to the date of her death; (3) the interest (increment in value) on the bonds purchased by her husband with his own funds and registered in his name and her name in the alternative as coowners, from the date of his death to the date of her death; and (4) the interest (increment in value) on the latter bonds, from the dates of purchase to the date of the husband's death, since no distribution was made in 1957, therefore deductions are allowable in such income tax return of (a) the amount of the Federal estate tax on the estate of the

decedent (wife) attributable to inclusion in her gross estate of the value of items (1), (2), (3) and (4); and (b) the amount of the Federal estate tax on the estate of her husband attributable to the inclusion in his gross estate of the value of item (4). The method of computing the amounts of Federal estate taxes attributable to such inclusions in gross estate is prescribed in paragraph (2) of section 691(c) of the Code. See section 1.691(c)-2 of the Income Tax Regulations with respect to treatment of the section 691(c) deduction where an estate or trust distributes or is required to distribute income in respect of a decedent within the taxable year.

SUBCHAPTER K.—PARTNERS AND PARTNERSHIPS

PART I.—DETERMINATION OF TAX LIABILITY

SECTION 704.—PARTNER'S DISTRIBUTIVE SHARE

26 CFR 1.704-1(d): Limitation on allowance of losses.

Exclusion of a partnership from the provisions of section 704(d) of the Code relating to the limitation on the allowance of a partner's share of a partnership loss. See Rev. Rul. 58-465, page 376.

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. Rev. Rul. 58-394

(Also Sections 61, 751; 1.61-1, 1.751-1.)

The sale of an interest in a partnership, organized for the purpose of conducting the business of managing and operating an insurance company, to other individuals, as trustees for another insurance company, constitutes the sale of a capital asset.

Any amount received by the partners in consideration of the relinquishment or cancellation of rights under their management contract, or attributable to the value of renewal commissions on policies outstanding at the time of the sale, is taxable as ordinary income.

Advice has been requested with respect to the treatment of the sale of interests in a partnership organized for the purpose of conducting the business of managing and operating an insurance company to trustees of another insurance company.

In May, 1955, a partnership was formed for the puropse of conducting the business of managing and operating life, health and accident insurance companies and mutual assessment associations. The two

partners contributed equal capital and in accordance with the partnership agreement have equal partnership interests in the partnership. The annual net profits are divided and credited to each partner equally.

At the time of its formation, the partnership entered into an agreement with the *M* Life Insurance Company whereby the company engaged its services as an independent contractor to manage and operate its business. In consideration for such services, the partnership may issue insurance policies in the name of the company and collect all membership fees and assessments due the company from such policies. Out of the collections the partnership retained all the fees for the first year of policies issued for such first year but was liable for payments of claims during the year and the expenses incident to such claims. From collections for years subsequent to the first year, the partnership is required to deposit 60 percent in the mortuary fund of the company and pay all operating and management expenses and the balance becomes the property of the partnership. The agreement covers a period of ten years.

In September, 1956, with *M* company's approval, the partners sold their interests in the partnership to two other individuals, as trustees for the use and benefit of *N* insurance company. *N* company will reinsure present members or policyholders of *M* company into *N* company, subject to the approval of such members and of the state board of insurance commissioners. Further, *N* company will, through the trustees, continue to operate the *M* company in accordance with the management contracts entered into by the partnership with the members for an indefinite period subject to the approval of the board of directors of the *M* company and the state board of insurance commissioners.

There is no family relationship between the members of the partnership and the trustees of the *N* insurance company and the sale is a bona fide arm's-length transaction for Federal income tax purposes, The partnership is a valid partnership and, aside from the management contract, its assets consist of office furniture, fixtures and equipment used in carrying out the business as provided in the management contract. There are no receivables realized or otherwise as defined by section 751(c) of the Internal Revenue Code of 1954.

Section 741 of the Code provides as follows:

> 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 1.741–1(b) of the Income Tax Regulations provides that section 741 of the Code shall apply even though the sale of the partnership interest results in the termination of the partnership under section 708(b) of the Code. Thus, the provisions of section 741 shall be applicable (1) to the transferor partner in a two-man partnership when he sells his interest to the other partner and (2) to all members of a partnership when they sell their interests to one or more persons outside the partnership.

Section 1.751–(1)(C)(1) of the Income Tax Regulations provides that the term "unrealized receivables" means any rights (contractual or otherwise) to payment for services rendered or to be rendered, to

the extent that income arising from such rights to payment was not previously includible in income under the method of accounting employed by the partnership.

The business operated under the management contract in the instant case is a capital asset within the meaning of section 1221 of the Code and the partnership interests have been held for a period of more than six months. However, the rights of management and operation of the company delegated by the management contract rest primarily in the board of directors of *M* company. Such a delegation of rights is personal and unassignable and a purported transfer of the management contract to a third party must involve the cancellation and relinquishment of such rights and the establishment of a new management agreement between the board of directors and the third party.

The relinquishment of simple contract rights does not involve the sale or exchange of a capital asset within the meaning of section 1222 of the Code and amounts received in consideration of such a relinquishment constitute ordinary income under section 61 of the Code. See Rev. Rul. 56–531, C. B. 1956–2, 983.

Accordingly, it is held that the sale of an interest in the instant partnership, organized for the purpose of conducting the business of managing and operating an insurance company, to other individuals, as trustees for another insurance company, constitutes the sale of a capital asset and any gain realized from such sale constitutes a long-term capital gain. Any amount received by the partners in consideration of the relinquishment or cancellation of rights under their management contract, or attributable to the value of renewal commissions on policies outstanding at the time of the sale, is taxable as ordinary income.

Subpart D.—Provisions Common to Other Subparts

SECTION 751.—UNREALIZED RECEIVABLES AND INVENTORY ITEMS

26 CFR 1.751–1: Unrealized receivables and inventory items.

Definition of terms. See Rev. Rul. 58–394, page 374.

PART III.—DEFINITIONS

SECTION 761.—TERMS DEFINED

26 CFR 1.761–1: Terms defined. (Also Section 704(d), 1.704–1(d).) Rev. Rul. 58–465

The approval by the Commissioner of Internal Revenue for certain investment and operating partnerships to be excluded from certain of the provisions of subchapter K of Chapter I of the In-

ternal Revenue Code of 1954, relating to partners and partnerships, will not be extended to section 704(d) of the Code for the purpose of relieving the partners from the provisions of that section, which limits the allowance of a partner's distributive share of a partnership loss to the extent of the adjusted basis of his interest in the partnership.

Advice has been requested whether investment partnerships, of the type described in section 761(a)(1) of the Internal Revenue Code of 1954, and operating partnerships, of the type described in section 761(a)(2) of the Code, may be excluded from the provisions of section 704(d) of the Code which, under certain conditions, limits the allowance of a partner's share of a partnership loss.

Section 761 of the Code, which defines a partnership, provides in part as follows:

* * * Under regulations the Secretary or his delegate may, at the election of all members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of—

(1) for investment purposes only and not for the active conduct of a business, or

(2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted,

if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

Section 1.761–1(a)(2)(iv)(b) of the Income Tax Regulations provides that if any such organization wishes to be excluded from only certain sections of Subchapter K of Chapter 1 of the Internal Revenue Code of 1954, relating to partners and partnerships, it must submit to the Commissioner of Internal Revenue a request for permission to be so excluded no later than 90 days after the beginning of the first taxable year for which partial exclusion is desired.

Section 704(d) of the Code provides as follows:

LIMITATION ON ALLOWANCE OF LOSSES.—A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnerhip year in which such excess is repaid to the partnership.

The method of computing the adjusted basis of a partner's interest in a partnership is described in section 705 of the Code and the regulations thereunder.

The approval of the Commissioner, required by section 1.761–1(a)(2)(iv)(b) of the Income Tax Regulations, regarding the exclusion of certain unincorporated organizations from certain sections of subchapter K of Chapter I of the Code, relating to partners and partnerships, will not be extended to section 704(d) of the Code for the purpose of eliminating the limitations on the allowance of a partner's distributive share of a partnership loss. Compare Revenue Ruling 57–215, C. B. 1957–1, 208, which holds that such approval by the Commissioner will not be extended to section 706(b) of the Code for the purpose of eliminating the necessity of establishing a business purpose for the adoption of a taxable year for the partnership which is different from that of all its principal partners.

SUBCHAPTER L.—INSURANCE COMPANIES

PART I.—LIFE INSURANCE COMPANIES

Subpart B.—1942 Formula

SECTION 812.—RESERVE AND OTHER POLICY LIABILITY DEDUCTION

T. D. 6309

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

Figure to be used for 1958 in determining reserve and other policy liability deduction for life insurance companies.

DEPARTMENT OF THE TREASURY,
Washington 25, D. C.

To Officers and Employees of the Treasury Department and Others Concerned:

By virtue of the authority contained in section 812(a) of the Internal Revenue Code of 1954 (70 Stat. 45; 26 U. S. C. 812(a)), it is hereby determined that the figure to be used under section 812 in computing the "reserve and other policy liability deduction" of life insurance companies for the taxable year 1958 shall be 0.7553.

Because the figure announced in this Treasury Decision is computed from information contained in the income tax returns of life insurance companies for the year 1957, which are not open to public inspection, the public accordingly cannot effectively participate in the determination of such figure. Therefore, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

September 4, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on Sep. 5, 1958, 9:46 a. m., and published in the issue of the Federal Register for Sep. 6, 1958, 23 F. R. 6879.)

PART II.—MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES)

SECTION 821.—TAX ON MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES)

26 CFR 1.821–1: Tax on mutual insurance companies other than life or marine or fire insurance companies subject to the tax imposed by section 831.

Characteristics that determine whether a company qualifies as a mutual insurance company. See Rev. Rul. 58–616, page 928.

SUBCHAPTER M.—REGULATED INVESTMENT COMPANIES

SECTION 852.—TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS

26 CFR 1.852–1: Taxation of regulated investment companies. Rev. Rul. 58–466
(Also Sections 301, 855; 1.301–1, 1.855–1.)

If a company would be a regulated investment company under section 851 of the Internal Revenue Code of 1954 for a particular taxable year, except that it fails to distribute at least 90 percent of its investment company taxable income as dividends and therefore fails to meet the requirements of section 852 of the Code, it will be treated as an ordinary corporation for such taxable year; and its current, as well as its accumulated, earnings and profits for dividend purposes will be computed as in the case of an ordinary corporation. If, in a subsequent taxable year, it distributes 90 percent or more of its investment company taxable income as dividends, it will be taxed as a regulated investment company for such year, provided it also meets the other requirements of subchapter M of the Code relating to regulated investment companies.

Advice has been requested with respect to the treatment, for Federal income tax purposes, of a company which for prior years qualified as a regulated investment company taxable under section 852(b) of the Internal Revenue Code of 1954, but which distributes less than 90 percent of its investment company taxable income as dividends for the taxable year and, therefore, is not taxable under such section because it fails to meet the requirements of section 852(a)(1) of the Code.

The taxpayer, an open-end regulated investment company whose fiscal year ends January 31, was incorporated in 1955. For each year prior to its fiscal year ended January 31, 1958, the company distributed all of its taxable income as computed in accordance with section 63 of the Code. The distributions made each year constituted dividends equaling or exceeding 90 percent of its investment company taxable income computed in accordance with section 852(b)(2) of the Code. On February 1, 1957, the beginning of its taxable year ended January 31, 1958, it had no accumulated earnings and profits for Federal income tax purposes. For the fiscal year ended January 31, 1958, the taxpayer sustained losses from the sale of certain securities. In that fiscal year it distributed as dividends less than 90 percent of its investment company taxable income.

Section 852(a) of the Code provides that the provisions of subchapter M of the Code, relating to regulated investment companies, shall not be applicable to a regulated investment company unless (1) the deduction for dividends paid during the taxable year equals or exceeds 90 percent of its investment company taxable income, and (2) such company complies with regulations prescribed by the Secretary of the Treasury or his delegate for the purpose of ascertaining the actual ownership of its outstanding stock.

Section 1.852–1 of the Income Tax Regulations, relating to the taxation of regulated investment companies, provides as follows:

(a) REQUIREMENTS APPLICABLE THERETO.—Section 852(a) denies the application of the provisions of subchapter M to a regulated investment company for a taxable year unless—

(1) The deduction for dividends paid for the taxable year as defined in section 561 computed without regard to capital gains dividends) is equal to at least 90 percent of its investment company taxable income for such taxable year (determined without regard to the provisions of section 852(b)(2)(D) and section 1.852–3(d); and

(2) The company complies for such taxable year with the provisions of section 1.852–6 (relating to records required to be maintained by a regulated investment company).

See section 853(b)(1)(B) and section 1.853–2(a) for amounts to be added to the dividend paid deduction, and section 855 and section 1.855–1, relating to dividends paid after the close of the taxable year.

(b) FAILURE TO QUALIFY.—If a regulated investment company does not meet the requirements of section 852(a) and paragraph (a) of this section for the taxable year, it will, even though it may otherwise be classified as a regulated investment company, be taxed in such year as an ordinary corporation and not as a regulated investment company. In such case, none of the provisions of subchapter M will be applicable to it.

In the instant case, since the regulated investment company failed to distribute at least 90 percent of its investment company taxable income as dividends for the fiscal year ended January 31, 1958, none of the provisions of subchapter M of the Code will apply to it. Therefore, it will be treated as an ordinary corporation, taxable under section 11 of the Code, for such year. Moreover, it will be subject, for such year, to the following rules applicable to an ordinary corporation in determining its earnings and profits for dividend purposes:

1. In determining the current earnings and profits for the taxable year ended January 31, 1958, in accordance with section 1.312–6(b) of the regulations—as in determining the accumulated earnings and profits of the company under section 1.852–5 of the regulations—capital losses are to be taken into account and serve to reduce the earnings and profits out of which dividends, as defined in section 316 of the Code, are paid for such year.

2. In accordance with sections 301(c) and 316 of the Code, distributions in such taxable year constitute ordinary dividends to the shareholders, but only to the extent paid out of its current earnings and profits computed in accordance with the preceding paragraph one, there being no accumulated earnings and profits at the beginning of such year. That portion of any distribution which is not such a dividend is required to be applied against and to reduce the adjusted basis of the shareholders' stock. See section 301(c)(2) of the Code.

3. Section 855(a) of the Code has no effect (a) upon the determination of the amount of earnings available for distribution to the shareholders as dividends or (b) upon the amount considered a dividend in accordance with the preceding paragraph two.

However, if the company distributes 90 percent or more of its investment company taxable income as dividends in the fiscal year ending January 31, 1959, or any subsequent taxable year, it will be taxed as a regulated investment company for such year, provided it also meets

the other requirements of subchapter M of the Code, relating to regulated investment companies.

SECTION 855.—DIVIDENDS PAID BY REGULATED INVESTMENT COMPANY AFTER CLOSE OF TAXABLE YEAR

26 CFR 1.855–1. Dividends paid by a regulated investment company after close of taxable year.

Effect of distributions to shareholders made by a corporation after the close of the taxable year where the corporation fails to qualify as a regulated investment company. See Rev. Rul. 58–466, page 379.

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subpart A.—Nonresident Alien Individuals

SECTION 873.—DEDUCTIONS

Deduction for child care paid by nonresident alien. See Rev. Rul. 58–434, page 110.

PART III.—INCOME FROM SOURCES WITHOUT THE UNITED STATES

Subpart A.—Foreign Tax Credit

SECTION 901.—TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES

26 CFR 1.901–1: Allowance of credit for taxes. Rev. Rul. 58–518
(Also Section 164; 1.164–1.)

M, a domestic corporation, owns all of the capital stock of *N*, also a domestic corporation, and all of the capital stock of *O*, a foreign corporation. The Government of the foreign country in which *O* is incorporated and does business assessed a tax on the earnings of *O* under its income tax laws. That Government also assessed an income tax on royalty income received by *N* (the domestic subsidiary) from *O* (the foreign subsidiary). In addition, *M*, as 100 percent owner of *N* and *O*, was assessed an income tax by such foreign Government on the combined net taxable income of *N* and *O* reduced by a credit attributable to the income taxes paid by *N* and *O*. *M* received no dividends from *O* during the taxable year. *Held*, (1) the foreign income taxes assessed against and borne by *M* may be taken by it, at its elec-

tion, as a foreign tax credit under section 901 of the Internal Revenue Code of 1954, subject to the limitation of section 904 of the Code, or as a deduction from gross income under section 164 of the Code; (2) the foreign income tax paid by *O* is not deemed to have been paid by *M*, pursuant to section 902 of the Code, since *M* received no dividends from *O* during the taxable year; and (3) the foreign income tax borne by *N* on its royalty income may be claimed by it at its election as a foreign tax credit pursuant to section 901 of the Code, subject to the limitation of section 904 of the Code, or as a deduction from gross income under section 164 of the Code. There is no authority in the law for prorating to the subsidiaries *N* and *O*, for the purpose of computing the allowance for income taxes paid to a foreign country, the foreign income taxes assessed against and borne by *M*.

Rev. Rul. 58–548

The taxes imposed under articles 51 and 72–(22) of the Local Tax Law of Japan (Law No. 226 of July 31, 1950, as amended by Law No. 204 of July 1, 1954) fall within the United States concept of income taxes and are allowable as credits against the United States income tax under section 901 of the Internal Revenue Code of 1954, subject to the limitation of section 904 of the Code. However, the tax imposed under article 52 of such Local Law is not an income tax or a tax in lieu of an income tax and may not be allowed as a credit against United States income tax.

Advice has been requested whether the taxes imposed under articles 51, 52 and 72–(22) of the Local Law of Japan (Law No. 226 of July 31, 1950, as amended by Law No. 204 of July 1, 1954) qualify as income taxes which may be allowable as credits against United States income tax.

Article 51 imposes an inhabitants' tax on corporations having an office or place of business in Japan on a per corporation tax basis. Article 52 imposes an inhabitants' tax on juridical persons on a per capita basis. Article 72–(22) imposes an enterprise tax on a business carried on by a juridical person.

Article 51 of the above-cited law [1] reads as follows:

Article 51. The standard tax rate of the tax on corporation tax basis shall be 5 percent. However, even in cases where the taxation is effected by the tax rate which exceeds the standard tax rate, it may not exceed 6 percent.

2. The rate of the tax on corporation tax basis shall conform to the tax rate as of the last day of the computation period of the taxable basis of corporation provided for in Art. 53 para. 1 or para. 2.

Article 53 of the Local Law provides, in effect, for the computation of such tax based upon the net income of the corporation as computed under the Corporation Tax Law of Japan, as amended. Other pertinent provisions of the Local Law read as follows:

Article 52. The standard rate of the tax on per capita basis of juridical person, etc. shall be six hundred yen per annum.

* * * * * * *

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[1] Quotations are taken from Volume XI of the Japanese Tax Code, 1954–1955, published by Trade Bulletin Corporation, Tokyo, Japan.

Article 72. The enterprise tax shall be imposed, for enterprises operated by juridical persons and enterprises of the first and second categories operated by individuals, with the use of income, liquidation income or proceeds for juridical persons and income for individuals as the taxable basis, * * *

* * * * * * *

Article 72-(12). Taxable basis of enterprise tax on business carried on by juridical person shall as to electricity supply business, gas supply business, local railway business, rail business and life insurance business, be the amount of proceeds for each of the accounting year, as to other businesses, income and liquidation income for each of the accounting year.

* * * * * * *

Article 72-(14). Income of each accounting period under Art. 72-(12) shall be amount obtained by deducting total losses from total profits of each accounting period * * *

* * * * * * *

Article 72-(22). The standard rate of enterprise tax on a business carried on by juridical person shall be as provided for in the following items according to the classification below, * * *

Paragraphs (1) and (2) of Article 72-(22) prescribe various tax rates on the income of juridical persons doing business in Japan, and subsection 5 of Article 72-(22) prescribes rates of tax on the income of individuals doing business in Japan.

Section 901 of the Internal Revenue Code of 1954, relating to the allowance of a credit for taxes paid to a foreign country or possession of the United States, provides in part as follows:

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902. * * *

(b) AMOUNT ALLOWED.—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; * * *

In order for a tax paid to a foreign country to be allowable as a credit against United States income tax under section 901 of the Code, it must be shown that the tax imposed by the foreign law is a tax on income within the United States concept or is a tax paid in lieu of an income tax. See I. T. 4014, C. B. 1950-1, 67.

It is held that the taxes imposed under article 51 and 72-(22) of the Local Tax Law of Japan (Law No. 226 of July 31, 1950, as amended by Law No. 204 of July 1, 1954) fall within the United States concept of income taxes and are allowable as credits against United States income tax under section 901 of the Code, subject to the limitation of section 904 of the Code. However, the tax imposed under article 52 of such Local Law is not an income tax or a tax in lieu of an income tax and may not be allowed as a credit against United States income tax.

SECTION 902.—CREDIT FOR CORPORATE STOCKHOLDER IN FOREIGN CORPORATION

26 CFR 1.902–1: Taxes of foreign corporation. T. D. 6310 [1]

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

Regulations relating to credit to a domestic corporate shareholder for foreign taxes paid by 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 December 4, 1957, notice of proposed rulemaking regarding regulations for taxable years beginning after December 31, 1957, under section 902 of the Internal Revenue Code of 1954 (relating to credit to a domestic corporate shareholder for foreign taxes paid by foreign corporations) was published in the Federal Register (22 F. R. 9698). That notice, the Appendix to which set forth a proposed amendment of the Income Tax Regulations (26 CFR Part 1) by the addition of a new paragraph (d) at the end of § 1.902–1, is hereby withdrawn. The Income Tax Regulations (26 CFR Part 1) are amended by adding at the end of § 1.902–1 the following new paragraph effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954:

(d) *Illustration of principles.*—The application of the principles of this section in the determination of the amount of the foreign tax available as a basis for a credit to the domestic corporation may be illustrated by the following example involving Corporation A, a domestic corporation which owns 40 percent of the voting stock of Corporation B, a foreign corporation which in turn owns 80 percent of the voting stock of Corporation C, another foreign corporation. It is assumed that all transactions have taken place within, and are related to, the same taxable year.

(1) *Application of section 902 (b) to determine tax deemed to be paid by Corporation B.*

(i) Gains, profits, and income of Corporation C	$125,000
(ii) Foreign tax paid by Corporation C with respect to such gains, profits and income	25,000
(iii) Accumulated profits of Corporation C: $125,000 less $25,000	100,000
(iv) Dividends paid by Corporation C to Corporation B	50,000
(v) Corporation C foreign tax with respect to the accumulated profits of Corporation C from which the dividends were paid to Corporation B: $\$25,000 \times \frac{100,000}{125,000}$	20,000
(vi) Corporation C foreign tax with respect to the accumulated profits distributed which is deemed to be paid by Corporation B: $\$20,000 \times \frac{50,000}{100,000}$	10,000

[1] 23 F. R. 7039.

(2) *Application of section 902(a) to determine tax deemed to be paid by Corporation A.*

(i) Gains, profits, and income of Corporation B: Business profits	$50,000	
Dividends from Corporation C (as per subparagraph (1))	50,000	
		$100,000
(ii) Foreign tax actually paid by Corporation B with respect to such gains, profits, and income		20,000
(iii) Accumulated profits of Corporation B: $100,000 income less $20,000 taxes paid		80,000
(iv) Dividends paid by Corporation B to Corporation A		15,000
(v) Corporation B foreign tax paid with respect to the accumulated profits of Corporation B from which the dividends were paid to Corporation A: $\$20,000 \times \frac{80,000}{100,000}$		16,000
(vi) Corporation B foreign tax paid, and deemed to be paid, with respect to the accumulated profits of Corporation B from which the dividends were paid to Corporation A: $16,000 plus $10,000		26,000
(vii) Corporation B foreign tax with respect to the accumulated profits distributed which is deemed to be paid by Corporation A: $\frac{15,000}{80,000} \times \$26,000$		4,875

Because this Treasury decision merely adopts the rule contained in § 39.131(f)-1(c) of Regulations 118 and continued in effect by Treasury Decision 6091, approved August 16, 1954 (19 F. R. 5167) [C. B. 1954–2, 47], 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).)

LEO SPEER,
Acting Commissioner of Internal Revenue.

Approved September 8, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 10, 1958, 8:53 a. m., and published in the issue of the Federal Register for September 11, 1958, 23 F. R. 7039.)

SECTION 903.—CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES

26 CFR 1.903–1: Definition of taxes in lieu of income, war profits, or excess profits taxes. Rev. Rul. 58–475

The tax of two percent on premiums received by insurance companies or their agents in respect of business transacted in the Province of Quebec, imposed under subdivision three of section three of the Corporation Tax Act of Quebec, of 1947, as in effect prior to amendment by Bill 44, 1957, does not constitute a tax in lieu of an income tax, within the meaning of section 903 of the Internal Revenue Code of 1954, and is, therefore, not allowable as a credit against United States income tax under section 901 of the Code.

Advice has been requested whether the insurance premium taxes paid to the Province of Quebec, Canada, pursuant to the Corporation Tax Act of Quebec of 1947, as in effect prior to amendment by Bill 44, 1957, qualify as taxes paid in lieu of income taxes within the meaning of section 903 of the Internal Revenue Code of 1954.

The Corporation Tax Act of Quebec of 1947, 11 George VI, Chapter 33, 1947 (as it stood prior to amendment by Bill 44, 1957, effective beginning with the financial year in progress on January 1, 1957), provides, among other things, under the general heading "Tax on Paid-up Capital and Places of Business," for a tax of two percent on premiums received by every insurance company in respect of business transacted in the Province of Quebec. Section three of the Act provides in part:

> 3. In order to provide for the exigencies of the public service of the province, every one of the following companies, corporations, partnerships, business houses and persons, doing business in this province, in his or its own name or under a firm name or through any person paid by salary or commission or in any other manner, acting as employee, vendor, agent, representative or otherwise, shall as from the second of September, 1947, pay to His Majesty in the rights of the province, for the period starting from the second of September, 1947, to the thirtieth of April, 1948, and thereafter for each of the twelve month periods beginning on the first of May of each year as from 1948, at the time and in the manner hereinafter provided, the following taxes:
>
> * * * * * * *
>
> 3. *Insurance Companies*
>
> In the case of every insurance company, a tax of two per centum on every premium received by the company or its agent or agents in respect of the business transacted in Quebec.
>
> * * * * * * *
>
> Only return premiums and the cash value of the dividends paid or credited to policy holders shall be deductible from the premiums received, provided the amounts so paid or credited are in respect of risks reported and allocated as being risks of persons residing in or property located in Quebec.

That section further provides for a minimum amount of annual tax to be paid by various types of insurance companies.

Section six of the above Act, under the general heading, "Tax on Companies, Based on Profits," provides, in effect, that in addition to the taxes on capital and upon places of business, every company, partnership or person contemplated in section three, *supra*, with certain exceptions, including insurance companies, shall pay an annual tax of seven percent on net revenues.

Section 903 of the Code provides:

> For the purpose of this subpart [Subpart A—Foreign Tax Credit] and of section 164(b), the term 'income, war profits, and excess profits taxes' shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

Section 1.903–1 of the Income Tax Regulations provides:

> (a) *In General.*—For the purposes of sections 901 through 905, inclusive, and section 164(b)(6), the term 'income, war profits, and excess profits taxes' includes a tax imposed by statute or decree by a foreign country or by a possession of the United States if—
>
> (1) Such country or possession has in force a general income tax law,

(2) The taxpayer claiming the credit would, in the absence of a specific provision applicable to such taxpayer, be subject to such general income tax, and

(3) Such general income tax is not imposed upon the taxpayer thus subject to such substituted tax.

Section six of the Corporation Tax Act, *supra*, under the heading, "Tax on Companies, Based on Profits," constitutes a "general income tax law" which provides for a tax on net revenues. Thus, the first condition of section 1.903–1(a) of the regulations is met with respect to that tax. Section six, however, specifically excepts insurance companies, as well as several other taxable entities, from the provisions of this general income tax.

The provisions of subdivision three of section three of the Corporation Tax Act, *supra*, under the general heading, "Taxes on Paid-Up Capital and Places of Business," imposes a tax on persons and certain legal entities doing business in Quebec. The tax is based, in general, on a percentage of paid-up capital and a fixed fee for each place of business. However, certain types of business enterprises, including insurance companies, are taxed on a different basis, the basis of such tax being, with certain adjustments, the gross premiums received in respect of business transacted in Quebec, subject to a certain minimum.

Viewed in the light of the structure of the Corporation Tax Act, *supra*, the two percent gross premiums tax appears to have been paid in lieu of the tax based on paid-up capital and places of business levied on other entities under section three of the Act, and nothing in the Act indicates that it was the intent of the Quebec legislature to relieve insurance companies from the income tax imposed under section six of the Act because they were subject to the two percent gross premiums tax. It follows, therefore, that conditions two and three of section 1.903–1 of the regulations are not satisfied with respect to the Quebec premiums tax.

The Quebec tax on premiums is substantially the same as the tax on net premiums imposed under the Canadian Special War Revenue Act of 1915, as amended in 1942. In *Northwestern Mutual Fire Association* v. *Commissioner*, 12 T. C. 498, it was held that the taxes paid on net premiums under the Canadian Special War Revenue Act, *supra*, were not "taxes in lieu of a tax upon income" as those terms are used in section 131(h) of the Internal Revenue Code of 1939 (now section 903 of the 1954 Code). While this decision was reversed by the Ninth Circuit in *Northwestern Mutual Fire Association* v. *Commissioner*, 181 Fed. (2d) 133, it is the position of the Internal Revenue Service, despite the reversal by the Ninth Circuit, that no credit is allowable with respect to the Canadian tax on net premiums. See *Philadelphia Manufacturers Mutual Fire Insurance Company* v. *Commissioner*, Tax Court Memorandum Opinion, entered October 18, 1951, wherein the court said, after referring to its earlier decision in the *Northwestern Mutual Fire Association* case, *supra*, "We still think our decision in that case is sound, and with all due respect to the Court which reversed us, we choose to follow our decision for the present."

Accordingly, the tax of two percent on premiums received by insurance companies or their agents in respect of business transacted in the Province of Quebec, imposed under subdivision three of section three

of the Corporation Tax Act of Quebec of 1947, *supra*, prior to its amendment by Bill 44, 1957, does not constitute a tax in lieu of an income tax, within the meaning of section 903 of the Code, and is, therefore, not allowable as a credit against United States income tax under section 901 of the Code.

SECTION 904.—LIMITATION ON CREDIT

26 CFR 1.904–1: Limitation on credit for foreign taxes.

Determination of taxable income for foreign tax credit purposes of Western Hemisphere trade corporations which are members of an affiliated group of corporations filing a consolidated return. See Rev. Rul. 58–618, page 430.

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. Rev. Rul. 58–485

A United States citizen employed by an agency of the United States performed services in a foreign country under the terms of an agreement between the governments of that country and of the United States whereby the United States agency agreed to furnish certain technical training to nationals of such foreign country. The foreign government agreed to reimburse the agency for the sost of salaries paid its employees assigned to give such technical assistance. The compensation of such employees constitutes amounts paid by the United States or an agency thereof within the meaning of section 911(a)(2) of the Internal Revenue Code of 1954. Therefore, such compensation is not excludable from the gross income of the taxpayer even though he was physically present in the foreign country for 510 full days or more of the 18 consecutive-month period to which such compensation is attributable.

Advice has been requested whether compensation received by a United States citizen an employee of an agency of the United States, for services he performed in a foreign country on assignment to the government of such foreign country, is excludable from his gross income under section 911(a)(2) of the Internal Revenue Code of 1954, where the foreign country reimbursed the United States agency for the cost of such employee's salary.

In the instant case the taxpayer, an employee of a United States Government agency, has been working in a foreign country since January 1954 on assignment to give technical aid to the foreign government. During the period January 1954 to the end of December 1955, his salary was paid in United States dollars by the United States, but all other expenses of giving such aid, such as transportation, housing and local expenses, were paid by the foreign government in its own currency. However, on January 1, 1956, an agreement relating to the services of the United tSates agency became effective between the two

governments. The provisions of agreement are, in general, as follows: The United States Government agency will furnish engineers (taxpayer included) who will instruct and train the nationals of the foreign country in the installation and maintenance of certain equipment and also will give technical direction to the extent necessary by providing solutions to technical problems, by supplying technical publications, manuals, drawings, instructions, and by periodic inspection by qualified inspectors. The engineers will remain employees of the United States Government agency, subject only to its direction and supervision, and their employment, retirement, and employee compensation rights, compensation, insurance, and all other rights of employees in the classified civil service of the United States will be continued and retained by them during the period of their service under the agreement. The foreign government will pay to the United States agency, by monthly installments, an amount in dollars representing the estimated actual dollar costs of the agency's activities under the agreement, exclusive of certain personal travel costs of such engineers, and will furnish all training facilities required.

Section 911 of the Code reads, in part, as follows:

> (a) GENERAL RULE.—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:
>
> * * * * * * *
>
> (2) PRESENCE IN FOREIGN COUNTRY FOR 17 MONTHS.—In the case of an individual citizen of the United States, who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or an agency thereof) if such amounts constitute earned income * * * attributable to such period; * * *.

In the instant case, the status of the taxpayer as an employee of an agency of the United States was not affected by his assignment in the foreign country. He retained all rights of employees in the classified civil service of the United States, and his Federal tax deductions are accounted for in the manner similar to that utilized before the effective date of the agreement. The services which he performs in the foreign country are performed for the United States, and payment for such services is made by the United States in settlement of its obligation to an employee. The transfer of funds between the two countries represents payments to the United States for services furnished by the United States. The fact that the amount of such funds is based in part on salary payments made to United States employees assigned to work with the foreign government does not operate to constitute the government furnishing such funds the payor of the taxpayer's salary.

Under the circumstances, the taxpayer's compensation constitutes an amount paid by the United States or an agency thereof within the meaning of section 911(a)(2) of the Code and is not excludable from his gross income under that section even though he was physically present in the foreign country for 510 full days or more of an 18-consecutive-month period to which such compensation is attributable.

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SECTION 912.—EXEMPTION FOR CERTAIN ALLOWANCES

26 CFR 1.912–1: Exclusion of certain cost-of-living allowances. (Also Sections 61, 3402; 1.61–1, 31, 3402(a)–1.) Rev. Rul. 58–503

Amounts paid to United States Government employees stationed outside continental United States which, before the conversion of their positions under the Classification Act of 1949, as amended, were designated as territorial cost-of-living allowances but which, by administrative order, become part of their basic compensation after conversion of their positions under that Act, are not cost-of-living allowances within the meaning of section 912(1) of the Internal Revenue Code of 1954 and must therefore be included in their gross incomes for Federal income tax purposes. Further, such amounts constitute wages paid to the employees for services and, as such, are subject to withholding of income tax under section 3402 of the Code.

Advice has been requested whether a territorial cost-of-living allowance which became part of the basic compensation of certain United States Government employees under the circumstances described below is includible in the gross income of the recipient.

Section 202(7) of the Classification Act of 1949, as amended by section 105(a) of Public Law 763, 5 U. S. C. 1082, requires the conversion of the positions of certain United States Government employees in the territories from the Classification Act schedule rate of compensation to the prevailing rate schedule. With respect to some positions, the prevailing rate to which some employees were converted was less than they had previously received under classified rates plus territorial cost-of-living allowances. Under section 113 of Public Law 763, *supra* which authorizes the Civil Service Commission to issue regulations necessary for the administration of the amendments to the Classification Act of 1949, *supra*, the Commission issued regulations which, among other provisions, required that existing foreign and territorial cost-of-living allowances be continued if the employee would otherwise suffer a monetary loss through conversion of his position. See 20 F. R. 6673; 5 CFR 25.502–25.505.

The specific issue in the instant case is whether the portion of an employee's compensation, after conversion to a prevailing rate schedule, which is attributable to a continuation of a cost-of-living allowance which he previously received under a classified rate schedule is excludable from his gross income as a cost-of-living allowance under section 912 of the Internal Revenue Code of 1954.

Section 912(1) of the Code provides that amounts received as cost-of-living allowances in accordance with regulations approved by the President in the case of civilian officers or employees of the United States Government stationed outside the continental United States are excludable from the gross income of the recipients.

Section 207 of Executive Order 10,000, 3 CFR, 1948 Supp., 202, as amended, provides in part that every executive department, independent establishment, and wholly-owned Government corporation shall

pay "* * * a Territorial cost-of-living allowance * * * to each of its employees whose basic compensation is fixed by statute and who is located at the post for which the allowance has been fixed."

Revenue Ruling 57–592, C. B. 1957–2, 459, holds that the exclusion provisions of section 912(1) of the Code apply only to personnel whose basic compensation is fixed by statute and not by administrative order.

In decision B–128029, 36 Comp. Gen. 37 at 39, the Comptroller General of the United States, in overruling his decision in 34 Comp. Gen. 708, on the pay differentials resulting from the Classification Act of 1949, as amended, *supra*, stated, in part:

> * * * Although an employee's aggregate rate for night work or for oversea service is administratively saved to him upon conversion to a prevailing wage system, such night rate or overseas rate thereafter constitutes his basic compensation for such service.

In addition, in decision B–129688, 36 Comp. Gen. 482, the Comptroller General stated, in part:

> * * * we do not now hold to the views expressed in 34 Comp. Gen. 708 that post differentials, cost-of-living allowances, and night pay differentials which may be saved by regulations of the Civil Service Commission or by administrative action are to be regarded as "additional" rather than "basic" compensation.

Inasmuch as the cost-of-living allowance "saved" in the instant case constitutes part of the employee's basic compensation under the prevailing rate schedule, and such schedule is fixed by administrative order and not by statute, it can no longer be considered a cost-of-living allowance within the meaning of section 912(1) of the Code.

Accordingly, it is held that amounts paid to United States Government employees stationed outside continental United States which, before the conversion of their positions under the Classification Act of 1949, as amended, *supra*, were designated as territorial cost-of-living allowances but which, by administrative order, become part of their basic compensation after conversion of their positions under that Act, are not cost-of-living allowances within the meaning of section 912(1) of the Code, and must therefore be included in their gross income for Federal income tax purposes. Further, such amounts constitute wages paid to the employees for services and, as such, are subject to withholding of income tax under section 3402 of the Code.

Subpart C.—Western Hemisphere Trade Corporations

SECTION 922.—SPECIAL DEDUCTION

26 CFR 1.922–1: Special deduction of Western Hemisphere trade corporation.

Allocation of consolidated section 922 deduction in the case of Western Hemisphere trade corporations which are members of an affiliated group of corporations filing a consolidated return. See Rev. Rul. 58–618, page 430.

Subpart D.—Possessions of the United States

SECTION 931.—INCOME FROM SOURCES WITHIN POSSESSIONS OF THE UNITED STATES

26 CFR 1.931-1: Citizens of the United States and domestic corporations deriving income from sources within a certain possession of the United States. Rev. Rul. 58-486

Determinations whether amounts collected by a bank, located in the United States, and credited to the account of a domestic corporation, doing business within a possession of the United States and meeting the conditions prescribed in section 931(a)(1) and (2) of the Internal Revenue Code of 1954, constitute amounts received within the United States within the meaning of section 931(b) of the Code.

Advice has been requested whether amounts collected by a bank in the United States and credited to the account of a domestic corporation engaged in business in a possession of the United States constitute amounts received within the United States within the meaning of section 931(b) of the Internal Revenue Code of 1954, under the various circumstances described below.

A domestic corporation is engaged in the active conduct of a trade or business within a possession of the United States and meets the conditions prescribed in section 931(a)(1) and section 931(a)(2) of the Code. The corporation is qualified to do business in a possession of the United States, maintains its principal place of business in the possession, does not effect its transactions in the possession chiefly by paper arrangements made in the United States, but actually carries on a substantial manufacturing business in the possession. The corporation involved is actively engaged in a business in the possession and sells all or a portion of its products to customers located in the United States.

Section 931 of the Code provides:

(a) GENERAL RULE.—In the case of citizens of the United States or domestic corporations, gross income means only gross income from sources within 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 citizen or domestic corporation (computed without the benefit of this section) 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 a possession of the United States; and

(2) TRADE OR BUSINESS.—If—

(A) in the case of such corporation, 50 percent or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(B) in the case of such citizen, 50 percent or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) AMOUNTS RECEIVED IN UNITED STATES.—Notwithstanding subsection (a), there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) DEFINITION.—For purposes of this section, the term "possession of the United States" does not include the Virgin Islands of the United States, and such term when used with respect to citizens of the United States does not include Puerto Rico.

Based upon the above quoted statutory provisions, particularly subsection 931(b) of the Code, the following questions have been presented for consideration:

(1) Will moneys received without the United States by a domestic corporation meeting the conditions prescribed in sections 931(a)(1) an 931(a)(2) of the Code, and subsequently deposited with a bank in the United States, constitute amounts received within the United States within the meaning of section 931(b) of the Code?

(2) Will moneys due such domestic corporation from its customers that are collected in the United States by a bank, as the corporation's agent, constitute amounts received within the United States within the meaning of section 931(b) of the Code, if the bank credits such amounts to the accounts of such domestic corporation with the bank's branch in the possession in which the corporation is conducting business, or credits such amounts to the corporation's account at the bank's office in the United States?

(3) Will moneys received by such domestic corporation constitute amounts received within the United States, if the customers appoint the bank as their agent and the bank, acting as agent of such customers, receives in the United States from such customers checks drawn to the order of the bank, representing moneys due the domestic corporation, and the bank instructs its branch in a possession to credit the proceeds to the account of such customers in that branch, and then transfer those amounts to the account of such corporation in that branch?

Section 931 of the Code represents an exception to the general rules of taxability and was enacted in order to promote American trade in the United States' possessions and give Americans and domestic corporations an equal opportunity to compete therein with foreign individuals and foreign corporations. To carry out such purpose, actual penetration into such United States possessions was contemplated and not merely the effecting of transactions therein chiefly by paper arrangements made in the United States.

In view of the foregoing, it is held that, with respect to domestic corporations that meet the requirements of section 931(a)(1), and section 931(a)(2) of the Code:

(1) Moneys received without the United States by such domestic corporation, doing business in a possession of the United States, and subsequently deposited with a bank located in the United States do not constitute amounts received within the United States within the meaning of section 931(b) of the Code or section 1.931–1(c) of the Income Tax Regulations.

(2) Moneys due such domestic corporation, doing business in a possession of the United States, and collected in the United States by a bank, as agent for such corporation, constitute amounts received within the United States within the meaning of section 931(b) of the Code and section 1.931–1(c) of the Income Tax Regulations, irrespective of whether the bank credits such amounts to the corporation's

account with the bank's branch in the possession or credits such amounts to the corporation's account in the bank's office in the United States.

(3) Moneys received by such domestic corporation, doing business in a possession of the United States, from its customers do not constitute amounts received within the United States within the meaning of section 931(b) of the Code and section 1.931–1(c) of the Income Tax Regulations, if the bank, acting as agent for such customers, receives in the United States from them, checks drawn to the order of the bank, representing money due the corporation, and (a) the bank instructs its branch in a possession to credit the proceeds to the account of such corporation in that branch, or (b) instructs its branch in a possession to credit the proceeds to the accounts of the customers in that branch and then transfer those amounts to the account of such corporation in that branch.

Taxability of annuities under United States Civil Service Retirement Act where services are performed partly within the United States and partly within a possession. See Rev. Rul. 58–472, page 30.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART II.—BASIS RULES OF GENERAL APPLICATION

SECTION 1012.—BASIS OF PROPERTY—COST

26 CFR 1.1012–1: Basis of property. T. D. 6311[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 1012 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 3, 1957, a notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under parts I and II (except sections 1017, 1020, and 1021) of subchapter O of chapter 1 of the Internal Revenue Code of 1954 was published in the Federal Register (22 F. R. 35). On November 7, 1957, with certain modifications, the regulations, as so proposed, except for those in paragraph (c) of § 1.1012–1 relating to identification of stock sold, were adopted and published in the Federal Register as Treasury Decision 6265 (22 F. R. 8935) [C. B. 1957–2, 463]. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed in paragraph (c) of § 1.1012–1, the following regulations are hereby prescribed:

[1] 23 F. R. 7040.

§ 1.1012-1. BASIS OF PROPERTY * * *

(c) *Sale of stock.*—(1) *In general.*—If shares of stock in a corporation are sold or transferred by a taxpayer who purchased or acquired lots of stock on different dates or at different prices, and the lot from which the stock was sold or transferred cannot be adequately identified, the stock sold or transferred shall be charged against the earliest of such lots purchased or acquired in order to determine the cost or other basis of such stock and in order to determine the holding period of such stock for purposes of subchapter P of chapter 1 of the Internal Revenue Code of 1954. If, on the other hand, the lot from which the stock is sold or transferred can be adequately identified, the rule stated in the preceding sentence is not applicable. As to what constitutes "adequate identification," see subparagraphs (2), (3), and (4) of this paragraph.

(2) *Identification of stock.*—An adequate identification is made if it is shown that certificates representing shares of stock from a lot which was purchased or acquired on a certain date or for a certain price were delivered to the taxpayer's transferee. Except as otherwise provided in subparagraphs (3) or (4) of this paragraph, such stock certificates delivered to the transferee constitute the stock sold or transferred by the taxpayer. Thus, unless the requirements of subparagraphs (3) or (4) of this paragraph are met, the stock hold or transferred is charged to the lot to which the certificates delivered to the transferee belong, whether or not the taxpayer intends, or instructs his broker or other agent, to sell or transfer stock from a lot purchased or acquired on a different date or for a different price.

(3) *Identification on confirmation document.*—(i) Where the stock is left in the custody of a broker or other agent, an adequate identification is made if—

(*a*) At the time of the sale or transfer, the taxpayer specifies to such broker or other agent having custody of the stock the particular stock to be sold or transferred, and

(*b*) Within a reasonable time thereafter, confirmation of such specification is set forth in a written document from such broker or other agent.

Stock identified pursuant to this subdivision is the stock sold or transferred by the taxpayer, even though stock certificates from a different lot are delivered to the taxpayer's transferee.

(ii) Where a single stock certificate represents stock from different lots, where such certificate is held by the taxpayer rather than his broker or other agent, and where the taxpayer sells a part of the stock represented by such certificate through a broker or other agent, an adequate identification is made if—

(*a*) At the time of the delivery of the certificate to the broker or other agent, the taxpayer specifies to such broker or other agent the particular stock to be sold or transferred, and

(*b*) Within a reasonable time thereafter, confirmation of such specification is set forth in a written document from such broker or agent.

Where part of the stock represented by a single certificate is sold or transferred directly by the taxpayer to the purchaser or transferee instead of through a broker or other agent, an adequate identification is made if the taxpayer maintains a written record of the particular stock which he intended to sell or transfer.

(4) *Stock held by a trustee, executor, or administrator.*—Where stock is held by a trustee or by an executor or administrator of an estate (and not left in the custody of a broker or other agent), an adequate identification is made if at the time of a sale, transfer, or distribution, the trustee, executor, or administrator—

(i) Specifies in writing in the books and records of the trust or estate the particular stock to be sold, transferred, or distributed, and

(ii) In the case of a distribution, also furnishes the distributee with a written document setting forth the particular stock distributed to him.

Stock identified pursuant to this subparagraph is the stock sold, transferred, or distributed by the trust or estate, even though stock certificates from a different lot are delivered to the purchaser, transferee, or distributee.

(5) *Subsequent sales.*—If stock identified under subparagraph (3) or (4) of this paragraph as belonging to a particular lot is sold, transferred, or distributed, the stock so identified shall be deemed to have been sold, transferred, or distributed, and such sale, transfer, or distribution will be taken into consideration in identifying the taxpayer's remaining stock for purposes of subsequent sales, transfers, or distributions.

(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).)

LEO SPEER,
Acting Commissioner of Internal Revenue.

Approved September 8, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 10, 1958, 8:53 a. m., and published in the issue of the Federal Register for September 11, 1958, 23 F. R. 7040.)

Rev. Rul. 58-374

The payment by a transferee corporation of the Federal income tax of a liquidated transferor and the receipt by the transferee of any refund of the transferor's Federal income tax, which, under the terms of a contract of sale, are reimbursed by or refunded to the corporation which sold the stock of the transferor to the transferee in a sale in which no gain or loss was recognized, relate back to the sale of the stock and constitute nontaxable adjustments to the sale price of the stock. Interest paid by the transferee on the income tax liability and reimbursed by the seller of the stock and interest received on the income tax refund and transmitted to the seller of the stock also constitute nontaxable adjustments to the sale price of the stock.

Advice has been requested concerning the Federal income tax consequences of a transferee's payment of a liquidated transferor's Federal income taxes and of the receipt by the transferee of a refund of the transferor's excess profits taxes under the circumstances as described below.

M corporation, a registered holding company, held 94 percent of the stock of *N* corporation, a public utility corporation, and *N* in turn owned all of the stock of *O* corporation, which owned and operated oil and gas producing properties. In 1944, pursuant to an order of the Securities and Exchange Commission, *N* sold all of its holdings in *O* to *M*. *M* then liquidated *O*, cancelled all of *O*'s stock and sold *O*'s properties acquired in the liquidation to an independent corporation. The entire transaction was considered by all parties as a transaction necessary or appropriate to effectuate the provisions of section 11(b) of the Public Utility Holding Company Act of 1935, 15 U. S. C. 79k(b). No gain or loss was recognized to *N* on the transaction under the provisions of sections 371(d) and (f) of the Internal Revenue Code of 1939. The contract of sale between *M* and *N* provided that as part of the purchase price *M* should pay *N* an amount equal to the cash held by *O* at the time of closing and that the price should be further adjusted by the net value or burden of the current items of *O*, at that time, such net value or burden to be determined by final liquidation of such items. Supplementing this latter provision, the parties in 1950 stipulated that after a certain date that year all amounts paid or received by *M* with respect to the current items of *O* should be paid or received for the account of *N*. In 1950, *M*, as transferee of *O*, paid an additional Federal income tax liability of *O* for 1944, plus interest thereon, in a total sum of 142x dollars. *N* then reimbursed *M*

in the same year for the additional tax and interest. In their respective Federal income tax returns for 1950, *N* claimed the amount of interest reimbursed to *M* as an interest deduction, while *M* reported it as interest income but, having paid it for *N*, offset it by an equivalent deduction. In 1952, *M*, as transferee of *O*, received refunds of $357x$ dollars of *O*'s excess profits tax for the taxable years 1942, 1943, and 1944, plus interest of $104x$ dollars. *M* reported the interest so received in its 1952 income tax return. *M*'s tax for 1952 attributable to the interest amounted to $56x$ dollars. In compliance with the supplemented sales contract, *M* paid *N* the entire amount of *O*'s excess profits tax refund plus the interest received, less the $56x$ dollars income tax paid by *M* on the interest reported in its 1952 return. *N* credited the entire net payment to its surplus account and reported none of the amount as income for 1952.

In *F. Donald Arrowsmith, et al.* v. *Commissioner*, 344 U. S. 6, Ct. D. 1752, C. B. 1952–2, 136, the petitioners, who had equal stock ownership in a corporation in liquidation, reported distributions received from the corporation as capital gains. Four years subsequent to the liquidation, a judgment was rendered against the corporation and against one of the petitioners individually, which, as transferees of the assets of the corporation, the petitioners paid. The Supreme Court of the United States held there that the nature of the loss sustained by payment of the judgment may be classified by considering all of the liquidation transaction events and that the loss was therefore a capital loss. The shareholders' liability as transferees was not based on any ordinary business transaction of theirs apart from the liquidation proceedings.

Accordingly, it is held that the principle of the *Arrowsmith* case, *supra*, is applicable to the facts in the instant case. The reimbursement by *N* to *M* for payment of the income tax deficiency of *O* and the receipt of the refund of excess profits tax paid to *M* as transferee of *O* and transmitted to *N* pursuant to the amended sales contract relate back to the sale of the shares of *O* stock and, accordingly, retain their identity as adjustments to the sale price of the stock. The contract of sale actually required all these adjustments to price. Since the original sale was nontaxable, no gain or loss is recognized with respect to either of these amounts.

Since *N* did not receive any of *O*'s assets, it had no liability for payment to the Government of the interest on *O*'s income tax deficiency; neither did *N* have any right to demand receipt from the Government of interest on *O*'s overpayment of excess profits tax, since *N*'s rights to any refund stemmed entirely from the sales contract. The interest items, therefore, lose their character as interest with respect to *N*. Accordingly, it is further held that *N* is not entitled to any interest deduction for its reimbursement of interest paid by *M*, and the interest adjustment with *M* for the refund of excess profits taxes in 1952 constitutes a nontaxable adjustment to the sale price of *O*'s stock.

Restoration of the basis of property in a situation to which section 1341 of the Code is applicable. See Rev. Rul. 58–456, page 415.

SECTION 1014.—BASIS OF PROPERTY ACQUIRED FROM A DECEDENT

26 CFR 1.1014–1: Basis of property acquired from a decedent.

Determination of basis for computing gain from the sale of allotted and restricted lands previously held by the United States in trust for Indians. See Rev. Rul. 58–341, page 400.

Unsold livestock and farm crops of decedent who had reported income on the cash method of accounting. See Rev. Rul. 58–436, page 366.

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26 CFR 1.1014–2: Property acquired from a decedent. (Also Section 2511.) Rev. Rul. 58–395

Donors transferring properties to a trust but reserving the power to revoke the trust instrument are not subject to the gift tax provisions of section 2511 of the Internal Revenue Code of 1954.

Upon the deaths of such donors, the properties which comprise the corpus of the trust funds under the trust are entitled to new bases in the hands of the trustees under the provisions of section 1014(b)(2) and (3) of the Code, since none of the donors have any adverse interest in the disposition of the property.

Advice has been requested whether a gift tax liability will be incurred by any of the five taxpayers here involved as a result of a transfer of properties to the trustees of a trust and whether, upon the death of any one of these taxpayers, the properties which constitute the corpus of each trust fund under the trust will take new bases in the hands of the trustees of such trust in an amount determined under the provisions of section 1014(b)(2) and section 1014(b)(3) of the Internal Revenue Code of 1954.

The five related taxpayers (herein designated as grantor-beneficiaries) created a spendthrift trust to which each of them transferred his share of certain property for the primary benefit of themselves. The properties received by the trustees were divided into five equal trust funds corresponding to the five taxpayers. The trust will automatically terminate in 1975 or upon the happening of (1) death, resignation, inability or refusal to act of both trustees, (2) revocation, or (3) death of all the grantor-beneficiaries.

The salient features of the trust agreement are as follows:

(1) During the lifetime of each grantor-beneficiary, ninety percent of the income of his trust fund is to be distributed to him and the remaining ten percent is, in the discretion of the trustees, to be either distributed to him or accumulated and made a part of the corpus of the trust fund.

(2) From and after the death of each grantor-beneficiary, the income of his trust fund is to be distributed one-half to his surviving, unmarried spouse, if any, and the balance, in equal shares upon the principle of representation, to his issue, if any; otherwise, in equal shares upon the principle of representation to the issue of the other grantor-beneficiaries.

(3) Upon termination of the trust, the entire principal and undistributed income of his trust fund is to be distributed to the grantor-beneficiary, if living; otherwise, in equal shares upon the principle of representation to his living issue, if any; otherwise, in equal shares upon the principle of representation to the living issue of the other grantor-beneficiaries.

(4) The trust is revocable and terminable, in whole or as to any one or more of the respective trust funds, by the unanimous written consent of all of the then living grantor-beneficiaries and, likewise, may be amended at any time in the same manner.

With respect to whether each donor incurred a gift tax liability, section 86.3 of Regulations 108, made applicable to the 1954 Code by virtue of Treasury Decision 6091, C. B. 1954–2, 47, states, in effect, that a gift is incomplete in every instance in which the donor reserves the power to revest a beneficial title to the property in himself and a donor shall be considered as himself having the power to accomplish such reversion where such power is exercisable in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom.

In the instant case, each grantor-beneficiary has the power, in conjunction with all of the other grantor-beneficiaries, to revoke and terminate the trust as to his particular trust fund, and he has a like power to amend the trust instrument. However, no grantor-beneficiary has any beneficial interest of any nature in any trust fund other than his own. Therefore, no grantor-beneficiary has an adverse interest in the disposition of the property or income of any other grantor-beneficiary's trust fund.

Accordingly, since each grantor-beneficiary has the right to revoke and terminate the trust in conjunction with other persons, none of whom have an adverse interest in the properties comprising his trust fund, it is held that no completed gift was made by any of such grantor-beneficiaries upon their transfers of property to the trust. Therefore, no gift tax liability was incurred by any of them upon such transfers.

With respect to the second question pertaining to the new basis in the hands of the trustees of the trust upon the death of such beneficiary, section 1014(a) of the Code provides in general that the basis of property in the hands of a person acquiring the property from a decedent shall be the fair market value of the property at the date of the decedent's death or, where there is an appropriate election, at the optional valuation date as provided in section 2032 of the Code.

Section 1014(b) of the Code states, in part, as follows:

> (b) PROPERTY ACQUIRED FROM THE DECEDENT.—For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:
>
> (1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent;
>
> (2) Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust;
>
> (3) In the case of decedents dying after December 31, 1951, property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent with the right reserved

to the decedent at all times before his death to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust;

Revenue Ruling 57-287, C. B. 1957-1, 517, modifying Revenue Ruling 55-502, C. B. 1955-2, 560, holds that section 113(a)(5) of the Internal Revenue Code of 1939 (which corresponds to paragraphs (a) and (b) of section 1014 of the 1954 Code) is applicable where the trust indenture provides that the income of the trust is payable to the grantor during his lifetime and reserves to the grantor at all times up to his death the right to revoke the trust with the consent of the named trustees, none of whom has any adverse interest in the trust.

In the instant case, the trust is revocable and terminable in whole or as to any one or more of the five separate trust funds by the unanimous written consent of all of the then living grantor-beneficiaries. No grantor-beneficiary has any beneficial interest in any trust fund other than his own; therefore, no grantor-beneficiary has any adverse interest in the disposition of the property or income of any other grantor-beneficiary's trust fund.

Accordingly, it is held that each asset comprising the corpus of a deceased grantor-beneficiary's trust fund is entitled to a new basis in the hands of the trustees of the trust equal to the fair market value at the date of death of the grantor or at the optional valuation date as provided in section 1014(b)(2) and section 1014(b)(3) of the Code.

SECTION 1015.—BASIS OF PROPERTY ACQUIRED BY GIFTS AND TRANSFERS IN TRUST

26 CFR 1.1015-3; Gift or transfer in trust before January 1, 1921. Rev. Rul. 58-341

(Also Sections 1014, 1053; 1.1014-1, 1.1053-1.)

The basis for determining an original Indian allottee's gain from the sale or exchange of his fee simple allotment, where the land had previously been held in trust for him by the United States under section 5 of the General Allotment Act of 1887, as amended, is its market value as of the date he had received his trust allotment if he had received it prior to January 1, 1921, but not less than the March 1, 1913, value if he had received his trust allotment prior to that date. If the original Indian allottee had received his trust allotment subsequent to December 31, 1920, his basis for determining gain after he has been issued fee simple patent is the March 1, 1913, value. If an Indian had inherited such a trust allotment and sells or exchanges the land after he has received fee simple patent, his basis for determining gain is fair market value as of the decedent's death, but if the decedent had died before March 1, 1913, it is not less than its fair market value as of that date. However, where Congress has provided otherwise in statutes dealing with particular tribes, the foregoing rules will not apply.

Advice has been requested regarding the determination of the basis for computing gain from the sale of allotted and restricted lands previously held by the United States in trust for Indians.

Under *Squire* v. *Horton Capoeman, et ux.*, 351 U. S. 1, Ct. D. 1796, C. B. 1956-1, 605, and Revenue Ruling 56-342, C. B. 1956-2, 20, income held in trust for or received by the patent holder which is directly derived from allotted and restricted Indian lands while such

lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, as amended, 25 U. S. C. 348, is exempt from Federal income tax. Consequently, any gain from the sale or exchange of the land while it is still held in trust is not subject to tax. See Rev. Rul. 57–407, C. B. 1957–2, 45. The question has therefore arisen whether if, after the termination of the trust period, an Indian who has received fee simple patent sells or exchanges his allotment, he is entitled to take as his basis the value of the allotment at the time fee simple patent was issued, rather than the basis determined under the Internal Revenue Code.

It is the position of the Internal Revenue Service that, in the absence of a statute providing otherwise, an Indian's basis in his fee simple allotment must be determined in accordance with the provisions of the Code. *Grace W. Dick* v. *Commissioner*, 76 Fed. (2d) 265, certiorari denied 296 U. S. 588.

Under section 1015(c) of the Code, the basis of property acquired by transfers in trust before January 1, 1921, is its fair market value at the time of acquisition. Lands held under section 5 of the General Allotment Act have been transferred to the United States as trustee for the designated allottee. Therefore, if an Indian had received his trust allotment under the General Allotment Act before January 1, 1921, his basis is fair market value at the date of the trust patent. See *Helvering* v. *Richard J. Reynolds*, 313 U. S. 428, Ct. D. 1516, C. B. 1941–1, 371, at 373, and section 1.1015–3 of the Income Tax Regulations. If, however, that date was prior to March 1, 1913, then under section 1053 his basis for determining gain would be not less than the fair market value of the allotment as of March 1, 1913.

Section 1015(b) of the Code provides that the basis of property acquired by transfers in trust after December 31, 1920 (other than transfers in trust by gift, bequest, or devise), shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor. Before allotment, allotted lands would have been owned by the tribes, which would also have owned them prior to March 1, 1913. Under section 1053, where property has been acquired before March 1, 1913, its basis for determining gain may not be less than the March 1, 1913, value. It is the position of the Service that the basis of tribal lands to the tribe for purposes of determining gain (in the absence of proof of a higher "cost" basis under section 1012) would be the March 1, 1913, value; and, accordingly, under section 1015(b), where an allotment is made from such lands after December 31, 1920, the basis for determining gain of the original allottee after fee simple patent has been issued would also be the March 1, 1913, value. See *Helvering* v. *Richard J. Reynolds*, *supra*, and section 1.1015–2 of the Income Tax Regulations.

If an Indian had inherited a trust allotment under the General Allotment Act, his basis, under section 1014, would be its fair market value at the date of the decedent's death, but if inherited prior to March 1, 1913, the basis, for purposes of gain, would be not less than the March 1, 1913, value.

In some instances, statutes dealing with particular tribes provide that the basis to the Indian receiving fee simple patent shall be the value of the allotment when fee patent is received. See, for example,

section 11 of Act of August 13, 1954, 25 U. S. C., sec. 564j (in respect to Indians of the Klamath Tribe). Where such statutes apply, basis will be determined pursuant to their terms rather than under the foregoing rules.

Accordingly, it is held that the basis for determining an original Indian allottee's gain from the sale or exchange of his fee simple allotment where the land had previously been held in trust for him by the United States under section 5 of the General Allotment Act of 1887, as amended, is its market value as of the date he had received his trust allotment if he had received it prior to January 1, 1921, but not less than the March 1, 1913, value if he had received his trust allotment prior to that date. If the original Indian allottee had received his trust allotment subsequent to December 31, 1920, his basis for determining gain after he had been issued fee simple patent is the March 1, 1913, value. If an Indian had inherited such a trust allotment and sells or exchanges the land after he has received fee simple patent, his basis for determining gain is fair market value as of the decedent's death, but if the decedent had died before March 1, 1913, it is not less than its fair market value as of that date. However, where Congress has provided otherwise in statutes dealing with particular tribes, the foregoing rules will not apply.

PART III.—COMMON NONTAXABLE EXCHANGES

SECTION 1033.—INVOLUNTARY CONVERSIONS

26 CFR 1.1033–1: Involuntary conversions; nonrecognition of gain. Rev. Rul. 58–557

The publishing of newspaper articles to the effect that certain property is being considered for condemnation by city authorities, even though confirmed by the mayor of the city, does not constitute a sufficient threat or imminence of condemnation under section 1033 of the Internal Revenue Code of 1954.

Advice has been requested whether the publishing of newspaper articles to the effect that certain property is being considered for condemnation by the city authorities, which articles are confirmed by the mayor of the city, constitutes a sufficient threat or imminence of condemnation for purposes of section 1033 of the Internal Revenue Code of 1954.

The taxpayer, a New York corporation which owns property within the area of a city slum clearance program, became aware through the medium of published news articles that the city intended to condemn certain property including its own. This information was confirmed by personal conversation with the mayor of the city. Thereupon, the taxpayer arranged to purchase property to replace its property involved.

Section 1033 of the Code provides in substance that where property is involuntarily converted and the taxpayer purchases other property similar or related in service or use to the property so converted, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized from such conversion exceeds the cost of replacement property. Section 1033(a)

of the Code defines an involuntary conversion as including a threat or imminence of condemnation. Section 1033(a)(3)(B) indicates that the taxpayer must replace the property within a period beginning with either the date on which the condemnation was first threatened or became imminent, whichever is earliest, and ending one year after the close of the first taxable year in which any gain is realized.

It is considered that a condemnation occurs when, under local law, the right of the property owner to the condemnation award becomes vested and the correlative duty of the condemning authority to make payment is fixed. Generally, the rights of the parties do not become fixed prior to the confirmation of the award or the entry of a judgment for damages. A threat or imminence of condmenation exists at such time as a public body having the authority to condemn land or to institute condemnation proceedings indicates, by public resolution or public act, that specifically designated property located within a given geographical area will be condemned. Property is converted *as a result* of a threat or imminence of condemnation only where knowledge of official action pertaining to the impending condemnation has reached the taxpayer prior to his disposition of the property. It is immaterial whether this knowledge is transmitted officially.

A news article, appearing in a newspaper or magazine, to the effect that city officials are considering the condemnation of certain property does not, in itself, constitute a threat or imminence of condemnation, regardless of whether the news article is confirmed, personally or in the body of the article, by those or other city officials.

Accordingly, it is held that the publishing of newspaper articles to the effect that certain property is being considered for condemnation by the city authorities, even though confirmed by the mayor of the city, does not constitute a sufficient threat or imminence of condemnation under section 1033 of the Code.

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26 CFR 1.1033(a)–2: Involuntary conversion where disposition of the converted property occurred after December 31, 1950. Rev. Rul. 58–396

The purchase of a residential house and lot and a vacant lot and the payment of the cost of moving a house from a condemned residential lot to the vacant lot, made from proceeds received as an award for such condemned property, constitute a replacement within the meaning of section 1033 of the Internal Revenue Code of 1954, of the property involuntarily converted.

Advice has been requested whether a replacement of involuntary converted property, within the meaning of section 1033 of the Internal Revenue Code of 1954, results from the transaction described below.

During the taxable year, residential property owned and resided upon by the taxpayer was condemned by the state in order to make way for the construction of a highway. During the period allotted to move from such condemned property, the taxpayer purchased a residential lot with a house thereon. Pursuant to the terms of the condemnation settlement, in addition to a monetary award the taxpayer was allowed to remove the house from the condemned property. In

order to take advantage of such benefit, the taxpayer purchased a second residential lot which was vacant to which he moved his house. The taxpayer now resides upon the second property acquired, while the first acquired property is occupied by his son for a nominal rental to pay taxes and interest on such property. The cost to the taxpayer of the two properties purchased and the expense of moving the house from the condemned property were in excess of the monetary condemnation award received.

Section 1033 of the Code provides, in part, that where property is compulsorily or involuntarily converted into money and the taxpayer, during the period specified, purchases other property similar or related in service or use to the property so converted, at the election of the taxpayer the gain, if any, shall be recognized only to the extent that the money realized upon such conversion exceeds the cost of such other property.

In determining whether a replacement has occurred, for the purposes of section 1033 of the Code, exact physical duplication is not required; however, an amount of money equivalent to the proceeds received pursuant to an involuntary conversion must be expended to acquire property similar in service or use to the property converted. Where both the old and the new properties are suitable for the same purposes and are so used, such properties are similar in service or use. See *Appeal of Cotton Concentration Co.*, 4 B. T. A. 121, acquiescence, C. B. V–2, 1 (1926). Also see *Lynchburg National Bank and Trust Company* v. *Commissioner*, 208 Fed. (2d) 757, affirming 20 T. C. 670.

The facts of the instant case indicate that the entire amount of the condemnation award received by the taxpayer was expended, in effect, to acquire residential property. The property purchased is being used for residence purposes as was the property which was involuntarily converted. Inasmuch as the "similar in service or use" requirement of section 1033 of the Code is satisfied, the fact that two properties were purchased with an amount received on the involuntary conversion of one property does not, on that basis alone, preclude the application of the nonrecognition of gain benefit under that section.

Accordingly, it is held that the purchase of a residential house and lot and a vacant lot and the payment of the cost of moving a house from the condemned residential lot to the vacant lot, made from proceeds received as an award for such condemned property, constitute a replacement, within the meaning of section 1033 of the Code, of the property involuntarily converted.

Rev. Rul. 58–407

Where property owned by a trustee is condemned and shortly thereafter the trust terminates and the trust res is distributed to the beneficiary, the portion of the trust res attributable to the amount received in the condemnation proceedings may qualify for the provisions of section 1033 of the Internal Revenue Code of 1954.

Advice has been requested relative to the application of section 1033 of the Internal Revenue Code of 1954 to property involuntarily converted under the circumstances described below.

The estate of the taxpayer's father, who died in 1953, included a farm of 80 acres and several dwellings. Under the provisions of his

will the taxpayer's mother was to have a life interest in the property and upon her death the trust was to terminate and be distributed to the taxpayer. In 1955, condemnation proceedings were instituted by the adjoining city to acquire one-half of the land which was unimproved pasture land. In accordance with the court order, the trustee sold half of the land under condemnation proceedings. Shortly after the receipt of the proceeds of the sale the taxpayer's mother died, the trust terminated, and the trust property, including the proceeds of the sale, was distributed to the taxpayer. He then used part of the corpus to purchase pasture land similar or related in service and use to the land condemned by the city.

The nonrecognition of gain provisions of section 1033 of the Internal Revenue Code of 1954 provide that where property is compulsorily or involuntarily converted and the taxpayer during the period specified purchases other property similar or related in service or use to the property so converted, then, at the election of the taxpayer, the gain shall be recognized only to the extent that the money realized from such conversion exceeds the cost of the replacement property.

In the case of *Estate of Isaac Goodman* v. *Commissioner*, 199 Fed. (2d) 895, Ct. D. 1763, C. B. 1954–1, 296, the court held that the personal representative of a taxpayer could reinvest the proceeds received from condemnation of property by an individual during his lifetime, but not expended before his death, provided that the reinvestment was made within the period of time required by the statute. The court held that the investment of the proceeds could be made by the taxpayer or by one acting on his behalf even after his death. In the opinion of the Internal Revenue Service the same principle applies where property owned by a trustee is involuntarily converted and, shortly thereafter, termination of the trust occurs and the trust res is distributed, since the trustee in effect is the beneficiary's representative. Accordingly, if a beneficiary invests in property similar or related in service or use to the property held by the trustee which was involuntarily converted, the provisions of section 1033 of the Code are available, providing that all of the other requirements of the section are met.

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26 CFR 1.1033 (f): Statutory provisions; involuntary conversions; livestock sold on account of drought. T. D. 6338[1]

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

Regulations under section 1033 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 October 17, 1958, notice of proposed rule making regarding the amendment of the regulations under section 1033 of the Internal

[1] 23 F. R. 9633.

Revenue Code of 1954 to conform to section 5 of the Act of June 29, 1956 (Public Law 629, 84th Cong., 70 Stat. 407) [C. B. 1956–2, 1165], relating to treatment of sales or exchanges of livestock solely on account of drought as involuntary conversions, was published in the Federal Register (23 F. R. 8035). 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. The second sentence of paragraph (b) of § 1.1033(a)–1 is amended to read as follows:

Special rules apply to involuntary conversions of residence property, property sold pursuant to reclamation laws, livestock destroyed by disease, and livestock sold on account of drought (see §§ 1.1033(b)–1, 1.1033(d)–1, 1.1033(e)–1, and 1.1033(f)–1, respectively).

PAR. 2. Sections 1.1033(f) and 1.1033(f)–1 are redesignated as § 1.1033(g) and § 1.1033(g)–1, respectively, and are amended to read as follows:

§ 1.1033 (g) STATUTORY PROVISIONS; INVOLUNTARY CONVERSIONS; CROSS REFERENCES,

SEC. 1033. INVOLUNTARY CONVERSIONS. * * *

(g) CROSS REFERENCES. (1) For determination of the period for which the taxpayer has held property involuntarily converted, see section 1223.

(2) For treatment of gains from involuntary conversions as capital gains in certain cases, see section 1231 (a).

§ 1.1033(g)–1 *Effective date.*—Except as provided otherwise in] 1.1033(f)–1, the provisions of section 1033 and the regulations thereunder are effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

PAR. 3. The following is inserted immediately after paragraph (c) of § 1.1033(e)–1:

§ 1.1033(f) STATUTORY PROVISIONS; INVOLUNTARY CONVERSIONS; LIVESTOCK SOLD ON ACCOUNT OF DROUGHT.

SEC. 1033. INVOLUNTARY CONVERSION. * * *

(f) LIVESTOCK SOLD ON ACCOUNT OF DROUGHT.—For purposes of this subtitle, the sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number the taxpayer would sell if he followed his usual business practices shall be treated as an involuntary conversion to which this section applies if such livestock are sold or exchanged by the taxpayer solely on account of drought.

[Sec. 1033(f) as added by sec. 5, Pub. Law 629, 84th Cong.]

§ 1.1033(f)–1 SALE OR EXCHANGE OF LIVESTOCK SOLELY ON ACCOUNT OF DROUGHT.—(a) The sale or exchange of livestock (other than poultry) held for draft, breeding, or dairy purposes in excess of the number the taxpayer would sell or exchange during the taxable year if he followed his usual business practices shall be treated as an involuntary conversion to which section 1033 and the regulations thereunder are applicable if the sale or exchange of such livestock by the taxpayer is solely on account of drought. Section 1033(f) and this section shall apply only to sales and exchanges occurring after December 31, 1955.

(b) To qualify under section 1033(f) and this section, the sale or exchange of the livestock need not take place in a drought area. While it is not necessary that the livestock be held in a drought area, the sale or exchange of the livestock must be solely on account of drought conditions the existence of which affected the water, grazing, or other requirements of the livestock so as to necessitate their sale or exchange.

(c) The total sales or exchanges of livestock held for draft, breeding, or dairy purposes occurring in any taxable year which may qualify as an involuntary conversion under section 1033(f) and this section is limited to the excess of the total number of such livestock sold or exchanged during the taxable year over the

number that the taxpayer would have sold or exchanged if he had followed his usual business practices, that is, the number he would have been expected to sell or exchange under ordinary circumstances if there had been no drought. For example, if in the past it has been a taxpayer's practice to sell or exchange annually one-half of his herd of dairy cows, only the number sold or exchanged solely on account of drought conditions which is in excess of one-half of his herd may qualify as an involuntary conversion under section 1033 (f) and this section.

(d) The replacement requirements of section 1033 will be satisfied only if the livestock sold or exchanged is replaced within the prescribed period with livestock which is similar or related in service or use to the livestock sold or exchanged because of drought, that is, the new livestock must be functionally the same as the livestock involuntarily converted. This means that the new livestock must be held for the same useful purpose as the old was held. Thus, although dairy cows could be replaced by dairy cows, a taxpayer could not replace draft animals with breeding or dairy animals.

(e) The provisions of § 1.1033(a)-2 shall be applicable in the case of a sale or exchange treated as an involuntary conversion under this section. The details in connection with such a disposition required to be reported under paragraph (c)(2) of § 1.1033(a)-2 shall include:

(1) Evidence of the existence of the drought conditions which forced the sale or exchange of the livestock;

(2) A computation of the amount of gain realized on the sale or exchange;

(3) The number and kind of livestock sold or exchanged; and

(4) The number of livestock of each kind that would have been sold or exchanged under the usual business practice in the absence of the drought.

(f) The term "involuntary conversion", where it appears in subtitle A or the regulations thereunder, includes the sale or exchange of livestock described in this section.

(g) The provisions of section 1033(f) and this section apply to taxable years ending after December 31, 1955, but only in the case of sales or exchange of livestock after December 31, 1955.

(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 December 8, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 11, 1958, 8:49 a. m., and published in the issue of the Federal Register for December 12, 1958, 23 F. R. 9633.)

SECTION 1034.—SALE OR EXCHANGE OF RESIDENCE

Temporary rules implementing the provisions of the Technical Amendments Act of 1958, relating to the treatment, as a sale, of an involuntary conversion of a personal residence due to condemnation after December 31, 1957. See T. D. 6335, page 1112.

PART IV.—SPECIAL RULES

SECTION 1053.—PROPERTY ACQUIRED BEFORE MARCH 1, 1913

26 CFR 1.1053-1: Property acquired before March 1, 1913.

Determination of basis for computing gain from the sale of allotted and restricted lands previously held by the United States in trust for Indians. See Rev. Rul. 58–341, page 400.

SUBCHAPTER P.—CAPITAL GAINS AND LOSSES

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1222.—OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES

26 CFR 1.1222–1: Other terms relating to capital gains and losses. Rev. Rul. 58–353
(Also Sections 61, 1235; 1.61–1, 1.1235–1.)
(Also Part II, Sections 22(a), 117(a), 117(q); Regulations 118, Sections 39.22(a)–1 and 39.117(a)–1.)

The decision of *Leonard Coplan et ux.* v. *Commissioner*, 28 T. C. 1189, and similar cases will be followed in determining whether the transfer of rights to a patent, in a transaction not coming within the purview of section 117(q) of the Internal Revenue Code of 1939, constitutes the sale of a capital asset.

Mimeograph 6490, C. B. 1950–1, 9, and Revenue Ruling 55–58, C. B. 1955–1, 97, are revoked.

In view of the decision of the Tax Court of the United States in the case of *Leonard Coplan et ux.* v. *Commissioner*, 28 T. C. 1189, the Internal Revenue Service has given further consideration to the position stated in Mimeograph 6490, C. B. 1950–1, 9, and Revenue Ruling 55–58, C. B. 1955–1, 97, and to the Commissioner's outstanding nonacquiescence in the decision of the Tax Court in *Edward C. Myers* v. *Commissioner*, 6 T. C. 258, C. B. 1950–1, 7. It has now been decided to acquiesce (pages 4 and 6, this Bulletin) in the *Myers* and *Coplan* decisions, as well as in *Roy J. Champayne* v. *Commissioner*, 26 T. C. 634, and to revoke Mimeograph 6490 and Revenue Ruling 55–58.

In Mimeograph 6490, *supra*, the Commissioner announced that the Service would not accept the decision in the *Myers* case as a precedent in like cases involving the issue whether amounts received under an exclusive license agreement were taxable as gain from the sale of property so as to be entitled to capital gain treatment. Instead, in respect of amounts received in taxable years beginning after May 31, 1950, the Mimeograph stated that the Service had "reached the conclusion that where the owner of a patent enters into an agreement whereby, in consideration of the assignment of the patent, or the license of the exclusive right to make, use, and sell a patented article, the assignee or licensee agrees to pay to the assignor or licensor an amount measured by a fixed percentage of the selling price of the article so manufactured and sold, or amounts per unit based upon units manufactured or sold, or any other method measured by production, sale, or use either by assignee or licensee, or amounts payable periodically over a period generally coterminous with the transferee's use of the patent, such agreement, for income tax purposes, is to be

regarded as providing for the payment of royalties taxable as ordinary income."

Revenue Ruling 55–58, *supra*, reviewed intervening developments, including the enactment of section 1235 of the Internal Revenue Code of 1954, allowing capital gain treatment to inventors and certain other individuals who transfer specified patent rights on terms generally within the rule of Mimeograph 6490, *supra*, where the transfer is not to a "related person." It was announced that the Service would continue to apply the rule of Mimeograph 6490, *supra*, in cases where section 1235 of the 1954 Code is not applicable. Without further announcement the Service has since continued to apply that rule in like situations where the retroactive provisions of section 117(q) of the Internal Revenue Code of 1939, as added by Public Law 629, 84th Congress, C. B. 1956–2, 1165, providing rules similar to those of section 1235 of the 1954 Code, do not apply. Section 117(q) was made applicable to taxable years beginning after May 31, 1950.

The revocation of Mimeograph 6490, *supra*, and Revenue Ruling 55–58, *supra*, and the acquiescences now being announced in the *Myers*, *Coplan*, and *Champayne* cases, *supra*, mean that capital gain treatment will be accorded to transfers of rights to patents involving facts and circumstances substantially the same as were involved in those cases. (But see section 1239 of the 1954 Code, relating to the treatment of certain gain as ordinary income.) It will be noted in that regard that those cases involved only the retention by the taxpayers of interests resembling royalties coupled with provisions for termination of the rights transferred upon failure of the transferee to pay specified minimum annual amounts, or upon the insolvency or at the instance of the transferee. In cases not within the purview of section 1235 of the 1954 Code or section 117(q) of the 1939 Code, where interests resembling royalties are retained by the transferor along with other rights, the transaction may fail to have sufficient characteristics of a sale to qualify for capital gain treatment. See for example, *Robert C. Switzer et al.* v. *Commissioner*, 226 Fed. (2d) 329; *James R. Watkins et al.* v. *United States*, 252 Fed. (2d) 722; and *Arthur M. Young et ux.* v. *Commissioner*, 29 T. C. No. 92. Compare also *Daniel M. Cory* v. *Commissioner*, 230 Fed. (2d) 941.

Mimeograph 6490, C. B. 1950–1, 9, and Revenue Ruling 55–58, C. B. 1955–1, 97, are revoked.

PART IV.—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1232.—BONDS AND OTHER EVIDENCES OF INDEBTEDNESS

26 CFR 1.1232–1: Bonds and other evidences of indebtedness; scope of section.

Amounts received on maturing secondary interest coupons detached from bonds of a political subdivision of a state by brokers and redeemed by the party who purchased the coupons from the broker. See Rev. Rul. 58–536, page 21.

SECTION 1233.—GAINS AND LOSSES FROM SHORT SALES

26 CFR 1.1233–1: Gains and losses from short sales.

Short sales made of certain corporate stock during period taxpayer held "call" (option to buy) on equal number of shares of such stock. See Rev. Rul. 58–384, below.

SECTION 1234.—OPTIONS TO BUY OR SELL

26 CFR 1.1234–1: Options to buy or sell. Rev. Rul. 58–384
(Also Section 1233, 1.1233–1.)

A taxpayer purchased on March 28, 1957, for $400 cash a "call" (option to buy) on 100 shares of *X* Corporation stock at $50 per share exercisable on or before September 30, 1957. (As to the nature of such option contracts, see generally Revenue Ruling 58–234, C. B. 1958–1, 279.) During the time that he held the "call" option, he made two short sales of 100 shares of *X* corporation stock each and covered those sales in 53 and 10 days, respectively, by purchases of equal numbers of shares of such stock. *Held*, the call option contract and the shares of stock subject to call thereunder are not "substantially identical property," within the meaning of section 1233 of the Internal Revenue Code of 1954 and, therefore, the holding period of the call option contract is not affected by the provisions of that section. Any gain or loss which resulted from a sale of the "call" option contract on September 30, 1957, constitutes long-term capital gain or loss, under sections 1222 and 1234 of the Code, provided the shares of stock subject to call under the contract would be "capital assets," as defined in section 1221 of the Code, in his hands if he acquired them.

SECTION 1235.—SALE OR EXCHANGE OF PATENTS

26 CFR 1.1235–1: Sale or exchange of patents.

Transfer of rights to patents for a consideration of the type described in section 1235(a)(1) and (2) of the Code. See Rev. Rul. 58–353, page 408.

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATION

PART I.—INCOME ATTRIBUTABLE TO SEVERAL TAXABLE YEARS

SECTION 1301.—COMPENSATION FROM AN EMPLOYMENT

Lump-sum "severance pay" received by commissioned officers honorably discharged from the United States Armed Forces pursuant to the Officers Personnel Act of 1947. See Rev. Rul. 58–496, page 20.

SECTION 1303.—INCOME FROM BACK PAY

Lump-sum "severance pay" received by commissioned officers honorably discharged from the United States Armed Forces pursuant to the Officers Personnel Act of 1947. See Rev. Rul. 58–496, page 20.

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26 CFR 1.1303–1: Income from back pay. Rev. Rul. 58–443
(Also Section 3401; 31.3401 (a)–1.)

Remuneration received by commissioned officers or former commissioned officers of the uniformed services, pursuant to the Act of September 2, 1957, for pay earned during the period from July 1, 1932, through June 30, 1934, qualifies as back pay under section 1303(b) (1) of the Internal Revenue Code of 1954. If such pay constitutes more than 15 percent of the gross income of the recipient for the year in which it is received, it qualifies for the treatment provided by section 1303(a) of the Code for Federal income tax purposes. Amounts so received constitute wages subject to the withholding of income tax at source on wages.

Advice has been requested whether amounts paid to a retired military officer under the Act of September 2, 1957, Public Law 85–255, 71 Stat. 575, constitute back pay within the meaning of section 1303(b) of the Internal Revenue Code of 1954.

The Act of September 2, 1957, *supra*, provides that, upon application of any commissioned officer or former commissioned officer of the uniformed services who, upon advancement in rank, did not receive an increase in the rates of pay or allowance for any part of the period beginning July 1, 1932, and ending June 30, 1934, by reason of the application in the case of such officers of section 201 of the Economy Act of June 30, 1932, 47 Stat. 403, and section 4(a), Title 2, of the Economy Act of March 20, 1933, 48 Stat. 13, he will receive the aggregate amount of pay and allowance, in addition to that otherwise accruing, which would have accrued to such officer if the sections cited had not been applied in his case. The Act of September 2, 1957, *supra*, includes payments to widows and legal representatives of such officers where deceased and involves increases earned by such officers during the period cited but which were denied to them by reason of what is now considered to have been an improper interpretation of the acts referred to.

Section 1303(a) of the Code provides that if the amount of back pay received or accrued by a taxpayer during the taxable year exceeds 15 percent of his gross income for the year in which the back pay is received, the tax on such back pay shall be limited to the amount that would have been payable if the back pay had been included in the taxpayer's gross income in the years to which it is attributable. Section 1303(b) of the Code, containing the definition of back pay, provides in part as follows:

(b) * * * For purposes of this section, the term "back pay" means amounts includible in gross income under this subtitle which are one of the following—

(1) Remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed before the taxable year for his employer and which would have been paid before the taxable year except for the intervention of one of the following events:

(A) bankruptcy or receivership of the employer:

(B) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings;
(C) if the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or
(D) any other event determined to be similar in nature under regulations prescribed by the Secretary or his delegate.

It is held that remunerations received by commissioned officers or former commissioned officers under the Act of September 2, 1957, *supra*, qualifies as back pay under section 1303(b)(1) of the Code as remuneration received by an employee for services performed for his employer, an agency of the United States, and which would have been paid before the taxable year except for lack of funds appropriated for such remuneration. If such back pay exceeds fifteen percent of the gross income received by such officer or former officer in question in the year in which it is received, it qualifies for the treatment provided by section 1303(a) of the Code for Federal income tax purposes.

The amounts so received constitute "wages," as defined in section 3401(a), of the Code, subject to the withholding of income tax at source. See I. T. 3742, C. B. 1945, 320.

PART IV.—WAR LOSS RECOVERIES

SECTION 1331.—WAR LOSS RECOVERIES

26 CFR 1.1331–1: Recoveries in respect of war losses. Rev. Rul. 58–397

(Also Sections 354, 356; 1.354–1, 1.356–1.)

Federal income tax treatment of the recovery of certain debenture bonds of a private German corporation and the exchange of the debentures recovered for new bonds, scrip, and cash.

Advice is requested relative to the Federal income tax treatment of the recovery by holders of certain debenture bonds of a private German corporation who exchange such bonds for new bonds, scrip, and cash.

Pursuant to Annex II to the London Agreement on German External Debts of February 27, 1953, a German corporation offered settlement of its old debenture bonds and related interest coupons attached thereto in exchange for new bonds. Prior to the exchange, it was established to the satisfaction of the Commissioner of Internal Revenue that such an exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes under section 367 of the Internal Revenue Code of 1954. See Revenue Ruling 54–501, C. B. 1954–2, 197, with respect to the circumstances and conditions of the London Agreement on German External Debts of February 27, 1953.

In accordance with the exchange offer, each $1,000 validated old debenture may be exchanged for $1,371.40 principal amount of new bonds bearing interest from January 1, 1953, and $35 in cash representing premium payable under the terms of the old debentures. In addi-

tion, for each $35 face amount of interest coupons maturing July 15, 1933, and thereafter (including the January 15, 1945, coupon), which is attached thereto at the time of the surrender, $23.34 principal amount of new bonds bearing interest from January 1, 1953, will be received.

New bonds are to be issued only in denominations of $1,000 and $100. Amounts less than $100 will be represented by scrip which will be exchangeable for bonds in amounts aggregating $100 or more at any time prior to December 31, 1961. For an additional three-year period, subject, however, to the right of the foreign corporation to pay the face amount of scrip with interest thereon, scrip will be exchangeable for bonds in amounts aggregating $100 or more.

Pursuant to the exchange offer, an old debenture having a principal amount of $1,000 with 24 interest coupons attached covering the period from January 15, 1933, to January 15, 1945, could be exchanged for $35 cash and new bonds bearing interest from January 1, 1953, and scrip, as follows:

	New bonds	*Scrip*	*Cash*
For the face amount of the old debenture surrendered	$1,000.00		
For two-thirds of the interest on the old debenture for the period from January 15, 1945, to December 31, 1952	350.00	$21.40	
For two-thirds of the interest on the old debenture for the period from January 15, 1933, to January 15, 1945 ($23.34 for each of the 24 coupons)	550.00	10.16	
Totals	$1,900.00	$31.56	$35.00

In addition to the cash amounting to $35 representing the premium on each $1,000 old debenture, a holder of an old debenture is entitled to receive in cash the interest accrued on the new bonds subsequent to January 1, 1953.

On July 21, 1955, the new bonds in temporary form were available for exchange. Validated old debentures representing a substantial amount of such debentures were exchanged in 1955 and it is anticipated that a substantial part of the balance will be exchanged prior to June 30, 1960. The established practice is for the exchange agent at the time of the exchange to present the matured interest coupons on the new bonds for payment and to deliver the amount received for such coupons to the holders of the old debentures in cash.

Holders of old debentures with coupons attached, not surrendered for exchange, retain their rights with respect to debentures and coupons. However, the London Agreement provides that only those holders of old debentures and the related coupons, who accept the offer to make the exchange, are entitled to the benefits of the Agreement and prohibits the instant corporation from making any payments or other performances with respect to the old debentures not surrendered for exchange until the date on which all of the new obligation of all the debtors subject to the London Agreement and its Annexes have been discharged. Such date is to be fixed by law to be enacted in the future.

Holders of the old debentures on December 11, 1941, the date the United States declared war against Germany, were entitled to claim the cost or other basis of the old debentures as war losses in their Federal income tax returns for the year 1941 under the provisions of section 127(a) of the Internal Revenue Code of 1939.

The restrictions against trading in the old debentures, which were imposed by the Securities and Exchange Commission following the declaration of war against Germany, were removed by the Commission on January 11, 1954. However, trading in the old debentures was resumed on March 15, 1954. The earliest quotations available for the first three days of trading were March 18, 1954 (140), March 19, 1954 (141), and March 22, 1954 (142), or an average for the three days of 141.

On the basis of the facts and circumstances presented, the Internal Revenue Service holds as follows:

(1) Only the old debentures which had been acquired prior to December 11, 1941, and which were held on January 11, 1954, the date the restrictions against trading in the debentures were removed, come under the provisions of section 127 of the Internal Revenue Code of 1939 and the corresponding provisions of sections 1331 through 1337 of the 1954 Code. These debentures were recovered on January 11, 1954, within the meaning of section 1331 of the 1954 Code. This is based on the assumption that there was no effective market for the securities during the existence of the restrictions against trading in the securities.

(2) In the absence of published quotations on the old debentures on or near the recovery date, it is held that they had a fair market value of 141 for each $100.00 principal amount of debentures recovered, this amount being the average of the quotations on the debentures on March 18, March 19, and March 22, 1954, as explained above.

(3) A holder of an old debenture acquired prior to December 11, 1941, will be deemed to have realized a recovery on the recovery date, measured by the fair market value of the debenture on that date, whether or not the debenture is exchanged pursuant to the exchange offer. The amount of the recovery is includible in gross income of the taxpayer in the year of the recovery to the extent provided in section 1332 of the 1954 Code unless, pursuant to the taxpayer's election under section 1335, the provisions of section 1333 are applicable to such recovery.

(4) The holding period, within the meaning of section 1223 of the 1954 Code, for debentures acquired prior to December 11, 1941, runs from the date of the recovery.

(5) In a case where a holder of old debentures did not elect to have the provisions of section 1333 of the 1954 Code apply to the recovery of debentures acquired prior to December 11, 1941, the basis of the debentures recovered is considered to be their fair market value as of the date of the recovery, with the following adjustments:

(a) If the recovery exceeded the deduction allowable in 1941, so that a portion of the recovery is treated as gain on the involuntary conversion of property within the meaning of section 1033 of the 1954 Code, such fair market value is reduced by the total gain, if any, derived from such recovered property as determined under section 1332 of the 1954 Code.

(b) The fair market value of the old debentures at the time recovered, as reduced under subdivision (a) of this subparagraph, is increased by the portion, if any, of the recognized gain resulting from the recovery as determined under section 1332 of the 1954 Code. In effect, the basis of such debentures is their fair market value upon the date of the recovery, reduced by the amount of nonrecognized gain attributable to the recovery under the provisions of sections 1332 and 1033 of the 1954 Code.

(6) In a case where a holder of old debentures elected to have the provisions of section 1333 of the 1954 Code apply to the recovery of debentures acquired prior to December 11, 1941, and the holder of the debentures, under section 1333(1) of the 1954 Code, included such property in the amount of the recovery at its cost or other basis to him which was allowable as a deduction in 1941 under section 127(a) of the 1939 Code, the basis of the debentures is such cost or other basis, reduced by the amount of nonrecognized gain attributable to the recovery under the provisions of sections 1333 and 1033 of the 1954 Code.

(7) The basis of old debentures acquired subsequent to December 11, 1941, is their cost or other basis to the holders thereof.

(8) The issuance by the corporation of the new bonds, with attached interest coupons form January 1, 1953, and scrip, for the old debentures outstanding, and

the related interest coupons attached thereto covering the accrued and unpaid interest from January 15, 1933, to January 15, 1945, constitutes a recapitalization and hence a reorganization within the meaning of section 368(a)(1)(E) of the 1954 Code.

(9) In view of the provisions of section 354(a)(1) and (2), section 356(d)(1), section 356(d)(2)(B), and section 356(a)(1)(B) of the 1954 Code, the gain realized by holders of old debentures, upon the exchange, regardless of whether the debentures were acquired before or after December 11, 1941, will be recognized but in an amount not in excess of the sum of the fair market value of the amount by which the principal of the new bonds received exceeds the principal of the old debentures surrendered and the fair market value of the scrip received, plus the cash received, including the cash received in payment of the accrued interest on the new bonds. The gain realized, if any, is measured by the amount by which the sum of the fair market value of the new bonds and the scrip, plus the cash received, exceeds the basis of the old debentures surrendered. If any part of the cash received upon the exchange represents interest accrued on the new bonds subsequent to the effective date of the exchange, such amount should be treated as interest income in the hands of the holders of the old debentures who acquired new bonds. The remainder of the gain recognized upon the exchange represents capital gain within the meaning of Subchapter P of Chapter 1 of the 1954 Code.

(10) The effective date of the exchange is the date on which the old debentures are received by the exchange agent with the proper instructions to exchange them for new bonds, scrip, and cash, pursuant to the terms of the exchange offer. However, inasmuch as the debentures which are not validated may not be exchanged, in no case will the effective date be earlier than the date of validation.

(11) Under the provisions of section 358(a)(1) of the 1954 Code, the basis of the new bonds, not including the portions thereof which are treated as other property under section 356(a)(1)(B), section 356(d)(1), section 356(a)(1)(B), section 356(d)(1) and section 356(d)(2)(B) of the 1954 Code, is the same as the basis of the old debentures exchanged therefor, decreased by the amounts treated as other property and the cash received, and increased by the gain to the taxpayer which is recognized on the exchange. The basis of the portions of the new bonds which are treated as other property is the fair market value thereof as of the effective date of the exchange. Section 358(a)(2) of the 1954 Code.

PART V.—CLAIM OF RIGHT

SECTION 1341.—COMPUTATION OF TAX WHERE TAXPAYER RESTORES SUBSTANTIAL AMOUNT HELD UNDER CLAIM OF RIGHT

26 CFR 1.1341–1: Restoration of amounts received or accrued under claim of right. (Also Sections 1012, 6601; 1.1012–1, 301.6601–1.)

Rev. Rul. 58–456

During the taxable year 1952, a corporation distributed to its stockholders the excess of the proceeds of mortgage loans insured by the Federal Housing Administration over the construction cost of the property covered by the loans. Each of the stockholders reported the excess of the amount received over the cost or other basis of their respective shares of stock in the corporation as a long-term capital gain in that taxable year. In 1957, the stockholders involuntarily repaid to the corporation all of such amounts received in 1952, which amount, in each case, was in excess of $3,000. *Held*, the amounts repaid to the corporation by the stockholders constitute allowable deductions for 1957 and entitle the stockholders to adjustments under section 1341 of the Internal Revenue Code of 1954 to the extent that they were reflected in gross income for 1952. The basis of the stock in the hands of the stockholders is restored, but only to the extent that such basis was previously applied against the

amounts received in determining the gains reported for 1952. Further, interest, if any, paid or due on any deficiency properly determined for 1952, with respect to a stockholder, does not enter into the computation of the decrease in tax under section 1341 (a) (5) (B) of the Code.

Advice has been requested relative to the application of section 1341 of the Internal Revenue Code of 1954 to payments made by the taxpayer to a corporation of which he is a substantial stockholder under the circumstances described below.

The taxpayer own $25x$ shares of the common stock of a corporation which has outstanding common stock of $200x$ shares. The corporation was properly organized under state law for the purpose of constructing and operating rental property pursuant to the National Housing Act, as amended, 48 Stat. 1246, 12 U. S. C. 1701. In order to qualify for insurance under the Act and to obtain the mortgage insurance benefits provided for therein, the corporation adopted a charter which, in all material aspects, followed the form prescribed by the Commissioner of the Federal Housing Administration. As part of the insurance plan, the Commissioner of the Federal Housing Administration, at a nominal cost of $1.00 per share, acquired all of the preferred stock of the corporation. The corporate charter adopted by the corporation restricted the payment of dividends to net earnings and also prohibited the assignment, transfer, disposition or encumbrance of any real or personal property of the corporation without the consent of the preferred stockholder.

The corporation, under section 608 of the Act, as amended, 56 Stat. 303, 12 U. S. C. 1743, obtained loans on notes secured by Federally insured mortgages on the properties. Although there was no apparent fraud or misrepresentation by the corporation in its relations with the Federal Housing Administration, the actual cost of construction of the project was less than the amount of the insured loans. During the taxable year 1952, and soon after completion of the project, the board of directors of the corporation, by resolution, authorized the distribution of the unexpended proceeds of the mortgage loans to the common stockholders of the corporation. Distribution was made in 1952. The amount so distributed was paid exclusively out of the excess mortgage proceeds; the corporation having neither current nor accumulated earnings and profits. Each stockholder reported, as a long-term capital gain, for the taxable year 1952, the excess of the amount thus received over the basis of his stock in the corporation.

The Federal Housing Administration determined that the corporate charter prohibited the distribution referred to above and formally declared a default under the terms of the loan agreement and proceeded to take the necessary action to assume control of the corporation in accordance with the procedure set up in the charter of the corporation. The corporation and the individual common stockholders thereupon instituted an action in the United States District Court seeking to restrain the Commissioner of the Federal Housing Administration from holding special meetings of the preferred stockholders, the purpose of which meetings was to elect new directors because of the alleged violation of the corporation's charter. The court sustained the proposed action of the Commissioner of the Federal Housing Administration and ruled that the corporation's charter restricted

dividends to net earnings and that the distribution of the excess mortgage proceeds violated the provisions of the corporate charter.

In 1957, an action was brought by the United States and the Commissioner of the Federal Housing Administration against the corporation and its common stockholders seeking to compel them to repay to the corporation the excess mortgage proceeds. The court ordered the stockholders to pay back to the corporation all of the excess mortgage proceeds previously distributed by the corporation. The court further directed the corporation to set aside such amounts in a special reserve account which would not be available for dividends to stockholders without the approval of the Commissioner of the Federal Housing Administration. The stockholders, in 1957, repaid such amounts in cash to the corporation, the amount in each case being in excess of $3,000.

Section 1341 of the Internal Revenue Code of 1954 provides, in part:

> (a) GENERAL RULE.—If—
>
> (1) an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;
>
> (2) a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item; and
>
> (3) the amount of such deduction exceeds $3,000,
>
> then the tax imposed by this chapter for the taxable year shall be the lesser of the following:
>
> (4) the tax for the taxable year computed with such deduction; or
>
> (5) an amount equal to —
>
> (A) the tax for the taxable year computed without such deduction, minus
>
> (B) the decrease in tax under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the exclusion of such item (or portion thereof) from gross income for such prior taxable year (or years).
>
> For the purposes of paragraph (5)(B), the corresponding provisions of the Internal Revenue Code of 1939 shall be chapter 1 of such code (other than subchapter E, relating to self-employment income).

In *Estate of Lloyd E. Crellin et al.* v. *Commissioner*, 17 T. C. 781, affirmed, 203 Fed. (2nd) 812, certiorari denied, 346 U. S. 873, the directors of a personal holding company in which the petitioners were stockholders declared and paid a dividend approximately equal to the capital gain which had been realized upon the sale of certain of its securities. The dividend was declared and paid by the corporation after the directors were advised that, in the opinion of a certified public accountant, the gains, unless distributed, would be subject to the personal holding company surtax. Later in the year, the directors were informed that the opinion of the accountant had been erroneous, whereupon they adopted a resolution purporting to rescind the declaration and payment of the dividend. After such action by the directors, and in the same year, the petitioners made payments to the corporation equal to the dividend payments previously received. The Tax Court of the United States held that neither the action of the directors nor the repayment by the stockholders of the amounts previously received changed the character of the dividend payments

so as to permit their exclusion from gross income or their deduction by the petitioners of the amounts repaid.

The United States Court of Appeals, in affirming the decision of the Tax Court of the United States in the *Crellin* case, stated that:

> In short, for tax purposes, it is that which the holding company could have compelled, not that in which the stockholders were willing to acquiesce, which controls. Otherwise, the taxpayers in this case could "lift the federal tax-hand" to suit their convenience. * * * We recognize that action may be taken by a party which results in a tax saving provided the action is authorized by law. But substance prevails over form. The consent given by the petitioners and relied upon them as justifying "recission" was in fact no more than a voluntary payment by stockholders. The judgment of the Tax Court is affirmed.

In *Charles Kay Bishop et al.* v. *Commissioner*, 25 T. C. 969, acquiescence, C. B. 1956–1, 3, a minority stockholder of a corporation claimed that the majority stockholders, who were partners in two other businesses similar to the corporation's business, were illegally diverting the corporate profits to the partnership businesses in a manner detrimental to the corporation. As a result of the settlement of the controversy the partnership assets were transferred to the corporation on December 31, 1946, as of January 1, 1946. One of the questions there to be resolved was whether the partners were required to report the 1946 income of the two partnerships which they transferred to the corporation as part of the settlement. The Tax Court found that the partnership income rightfully belonged to the corporation and that the partners were not required to report the income in their individual returns.

The Tax Court distinguished the *Bishop* case from the *Estate of Lloyd Crellin*, *supra*, on the basis that in the *Crellin* case there was a voluntary return of a dividend, whereas in the *Bishop* case there was no voluntary repayment but instead the partners recognized the superior claim of the corporation to the income earned from the partnership businesses.

In the instant case, the repayment was involuntary, being made pursuant to a judgment by the court. Thus, the principles of the *Bishop* case are applicable. That is not to say that a repayment is involuntary only if made pursuant to a judgment. For example, if repayment is made pursuant to a demand by the Federal Housing Administration under circumstances entitling such Administration to enforce the demand by legal action in the absence of compliance, such repayment would be considered as involuntary.

Section 1341 of the Code, as indicated above, provides that the tax imposed for the taxable year shall be the lesser of (a) the tax for the taxable year computed with the deduction for repayment or (b) an amount equal to (1) the tax for the taxable year computed without such deduction minus (2) the decrease in tax under Chapter 1 of the Code (or corresponding prior law) for the prior taxable year which would result from the exclusion of such item from gross income for such prior taxable year. Under the first method there is no recomputation of tax for the earlier year. Under the second method the tax for the earlier year is recomputed. Such recomputation for the earlier year does not mean, however, that there is any refund of tax due the taxpayer for such earlier year. Rather, the recomputation for the

earlier year is made solely for the purpose of determining the tax liability for the year of repayment. The deficiency, if any, asserted against the taxpayer for the earlier taxable year remains unchanged and must be satisfied by payment or credit.

Under section 6601 of the Code, interest runs on the deficiency until it is satisfied, except for any temporary suspension under section 6601(d) of the Code. Thus, if it is established that the original distribution by the corporation in 1952 resulted in ordinary income to the stockholder for such year, rather than long-term capital gain as reported on his income tax return for the year 1952, deficiency interest runs from the due date of that return. The interest thus determined is not includible in computing the decrease in tax for 1957 under section 1341(a)(5)(B) of the Code. See *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 570, Ct. D. 1729, C. B. 1950–1, 113.

To the extent that the original distribution received by the stockholder constituted a return of his basis in the stock, but to that extent only, the repayment of such amount will serve to restore such basis. For example, if the taxpayer had a basis in his stock of $1,000 and received a distribution of $10,000 in 1952 from a corporation which had no earnings or profits, the first $1,000 would constitute a return of the basis of his stock and the remaining $9,000 would constitute income. If, during 1957, the taxpayer was required to repay the entire $10,000, only $9,000, which previously had been included in income, could qualify as a deduction under section 1341(a)(4) or as an exclusion under section 1341(a)(5)(B) of the Code, and the remaining $1,000 would constitute a restoration of the basis of the stock.

Accordingly, on the facts here presented, as stated in the foregoing, it is held that the amounts repaid to the corporation by the stockholders constitute allowable deductions for 1957 under the provisions of section 1341 of the Code to the extent that they were reflected in gross income for 1952. Under such circumstances, the basis of the stock is restored, but only to the extent that such basis was previously applied against the amounts received in determining the gains reported for 1952. Further, interest, if any, paid or due on any deficiency properly determined for 1952, with respect to a stockholder, does not enter into the computation of the decrease in tax under section 1341(a)(5)(B) of the Code.

SUBCHAPTER R.—ELECTION OF CERTAIN PARTNERSHIPS AND PROPRIETORSHIPS AS TO TAXABLE STATUS

SECTION 1361.—UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS

Temporary rules under section 63 of the Technical Amendments Act of 1958 relating to the revocation of elections by certain proprietors or partnerships to be taxed as domestic corporations. See T. D. 6332, page 1108.

SUBCHAPTER S.—ELECTION OF CERTAIN SMALL BUSINESS CORPORATIONS AS TO TAXABLE STATUS

SECTION 1371.—DEFINITIONS

Temporary rules under subchapter S, comprising sections 1371 through 1377, and section 6037, as added to the 1954 Code by the Technical Amendments Act of 1958. See T. D. 6317, page 1096.

SECTION 1372.—ELECTION BY SMALL BUSINESS CORPORATION

Rev. Rul. 58–516

The term "calendar month" as used in section 18.1–1(b) of the Income Tax Regulations, Treasury Decision 6317, approved September 22, 1958, relating to the election of certain small business corporations under subchapter S of the Internal Revenue Code of 1954, as added by section 64 of the Technical Amendments Act of 1958, means, in the case of a new corporation whose taxable year begins after the first day of a particular month, for purposes of making the election under section 1372 of the Code by such corporation, the period beginning on such first day of the taxable year and ending on the corresponding day of the succeeding month, or in case there is no such corresponding day, the last day of the succeeding month.

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1401.—RATE OF TAX

26 CFR 1.1401–1: Tax on self-employment income.

Services performed by officers in the sale of insurance for their company. See Rev. Rul. 58–505, page 728.

SECTION 1402.—DEFINITIONS

Rev. Rul. 58–607

Section 403 of the Social Security Amendments of 1958 amends section 1402 of the Self-Employment Contributions Act of 1954 by providing a new rule for computing the net earnings from self-employment of a partner in certain cases where the partner's taxable year ends as a result of his death.

The Internal Revenue Service has been asked to discuss the new rule for the computation of the "net earnings from self-employment" of a partner whose taxable year ends because of his death.

Subsection (f) of section 1402 of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), which subsection was added by section 403(a) of the Social Security Amendments of 1958, P. L. 85–840, 85th Cong., 26 U. S. C. 1402, C. B. 1958–3, page 85, provides a new rule for the computation of the "net earnings from self-employment" of a partner whose taxable year ends, because of his death, before the last day of the current taxable year of the partnership. Under the law in effect before the amendment, if the partnership's current taxable year ended on a date after the date of the death of a partner, no part of the partnership's ordinary income or loss for that year could be taken into account in determining the partner's net earnings from self-employment for his last taxable year.

Section 1402(f) of the Self-Employment Contributions Act provides that "net earnings from self-employment" of a deceased partner for his taxable year which ends, as a result of his death, before the end of the current taxable year of the partnership shall include so much of the "deceased partner's distributive share" of the partnership's ordinary income or loss for such current taxable year as is not attributable to an interest in the partnership during any period beginning on or after the first day of the first calendar month following the month in which the partner died. For the purpose of making the allocation, the ordinary income or loss of the partnership shall be treated as having been realized or sustained ratably over the partnership's taxable year.

The term "deceased partner's distributive share" includes the share of his estate or of any other person succeeding, by reason of the partner's death, to rights with respect to his partnership interest. It does not include any share attributable to a partnership interest which was not held by the deceased partner prior to his death.

Pursuant to section 403(b) of the Social Security Amendments of 1958, the provisions of section 1402(f) of the Act are effective in the case of any partner who dies after August 28, 1958, the date of enactment of the Social Security Amendments of 1958. Section 1402(f) of the Act will also apply in the case of a partner who died after 1955, and on or before August 28, 1958, if there is filed, before January 1, 1960, a return (or amended return) of self-employment tax for the partner's taxable year ending as a result of his death. If such return is filed solely for the purpose of reporting net earnings from self-employment resulting from this rule, the return must be accompanied by remittance of the appropriate amount of self-employment tax. No interest or penalty may be assessed or collected on such amount of tax.

The amendment has no effect upon the computation of the deceased partner's distributive share of partnership income for income tax purposes.

The amendment may be illustrated by the following examples:

Example 1.

B has a taxable year ending December 31 and is a member of partnership *ABC*, the taxable year of which ends on June 30. *B* dies on October 17, 1958. *B*'s distributive share of the partnership's ordinary income for the taxable year of the partnership ended June 30, 1958, was $2,400. Under the law before amendment, *B*'s return for his last taxable year would include as his distributive share of the

partnership's ordinary income, for the purpose of the tax on self-employment income, only this $2,400. The amendment requires that a portion of *B*'s distributive share of the partnership's ordinary income for the taxable year of the partnership ending June 30, 1959, must also be included. It is assumed that *B*'s distributive share of such income, which, under the amendment, includes the share of his estate with respect to his partnership interest for such taxable year, is $4,500. The portion of *B*'s distributive share of such income not attributable to an interest in the partnership subsequent to the end of the month in which he died is $1,500 ($\frac{4}{12}$ths of $4,500). Therefore, under the amendment *B*'s return for the period January 1, 1958, to October 17, 1958, will include $3,900 ($2,400 plus $1,500) of net earnings from self-employment.

Example 2.

If *B* had died on October 17, 1957, the representative of his estate may file, before January 1, 1960, an amended return reporting $800 ($\frac{4}{12}$ths of $2,400) of net earnings from self-employment which represents that portion of his distributive share of partnership income for the taxable year of the partnership ended June 30, 1958, which is not attributable to an interest in the partnership subsequent to the end of the month in which he died. If such amended return is filed solely for the purpose of reporting the additional amount includible in net earnings from self-employment resulting from this new rule, the return must be accompanied by remittance of the appropriate amount of self-employment tax. No interest or penalty may be assessed or collected on such amount of tax.

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26 CFR 1.1402(a)-1: Net earnings from self-employment. Rev. Rul. 58-359

Pension payments or retirement allowances received by a retired minister of a church with respect to services performed in the exercise of his ministry do not constitute net earnings from self-employment for self-employment tax purposes, although such minister has elected coverage under the insurance system established by title II of the Social Security Act pursuant to section 1402(e) of the Self-Employment Contributions Act of 1954.

Advice has been requested whether pension payments or retirement allowances received by a retired minister of a church under a retirement plan of his church are includible in computing net earnings from self-employment for self-employment tax purposes, where the minister has elected coverage under the insurance system established by title II of the Social Security Act pursuant to the provisions of section 1402(e) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

Section 1402(a) of the Self-Employment Contributions Act of 1954, in general, defines the term "net earnings from self-employment" as meaning gross income derived from any trade or business carried on by an individual. Such section excludes certain items of income in computing an individual's "net earnings from self-employment," but does not specifically exclude pension payments or retirement allowances, although such payments are generally includible in gross income for income tax purposes.

The question presented here is whether the pension payments or retirement allowances received by the minister in the instant case should be included in computing his net earnings from self-employment, notwithstanding the fact that such payments are not specifically excluded from such earnings under section 1402(a) *supra*.

Section 1402(e), as added to the Internal Revenue Code of 1954 by the Social Security Amendments of 1954, C. B. 1954–2, 603, provides, among other things, that a duly ordained, commissioned, or licensed minister of a church may, under the circumstances stated therein, certify that he elects to have the insurance system established by title II of the Social Security Act extended to services performed in the exercise of his ministry. Such coverage is extended to both employed and self-employed ministers, but all coverage is *on a self-employed basis*.

It is the position of the Internal Revenue Service that the Social Security Amendments of 1954 were intended to provide that a minister may waive his exclusion as an employed minister under section 3121(b)(8)(A) of the Federal Insurance Contributions Act, but that Congress did not intend to provide for such a waiver with respect to pensions or retirement allowances received by a minister upon retirement which are excludible from the definition of "wages" in section 3121(a) of that act. Although the Self-Employment Contributions Act of 1954 does not contain a provision comparable to section 3121(a), *supra*, it was not necessary to make a special provision excluding payment of pensions or retirement allowances from that Act since such payments are universally construed as rewards for long continued service, having their basis in the employer and employee relationship, a relationship which does not exist in a self-employment situation. Furthermore, the legislative history of the provisions here under consideration shows that in amending the Self-Employment Contributions Act of 1954, it was clearly the intent of Congress that *self-employed* ministers should be treated in the same manner as *employed* ministers. See the Conference Report, House of Representatives Report No. 2679, 83rd Congress, 2nd Session, C. B. 1954–2, 712, at 714.

Accordingly, it is held that pension payments or retirement allowances, received by an ordained minister who has elected coverage under the social security system by filing the required waiver certificate, do not constitute net earnings from self-employment for self-employment tax purposes.

(Also Section 3122.) Rev. Rul. 58–360

Fees received by Federal court reporters from the preparation and sale of official transcripts represent income from a trade or business, such activity being aside from their basic duties for which they receive a statutory wage. Such additional income is includible in computing net earnings from self-employment for purposes of the tax on self-employment income.

Advice has been requested as to the status, for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), of fees collected by Federal court reporters from the sale of official transcripts of court proceedings.

Court reporters in Federal district courts are appointed by the judges of the courts which they respectively serve pursuant to section 753

of Title 28 of the United States Code. They are required by law to perform certain basic duties for which they are remunerated on a salary basis from funds appropriated by the Congress. Such duties are (1) to be present in court at all times when it is sitting to record the proceedings therein; (2) to orally or in writing transcribe, without charge, such proceedings, in whole or in part, at the request of the judge; (3) to transcribe, without charge, pleas and sentencing proceedings in criminal cases; (4) to file with the clerk of the court a free copy of any transcription made; (5) to file the original shorthand notes of any proceeding with the clerk of the court; and (6) to file with the Administrative Office of the United States Courts a statement concerning their income and expenses.

In addition to the statutory wage received for the performance of the above described duties, the reporter receives income from fees charged for furnishing official transcript of recorded proceedings to those persons ordering them, including those ordered by the court in certain cases. The maximum page fees charged for such transcripts are prescribed by the Judicial Conference. However, in certain instances such as in cases of an unduly long trial, or those requiring daily copy or voluminous transcription, the reporter retains bargaining power in that fees charged are the result of an agreement, albeit subject to the court's approval, between the reporter and the person ordering the transcript. Transcripts ordered by any person, other than the judge, are generally billed to that person. The reporter may request payment in advance from such person and may refuse to furnish the transcript if the prescribed or agreed upon fee is not then paid.

The taxes imposed by the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) attach to "wages" paid for "employment," as those terms are defined in section 3121 of that Act. Section 3121(b)(6)(A) of the Act excepts from "employment" services performed in the employ of the United States or any instrumentality thereof, if such services are covered by a retirement system established by a law of the United States. Section 3122 of the Act provides, with respect to services performed in the employ of the United States or a wholly-owned instrumentality thereof, that the determination whether an individual has performed services which constitute "employment," as defined in section 3121(b), and the determination of the amount of remuneration for such services which constitute "wages," as defined in section 3121(a), shall be made by the head of the Federal agency or instrumentality having control of such services or by such agents as he may designate. See Revenue Ruling 56-615, C. B. 1956-2, 565. However, determinations made by Federal agencies under section 3122 are not controlling for the purposes of the Self-Employment Contributions Act of 1954.

On the basis of the facts presented herein, it is the position of the Internal Revenue Service that Federal court reporters operate in a dual capacity. They are employees with respect to the performance of their basic statutory duties as described in (1) through (6) above and independent contractors with respect to the other preparation and sale of official transcripts. To a large extent, the over-all income of the reporter is dependent upon his own initiative and ingenuity and neither the courts nor the Judicial Conference prescribe or super-

vise the manner and means of accomplishment. Whether the reporter produces typewritten or mimeographed transcripts, or whether, in some instances, the transcription is done by an outside reporting firm on the basis of a contract with the official reporter are matters within the discretion of the official reporter. It is solely within the reporter's discretion to require payment in advance for transcripts ordered and, in the absence of such advance payment where requested, there is no duty to prepare and furnish such transcripts.

The tax imposed by the Self-Employment Contributions Act is applicable to the "net earnings from self-employment" derived by an individual (other than a non-resident alien) from a trade or business carried on by him as sole proprietor or by a partnership of which he is a member, subject to certain exclusions, exceptions and limitations.

It is held that fees received by Federal court reporters from the preparation and sale of official transcripts represent income from a trade or business, such activity being aside from their basic duties for which they receive a statutory wage, and that such income is includible in computing net earnings from self-employment for purposes of the tax on self-employment income. This ruling is equally applicable in determining the status of official state court reporters for self-employment tax purposes where the facts are not substantially different from the facts of the instant case.

Advance payments made to a farmer by the operator of a feed store under a broiler production agreement for the use of his brooder houses. See Rev. Rul. 58–568, page 730.

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26 CFR 1.1402(c)–1: Trade or business. Rev. Rul. 58–549

Where an individual is appointed by a court pursuant to statutory authority of the state of *M* to perform services in the capacity of commissioner, receiver, or referee in cases coming before it, those services are excluded from the term "trade or business" as defined in the Self-Employment Contributions Act of 1954. Services performed in the capacity of appraiser or guardian, depending upon the circumstances involved, may or may not constitute the carrying on of a "trade or business" for purposes of the Self-Employment Contributions Act of 1954.

Advice has been requested relative to the status, under the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) of an individual performing services as a commissioner, receiver, referee, appraiser, and guardian, pursuant to appointment by a state court as authorized by state statute.

Under the Government Code of the state of *M*, a superior court may appoint a commissioner, or commissioners, with power to hear and determine ex parte motions for orders and writs in the absence or inability of the judge or judges of the court. Further powers granted to such appointed commissioners include the taking of proof and reporting conclusions upon information which is required by the court, the taking and approving of bonds, including examination of sureties thereon, the administering of oaths and affirmations, and the taking of affidavits.

The Code of Civil Procedure of the state of *M* provides that a receiver appointed by the court, or by a judge thereof, has, under the control of the court, power to bring and defend actions in his own name, as receiver, to take and keep possession of the property, to receive rents, collect debts, to compound for and compromise the same, to make transfers, and generally to do such acts respecting the property as the court may authorize.

With respect to the duties of a referee, the Code provides that such person must report his findings in writing to the court within a specified time after testimony, stating separately facts found and conclusions of law. The findings of the referee must stand as the finding of the court and, upon proper filing of the finding, judgment may be entered thereon in the same manner as if the action had been tried by the court.

The Code of Civil Procedure provides, with respect to appraisers, that in any action or proceeding for the purpose of condemning property the court may appoint appraisers or other persons for the purpose of determining the value of such property and fixing the compensation thereof.

With respect to guardians, the Code provides that a general guardian or guardian ad litem appearing for an infant or incompetent person in any action or proceeding shall have power, with proper court approval, to compromise the same, to agree to the order or judgment to be entered therein for or against his ward, and to satisfy any judgment or order in favor of said ward or release or discharge any claim of said ward pursuant to such compromise.

The individual in question works in the capacity of clerk in the presiding judge's court, superior court of the state of *M*, and, in such connection, he receives a monthly salary. Also, he is under the retirement plan of the city and county of *N*. With respect to such services, he is admittedly an employee of the city and county of *N*. His appointments to act as commissioner, guardian, receiver, referee, and appraiser are made by the presiding judge. His services in those capacities are performed during his spare time and the appointments are not dependent upon the fact that he is a clerk of the court. He receives an average of fifteen appointments yearly to act in each capacity. His duties as an appraiser are to examine personal and real property and to place a fair valuation thereon. He receives separate appointments as an appraiser and his work in that capacity is not a part of his duties as commissioner or referee. When acting as guardian, it is his duty to marshall the assets of the ward or minor, prepare inventories of such properties, receive and disburse the income of the estate, and to prepare and file a statement of account to be submitted to the court. He maintains an office in his home, provides his own equipment and supplies, and pays all expenses incurred in connection with such activities. His services in the aforementioned capacities are performed without supervision or control by the judge. The fees for his services are fixed by the judge and are paid to him by the litigents in the case before the court. Occasionally, he engages individuals to assist in some phase of his work and pays them from his own funds. He has not been admitted to practice law in the state of *M*.

Section 1402(c) of the Self-Employment Contributions Act of 1954, *supra*, provides, in part, that the term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses), except that such term shall not include (1) the performance of the functions of a public office, and (2) the performance of services by an individual as an employee (with certain exceptions not here material) as defined in the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

It is held that the services performed by the individual in his capacity as commissioner, receiver, and referee under appointments by the judge of the court pursuant to the provisions of the state law are excluded from the term "trade or business" under section 1402(c) of the Self-Employment Contributions Act of 1954 as services performed by an officer or employee of the court. Accordingly, the tax imposed by that Act is not applicable to his remuneration for such services.

An appraiser and a guardian appointed pursuant to the laws of the state of *M* are not considered to be officers or employees of the court. An appraiser is required to ascertain the true value of property submitted to his inspection and make return thereof to the court. The duties of a guardian are to protect the interests of the wards of the court and he is an officer or employee of the court only in the limited sense that all attorneys representing their clients in a proceeding before a court are officers of the court. Based upon the facts concerning the circumstances under which the services are performed in the instant case, it is held that the individual's activities as appraiser constitute the carrying on of a trade or business for purposes of the Self-Employment Contributions Act of 1954. His activities as guardian constitute the carrying on of a trade or business as a professional fiduciary for purposes of such Act. See Rev. Rul. 58–5, C. B. 1958–1, 322. To the extent that the income from the individuals activities as appraiser and guardian does not exceed $4,200 after considering the amount of wages he receives for his services as an employee, such income is taken into account in computing his net earnings from self-employment for purposes of the tax imposed by the Self-Employment Contributions Act of 1954.

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 1.1441–2: Income subject to withholding.

Commissions received by masters of "tramp steamers" of foreign registry from marine suppliers. See Rev. Rul. 58–479, page 60.

CHAPTER 4.—RULES APPLICABLE TO RECOVERY OF EXCESSIVE PROFITS ON GOVERNMENT CONTRACTS

SUBCHAPTER B.—MITIGATION OF EFFECT OF RENEGOTIATION OF GOVERNMENT CONTRACTS

SECTION 1481.—MITIGATION OF EFFECT OF RENEGOTIATION OF GOVERNMENT CONTRACTS

Rev. Rul. 58–342

Where repayments of excessive profits on Government contracts are made to a Government agency, without a tax credit, prior to payment of the tax liability shown on the return for the year to which the excessive profits relate, the interest allowable on any overpayment of tax resulting upon its subsequent payment is computed, in accordance with the provisions of section 6611 of the Internal Revenue Code of 1954 (section 3771 of the Internal Revenue Code of 1939), from the date or dates of such overpayment of tax.

Revenue Ruling 54–82, C. B. 1954–1, 286, amplified.

Advice has been requested regarding the proper method and periods for computing interest in connection with repayments of excessive profits on Government contracts to a Government agency which are made, without a tax credit under section 1481(b) of the Internal Revenue Code of 1954 (formerly section 3806(b) of the Internal Revenue Code of 1939), prior to payment of the tax liability shown on the return for the year to which the excessive profits relate.

The treatment, for Federal income tax purposes, of repayment of excessive profits without such a tax credit is set forth in Revenue Ruling 54–82, C. B. 1954–1, 286. The general position of the Service is contained in the penultimate sentence of that ruling which states, "In the event that excessive profits have been repaid without benefit of a tax credit, where such credit is allowable under section 3806(b) of the Code, the credit shall be treated as an overpayment of tax for the prior taxable year." The last sentence of the ruling, referring to interest on such overpayments, concludes that "Such overpayment is considered as made at the time the payment, repayment, or offset was made, for the purposes of computing interest under section 3771(b) of the Code" (Now section 6611(b) and (e) of the Internal Revenue Code of 1954).

Although not so stated in Revenue Ruling 54–82, *supra*, it anticipated situations where the repayment of excessive profits takes place after the last payment of tax. In such case, interest on the resulting overpayment of tax is allowable only from the date or date of repayment of excessive profits.

Section 1481(b) of the 1954 Code (section 3806(b) of the 1939 Code) provides, *inter alia*, that there shall be credited against the amount of excessive profits eliminated the amount by which the Federal income tax for the prior taxable year is decreased by reason of the elimination of excessive profits. Section 1481(c) of the 1954 Code (section 3806(c) of the 1939 Code) provides, in its second sentence, that "If the amount allowable as a credit under subsection (b) exceeds the amount

allowed under such subsection, the excess shall, for the purposes of the internal revenue laws relating to credit or refund of tax, be treated as an overpayment for the prior taxable year which was made at the time payment, repayment, or offset was made." However, a tax credit under section 1481(b), *supra*, is not allowable unless *tax* (including tax on excessive profits) has been paid; in fact, such tax credit is the legal equivalent of a tax refund. See, generally, *Baltimore Foundry & Machine Corporation* v. *Commissioner*, 7 T. C. 998; *Stow Manufacturing Company, Inc.* v. *Commissioner*, 14 T. C. 1440; *Morris Kurtzon* v. *Commissioner*, 17 T. C. 1542; *Universal Oil Products Co.* v. *Campbell*, 181 F. (2d) 451; and *Joseph T. Miller et ux.*, v. *Commissioner*, 231 F. (2d) 8, affirming 23 T. C. 565. Therefore, where such tax has not been paid, no such tax credit, and, likewise, no tax refund under section 1481(c), *supra*, is available until such tax has been paid.

In view of the foregoing, it is held that, where repayments of excessive profits on Government contracts are made to a Government agency, without such a tax credit, prior to the payment of the tax liability shown on the return for the year to which the excessive profits relate, the interest allowable on any overpayment of tax resulting upon its subsequent payment is computed, in accordance with the provisions of section 6611 of the 1954 Code (section 3771 of the 1939 Code), from the date or dates of such overpayment of tax.

Revenue Ruling 54–82, C. B. 1954–1, 286, amplified.

CHAPTER 6.—CONSOLIDATED RETURNS

SUBCHAPTER A.—RETURNS AND PAYMENT OF TAX

SECTION 1502.—REGULATIONS

26 CFR 1.1502–11: Consolidated returns for subsequent years. Rev. Rul. 58–471

Affiliated Corporations filing consolidated returns may make a new election to file separate returns for the first taxable year for which returns are to be filed after the enactment of the Technical Amendments Act of 1958, on September 2, 1958.

Advice has been requested as to whether enactment of the Technical Amendments Act of 1958, Public Law 85–866, 72 Stat., 1606, approved September 2, 1958, will permit affiliated corporations a new election to file separate returns in lieu of consolidated returns and as to the year for which such new elections will be available.

The Technical Amendments Act of 1958, which provides a three-year net operating loss carryback for taxable years ending after December 31, 1957, and a carryback and carryover of foreign tax credit with respect to taxable years beginning after December 31, 1957, is of such a character as to make substantially less advantageous to affiliated groups of corporations as a class the continued filing of consolidated income tax returns, within the meaning of section 1.1502–11(a)(2) of the Income Tax Regulations.

In view of this legislative enactment, a new election is authorized to file separate returns for the first taxable year for which returns are due to be filed after the date of enactment of the Technical Amendments Act of 1958. In this regard returns due to be filed after the date of enactment of the new Act (including any extensions of time granted by the Commissioner of Internal Revenue) will be considered as filed and the election exercised on such due date regardless of the actual previous date of filing. However, the last return (or returns), whether original or revised, filed on or before the due date for the return (including any extensions of time for filing such return), will be considered the return or returns filed on such due date.

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26 CFR 1.1502–31: Bases of tax computation.

Determination of taxable income, including allocation of consolidated section 922 deduction, for foreign tax purposes of Western Hemisphere trade corporations which are members of an affiliated group of corporations. See Rev. Rul. 58–618, below.

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26 CFR 1.1502–43: Credit for foreign taxes. Rev. Rul. 58–618
(Also Sections 904, 922, 1502; 1.904–1, 1.922–1(a), 1.1502–31.)

Determination of taxable income from sources within a foreign country, for foreign tax credit purposes, of Western Hemisphere trade corporations which are members of an affiliated group of corporations filing a consolidated income tax return.

Advice has been requested with respect to the method of computing the limitation on foreign tax credits of an affiliated group of corporations filing a consolidated income tax return, where some members of the affiliated group are Western Hemisphere trade corporations having profits, while some others are Western Hemisphere trade corporations sustaining operating losses.

An affiliated group of corporations filed a consolidated income tax return for the calendar year 1955. The affiliated group includes a number of member companies qualifying as Western Hemisphere trade corporations. One of such companies is engaged in marketing operations in two Central American republics which impose income taxes, and another such company operates in a South American republic which also imposes an income tax. These companies reported net income for the calendar year 1955. The remaining members of the group qualifying as Western Hemisphere trade corporations sustained net losses for 1955.

Section 1.1502–31(a)(1) of the Income Tax Regulations provides that the consolidated taxable income of an affiliated group of corporations shall be the combined taxable income of the several affiliated corporations, minus, among other items, the sum of any consolidated section 922 deduction.

Section 1.1502–31(a)(15) of the regulations provides as follows:

(15) *Consolidated Section 922 Deduction.*—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).

Section 922 of the Internal Revenue Code of 1954 provides as follows:

> In the case of a Western Hemisphere trade corporation there shall be allowed as a deduction in computing taxable income an amount computed as follows—
>
> (1) First determine the taxable income of such corporation computed without regard to this section.
>
> (2) Then multiply the amount determined under paragraph (1) by the fraction—
>
> (A) the numerator of which is 14 percent, and
>
> (B) the denominator of which is that percentage which equals the sum of the normal tax rate and the surtax rate for the taxable year prescribed by section 11.

Section 1.1502–43 of the regulations provides that the credit allowed to an affiliated group of corporations for taxes paid or accrued, and for such taxes deemed to have been paid, during the consolidated return period to any foreign country or to any possession of the United States shall be computed and allowed as if the affiliated group were the taxpayer and as if the aggregate taxes paid or deemed to have been paid by the several members of the group and the credits allowed with respect to such payments were payments made and deemed to have been made by, and credits allowed to, the group.

Section 904(a) of the Code provides that the amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year. Taxable income from a foreign country and the entire taxable income for the purpose of this limiting fraction are to be computed according to the provisions of sections 861 and 862 of the Code.

The problem in this case is whether, in determining the limiting fraction under section 904(a) of the Code, the section 922 deduction allowable to the affiliates who qualify as Western Hemisphere trade corporations is computed on a separate company basis, or whether the consolidated section 922 deduction is to be allocated on the basis of some ratio. No problem arises on this point where all the Western Hemisphere trade members have profits. Where, however, one or more of such members have operating losses, resulting in either a reduced consolidated section 922 deduction, or in no consolidated section 922 deduction, the foreign tax credit is substantially reduced unless only an allocated portion of the consolidated section 922 deduction is used in determining the taxable income in the foreign country. If, in those cases where there is a reduced consolidated section 922 deduction, or no such deduction, the section 922 deduction is computed on a separate company basis, the deduction is invariably greater and therefore the taxable income in the foreign country (*i. e.*, the numerator of the limiting fraction) is reduced to a greater extent than is the entire taxable income (*i. e.*, the denominator of the limiting fraction) which has been determined by applying a smaller deduction or no deduction at all against entire income. This results in less foreign tax credit than if the taxable income within the foreign country were

determined by applying an allocated portion of the consolidated section 922 deduction.

There appears to be no authority to determine the section 922 deduction on a separate company basis since, if one of the Western Hemisphere trade corporations has a loss, the total of the section 922 deductions for the other Western Hemisphere trade corporations would be greater than the section 922 deduction as computed for the affiliated group.

Accordingly, it is held that in computing the limitation on foreign tax credits of an affiliated group of corporations filing a consolidated income tax return where some members of the affiliated group are Western Hemisphere trade corporations having profits while others are Western Hemisphere trade corporations having operating losses, taxable income from sources within a foreign country means income from such country computed without the section 922 deduction minus the allocable portion of the consolidated section 922 deduction. Such allocation is made only among the profit companies qualifying as Western Hemisphere trade corporations on the basis of the ratio of their respective net incomes to their combined net income. Where a portion of the consolidated section 922 deduction is allocated to a profit company operating in several countries, such portion may be further allocated to the separate countries on the basis of the ratio of the net income within each country to its total net income. In a case where there is no consolidated section 922 deduction allowable to the group, there exists no section 922 deduction to be taken into account by the profit companies qualifying as Western Hemisphere trade companies in determining their taxable income for the purposes of section 904(a) of the Code.

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATES OF CITIZENS OR RESIDENTS

PART I.—TAX IMPOSED

SECTION 2001.—RATE OF TAX

26 CFR 20.2001: Statutory provisions; rate of tax. T. D. 6296[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER B, PARTS 20 AND 301

Regulations under provisions of the Internal Revenue Code of 1954 relating to the 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:

On October 16, 1956, notice of proposed rulemaking regarding (1) the Estate Tax Regulations (26 CFR Part 20) under chapter 11 of

[1] 23 F. R. 4529.

subtitle B of the Internal Revenue Code of 1954 and under certain sections of subtitle F of the Internal Revenue Code of 1954, and (2) amendments to conform the Regulations on Procedure and Administration (26 CFR Part 301) to section 2 of the Act of August 6, 1956 (Public Law 1011, 84th Cong., 70 Stat. 1075) [C. B. 1956–2, 1206], was published in the Federal Register (21 F. R. 7850). 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 specifically provided otherwise, such regulations are applicable to estates of decedents dying after August 16, 1954:

Estate Tax Regulations (26 CFR Part 20)

PARAGRAPH 1. The following Estate Tax Regulations are hereby prescribed under chapter 11 of subtitle B of the Internal Revenue Code of 1954 and under certain sections of subtitle F of the Internal Revenue Code of 1954:

ESTATE TAX REGULATIONS

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AUTHORITY: §§ 20.0–1 to 20.7404, incl., issued under sec. 7805, I. R. C. 68A Stat. 917; 26 U.S.C. 7805.

ESTATE TAX

INTRODUCTION

§ 20.0–1 INTRODUCTION.—(a) *In general.*—The regulations in this part (Part 20, Subchapter B, Chapter I, Title 26, Code of Federal Regulations) are designated "Estate Tax Regulations". These regulations pertain to (1) the Federal estate tax imposed by chapter 11 of subtitle B of the Internal Revenue Code on the transfer of estates of decedents dying after August 16, 1954, and (2) certain related administrative provisions of subtitle F of the Code. It should be noted that the application of many of the provisions of these regulations may be affected by the provisions of an applicable death tax convention with a foreign country. Unless otherwise indicated, references in the regulations to the "Internal Revenue Code" or the "Code" are references to the Internal Revenue Code of 1954, as amended, and references to a section or other provision of law are references to a section or other provision of the Internal Revenue Code of 1954, as amended. Unless otherwise provided, the Estate Tax Regulations are applicable to the estates of decedents dying after August 16, 1954, and supersede the regulations contained in Part 81, Subchapter B, Chapter I, Title 26, Code of Federal Regulations (1939) (Regulations 105, Estate Tax), as prescribed and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, signed August 16, 1954 (19 F. R. 5167, Aug. 17, 1954) [C. B. 1954–2, 47].

(b) *Scope of regulations.*—(1) *Estates of citizens or residents.*—Subchapter A of chapter 11 of the Code pertains to the taxation of the estate of a person who was a citizen or a resident of the United States at the time of his death. The term "resident" means a decedent who, at the time of his death, had his domicile in the United States. The term "United States", as used in the Estate Tax Regulations, includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia (see section 7701(a)(9)). A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal. The regulations pursuant to subchapter A are set forth in §§ 20.2001–1 through 20.2056(e)–3 of this part.

(2) *Estates of nonresidents not citizens.*—Subchapter B of chapter 11 of the Code pertains to the taxation of the estate of a person who was a nonresident not a citizen of the United States at the time of his death. A "nonresident" is a decedent who, at the time of his death, had his domicile outside the United States under the principles set forth in subparagraph (1) of this paragraph. (See, however, section 2202 with respect to missionaries in foreign service.) The regulations pursuant to subchapter B are set forth in §§ 20.2101–1 through 20.2106–2 of this part.

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(3) *Miscellaneous substantive provisions.*—Subchapter C of chapter 11 of the Code contains a number of miscellaneous substantive provisions. The regulations pursuant to subchapter C are set forth in §§ 20.2201–1 through 20.2207–1 of this part.

(4) *Procedure and administration provisions.*—Subtitle F of the Internal Revenue Code contains some sections which are applicable to the Federal estate tax. The regulations pursuant to those sections are set forth in §§ 20.6001–1 through 20.7101–1. Such regulations do not purport to be all the regulations on procedure and administration which are pertinent to estate tax matters. For the remainder of the regulations on procedure and administration which are pertinent to estate tax matters, see part 301 of this chapter (Regulations on Procedure and Administration).

(c) *Arrangement and numbering.*—Each section of the regulations (except this section and § 20.0–2) is preceded by the section or subsection of the Internal Revenue Code which it interprets. The sections of the regulations can readily be distinguished from sections of the Code since—

(1) The sections of the regulations are printed in larger type;

(2) The sections of the regulations are preceded by a section symbol and the part number, arabic number 20 followed by a decimal point (§ 20.); and

(3) The sections of the Code are preceded by "Sec.".

Each section of the regulations setting forth law or regulations is designated by a number composed of the part number followed by a decimal point (20.) and the number of the corresponding provision of the Internal Revenue Code. In the case of a section setting forth regulations, this designation is followed by a hyphen (-) and a number identifying such section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. Thus, the section of the regulations setting forth section 2012 of the Internal Revenue Code is designated § 20.2012 and the regulations pertaining to section 2012 are designated § 20.2012–1.

§ 20.0–2 General Description of Tax.—(a) *Nature of tax.*—The Federal estate tax is neither a property tax nor an inheritance tax. It is a tax imposed upon the transfer of the entire taxable estate and not upon any particular legacy, devise, or distributive share. Escheat of a decedent's property to the State for lack of heirs is a transfer which causes the property to be included in the decedent's gross estate.

(b) *Method of determining tax; estate of citizen or resident.*—(1) *In general.*—The following subparagraphs contain a general description of the method to be used in determining the Federal estate tax imposed upon the transfer of the estate of a decedent who was a citizen or resident of the United States at the time of his death.

(2) *Gross estate.*—The first step in determining the tax is to ascertain the total value of the decedent's gross estate. The value of the gross estate includes the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death. However, the gross estate also may include property in which the decedent did not have an interest at the time of his death. A decedent's gross estate for Federal estate tax purposes may therefore be very different from the same decedent's estate for local probate purposes. Examples of items which

may be included in a decedent's gross estate and not in his probate estate are the following: certain property transferred by the decedent during his lifetime without adequate consideration; property held jointly by the decedent and others; property over which the decendent had a general power of appointment; proceeds of certain policies of insurance on the decedent's life; annuities; and dower or curtesy of a surviving spouse or a statutory estate in lieu thereof. For a detailed explanation of the method of ascertaining the value of the gross estate, see sections 2031 through 2044, and the regulations thereunder.

(3) *Taxable estate.*—The second step in determining the tax is to ascertain the value of the decedent's taxable estate. The value of the taxable estate is determined by subtracting from the value of the gross estate the authorized exemption and deductions. Under various conditions and limitations, deductions are allowable for expenses, indebtedness, taxes, losses, charitable transfers, and transfers to a surviving spouse. For a detailed explanation of the method of ascertaining the value of the taxable estate, see sections 2051 through 2056, and the regulations thereunder.

(4) *Gross estate tax.*—The third step is the determination of the gross estate tax. This is accomplished by the application of certain rates to the value of the decedent's taxable estate. In this connection, see section 2001 and the regulations thereunder.

(5) *Net estate tax payable.*—The final step is the determination of the net estate tax payable. This is done by subtracting from the gross estate tax the authorized credits against tax. Under certain conditions and limitations, credits are allowable for the following (computed in the order stated below):

(i) State death taxes paid in connection with the decedent's estate (section 2011);

(ii) Gift taxes paid on inter-vivos transfers by the decedent of property included in his gross estate (section 2012);

(iii) Foreign death taxes paid in connection with the decedent's estate (section 2014); and

(iv) Federal estate taxes paid on transfers of property to the decedent (section 2013).

Sections 2015 and 2016 contain certain further rules for the application of the credits for State and foreign death taxes. For a detailed explanation of the credits against tax, see sections 2011 through 2016, and the regulations thereunder.

(c) *Method of determining tax; estate of nonresident not a citizen.*—In general, the method to be used in determining the Federal estate tax imposed upon the transfer of an estate of a decedent who was a nonresident not a citizen of the United States is similar to that described in paragraph (b) of this section with respect to the estate of a citizen or resident. Briefly stated, the steps are as follows: first, ascertain the value of that part of the decedent's "entire gross estate" which at the time of his death was situated in the United States (see §§ 20.2103–1 and 20.2104–1); second, determine the value of the taxable estate by substracting from the value of that part of the "entire gross estate" which was situated in the United States at the time of the decedent's death the amount of the allowable deductions (see § 20.2106–1); third, compute the gross estate tax on the taxable estate, using the rates set forth in section 2001 (see

§ 20.2101–1); and fourth, subtract from the gross estate tax the total amount of any allowable credits in order to arrive at the net estate tax payable (see § 20.2102–1).

ESTATES OF CITIZENS OR RESIDENTS

TAX IMPOSED

§ 20.2001 STATUTORY PROVISIONS; RATE OF TAX.

SEC. 2001. RATE OF TAX.

A tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2051, of every decedent, citizen or resident of the United States dying after the date of enactment of this title:

If the taxable estate is—	The tax shall be—
Not over $5,000	3% of the taxable estate.
Over $5,000 but not over $10,000	$150, plus 7% of excess over $5,000.
Over $10,000 but not over $20,000	$500, plus 11% of excess over $10,000.
Over $20,000 but not over $30,000	$1,600, plus 14% of excess over $20,000.
Over $30,000 but not over $40,000	$3,000, plus 18% of excess over $30,000.
Over $40,000 but not over $50,000	$4,800, plus 22% of excess over $40,000.
Over $50,000 but not over $60,000	$7,000, plus 25% of excess over $50,000.
Over $60,000 but not over $100,000	$9,500, plus 28% of excess over $60,000.
Over $100,00 but not over $250,000.	$20,700, plus 30% of excess over $100,000.
Over $250,000 but not over $500,000.	$65,700, plus 32% of excess over $250,000.
Over $500,000 but not over $750,000.	$145,700, plus 35% of excess over $500,000.
Over $750,000 but not over $1,000,000.	$233,200, plus 37% of excess over $750,000.
Over $1,000,000 but not over $1,250,000.	$325,700, plus 39% of excess over $1,000,000.
Over $1,250,000 but not over $1,500,000.	$423,200, plus 42% of excess over $1,250,000.
Over $1,500,000 but not over $2,000,000.	$528,200, plus 45% of excess over $1,500,000.
Over $2,000,000 but not over $2,500,000.	$753,200, plus 49% of excess over $2,000,000.
Over $2,500,000 but not over $3,000,000.	$998,200, plus 53% of excess over $2,500,000.
Over $3,000,000 but not over $3,500,000.	$1,263,200, plus 56% of excess over $3,000,000.
Over $3,500,000 but not over $4,000,000.	$1,543,200, plus 59% of excess over $3,500,000.
Over $4,000,000 but not over $5,000,000.	$1,838,200, plus 63% of excess over $4,000,000.
Over $5,000,000 but not over $6,000,000.	$2,468,200 plus 67% of excess over $5,000,000.
Over $6,000,000 but not over $7,000,000.	$3,138,200, plus 70% of excess over $6,000,000.
Over $7,000,000 but not over $8,000,000.	$3,838,200, plus 73% of excess over $7,000,000.
Over $8,000,000 but not over $10,000,000.	$4,568,200, plus 76% of excess over $8,000,000.
Over $10,000,000	$6,088,200, plus 77% of excess over $10,000,000.

§ 20.2001–1 RATE OF TAX.—(a) The gross estate tax is computed by the application of progressively graduated rates to the value of the decedent's taxable estate in accordance with the following table:

Table for Computation of Gross Estate Tax

(A) Taxable estate equal to or more than—	(B) Taxable estate less than—	(C) Tax on amount in column (A)	(D) Rate of tax on excess over amount in column (A)
			Percent
----------	$5, 000	----------	3
$5, 000	10, 000	$150	7
10, 000	20, 000	500	11
20, 000	30, 000	1, 600	14
30, 000	40, 000	3, 000	18
40, 000	50, 000	4, 800	22
50, 000	60, 000	7, 000	25
60, 000	100, 000	9, 500	28
100, 000	250, 000	20, 700	30
250, 000	500, 000	65, 700	32
500, 000	750, 000	145, 700	35
750, 000	1, 000, 000	233, 200	37
1, 000, 000	1, 250, 000	325, 700	39
1, 250, 000	1, 500, 000	423, 200	42
1, 500, 000	2, 000, 000	528, 200	45
2, 000, 000	2, 500, 000	753, 200	49
2, 500, 000	3, 000, 000	998, 200	53
3, 000, 000	3, 500, 000	1, 263, 200	56
3, 500, 000	4. 000, 000	1, 543, 200	59
4, 000, 000	5, 000, 000	1, 838, 200	63
5, 000, 000	6, 000, 000	2, 468, 200	67
6, 000, 000	7, 000, 000	3, 138, 200	70
7, 000, 000	8, 000, 000	3, 838, 200	73
8, 000, 000	10, 000, 000	4, 568, 200	76
10, 000, 000	----------	6, 088, 200	77

(b) The application of the table may be illustrated by the following example:

Example. The decedent died January 1, 1955, having a gross estate of $600,000. The exemption and authorized deductions amount to $75,000, thus leaving a taxable estate of $525,000. Reference to the table discloses that the specified amount in column (A) nearest to and less than the value of the decedent's taxable estate is $500,000. The tax upon this amount, as indicated in column (C), is $145,700. The amount by which the taxable estate exceeds the same specified amount is $25,000. The tax upon this amount, computed at the rate of 35 percent indicated in column (D), is $8,750. Thus, the total gross estate tax upon a taxable estate of $525,000 is $154,450. From this amount, the credits authorized by sections 2011 through 2014 are subtracted in order to determine the net estate tax payable.

§ 20.2002 STATUTORY PROVISIONS; LIABILITY FOR PAYMENT.

SEC. 2002. LIABILITY FOR PAYMENT.

The tax imposed by this chapter shall be paid by the executor.

§ 20.2002–1 LIABILITY FOR PAYMENT OF TAX.—The Federal estate tax imposed both with respect to the estates of citizens or residents and with respect to estates of nonresidents not citizens is payable by the executor or administrator of the decedent's estate. This duty applies to the entire tax, regardless of the fact that the gross estate consists in part of property which does not come within the possession of the executor or administrator. If there is no executor or administrator appointed, qualified and acting in the United States, any person in actual or constructive possession of any property of the decedent is required to pay the entire tax to the extent of the value of the property in his possession. See section 2203, defining the term "executor". The personal liability of the executor or such other person is described in section 3467 of the Revised Statutes (31 U. S. C. 192) as follows:

> Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

As used in said section, the word "debt" includes a beneficiary's distributive share of an estate. Thus, if the executor pays a debt due by the decedent's estate or distributes any portion of the estate before all the estate tax is paid, he is personally liable, to the extent of the payment or distribution, for so much of the estate tax as remains due and unpaid. In addition, section 6324(a)(2) provides that if the estate tax is not paid when due, then the spouse, transferee, trustee (except the trustee of an employee's trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 through 2042, is personally liable for the tax to the extent of the value, at the time of the decedent's death, of such property. See also the following related sections of the Internal Revenue Code: section 2204, discharge of executor from personal liability; section 2205, reimbursement out of estate; sections 2206 and 2207, liability of life insurance beneficiaries and recipients of property over which decedent had power of appointment; sections 6321 through 6325, concerning liens for taxes; and section 6901(a)(1), concerning the liabilities of transferees and fiduciaries.

CREDITS AGAINST TAX

§ 20.2011 STATUTORY PROVISIONS; CREDIT FOR STATE DEATH TAXES.

SEC. 2011. CREDIT FOR STATE DEATH TAXES.

(a) IN GENERAL.—The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or Territory or the District of Columbia, or any possession of the United States, in respect of any property included

in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent).

(b) AMOUNT OF CREDIT.—The credit allowed by this section shall not exceed the appropriate amount stated in the following table:

If the taxable estate is—	The maximum tax credit shall be—
Not over $90,000	8/10ths of 1% of the amount by which the taxable estate exceeds $40,000.
Over $90,000 but not over $140,000.	$400 plus 1.6% of the excess over $90,000.
Over $140,000 but not over $240,000.	$1,200 plus 2.4% of the excess over $140,000.
Over $240,000 but not over $440,000.	$3,600 plus 3.2% of the excess over $240,000.
Over $440,000 but not over $640,000.	$10,000 plus 4% of the excess over $440,000.
Over $640,000 but not over $840,000.	$18,000 plus 4.8% of the excess over $640,000.
Over $840,000 but not over $1,040,000.	$27,600 plus 5.6% of the excess over $840,000.
Over $1,040,000 but not over $1,540,000.	$38,800 plus 6.4% of the excess over $1,040,000.
Over $1,540,000 but not over $2,040,000.	$70,800 plus 7.2% of the excess over $1,540,000.
Over $2,040,000 but not over $2,540,000.	$106,800 plus 8% of the excess over $2,040,000.
Over $2,540,000 but not over $3,040,000.	$146,800 plus 8.8% of the excess over $2,540,000.
Over $3,040,000 but not over $3,540,000.	$190,800 plus 9.6% of the excess over $3,040,000.
Over $3,540,000 but not over $4,040,000.	$238,800 plus 10.4% of the excess over $3,540,000.
Over $4,040,000 but not over $5,040,000.	$290,800 plus 11.2% of the excess over $4,040,000.
Over $5,040,000 but not over $6,040,000.	$402,800 plus 12% of the excess over $5,040,000.
Over $6,040,000 but not over $7,040,000.	$522,800 plus 12.8% of the excess over $6,040,000.
Over $7,040,000 but not over $8,040,000.	$650,800 plus 13.6% of the excess over $7,040,000.
Over $8,040,000 but not over $9,040,000.	$786,800 plus 14.4% of the excess over $8,040,000.
Over $9,040,000 but not over $10,040,000.	$930,800 plus 15.2% of the excess over $9,040,000.
Over $10,040,000	$1,082,800 plus 16% of the excess over $10,040,000.

(c) PERIOD OF LIMITATIONS ON CREDIT.—The credit allowed by this section shall include only such taxes as were actually paid and credit therefor claimed within 4 years after the filing of the return required by section 6018, except that—

(1) If a petition for redetermination of a deficiency has been filed with the Tax Court within the time prescribed in section 6213(a), then within such 4-year period or before the expiration of 60 days after the decision of the Tax Court becomes final.

(2) If, under section 6161, an extension of time has been granted for payment of the tax shown on the return, or of a deficiency, then within such 4-year period or before the date of the expiration of the period of the extension.

Refund based on the credit may (despite the provisions of sections 6511 and 6512) be made if claim therefor is filed within the period above provided. Any such refund shall be made without interest.

(d) BASIC ESTATE TAX.—The basic estate tax and the estate tax imposed by the Revenue Act of 1926 shall be 125 percent of the amount determined to be the maximum credit provided by subsection (b). The additional estate tax shall be the difference between the tax imposed by section 2001 or 2101 and the basic estate tax.

(e) LIMITATION IN CASES INVOLVING DEDUCTION UNDER SECTION 2053 (d).—In any case where a deduction is allowed under section 2053(d) for an estate, succession, legacy, or inheritance tax imposed upon a transfer for public, charitable, or religious uses described in section 2055 or 2106(a)(2), the allowance of the credit under this section shall be subject to the following conditions and limitations:

(1) The taxes described in subsection (a) shall not include any estate, succession, legacy, or inheritance tax for which a deduction is allowed under section 2053(d).

(2) The credit shall not exceed the lesser of—

(A) The amount stated in subsection (b) on a taxable estate determined by allowing the deduction authorized by section 2053(d), or

(B) That proportion of the amount stated in subsection (b) on a taxable estate determined without regard to the deduction authorized by section 2053(d) as (i) the amount of the taxes described in subsection (a), as limited by the provisions of paragraph (1) of this subsection, bears to (ii) the amount of the taxes described in subsection (a) before applying the limitation contained in paragraph (1) of this subsection.

(3) If the amount determined under subparagraph (B) of paragraph (2) is less than the amount determined under subparagraph (A) of that paragraph, then for purposes of subsection (d) such lesser amount shall be the maximum credit provided by subsection (b).

[Sec. 2011 as amended by sec. 3, Act of Feb. 20, 1956 (Pub. Law 414, 84th Cong., 70 Stat. 24) [C. B. 1956-1, 855]

§ 20.2011-1 CREDIT FOR STATE DEATH TAXES.—(a) *In general.*—A credit is allowed under section 2011 against the Federal estate tax for estate, inheritance, legacy or succession taxes actually paid to any State, Territory, or possession of the United States, or the District of Columbia (hereafter referred to as "State death taxes"). The credit, however, is allowed only for State death taxes paid (1) with respect to property included in the decedent's gross estate, and (2) with respect to the decedent's estate. The amount of the credit is subject to the limitation described in paragraph (b) of this section. It is subject to further limitations described in § 20.2011-2 if a deduction is allowed under section 2053(d) for State death taxes paid with respect to a charitable gift.

(b) *Amount of credit.*—(1) If the decedent's taxable estate does not exceed $40,000, the credit for State death taxes is zero. If the decedent's taxable estate does exceed $40,000, the credit for State death taxes is limited to an amount computed in accordance with the following table:

Table for Computation of Maximum Credit for State Death Taxes

(A) Taxable estate equal to or more than—	(B) Taxable estate less than—	(C) Credit on amount in column (A)	(D) Rates of credit on excess over amount in column (A)
			Percent
$40,000	$90,000	----------	0.8
90,000	140,000	$400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	----------	1,082,800	16.0

(2) Subparagraph (1) of this paragraph may be illustrated by the following example:

Example. (i) The decedent died January 1, 1955, leaving a taxable estate of $150,000. On January 1, 1956, inheritance taxes totaling $2,500 were actually paid to a State with respect to property included in the decedent's gross estate. Reference to the table discloses that the specified amount in column (A) nearest to but less than the value of the decedent's taxable estate is $140,000. The maximum credit in respect of this amount, as indicated in column (C), is $1,200. The amount by which the taxable estate exceeds the same specified amount is $10,000. The maximum credit in respect of this amount, computed at the rate of 2.4 percent indicated in column (D), is $240. Thus, the maximum credit in respect of the decedent's taxable estate of $150,000 is $1,440, even though $2,500 in inheritance taxes was actually paid to the State.

(ii) If, in subdivision (i) of this example, the amount actually paid to the State was $950, the credit for State death taxes would be limited to $950. If, in subdivision (i) of this example, the decedent's taxable estate was $35,000, no credit for State death taxes would be allowed.

(c) *Miscellaneous limitations and conditions to credit.*—(1) *Period of limitations.*—The credit for State death taxes is limited under section 2011(c) to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the estate tax return for the decendent's estate. If, however, a petition has been filed with The Tax Court of the United States for the redetermination of a deficiency within the time prescribed in section 6213(a), the credit is limited to those taxes which were actually paid and for which a

credit was claimed within four years after the filing of the return or within 60 days after the decision of the Tax Court becomes final, whichever period is the last to expire. Similarly, if an extension of time has been granted under section 6161 for payment of the tax shown on the return, or of a deficiency, the credit is limited to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the return, or before the date of the expiration of the period of the extension, whichever period is last to expire. See section 2015 for the applicable period of limitations for credit for State death taxes on reversionary or remainder interests if an election is made under section 6163(a) to postpone payment of the estate tax attributable to reversionary or remainder interests. If a claim for refund based on the credit for State death taxes is filed within the applicable period described in this subparagraph, a refund may be made despite the general limitation provisions of sections 6511 and 6512. Any refund based on the credit described in this section shall be made without interest.

(2) *Submission of evidence.*—Before the credit for State death taxes is allowed, evidence that such taxes have been paid must be submitted to the district director. The district director may require the submission of a certificate from the proper officer of the taxing State, Territory, or possession of the United States, or the District of Columbia, showing: (i) the total amount of tax imposed (before adding interest and penalties and before allowing discount); (ii) the amount of any discount allowed; (iii) the amount of any penalties and interest imposed or charged; (iv) the total amount actually paid in cash; and (v) the date or dates of payment. If the amount of these taxes has been redetermined, the amount finally determined should be stated. The required evidence should be filed with the return, but if that is not convenient or possible, then it should be submitted as soon thereafter as practicable. The district director may require the submission of such additional proof as is deemed necessary to establish the right to the credit. For example, he may require the submission of a certificate of the proper officer of the taxing jurisdiction showing (vi) whether a claim for refund of any part of the State death tax is pending and (vii) whether a refund of any part thereof has been authorized, and if a refund has been made, its date and amount, and a description of the property or interest in respect of which the refund was made. The district director may also require an itemized list of the property in respect of which State death taxes were imposed certified by the officer having custody of the records pertaining to those taxes. In addition, he may require the executor to submit a written statement (containing a declaration that it is made under penalties of perjury) stating whether, to his knowledge, any person has instituted litigation or taken an appeal (or contemplates doing so), the final determination of which may affect the amount of those taxes. See section 2016 concerning the redetermination of the estate tax if State death taxes claimed as credit are refunded.

(d) *Definition of "basic estate tax".*—Section 2011(d) provides definitions of the terms "basic estate tax" and "additional estate tax", used in the Internal Revenue Code of 1939, and "estate tax imposed by the Revenue Act of 1926", for the purpose of supplying a means of computing State death taxes under local statutes using those terms, and

for use in determining the exemption provided for in section 2201 for estates of certain members of the Armed Forces. See section 2011(e)(3) for a modification of these definitions if a deduction is allowed under section 2053(d) for State death taxes paid with respect to a charitable gift.

§ 20.2011–2 Limitation on Credit if a Deduction Is Allowed Under Section 2053(d).—If a deduction is allowed under section 2053(d) for State death taxes paid with respect to a charitable gift, the credit for State death taxes is subject to special limitations. Under these limitations, the credit cannot exceed the least of the following:

(a) The amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d);

(b) The amount indicated in section 2011 (b) to be the maximum credit allowable with respect to the decedent's taxable estate; or

(c) An amount, A, which bears the same ratio to B (the amount which would be the maximum credit allowable under section 2011(b) if the deduction under section 2053(d) were not allowed in computing the decedent's taxable estate) as C (the amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d)) bears to D (the total amount of State death taxes paid). For the purpose of this computation, in determining what the decedent's taxable estate would be if the deduction under section 2053(d) were not allowed, adjustment must be made for the decrease in the deduction for charitable gifts under section 2055 or 2106(a)(2) (for estates of nonresidents not citizens) by reason of any increase in Federal estate tax which would be charged against the charitable gifts.

The application of this section may be illustrated by the following example:

Example. The decedent died January 1, 1955, leaving a gross estate of $925,000. Expenses, indebtedness, etc., amounted to $25,000. The decedent bequeathed $400,000 to his son with the direction that the son bear the State death taxes on the bequest. The residuary estate was left to a charitable organization. Except as noted above, all Federal and State death taxes were payable out of the residuary estate. The State imposed death taxes of $60,000 on the son's bequest and death taxes of $75,000 on the bequest to charity. The decedent's taxable estate (determined without regard to the limitation imposed by section 2011(e)(2)(B)) is computed as follows:

Gross estate				$925,000.00
Expenses, indebtedness, etc			$25,000.00	
Exemption			60,000.00	
Deduction under section 2053(d)			75,000.00	
Charitable deduction:				
Gross estate		$925,000.00		
Expenses, etc.	$25,000.00			
Bequest to son	400,000.00			
State death tax paid from residue	75,000.00			
Federal estate tax paid from residue	122,916.67	622,916.67	302,083.33	462,083.33
Taxable estate				462,916.67

If the deduction under section 2053(d) were not allowed, the decedent's taxable estate would be computed as follows:

Gross estate				$925,000.00
Expenses, indebtedness, etc			$25,000.00	
Exemption			60,000.00	
Charitable deduction:				
Gross estate		$925,000.00		
Expenses, etc.	$25,000.00			
Bequest to son	400,000.00			
State death tax paid from residue	75,000.00			
Federal estate tax paid from residue	155,000.00	655,000.00	270,000.00	355,000.00
Taxable estate				570,000.00

On a taxable estate of $570,000, the maximum credit allowable under section 2011(b) would be $15,200. Under these facts, the credit for State death taxes is determined as follows:

(1) Amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d) ($135,000–$75,000)	$60,000.00
(2) Amount indicated in section 2011(b) to be the maximum credit allowable with respect to the decedent's taxable estate of $462,916.67	10,916.67
(3) Amount determined by use of the ratio described in paragraph (c) above $\left(\frac{\$60,000}{\$135,000} \times \$15,200\right)$	6,755.56
(4) Credit for State death taxes (least of subparagraphs (1) through (3) above)	6,755.56

§ 20.2012 Statutory Provisions; Credit for Gift Tax.

SEC. 2012. CREDIT FOR GIFT TAX.

(a) In General.—If a tax on a gift has been paid under chapter 12 (sec. 2501 and following), or under corresponding provisions of prior laws, and thereafter on the death of the donor any amount in respect of such gift is required to be included in the value of the gross estate of the decedent for purposes of this chapter, then there shall be credited against the tax imposed by section 2001 the amount of the tax paid on a gift under chapter 12, or under corresponding provisions of prior laws, with respect to so much of the property which constituted the gift as is included in the gross estate, except that the amount of such credit shall not exceed an amount which bears the same ratio to the tax imposed by section 2001 (after deducting from such tax the credit for State death taxes provided by section 2011) as the value (at the time of the gift or at the time of the death, whichever is lower) of so much of the property which constituted the gift as is included in the gross estate bears to the value of the entire gross estate reduced by the aggregate amount of the charitable and marital deductions allowed under sections 2055, 2056, and 2106(a)(2).

(b) In applying, with respect to any gift, the ratio stated in subsection (a), the value at the time of the gift or at the time of the death, referred to in such ratio, shall be reduced—

(1) By such amount as will properly reflect the amount of such gift which was excluded in determining (for purposes of section 2503(a)), or of corresponding provisions of prior laws, the total amount of gifts made during the year in which the gift was made;

(2) If a deduction with respect to such gift is allowed under section 2056(a) (relating to marital deduction)—then by an amount which bears the same ratio to such value (reduced as provided in paragraph (1) of this subsection) as the aggregate amount of the

marital deductions allowed under section 2056(a) bears to the aggregate amount of such marital deductions computed without regard to subsection (c) thereof; and

(3) If a deduction with respect to such gift is allowed under sections 2055 or 2106(a)(2) (relating to charitable deduction)—then by the amount of such value, reduced as provided in paragraph (1) of this subsection.

(c) Where the decedent was the donor of the gift but, under the provisions of section 2513, or corresponding provisions of prior laws, the gift was considered as made one-half by his spouse—

(1) The term "the amount of the tax paid on a gift under chapter 12", as used in subsection (a), includes the amounts paid with respect to each half of such gift, the amount paid with respect to each being computed in the manner provided in subsection (d); and

(2) In applying, with respect to such gift, the ratio stated in subsection (a), the value at the time of the gift or at the time of the death, referred to in such ratio, includes such value with respect to each half of such gift, each such value being reduced as provided in paragraph (1) of subsection (b).

(d) (1) For purposes of subsection (a), the amount of tax paid on a gift under chapter 12, or under corresponding provisions of prior laws, with respect to any gift shall be an amount which bears the same ratio to the total tax paid for the year in which the gift was made as the amount of such gift bears to the total amount of taxable gifts (computed without deduction of the specific exemption) for such year.

(2) For purposes of paragraph (1), the "amount of such gift" shall be the amount included with respect to such gift in determining (for the purposes of section 2503(a), or of corresponding provisions of prior laws) the total amount of gifts made during such year, reduced by the amount of any deduction allowed with respect to such gift under section 2522, or under corresponding provisions of prior laws (relating to charitable deduction), or under section 2523 (relating to marital deduction).

§ 20.2012–1 CREDIT FOR GIFT TAX.—(a) *In general.*—A credit is allowed under section 2012 against the Federal estate tax for gift tax paid under chapter 12 of the Internal Revenue Code, or corresponding provisions of prior law, on a gift by the decedent of property subsequently included in the decedent's gross estate. The credit is allowable even though the gift tax is paid after the decedent's death and the amount of the gift tax is deductible from the gross estate as a debt of the decedent.

(b) *Limitations on credit.*—The credit for gift tax is limited to the smaller of the following amounts:

(1) The amount of gift tax paid on the gift, computed as set forth in paragraph (c) of this section, or

(2) The amount of the estate tax attributable to the inclusion of the gift in the gross estate, computed as set forth in paragraph (d) of this section.

When more than one gift is included in the gross estate, a separate computation of the two limitations on the credit is to be made for each gift.

(c) "*First limitation*".—The amount of the gift tax paid on the gift is the "first limitation". Thus, if only one gift was made during a certain calendar year, and the gift is wholly included in the decedent's gross estate for the purpose of the estate tax, the credit with respect to the gift is limited to the amount of the gift tax paid for that calendar year. On the other hand, if more than one gift was made during a certain calendar year, the credit with respect to any such gift which is included in the decedent's gross estate is limited under section 2012(d)

to an amount, A, which bears the same ratio to B (the total gift tax paid for that calendar year) as C (the "amount of the gift", computed as described below) bears to D (the total taxable gifts for the year, computed without deduction of the gift tax specific exemption). Stated algebraically, the "first limitation" (A) equals

$$\frac{\text{"amount of the gift" (C)}}{\text{total taxable gifts, plus specific exemption allowed (D)}} \times \text{total gift tax paid (B)}.$$

For purposes of the ratio stated above, the "amount of the gift" referred to as factor "C" is the value of the gift reduced by any portion excluded or deducted under section 2503(b) (annual exclusion), 2522 (charitable deduction), or 2523 (marital deduction) of the Internal Revenue Code or corresponding provisions of prior law. In making the computations described in this paragraph, the values to be used are those finally determined for the purpose of the gift tax, irrespective of the values determined for the purpose of the estate tax. A similar computation is made in case only a portion of any gift is included in the decedent's gross estate. The application of this paragraph may be illustrated by the following example:

Example. The donor made gifts during the calendar year 1955 on which a gift tax was determined as shown below:

Gift of property to son on February 1		$13,000
Gift of property to wife on May 1		86,000
Gift of property to charitable organization on May 15		10,000
Total gifts		109,000
Less exclusions ($3,000 for each gift)		9,000
Total included amount of gifts		100,000
Marital deduction (for gift to wife)	$43,000	
Charitable deduction	7,000	
Specific exemption ($30,000 less $20,000 used in prior years)	10,000	
Total deductions		60,000
Taxable gifts		40,000
Total gift tax paid for calendar year 1955		3,600

The donor's gift to his wife was made in contemplation of death and was thereafter included in his gross estate. Under the "first limitation", the credit with respect to that gift cannot exceed

$$\frac{\$86,000-\$3,000-\$43,000 \text{ (gift to wife, less annual exclusion and marital deduction)}}{\$40,000+\$10,000 \text{ (taxable gifts, plus specific exemption allowed)}} \times \$3,600 \text{ (total gift tax paid)} = \$2,880$$

(d) "*Second limitation*".—(1) The amount of the estate tax attributable to the inclusion of the gift in the gross estate is the "second limitation". Thus, the credit with respect to any gift of property included in the gross estate is limited to an amount, E, which bears the same ratio to F (the gross estate tax, reduced by any credit for State

death taxes under section 2011) as G (the "value of the gift", computed as described in subparagraph (2) of this paragraph) bears to H (the value of the entire gross estate, reduced by the total deductions allowed under sections 2055 or 2106(a)(2) (charitable deduction) and 2056 (marital deduction)). Stated algebraically, the "second limitation" (E) equals

$$\frac{\text{"value of the gift" (G)}}{\text{value of gross estate, less marital and charitable deductions (H)}} \times \text{gross estate tax, less credit for State death taxes (F).}$$

(2) For purposes of the ratio stated in subparagraph (1) of this paragraph, the "value of the gift" referred to as factor "G" is the value of the property transferred by gift and included in the gross estate, as determined for the purpose of the gift tax or for the purpose of the estate tax, whichever is lower, and adjusted as follows:

(i) The appropriate value is reduced by all or a portion of any annual exclusion allowed for gift tax purposes under section 2503(b) of the Internal Revenue Code or corresponding provisions of prior law. If the gift tax value is lower than the estate tax value, it is reduced by the entire amount of the exclusion. If the estate tax value is lower than the gift tax value, it is reduced by an amount which bears the same ratio to the estate tax value as the annual exclusion bears to the total value of the property as determined for gift tax purposes. To illustrate: In 1955, a donor, in contemplation of death, transferred certain property to his five children which was valued at $300,000 for the purpose of gift tax. Thereafter, the same property was included in his gross estate at a value of $270,000. In computing his gift tax, the donor was allowed annual exclusions totaling $15,000. The reduction provided for in this subdivision is

$$\frac{\$15{,}000 \text{ (annual exclusions allowed)}}{\$300{,}000 \text{ (value of transferred property for the purpose of the gift tax)}} \times \$270{,}000 \text{ (value of transferred property for the purpose of the estate tax)} = \$13{,}500.$$

(ii) The appropriate value is further reduced if any portion of the value of the property is allowed as a marital deduction under section 2056 or as a charitable deduction under section 2055 or section 2106 (a)(2) (for estates of nonresidents not citizens). The amount of the reduction is an amount which bears the same ratio to the value determined under subdivision (i) of this subparagraph as the portion of the property allowed as a marital deduction or as a charitable deduction bears to the total value of the property as determined for the purpose of the estate tax. Thus, if a gift is made solely to the decedent's surviving spouse and is subsequently included in the decedent's gross estate as having been made in contemplation of death, but a marital deduction is allowed under section 2056 for the full value of the gift, no credit for gift tax on the gift will be allowed since the reduction under this subdivision together with the reduction under subdivision (i) of this subparagraph will have the effect of reducing the factor "G" of the ratio in subparagraph (1) of this paragraph to zero. How-

ever, if by reason of the limitation on the aggregate marital deduction to 50 percent of the value of the adjusted gross estate (see section 2056(c)) the aggregate marital deduction allowed is less than the aggregate marital deduction computed without regard to that limitation, then the reduction under this subdivision is an amount, I, which bears the same ratio to J (the value determined in subdivision (i) of this subparagraph) as K (the aggregate marital deduction allowed) bears to L (the aggregate marital deduction computed without regard to the 50-percent limitation). For an illustration, see subparagraph (3) of this paragraph.

(3) The application of this paragraph may be illustrated by the following example:

Example. (i) In 1955, a donor, in contemplation of death, transferred certain property to his wife which was valued, for the purpose of the gift tax, at $86,000. In computing his gift tax the donor was allowed an annual exclusion of $3,000. In 1956, the donor died leaving a gross estate of $350,000. Expenses, indebtedness, etc., amounted to $50,000. The gross estate included the property transferred by the decedent to his wife in 1955. This property was valued, for the purpose of the estate tax, at $100,000 and was property for which a marital deduction may be taken. The decedent was survived by his wife to whom he left the major part of his estate. The estate was allowed an aggregate marital deduction of $150,000. The amount of the marital deduction computed without regard to the 50-percent limitation in section 2056(c) would have been $250,000. The gross estate tax was $17,900, and the credit for State death taxes was $400.

(ii) Factor "G" of the ratio which is used in computing the "second limitation" is computed as follows (see paragraph (d)(2) of § 20.2012–1):

Value of gift to wife for the purpose of the gift tax or for the purpose of the estate tax, whichever is lower			$86,000
Less: Portion of annual exclusion allowed in determining the gift tax (see § 20.2012–1(d)(2)(i))			3,000
Net value			83,000
Less: Portion of the net value allowed as a marital deduction under section 2056 (see § 20.2012–1(d)(2)(ii))			
$150,000 (aggregate marital deduction allowed for the purpose of the estate tax) / $250,000 (aggregate marital deduction computed without regard to the limitation stated in section 2056(c))	× ($86,000 − $3,000)	(value of gift to wife for the purpose of the gift tax or for the purpose of the estate tax, whichever is lower, less portion of annual exclusion allowed in determining the gift tax (see § 20.2012–1(d)(2)(i))	= $49,800
Factor "G" of the ratio			33,200

(iii) Under the "second limitation", the credit for gift tax on the donor's gift to his wife cannot exceed (see § 20.2012–1(d)(1))

$$\frac{\$33,200 \text{ (factor "G" of the ratio; see subdivision (ii) of this example)}}{\$350,000-\$150,000 \text{ (value of gross estate, less marital deduction allowed)}} \times (\$17,900-\$400) \text{ (gross estate tax, less credit for State death taxes)}$$

$$=\$2,905.$$

The lesser of the "first limitation" as computed in paragraph (c) of this section and the "second limitation" as computed in this paragraph is the credit for gift tax.

(e) *Credit for "split gifts".*—If a decedent made a gift of property which is thereafter included in his gross estate, and, under the provisions of section 2513 of the Internal Revenue Code of 1954 or section 1000(f) of the Internal Revenue Code of 1939, the gift was considered as made one-half by the decedent and one-half by his spouse, credit against the estate tax is allowed for the gift tax paid with respect to both halves of the gift. The "first limitation" is to be separately computed with respect to each half of the gift in accordance with the principles stated in paragraph (c) of this section. The "second limitation" is to be computed with respect to the entire gift in accordance with the principles stated in paragraph (d) of this section. To illustrate: A donor, in contemplation of death, transferred property valued at $106,000 to his son on January 1, 1955, and he and his wife consented that the gift should be considered as made one-half by him and one-half by her. The property was thereafter included in the donor's gross estate. Under the "first limitation", the amount of the gift tax of the donor paid with respect to the one-half of the gift considered as made by him is determined to be $11,250, and the amount of the gift tax of his wife paid with respect to the one-half of the gift considered as made by her is determined to be $1,200. Under the "second limitation", the amount of the estate tax attributable to the property is determined to be $28,914. Therefore, the credit for gift tax allowed is $12,450 ($11,250 plus $1,200).

§ 20.2013 Statutory Provisions; Credit for Tax on Prior Transfers.

SEC. 2013. CREDIT FOR TAX ON PRIOR TRANSFERS.

(a) General Rule.—The tax imposed by section 2001 shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of property (including property passing as a result of the exercise or non-exercise of a power of appointment) to the decedent by or from a person (herein designated as a "transferor") who died within 10 years before, or within 2 years after, the decedent's death. If the transferor died within 2 years of the death of the decedent, the credit shall be the amount determined under subsections (b) and (c). If the transferor predeceased the decedent by more than 2 years, the credit shall be the following percentage of the amount so determined—

(1) 80 percent, if within the third or fourth years preceding the decedent's death;

(2) 60 percent, if within the fifth or sixth years preceding the decedent's death;

(3) 40 percent, if within the seventh or eighth years preceding the decedent's death; and

(4) 20 percent, if within the ninth or tenth years preceding the decedent's death.

(b) COMPUTATION OF CREDIT.—Subject to the limitation prescribed in subsection (c), the credit provided by this section shall be an amount which bears the same ratio to the estate tax paid (adjusted as indicated hereinafter) with respect to the estate of the transferor as the value of the property transferred bears to the taxable estate of the transferor (determined for purposes of the estate tax) decreased by any death taxes paid with respect to such estate and increased by the exemption provided for by section 2052 or section 2106(a)(3), or the corresponding provisions of prior laws, in determining the taxable estate of the transferor for purposes of the estate tax. For purposes of the preceding sentence, the estate tax paid shall be the Federal estate tax paid increased by any credits allowed against such estate tax under section 2012, or corresponding provisions of prior laws, on account of gift tax, and for any credits allowed against such estate tax under this section on account of prior transfers where the transferor acquired property from a person who died within 10 years before the death of the decedent.

(c) LIMITATION ON CREDIT.—

(1) IN GENERAL.—The credit provided in this section shall not exceed the amount by which—

(A) The estate tax imposed by section 2001 or section 2101 (after deducting the credits for State death taxes, gift tax, and foreign death taxes provided for in sections 2011, 2012, and 2014) computed without regard to this section, exceeds

(B) Such tax computed by excluding from the decedent's gross estate the value of such property transferred and, if applicable, by making the adjustment hereinafter indicated.

If any deduction is otherwise allowable under section 2055 or section 2106(a)(2) (relating to charitable deduction) then, for the purpose of the computation indicated in subparagraph (B), the amount of such deduction shall be reduced by that part of such deduction which the value of such property transferred bears to the decedent's entire gross estate reduced by the deductions allowed under sections 2053 and 2054, or section 2106(a)(1) (relating to deduction for expenses, losses, etc.). For purposes of this section, the value of such property transferred shall be the value as provided for in subsection (d) of this section.

(2) TWO OR MORE TRANSFERORS.—If the credit provided in this section relates to property received from 2 or more transferors, the limitation provided in paragraph (1) of this subsection shall be computed by aggregating the value of the property so transferred to the decedent. The aggregate limitation so determined shall be apportioned in accordance with the value of the property transferred to the decedent by each transferor.

(d) VALUATION OF PROPERTY TRANSFERRED.—The value of property transferred to the decedent shall be the value used for the purpose of determining the Federal estate tax liability of the estate of the transferor but—

(1) There shall be taken into account the effect of the tax imposed by section 2001 or 2101, or any estate, succession, legacy, or inheritance tax, on the net value to the decedent of such property;

(2) Where such property is encumbered in any manner, or where the decedent incurs any obligation imposed by the transferor with respect to such property, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to the decedent of such property was being determined; and

(3) If the decedent was the spouse of the transferor at the time of the transferor's death, the net value of the property transferred to the decedent shall be reduced by the amount allowed under section 2056 (relating to marital deductions), or the corresponding provision of prior law, as a deduction from the gross estate of the transferor.

(e) PROPERTY DEFINED.—For purposes of this section, the term "property" includes any beneficial interest in property, including a general power of appointment (as defined in section 2041).

§ 20.2013–1 CREDIT FOR TAX ON PRIOR TRANSFERS.—(a) *In general.*—A credit is allowed under section 2013 against the Federal estate tax imposed on the present decedent's estate for Federal estate tax paid on the transfer of property to the present decedent from a transferor who died within ten years before, or within two years after, the present decedent's death. See § 20.2013–5 for definition of the terms "property" and "transfer". There is no requirement that the transferred property be identified in the estate of the present decedent or that the property be in existence at the time of the decedent's death. It is sufficient that the transfer of the property was subjected to Federal estate tax in the estate of the transferor and that the transferor died within the prescribed period of time. The executor must submit such proof as may be requested by the district director in order to establish the right of the estate to the credit.

(b) *Limitations on credit.*—The credit for tax on prior transfers is limited to the smaller of the following amounts:

(1) The amount of the Federal estate tax attributable to the transferred property in the transferor's estate, computed as set forth in § 20.2013–2; or

(2) The amount of the Federal estate tax attributable to the transferred property in the decedent's estate, computed as set forth in § 20.2013–3.

Rules for valuing property for purposes of the credit are contained in § 20.2013–4.

(c) *Percentage reduction.*—If the transferor died within the two years before, or within two years after, the present decedent's death, the credit is the smaller of the two limitations described in paragraph (b) of this section. If the transferor predeceased the present decedent by more than two years, the credit is a certain percentage of the smaller of the two limitations described in paragraph (b) of this section, determined as follows:

(1) 80 percent, if the transferor died within the third or fourth years preceding the present decedent's death;

(2) 60 percent, if the transferor died within the fifth or sixth years preceding the present decedent's death;

(3) 40 percent, if the transferor died within the seventh or eighth years preceding the present decedent's death; and

(4) 20 percent, if the transferor died within the ninth or tenth years preceding the present decedent's death.

The word "within" as used in this paragraph means "during". Therefore, if a death occurs on the second anniversary of another death, the first death is considered to have occurred within the two years before the second death. If the credit for tax on prior transfers relates to property received from two or more transferors, the provisions of this paragraph are to be applied separately with respect to the property received from each transferor. See paragraph (d) of example (2) in § 20.2013–6.

(d) *Examples.*—For illustrations of the application of this section, see examples (1) and (2) set forth in § 20.2013–6.

§ 20.2013–2 "First Limitation".—(a) The amount of the Federal estate tax attributable to the transferred property in the transferor's estate is the "first limitation." Thus, the credit is limited to an amount, A, which bears the same ratio to B (the "transferor's adjusted Federal estate tax", computed as described in paragraph (b) of this section) as C (the value of the property transferred (see § 20.2013–4)) bears to D (the "transferor's adjusted taxable estate", computed as described in paragraph (c) of this section). Stated algebraically, the "first limitation" (A) equals

$$\frac{\text{value of transferred property (C)}}{\text{"transferor's adjusted taxable estate" (D)}} \times \text{"transferor's adjusted Federal estate tax" (B).}$$

(b) For purposes of the ratio stated in paragraph (a) of this section, the "transferor's adjusted Federal estate tax" referred to as factor "B" is the amount of the Federal estate tax paid with respect to the transferor's estate plus:

(1) Any credit allowed the transferor's estate for gift tax under section 2012, or the corresponding provisions of prior law; and

(2) Any credit allowed the transferor's estate, under section 2013, for tax on prior transfers, but only if the transferor acquired property from a person who died within 10 years before the death of the present decedent.

(c) For purposes of the ratio stated in paragraph (a) of this section, the "transferor's adjusted taxable estate" referred to as factor "D" is the amount of the transferor's taxable estate (or net estate) decreased by the amount of any "death taxes" paid with respect to his gross estate and increased by the amount of the exemption allowed in computing his taxable estate (or net estate). The amount of the transferor's taxable estate (or net estate) is determined in accordance with the provisions of § 20.2051–1 (or the corresponding provisions of prior regulations). The term "death taxes" means the Federal estate tax plus all other estate, inheritance, legacy, succession, or similar death taxes imposed by and paid to any taxing authority, whether within or without the United States. However, only the net amount of such taxes paid is taken into consideration. The amount of the exemption depends upon the citizenship and residence of the transferor at the time of his death. If he was a citizen or resident of the United States, the exemption is the $60,000 authorized by section 2052 (or the corresponding provisions of prior law). If he was not a citizen or resident of the United States, the exemption is the $2,000 authorized by section 2106(a)(3) (or the corresponding provisions of prior law), or such larger amount as may have been allowed as an exemption pursuant to the prorated exemption provisions of an applicable death tax convention .

(d) If the credit for tax on prior transfers relates to property received from two or more transferors, the provisions of this section are to be applied separately with respect to the property received from each transferor. See paragraph (b) of example (2) in § 20.2013–6.

(e) For illustrations of the application of this section, see examples (1) and (2) set forth in § 20.2013–6.

§ 20.2013–3 "SECOND LIMITATION".—(a) The amount of the Federal estate tax attributable to the transferred property in the present decedent's estate is the "second limitation." Thus, the credit is limited to the difference beween—

(1) The net estate tax payable (see paragraph (b)(5) of § 20.0–2) with respect to the present decedent's estate, determined without regard to any credit for tax on prior transfers under section 2013 or any credit for foreign death taxes claimed under the provisions of a death tax convention, and

(2) The net estate tax determined as provided in paragraph (1) of this section, but computed by subtracting from the present decedent's gross estate the value of the property transferred (see § 20.2013–4), and by making only the adjustment indicated in paragraph (b) of this section if a charitable deduction is allowable to the estate of the present decedent.

(b) If a charitable deduction is allowable to the estate of the present decedent under the provisions of section 2055 or section 2106(a)(2) (for estates of nonresidents not citizens), for purposes of determining the tax described in paragraph (a)(2) of this section, the charitable deduction otherwise allowable is reduced by an amount, E, which bears the same ratio to F (the charitable deduction otherwise allowable) as G (the value of the transferred property (see § 20.2013–4)) bears to H (the value of the present decedent's gross estate reduced by the amount of the deductions for expenses, indebtedness, taxes, losses, etc., allowed under the provisions of sections 2053 and 2054 or section 2106(a)(1) (for estates of nonresidents not citizens)). See paragraph (c)(2) of example (1) and paragraph (c)(2) of example (2) in § 20.2013–6.

(c) If the credit for tax on prior transfers relates to property received from two or more transferors, the property received from all transferors is aggregated in determining the limitation on credit under this section (the "second limitation"). However, the limitation so determined is apportioned to the property received from each transferor in the ratio that the property received from each transferor bears to the total property received from all transferors. See paragraph (c) of example (2) in § 20.2013–6.

(d) For illustrations of the application of this section, see examples (1) and (2) set forth in § 20.2013–6.

§ 20.2013–4 VALUATION OF PROPERTY TRANSFERRED.—(a) For purposes of section 2013 and §§ 20.2013–1 through 20.2013–6, the value of the property transferred to the decedent is the value at which such property was included in the transferor's gross estate for the purpose of the Federal estate tax (see sections 2031, 2032, and the regulations thereunder) reduced as indicated in paragraph (b) of this section. If the decedent received a life estate or remainder or other limited interest in property included in the transferor's gross estate, the value of the interest is determined as of the date of the transferor's death on the basis of recognized valuation principles (see especially § 20.2031–7). The application of this paragraph may be illustrated by the following examples:

Example (1). A died on January 1, 1953, leaving Blackacre to B. The property was included in A's gross estate at a value of $100,000.

On January 1, 1955, B sold Blackacre to C for $150,000. B died on February 1, 1955. For purposes of computing the credit against the tax imposed on B's estate, the value of the property transferred to B is $100,000.

Example (2). A died on January 1, 1953, leaving Blackacre to B for life and, upon B's death, remainder to C. At the time of A's death, B was 56 years of age. The property was included in A's gross estate at a value of $100,000. The part of that value attributable to the life estate is $44,688 (see paragraph (c) of § 20.2031–7), and the part of that value attributable to the remainder is $55,312 (see paragraph (d) of § 20.2031–7). B died on January 1, 1955, and C died on January 1, 1956. For purposes of computing the credit against the tax imposed on B's estate, the value of the property transferred to B is $44,688. For purposes of computing the credit against the tax imposed on C's estate, the value of the property transferred to C is $55,312.

(b) In arriving at the value of the property transferred to the decedent, the value at which the property was included in the transferor's gross estate (see paragraph (a) of this section) is reduced as follows:

(1) By the amount of the Federal estate tax and any other estate, inheritance, legacy, or succession taxes which were payable out of the property transferred to the decedent or which were payable by the decedent in connection with the property transferred to him. For example, if under the transferor's will or local law all death taxes are to be paid out of other property with the result that the decedent receives a bequest free and clear of all death taxes, no reduction is to be made under this subparagraph;

(2) By the amount of any marital deduction allowed the transferor's estate under section 2056 (or under section 812(e) of the Internal Revenue Code of 1939) if the decedent was the spouse of the transferor at the time of the transferor's death; and

(3) (i) By the amount of any encumbrance on the property or by the amount of any obligation imposed by the transferor and incurred by the decedent with respect to the property, to the extent such charges would be taken into account if the amount of a gift to the decedent of such propery were being determined.

(ii) For purposes of this subparagraph, an obligation imposed by the transferor and incurred by the decedent with respect to the property includes a bequest, etc., in lieu of the interest of the surviving spouse under community property laws, unless the interest was, immediately prior to the transferor's death, a mere expectancy. (As to the circumstances under which the interest of a surviving spouse is regarded as a mere expectancy, see the provisions of paragraph (d) of § 20.2056(c)–2 which are equally applicable here.) However, an obligation imposed by the transferor and incurred by the decedent with respect to the property does not include a bequest, devise, or other transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the transferor's property or estate.

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

Example (*1*). The transferor devised to the decedent real estate subject to a mortgage. The value of the property transferred to the decedent does not include the amount of the mortgage. If, however, the transferor by his will directs the executor to pay off the mortgage, such payment constitutes an additional amount transferred to the decedent.

Example (*2*). The transferor bequeathed certain property to the decedent with a direction that the decedent pay $1,000 to X. The value of the property transferrd to the decedent is the value of the property reduced by $1,000.

Example (*3*). The transferor bequeathed certain property to his wife, the decedent, in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. The value of the property transferred to the decedent is the value of the property reduced by the value of the community property interest relinquished by the wife.

Example (*4*). The transferor bequeathed to the decedent his entire residuary estate, out of which certain claims were to be satisfied. The entire distributable income of the transferor's estate (during the period of its administration) was applied toward the satisfaction of these claims and the remaining portion of the claims was satisfied by the decedent out of his own funds. Thus, the decedent received a larger sum upon settlement of the transferor's estate than he was actually bequeathed. The value of the property transferred to the decedent is the value at which such property was included in the transferor's gross estate, reduced by the amount of the estate income and the decedent's own funds paid out in satisfaction of the claims.

§ 20.2013–5 "PROPERTY" AND "TRANSFER" DEFINED.—(a) For purposes of section 2013 and §§ 20.2013–1 through 20.2013–6, the term "property" means any beneficial interest in property including a general power of appointment (as defined in section 2041) over property. Thus, the term does not include an interest in property consisting merely of a bare legal title, such as that of a trustee. Nor does the term include a power of appointment over property which is not a general power of appointment (as defined in section 2041). Examples of property, as described in this paragraph, are annuities, life estates, estates for terms of years, vested or contingent remainders and other future interests.

(b) In order to obtain the credit for tax on prior transfers, there must be a transfer of property described in paragraph (a) of this section by or from the transferor to the decedent. The term "transfer" of property by or from a transferor means any passing of property or an interest in property under circumstances which were such that the property or interest was included in the gross estate of the transferor. In this connection, if the decedent receives property as a result of the exercise or nonexercise of a power of appointment, the donee of the power (and not the creator) is deemed to be the transferor of the property if the property subject to the power is includible in the donee's gross estate under section 2041 (relating to powers of appoint-

ment). Thus, notwithstanding the designation by local law of the capacity in which the decedent takes, property received from the transferor includes interests in property held by or devolving upon the decedent: (1) as spouse under dower or curtesy laws or laws creating an estate in lieu of dower or curtesy; (2) as surviving tenant of a tenancy by the entirety or joint tenancy with survivorship rights; (3) as beneficiary of the proceeds of life insurance; (4) as survivor under an annuity contract; (5) as donee (possessor) of a general power of appointment (as defined in section 2041); (6) as appointee under the exercise of a general power of appointment (as defined in section 2041); or (7) as remainderman under the release or nonexercise of a power of appointment by reason of which the property is included in the gross estate of the donee of the power under section 2041.

(c) The application of this section may be illustrated by the following example:

Example. A devises Blackacre to B, as trustee, with directions to pay the income therefrom to C, his son, for life. Upon C's death, Blackacre is to be sold. C is given a general testamentary power to appoint one-third of the proceeds, and a testamentary power, which is not a general power, to appoint the remaining two-thirds of the proceeds, to such of the issue of his sister D as he should choose. D has a daughter, E, and a son, F. Upon his death, C exercised his general power by appointing one-third of the proceeds to D and his special power by appointing two-thirds of the proceeds to E. Since B's interest in Blackacre as a trustee is not a beneficial interest, no part of it is "property" for purpose of the credit in B's estate. On the other hand, C's life estate and his testamentary power over the one-third interest in the remainder constitute "property" received from A for purpose of the credit in C's estate. Likewise, D's one-third interest in the remainder received through the exercise of C's general power of appointment is "property" received from C for purpose of the credit in D's estate. No credit is allowed E's estate for the property which passed to her from C since the property was not included in C's gross estate. On the other hand, no credit is allowed in E's estate for property passing to her from A since her interest was not susceptible of valuation at the time of A's death (see § 20.2013–4).

§ 20.2013–6 Examples.—The application of §§ 20.2013–1 through 20.2013–5 may be further illustrated by the following examples:

Example (1). (a) A died December 1, 1953, leaving a gross estate of $1,000,000. Expenses, indebtedness, etc., amounted to $90,000. A bequeathed $200,000 to B, his wife, $100,000 of which qualifies for the marital deduction. B died November 1, 1954, leaving a gross estate of $500,000. Expenses, indebtedness, etc., amounted to $40,000. B bequeathed $150,000 to charity. A and B were both citizens of the United States. The estates of A and B both paid State death taxes equal to the maximum credit allowable for State death taxes. Death taxes were not a charge on the bequest to B.

(b) "First limitation" on credit for B's estate (§ 20.2013–2):

A's gross estate		$1,000,000.00
Expenses, indebtedness, etc		90,000.00
A's adjusted gross estate		910,000.00
Marital deduction	$100,000.00	
Exemption	60,000.00	160,000.00
A's taxable estate		750,000.00
A's gross estate tax		233,200.00
Credit for State death taxes		23,280.00
A's net estate tax payable		209,920.00

"First limitation"=$209,920.00 (§ 20.2013-2(b)) × $\frac{\$200,000.00-\$100,000.00 \text{ (§ 20.2013-4)}}{\$750,000.00-\$209,920.00=\$23,280.00+\$60,000.00 \text{ (§ 20.2013-2(c))}}$

=$36,393.90

(c) "Second limitation" on credit for B's estate (§ 20.2013-3):

(1) B's net estate tax payable as described in § 20.2013-3(a)(1) (previously taxed transfer included):

B's gross estate		$500,000.00
Expenses, indebtedness, etc	$40,000.00	
Charitable deduction	150,000.00	
Exemption	60,000.00	
		250,000.00
B's taxable estate		250,000.00
B's gross estate tax		65,700.00
Credit for State death taxes		3,920.00
B's net estate tax payable		61,780.00

(2) B's net estate tax payable as described in § 20.2013-3(a)(2) (previously taxed transfer excluded):

B's gross estate		$400,000.00
Expenses, indebtedness, etc	$40,000.00	
Charitable deduction (§ 20.2013-3(b))= $150,000.00−($150,000.00× $\frac{\$200,000.00-\$100,000.00)}{\$500,000.00-\$40,000.00)}$		
	=117,391.30	
Exemption	60,000.00	217,391.30
B's taxable estate		182,608.70
B's gross estate tax		45,482.61
Credit for State death taxes		2,221.61
B's net estate tax payable		43,260.00

(3) "Second limitation":

Subparagraph (1)	$61,780.00	
Less: Subparagraph (2)	43,260.00	$18,520.00

(d) Credit of B's estate for tax on prior transfer (§ 20.2013–1(c)):

Credit for tax on prior transfers=
$18,520.00 (lower of paragraphs (b) and (c))×100% (percentage to be taken into account under § 20.2013–1(c)) $18,520.00

Example (2). (a) The facts are the same as those contained in example (1) of this paragraph with the following additions. C died December 1, 1950, leaving a gross estate of $250,000. Expenses, indebtedness, etc., amounted to $50,000. C bequeathed $50,000 to B. C was a citizen of the United States. His estate paid State death taxes equal to the maximum credit allowable for State death taxes. Death taxes were not a charge on the bequest to B.

(b) "First limitation" on credit for B's estate (§ 20.2013–2(d))—

(1) With respect to the property received from A:

"First limitation"=$36,393.90 (this computation is identical with the one contained in paragraph (b) of example (1) of this section).

(2) With respect to the property received from C:

C's gross estate		$250,000.00
Expenses, indebtedness, etc	$50,000.00	
Exemption	60,000.00	110,000.00
C's taxable estate		140,000.00
C's gross estate tax		32,700.00
Credit for State death taxes		1,200.00
C's net estate tax payable		31,500.00

"First limitation"=$31,500.00 (§ 20.2013–2(b))×
$$\frac{\$50{,}000.00\ (\S\ 20.2013\text{–}4)}{\$140{,}000.00-\$31{,}500.00-\$1{,}200.00+\$60{,}000.00\ (\S\ 20.2013\text{–}2(c))}$$
=$9,414.23

(c) "Second limitation" on credit for B's estate (§ 20.2013–3(c)):

(1) B's net estate tax payable as described in § 20.2013–3(a)(1) (previously taxed transfers included)=$61,780.00 (this computation is identical with the one contained in paragraph (c)(1) of example (1) of this section).

(2) B's net estate tax payable as described in § 20.2013–3(a)(2) (previously taxed transfers excluded):

B's gross estate		$350,000.00
Expenses, indebtedness, etc	$40,000.00	
Charitable deduction (§ 20.2013–3(b))= $150,000.00−($150,000.00× $\frac{\$200{,}000.00-\$100{,}000.00+\$50{,}000.00}{\$500{,}000.00-\$40{,}000.00}$) =101,086.96		
Exemption	60,000.00	201,086.96
B's taxable estate		148,913.04
B's gross estate tax		35,373.91
Credit for State death taxes		1,413.91
B's net estate tax payable		33,960.00

(3) "Second limitation":

Subparagraph (1)	$61,780.00	
Less: Subparagraph (2)	33,960.00	$27,820.00

(4) Apportionment of "second limitation" on credit:

Transfer from A (§ 20.2013–4)	$100,000.00
Transfer from C (§ 20.2013–4)	50,000.00
Total	150,000.00
Portion of "second limitation" attributable to transfer from A (100/150 of $27,820.00)	18,546.67
Portion of "second limitation" attributable to transfer from C (50/150 of $27,820.00)	9,273.33

(d) Credit of B's estate for tax on prior transfers (§ 20.2013–1(c)):

Credit for tax on transfer from A= $18,546.67 (lower of "first limitation" computed in paragraph (b)(1) and "second limitation" apportioned to A's transfer in paragraph (c)(4))×100% (percentage to be taken into account under § 20.2013–1(c))	$18,546.67
Credit for tax on transfer from C= $9,273.33 (lower of "first limitation" computed in paragraph (b)(2) and "second limitation" apportioned to B's transfer in paragraph (c)(4))×80% (percentage to be taken into account under § 20.2013–1(c))	7,418.66
Total credit for tax on prior transfers	25,965.33

§ 20.2014 STATUTORY PROVISIONS; CREDIT FOR FOREIGN DEATH TAXES.

SEC. 2014. CREDIT FOR FOREIGN DEATH TAXES.

(a) IN GENERAL.—The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any foreign country in respect of any property situated within such foreign country and included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent. If the decedent at the time of his death was not a citizen of the United States, credit shall not be allowed under this section unless the foreign country of which such decedent was a citizen or subject, in imposing such taxes, allows a similar credit in the case of a citizen of the United States resident in such country. The determination of the country within which property is situated shall be made in accordance with the rules applicable under subchapter B (sec. 2101 and following) in determining whether property is situated within or without the United States.

(b) LIMITATIONS ON CREDIT.—The credit provided in this section with respect to such taxes paid to any foreign country—

(1) Shall not, with respect to any such tax, exceed an amount which bears the same ratio to the amount of such tax actually paid to such foreign country as the value of property which is—

(A) Situated within such foreign country,

(B) Subjected to such tax, and

(C) Included in the gross estate

bears to the value of all property subjected to such tax; and

(2) Shall not, with respect to all such taxes, exceed an amount which bears the same ratio to the tax imposed by section 2001 (after deducting from such tax the credits provided by sections 2011 and 2012) as the value of property which is—

(A) Situated within such foreign country,

(B) Subjected to the taxes of such foreign country, and

(C) Included in the gross estate

bears to the value of the entire gross estate reduced by the aggregate amount of the deductions allowed under section 2055 and 2056.

(c) VALUATION OF PROPERTY.—

(1) The values referred to in the ratio stated in subsection (b) (1) are the values determined for purposes of the tax imposed by such foreign country.

(2) The values referred to in the ratio stated in subsection (b) (2) are the values determined under this chapter; but, in applying such ratio, the value of any property described in subparagraphs (A), (B), and (C) thereof shall be reduced by such amount as will properly reflect, in accordance with regulations prescribed by the Secretary or his delegate, the deductions allowed in respect of such property under sections 2055 and 2056 (relating to charitable and marital deductions).

(d) PROOF OF CREDIT.—The credit provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Secretary or his delegate—

(1) The amount of taxes actually paid to the foreign country,

(2) The amount and date of each payment thereof,

(3) The description and value of the property in respect of which such taxes are imposed, and

(4) All other information necessary for the verification and computation of the credit.

(e) PERIOD OF LIMITATION.—The credit provided in this section shall be allowed only for such taxes as were actually paid and credit therefor claimed within 4 years after the filing of the return required by section 6018, except that—

(1) If a petition for redetermination of a deficiency has been filed with the Tax Court within the time prescribed in section 6213(a), then within such 4-year period or before the expiration of 60 days after the decision of the Tax Court becomes final.

(2) If, under section 6161, an extension of time has been granted for payment of the tax shown on the return, or of a deficiency, then within such 4-year period or before the date of the expiration of the period of the extension.

Refund based on such credit may (despite the provisions of sections 6511 and 6512) be made if claim therefor is filed within the period above provided. Any such refund shall be made without interest.

§ 20.2014–1 CREDIT FOR FOREIGN DEATH TAXES.—(a) *In general.*—(1) A credit is allowed under section 2014 against the Federal estate tax for any estate, inheritance, legacy, or succession taxes actually paid to any foreign country (hereinafter referred to as "foreign death taxes"). The credit is allowed only for foreign death taxes paid (i) with respect to property situated within the country to which the tax is paid, (ii) with respect to property included in the decedent's gross estate, and (iii) with respect to the decedent's estate. The credit is allowable to the estate of a decedent who was a citizen of the United States at the time of his death. The credit is also allowable to the estate of a decedent who was a resident but not a citizen of the United States at the time of his death if the country of which the decedent was a national, in imposing death taxes, allows a similar credit to the estates of citizens of the United States resident in that country. See paragraph (b) (1) of § 20.0–1 for definition of the term "resident". The credit is not allowable to the estate of a decedent who was neither a citizen nor a resident of the United States at the time of his death. The credit is allowable not only for death taxes paid to foreign countries which are states in the international sense, but also for death taxes paid to possessions or political subdivisions of foreign states. No credit is allowable for interest or penalties paid in connection with foreign death taxes.

(2) In addition to the credit for foreign death taxes under section 2014, similar credits are allowed under death tax conventions with certain foreign countries. If credits against the Federal estate tax are allowable under section 2014, or under section 2014 and one or more death tax conventions, for death taxes paid to more than one country, the credits are combined and the aggregate amount is credited against the Federal estate tax, subject to the limitation provided for in paragraph (c) of § 20.2014–4. For application of the credit in cases involving a death tax convention, see § 20.2014–4.

(3) No credit is allowable under section 2014 in connection with property situated outside of the foreign country imposing the tax for which credit is claimed. However, such a credit may be allowable under certain death tax conventions. In the case of a tax imposed by a political subdivision of a foreign country, credit for such tax shall be allowed with respect to property having a situs in that foreign country, even though, under the principles described in this subparagraph, such property has a situs in a political subdivision different from the one imposing the tax. Whether or not particular property of a decedent is situated in the foreign country imposing the tax is determined in accordance with the same principles that would be applied in determining whether or not similar property of a nonresident decedent not a citizen of the United States is situated within the United States for Federal estate tax purposes. See §§ 20.2104–1 and 20.2105–1. For example, under § 20.2104–1, a bond for the payment of money is not within the United States unless it is physically located in the United States. Accordingly, a bond is deemed situated in the foreign country imposing the tax only if it is physically located in that country. Similarly, under § 20.2104–1, shares of stock are deemed to be situated in the United States only if issued by a domestic (United States) corporation. Thus, a share of corporate stock is regarded as situated in the foreign country imposing the tax only if the issuing corporation is incorporated in that country. Further, under § 20.2105–1, moneys deposited with any person carrying on the banking business by or for a nonresident not a citizen of the United States who was not engaged in business in the United States at the time of death are not deemed situated in the United States. Therefore, an account with a foreign bank in the country imposing the tax is not considered to be situated in that country under corresponding circumstances.

(b) *Limitations on credit.*—The credit for foreign death taxes is limited to the smaller of the following amounts:

(1) The amount of a particular foreign death tax attributable to property situated in the country imposing the tax and included in the decedent's gross estate for Federal estate tax purposes, computed as set forth in § 20.2014–2; or

(2) The amount of the Federal estate tax attributable to particular property situated in a foreign country, subjected to foreign death tax in that country, and included in the decedent's gross estate for Federal estate tax purposes, computed as set forth in § 20.2014–3.

§ 20.2014–2 "First Limitation".—(a) The amount of a particular foreign death tax attributable to property situated in the country imposing the tax and included in the decedent's gross estate for Federal

estate tax purposes is the "first limitation." Thus, the credit for any foreign death tax is limited to an amount, A, which bears the same ratio to B (the amount of the foreign death tax without allowance of credit, if any, for Federal estate tax) as C (the value of the property situated in the country imposing the foreign death tax, subjected to the foreign death tax, and included in the gross estate) bears to D (the value of all property subjected to the foreign death tax). Stated algebraically, the "first limitation" (A) equals

$$\frac{\text{value of property in foreign country subjected to foreign death tax and included in gross estate (C)}}{\text{value of all property subjected to foreign death tax (D)}} \times \text{amount of foreign death tax (B)}.$$

The values used in this proportion are the values determined for the purpose of the foreign death tax. The amount of the foreign death tax for which credit is allowable must be converted into United States money. The application of this paragraph may be illustrated by the following example:

Example. At the time of his death, the decedent, a citizen of the United States, owned real property in Country X valued at $80,000 and stock in Y Corporation (a corporation organized under the laws of Country X) valued at $80,000. Decedent left by will $50,000 of the real property and $20,000 of the Y Corporation stock to his surviving spouse. He left the rest of the real property and Y Corporation stock to his son. The real property was not included in his gross estate (see section 2031). There is no death tax convention in existence between the United States and Country X. Under the laws of Country X, the inheritance taxes are computed as follows:

Inheritance tax of surviving spouse:

Value of real property in Country X	$50,000
Value of stock in Corporation Y	20,000
Total value	70,000
Tax (16% rate)	11,200

Inheritance tax of son:

Value of real property in Country X	30,000
Value of stock in Y Corporation	60,000
Total value	90,000
Tax (16% rate)	14,400

The "first limitation" on the credit for foreign death taxes is

$$\frac{\$20{,}000+\$60{,}000 \text{ (factor C of the ratio stated at § 20.2014–2(a))}}{\$70{,}000+\$90{,}000 \text{ (factor D of the ratio stated at § 20.2014–2(a))}} \times (\$11{,}200+\$14{,}400) \text{ (factor B of the ratio stated at § 20.2014–2(a))}$$

$$= \$12{,}800.$$

(b) If a foreign country imposes more than one kind of death tax or imposes taxes at different rates upon the several shares of an estate, or if a foreign country and a political subdivision or possession thereof

each imposes a death tax, a "first limitation" is to be computed separately for each tax or rate and the results added in order to determine the total "first limitation." The application of this paragraph may be illustrated by the following example:

Example. The facts are the same as those contained in the example set forth in paragraph (a) of this section, except that the tax of the surviving spouse was computed at a 10-percent rate and amounted to $7,000, and the tax of the son was computed at a 20-percent rate and amounted to $18,000. In this case, the "first limitation" on the credit for foreign death taxes is computed as follows:

"First limitation" with respect to inheritance tax of surviving spouse = $\frac{\text{\$20,000 (factor C of the ratio stated at § 20.2014-2(a))}}{\text{\$70,000 (factor D of the ratio stated at § 20.2014-2(a))}}$	× $7,000	(factor B of the ratio stated at § 20.2014-2(a)) =	$2,000
"First limitation" with respect to inheritance tax of son = $\frac{\text{\$60,000 (factor C of the ratio stated at § 20.2014-2(a))}}{\text{\$90,000 (factor D of the ratio stated at § 20.2014-2(a))}}$	× $18,000	(factor B of the ratio stated at § 20.2014-2(a)) =	12,000
Total "first limitation" on the credit for foreign death taxes			14,000

§ 20.2014-3 "SECOND LIMITATION".—(a) The amount of the Federal estate tax attributable to particular property situated in a foreign country, subjected to foreign death tax in that country, and included in the decedent's gross estate for Federal estate tax purposes is the "second limitation." Thus, the credit is limited to an amount, E, which bears the same ratio to F (the gross Federal estate tax, reduced by any credit for State death taxes under section 2011 and by any credit for gift tax under section 2012) as G (the "adjusted value of the property situated in the foreign country, subjected to foreign death tax, and included in the gross estate", computed as described in paragraph (b) of this section) bears to H (the value of the entire gross estate, reduced by the total amount of the deductions allowed under sections 2055 (charitable deduction) and 2056 (marital deduction)). Stated algebraically, the "second limitation" (E) equals

$$\frac{\text{"adjusted value of the property situated in the foreign country, subjected to foreign death taxes, and included in the gross estate" (G)}}{\text{value of entire gross estate, less charitable and marital deductions (H)}} \times \text{gross Federal estate tax, less credits for State death taxes and gift tax (F).}$$

The values used in this proportion are the values determined for the purpose of the Federal estate tax.

(b) Adjustment is required to factor "G" of the ratio stated in paragraph (a) of this section if a charitable deduction under section 2055 or a marital deduction under section 2056 is allowed with respect to the foreign property. In such case, factor "G" is the value of the

property situated in the foreign country, subjected to foreign death tax, and included in the gross estate reduced as follows:

(1) If a charitable deduction or a marital deduction is allowed to a decedent's estate with respect to any part of the foreign property specifically bequeathed, devised, or otherwise specifically passing to a charitable organization or to the decedent's spouse, the value of the foreign property is reduced by the amount of the charitable deduction or marital deduction allowed with respect to such specific transfer. See example (1) of paragraph (c) of this section.

(2) If a charitable deduction or a marital deduction is allowed to a decedent's estate with respect to a bequest, devise, or other transfer of an interest in a group of assets including both the foreign property and other property, the value of the foreign property is reduced by an amount, I, which bears the same ratio to J (the amount of the charitable deduction or marital deduction allowed with respect to such transfer of an interest in a group of assets) as K (the value of the foreign property included in the group of assets) bears to L (the value of the entire group of assets). As used in this subparagraph, the term "group of assets" has reference to those assets which, under applicable law, are chargeable with the charitable or marital transfer. See example (2) of paragraph (c) of this section.

Any reduction described in subparagraph (1) or (2) of this paragraph on account of the marital deduction must proportionately take into account the 50-percent limitation on the aggregate amount of the marital deduction contained in section 2056(c), if applicable. See example (3) of paragraph (c) of this section.

(c) The application of paragraphs (a) and (b) of this section may be illustrated by the following examples. In each case, the computations relate to the amount of credit under section 2014 without regard to the amount of credit which may be allowable under an applicable death tax convention.

Example (1). (i) Decedent, a citizen and resident of the United States at the time of his death, left a gross estate of $1,000,000 which includes: shares of stock issued by a United States corporation, valued at $750,000; bonds issued by the government of Country X physically located in the United States, valued at $50,000; and shares of stock issued by a Country X corporation, valued at $200,000. Expenses, indebtedness, etc., amounted to $60,000. Decedent specifically bequeathed $40,000 of the stock issued by the Country X corporation to a United States charity and left the residue of his estate, in equal shares, to his son and daughter. The gross Federal estate tax is $266,500 and the credit for State death taxes is $27,600. Under the situs rules referred to in paragraph (a)(3) of § 20.2014–1, the shares of stock issued by the Country X corporation comprise the only property deemed to be situated in Country X.

(ii) The "second limitation" on the credit for foreign death taxes is

$$\frac{\$200{,}000-\$40{,}000 \text{ (factor G of the ratio stated at § 20.2014-3(a); see also § 20.2014-3(b)(1))}}{\$1{,}000{,}000-\$40{,}000 \text{ (factor H of the ratio stated at § 20.2014-3(a))}} \times (\$266{,}500-\$27{,}600) \text{ (factor F of the ratio stated at § 20.2014-3(a))}$$

$$=\$39{,}816.67.$$

The lesser of this amount and the amount of the "first limitation" (computed under § 20.2014–2) is the credit for foreign death taxes.

Example (*2*). (i) Decedent, a citizen and resident of the United States at the time of his death, left a gross estate of $1,000,000 which includes: shares of stock issued by a United States corporation, valued at $650,000; shares of stock issued by a Country X corporation, valued at $200,000; and life insurance, in the amount of $150,000, payable to a son. Expenses, indebtedness, etc., amounted to $40,000. The decedent made a specific bequest of $25,000 of the Country X corporation stock to Charity A and a general bequest of $100,000 to Charity B. The residue of his estate was left to his daughter. The gross Federal estate tax is $242,450 and the credit for State death taxes is $24,480. Under these facts and applicable law, neither the stock of the Country X corporation specifically bequeathed to Charity A nor the insurance payable to the son could be charged with satisfying the bequest to Charity B. Therefore, the "group of assets" which could be so charged is limited to stock of the Country X corporation valued at $175,000 and stock of the United States corporation valued at $650,000.

(ii) Factor "G" of the ratio which is used in determining the "second limitation" is computed as follows:

Value of property situated in Country X		$200,000.00
Less: Reduction described in § 20.2014-3(b)(1)	$25,000.00	
Reduction described in § 20.2014-3(b)(2) = $175,000 (factor K of the ratio stated at § 20.2014-3(b)(2)) / $175,000+$650,000 (factor L of the ratio stated at § 20.2014-3(b)(2)) × $100,000 (factor J of the ratio stated at § 20.2014-3(b)(2))	=21,212.12	46,212.12
Factor "G" of the ratio		153,787.88

(iii) In this case, the "second limitation" on the credit for foreign death taxes is

$$\frac{\$153{,}787.88 \text{ (factor G of the ratio stated at § 20.2014-3(a); see also subdivision (ii) above)}}{\$1{,}000{,}000-\$125{,}000 \text{ (factor H of the ratio stated at § 20.2014-3(a))}} \times (\$242{,}450-\$24{,}480) \text{ (factor F of the ratio stated at § 20.2014-3(a))}$$

$$=\$38{,}309.88.$$

Example (3). (i) Decedent, a citizen and resident of the United States at the time of his death, left a gross estate of $850,000 which includes: shares of stock issued by United States corporations, valued at $440,000; real estate located in the United States, valued at $110,000; and shares of stock issued by Country X corporations, valued at $300,000. Expenses, indebtedness, etc., amounted to $50,000. Decedent devised $40,000 in real estate to a United States charity. In addition, he bequeathed to his wife $200,000 in United States stocks and $300,000 in Country X stocks. The residue of his estate passed to his children. The gross Federal estate tax is $81,700 and the credit for State death taxes is $5,520.

(ii) Decedent's adjusted gross estate is $800,000 (i. e., $850,000, gross estate less $50,000, expenses, indebtedness, etc.). The aggregate marital deduction allowed to his estate is limited by section 2056 (c) to one-half of this amount, or $400,000. Factor "G" of the ratio which is used in determining the "second limitation" is computed as follows:

Value of property situated in Country X		$300,000
Less: Reduction described in § 20.2014–3(b)(1) determined as follows (see also end of § 20.2014–3(b))—		
Total amount of bequests which qualify for the marital deduction:		
Specific bequest of Country X stock	$300,000	
Specific bequest of United States stock	200,000	
	500,000	
Limitation on aggregate marital deduction under section 2056(c)	400,000	
Part of specific bequest of Country X stock with respect to which the marital deduction is allowed—		
$\left(\frac{\$400,000}{\$500,000}\times\$300,000\right)$		240,000
Factor "G" of the ratio		60,000

(iii) Thus, the "second limitation" on the credit for foreign death taxes is

$$\frac{\$60,000 \text{ (factor G of the ratio stated at § 20.2014–3(a); see also subdivision (ii) above)}}{\$850,000-\$40,000-\$400,000 \text{ (factor H of the ratio stated at § 20.2014–3(a))}}\times(\$81,700-\$5,520) \text{ (factor F of the ratio stated at § 20.2014–3(a))}$$

$=\$11,148.29.$

(d) If the foreign country imposes more than one kind of death tax or imposes taxes at different rates upon the several shares of an estate, or if the foreign country and a political subdivision or possession thereof each imposes a death tax, the "second limitation" is still computed by applying the ratio set forth in paragraph (a) of § 20.2014–3. Factor "G" of the ratio is determined by taking into consideration the combined value of the foreign property which is subjected to each different tax or different rate. The combined value, however, cannot exceed the value at which such property was included

in the gross estate for Federal estate tax purposes. Thus, if Country X imposes a tax on the inheritance of a surviving spouse at a 10-percent rate and on the inheritance of a son at a 20-percent rate, the combined value of their inheritances is taken into consideration in determining factor "G" of the ratio, which is then used in computing the "second limitation." However, the "first limitation" is computed as provided in paragraph (b) of § 20.2014–2. The lesser of the "first limitation" and the "second limitation" is the credit for foreign death taxes.

§ 20.2014–4 APPLICATION OF CREDIT IN CASES INVOLVING A DEATH TAX CONVENTION.—(a) *In general.*—(1) If credit for a particular foreign death tax is authorized by a death tax convention, there is allowed either the credit provided for by the convention or the credit provided for by section 2014, whichever is the more beneficial to the estate. The application of this paragraph may be illustrated by the following example:

Example. (i) Decedent, a citizen of the United States and a domiciliary of Country X at the time of his death, left a gross estate of $1,000,000 which includes: shares of stock issued by a Country X corporation, valued at $400,000; bonds issued by a Country X corporation physically located in the United States, valued at $350,000; and real estate located in the United States, valued at $250,000. Expenses, indebtedness, etc., amounted to $50,000. Decedent left his entire estate to his son. There is in effect a death tax convention between the United States and Country X which provides for allowance of credit by the United States for succession duties imposed by the national government of Country X. The gross Federal estate tax is $307,200 and the credit for State death taxes is $33,760. Country X imposed a net succession duty on the stocks and bonds of $180,000. Under the situs rules described in paragraph (a)(3) of § 20.2014–1, the shares of stock comprise the only property deemed to be situated in Country X. Under the convention, both the stocks and the bonds are deemed to be situated in Country X.

(ii)(*a*) The credit authorized by the convention for death taxes imposed by Country X is computed as follows:

(*1*) Country X tax attributable to property situated in Country X and subjected to tax by both countries	
$\left(\frac{\$750,000}{\$750,000} \times \$180,000\right)$	$180,000
(*2*) Federal estate tax attributable to property situated in Country X and subjected to tax by both countries	
$\left(\frac{\$750,000}{\$1,000,000} \times \$273,440\right)$	205,080
(*3*) Credit (subdivision (*1*) or (*2*), whichever is less)	180,000

(*b*) The credit authorized by section 2014 for death taxes imposed by Country X is computed as follows:

(*1*) "First limitation" computed under § 20.2014–2	
$\left(\frac{\$400,000}{\$750,000} \times \$180,000\right)$	$96,000
(*2*) "Second limitation" computed under § 20.2014–3	
$\left(\frac{\$400,000}{\$1,000,000} \times \$273,440\right)$	109,376
(*3*) Credit (subdivision (*1*) or (*2*), whichever is less)	96,000

(iii) On the basis of the facts contained in this example, the credit of $180,000 authorized by the convention is the more beneficial to the estate.

(2) It should be noted that the greater of the treaty credit and the statutory credit is not necessarily the more beneficial to the estate. Such is the situation, for example, in those cases which involve both a foreign death tax credit and a credit under section 2013 for tax on prior transfers. The reason is that the amount of the credit for tax on prior transfers may differ depending upon whether the credit for foreign death tax is taken under the treaty or under the statute. Therefore, under certain circumstances, the advantage of taking the greater of the treaty credit and the statutory credit may be more than offset by a resultant smaller credit for tax on prior transfers. The solution is to compute the net estate tax payable first on the assumption that the treaty credit will be taken and then on the assumption that the statutory credit will be taken. Such computations will indicate whether the treaty credit or the statutory credit is in fact the more beneficial to the estate.

(b) *Taxes imposed by both a foreign country and a political subdivision thereof.*—If a foreign death tax is imposed by both a foreign country with which the United States has entered into a death tax convention and one of its possessions or political subdivisions, there is allowed either the credit provided for by the convention or the credit provided for by section 2014, whichever is the more beneficial to the estate. Thus, if a portion of the estate of a United States citizen is situated in X (a country with which the United States has entered into a death tax convention providing for allowance of credit by the United States for death tax imposed by the national government of X) and is subjected to death taxes imposed by both the national government of X and the government of Y, a province of X, there is allowed either a credit for the national death tax computed under the convention or a credit for the combined national and provincial death taxes computed under section 2014, whichever is the more beneficial to the estate. It should be noted that, unless the convention provides otherwise, credit may not be claimed separately under the convention for the national tax and under section 2014 for the provincial tax. The application of this paragraph is illustrated in greater detail in the following example:

Example. (1) Decedent, a citizen of the United States and a domiciliary of Country X at the time of his death, left a gross estate of $225,000 which includes: bonds issued by a United States corporation physically located in Y, a province of Country X, valued at $100,000; bonds issued by a Country X corporation physically located in the United States, valued at $75,000; and shares of stock issued by a Country X corporation, valued at $50,000. Expenses, indebtedness, etc., amounted to $10,000. Decedent left his entire estate to his son. There is in effect a death duty convention between the United States and Country X which provides for allowance of credit by the United States for succession duties imposed by the national government of Country X. The gross Federal estate tax is $55,200 and the credit for State death taxes is $3,000. Country X imposed a net succession duty on the Country X stock and the Country X bonds of $18,000. Prov-

ince Y imposed a net succession duty on the United States bonds of $16,000. Under the situs rules described in paragraph (a)(3) of § 20.2014–1, the United States bonds and the Country X stock are deemed to be situated in Country X. Under the convention, the Country X bonds and the Country X stock are deemed to be situated in Country X.

(2)(i) The credit authorized by the convention for death taxes imposed by Country X is computed as follows:

(*a*)	Country X tax attributable to property situated in Country X and subjected to tax by both countries $\left(\frac{\$125,000}{\$125,000} \times \$18,000\right)$	$18,000
(*b*)	Federal estate tax attributable to property situated in Country X and subjected to tax by both countries $\left(\frac{\$125,000}{\$225,000} \times \$52,000\right)$	29,000
(*c*)	Credit (subdivision (*a*) or (*b*), whichever is less)	18,000

(ii) The credit authorized by section 2014 for death taxes imposed by Country X (which includes death taxes imposed by Province Y according to § 20.2014–1(a)(1)) is computed as follows:

(*a*)	"First limitation" with respect to tax imposed by national government of Country X computed under § 20.2014–2(b) $\left(\frac{\$50,000}{\$125,000} \times \$18,000\right)$	$7,200
(*b*)	"First limitation" with respect to tax imposed by Province Y computed under § 20.2014–2(b) $\left(\frac{\$100,000}{\$100,000} \times \$16,000\right)$	16,000
(*c*)	Total "first limitation"	23,200
(*d*)	"Second limitation" computed under § 20.2014–3(d) $\left(\frac{\$150,000}{\$225,000} \times \$52,200\right)$	34,800
(*e*)	Credit (subdivision (*c*) or (*d*), whichever is less)	23,200

(3) On the basis of the facts contained in this example, the credit of $23,200 authorized by section 2014 is the more beneficial to the estate.

(c) *Taxes imposed by two foreign countries with respect to the same property.*—It is stated as a general rule in paragraph (a)(2) of § 20.2014–1 that if credits against the Federal estate tax are allowable under section 2014, or under section 2014 and one or more death tax conventions, for death taxes paid to more than one country, the credits are combined and the aggregate amount is credited against the Federal estate tax. This rule may result in credit being allowed for taxes imposed by two different countries upon the same item of property. If such is the case, the total amount of the credits with respect to such property is limited to the amount of the Federal estate tax attributable to the property, determined in accordance with the rules prescribed for computing the "second limitation" set forth in § 20.2014–3. The application of this section may be illustrated by the following example:

Example. The decedent, a citizen of the United States and a domiciliary of Country X at the time of his death, left a taxable estate which included bonds issued by Country X corporations, physically located in Country Z. Each of the three countries involved imposed death taxes on the Country X bonds. Assume that under the provisions of a treaty between the United States and Country X, the estate

is entitled to a credit against the Federal estate tax for death taxes imposed by Country X on the Country X bonds in the maximum amount of $20,000. Assume, also, that under the provisions of section 2014, the estate is entitled to a credit against the Federal estate tax for death taxes imposed by Country Z on the Country X bonds in the maximum amount of $10,000. Finally, assume that the Federal estate tax attributable to the Country X bonds is $25,000. Under such circumstances, the credit allowed the estate with respect to the Country X bonds would be limited to $25,000.

§ 20.2014–5 Proof of Credit.—(a) If the foreign death tax has not been determined and paid by the time the Federal estate tax return required by section 6018 is filed, credit may be claimed on the return in an estimated amount. However, before credit for the foreign death tax is finally allowed, satisfactory evidence, such as a statement by an authorized official of each country, possession or political subdivision thereof imposing the tax, must be submitted on Form 706CE certifying: (1) the full amount of the tax (exclusive of any interest or penalties), as computed before allowance of any credit, remission, or relief; (2) the amount of any credit, allowance, remission, or relief, and other pertinent information, including the nature of the allowance and a description of the property to which it pertains; (3) the net foreign death tax payable after any such allowance; (4) the date on which the death tax was paid, or if not all paid at one time, the date and amount of each partial payment; and (5) a list of the property situated in the foreign country and subjected to its tax, showing a description and the value of the property. Satisfactory evidence must also be submitted showing that no refund of the death tax is pending and none is authorized or, if any refund is pending or has been authorized, its amount and other pertinent information. See also section 2016 and § 20.2016–1 for requirements if foreign death taxes claimed as a credit are subsequently recovered.

(b) The following information must also be submitted whenever applicable:

(1) If any of the property subjected to the foreign death tax was situated outside of the country imposing the tax, the description of each item of such property and its value.

(2) If more than one inheritance or succession is involved with respect to which credit is claimed, or if the foreign country, possession or political subdivision thereof imposes more than one kind of death tax, or if both the foreign country and a possession or political subdivision thereof each imposes a death tax, a separate computation with respect to each inheritance or succession tax.

(c) In addition to the information required under paragraphs (a) and (b) of this section, the district director may require the submission of any further proof deemed necessary to establish the right to the credit.

§ 20.2014–6 Period of Limitations on Credit.—The credit for foreign death taxes under section 2014 is limited to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the estate tax return for the decedent's estate. If, however, a petition has been filed with The Tax Court of the United

States for the redetermination of a deficiency within the time prescribed in section 6213(a), the credit is limited to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the return, or before the expiration of 60 days after the decision of the Tax Court becomes final, whichever period is the last to expire. Similarly, if an extension of time has been granted under section 6161 for payment of the tax shown on the return, or of a deficiency, the credit is limited to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the return, or before the date of the expiration of the period of the extension, whichever period is the last to expire. See section 2015 for the applicable period of limitations for credit for foreign death taxes on reversionary or remainder interests if an election is made under section 6163(a) to postpone payment of the estate tax attributable to reversionary or remainder interests. If a claim for refund based on the credit for foreign death taxes is filed within the applicable period described in this section, a refund may be made despite the general limitation provisions of sections 6511 and 6512. Any refund based on the credit for foreign death taxes shall be made without interest.

§ 20.2015 Statutory Provisions; Credit for Death Taxes on Remainders.

SEC. 2015. CREDIT FOR DEATH TAXES ON REMAINDERS.

Where an election is made under section 6163(a) to postpone payment of the tax imposed by section 2001 or 2101, such part of any estate, inheritance, legacy, or succession taxes allowable as a credit under section 2011 or 2014, as is attributable to a reversionary or remainder interest may be allowed as a credit against the tax attributable to such interest, subject to the limitations on the amount of the credit contained in such sections, if such part is paid, and credit therefor claimed, at any time before the expiration of 60 days after the termination of the precedent interest or interests in the property.

§ 20.2015–1 Credit for Death Taxes on Remainders.—(a) If the executor of an estate elects under section 6163(a) to postpone the time for payment of any portion of the Federal estate tax attributable to a reversionary or remainder interest in property, credit is allowed under sections 2011 and 2014 against such portion of the Federal estate tax for State death taxes and foreign death taxes attributable to the reversionary or remainder interest if such State death taxes or foreign death taxes are paid and if credit therefor is claimed either—

(1) Within the time provided for in sections 2011 and 2014, or

(2) Within 60 days after the termination of the preceding interest or interests in the property.

The allowance of credit, however, is subject to the other limitations contained in sections 2011 and 2014.

(b) In applying the rule stated in paragraph (a) of this section, credit for State death taxes or foreign death taxes paid within the time provided in sections 2011 and 2014 is applied first to the portion of the Federal estate tax payment of which is not postponed, and any excess is applied to the balance of the Federal estate tax. However, credit for State death taxes or foreign death taxes not paid within the time provided in sections 2011 and 2014 is allowable only against the

portion of the Federal estate tax attributable to the reversionary or remainder interest, and only for State or foreign death taxes attributable to that interest. If a State death tax or a foreign death tax is imposed upon both a reversionary or remainder interest and upon other property, without a definite apportionment of the tax, the amount of the tax deemed attributable to the reversionary or remainder interest is an amount which bears the same ratio to the total tax as the value of the reversionary or remainder interest bears to the value of the entire property with respect to which the tax was imposed. In applying this ratio, adjustments consistent with those required under paragraph (c) of § 20.6163–1 must be made.

(c) The application of this section may be illustrated by the following examples:

Example (1). One-third of the Federal estate tax was attributable to a remainder interest in real property located in State Y, and two-thirds of the Federal estate tax was attributable to other property located in State X. The payment of the tax attributable to the remainder interest was postponed under the provisions of section 6163 (a). The maximum credit allowable for State death taxes under the provisions of section 2011 is $12,000. Therefore, of the maximum credit allowable, $4,000 is attributable to the remainder interest and $8,000 is attributable to the other property. Within the 4-year period provided for in section 2011, inheritance tax in the amount of $9,000 was paid to State X in connection with the other property. With respect to this $9,000, $8,000 (the maximum amount allowable) is allowed as a credit against the Federal estate tax attributable to the other property, and $1,000 is allowed as a credit against the postponed tax. After the expiration of the 4-year period but before expiration of 60 days after termination of the life estate or other precedent interest, inheritance tax in the amount of $5,000 was paid to State Y in connection with the remainder interest. As the maximum credit allowable with respect to the remainder interest is $4,000 and $1,000 has already been allowed as a credit, an additional $3,000 will be credited against the Federal estate tax attributable to the remainder interest.

Example (2). The facts are the same as in example (1), except that within the 4-year period inheritance tax in the amount of $2,500 was paid to State Y with respect to the remainder interest and inheritance tax in the amount of $7,500 was paid to State X with respect to the other property. The amount of $8,000 is allowed as a credit against the Federal estate tax attributable to the other property and the amount of $2,000 is allowed as a credit against the postponed tax. After the expiration of the 4-year period but before the expiration of 60 days after the termination of the life estate or other precedent interest, the estate pays additional inheritance taxes of $5,000 to State Y in connection with the remainder interest. Thus, additional credit will be allowed in the amount of $2,000 ($4,000, maximum credit allowable, less $2,000 credit previously allowed) against the Federal estate tax attributable to the remainder interest.

Example (3). The facts are the same as in example (2), except that no payment was made to State Y within the 4-year period. The amount of $7,500 is allowed as a credit against the Federal estate tax attributable to the other property. After termination of the life interest additional credit will be allowed in the amount of $4,000 against the Federal estate tax attributable to the remainder interest.

Since the payment of $5,000 was made to State Y following the expiration of the 4-year period, no part of the payment may be allowed as a credit against the Federal estate tax attributable to the other property.

§ 20.2016 STATUTORY PROVISIONS; RECOVERY OF TAXES CLAIMED AS CREDIT.

SEC. 2016. RECOVERY OF TAXES CLAIMED AS CREDIT.

If any tax claimed as a credit under section 2011 or 2014 is recovered from any foreign country, any State, any Territory or possession of the United States, or the District of Columbia, the executor, or any other person or persons recovering such amount, shall give notice of such recovery to the Secretary or his delegate at such time and in such manner as may be required by regulations prescribed by him, and the Secretary or his delegate shall (despite the provisions of section 6501) redetermine the amount of the tax under this chapter and the amount, if any, of the tax due on such redetermination, shall be paid by the executor or such person or persons, as the case may be, on notice and demand. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary or his delegate, resulting from a refund to the executor of tax claimed as a credit under section 2014, for any period before the receipt of such refund, except to the extent interest was paid by the foreign country on such refund.

§ 20.2016–1 RECOVERY OF DEATH TAXES CLAIMED AS CREDIT.—In accordance with the provisions of section 2016, the executor (or any other person) receiving a refund of any State death taxes or foreign death taxes claimed as a credit under section 2011 or section 2014 shall notify the district director of the refund within 30 days of its receipt. The notice shall contain the following information:

(a) The name of the decedent;
(b) The date of the decedent's death;
(c) The property with respect to which the refund was made;
(d) The amount of the refund, exclusive of interest;
(e) The date of the refund; and
(f) The name and address of the person receiving the refund.

If the refund was in connection with foreign death taxes claimed as a credit under section 2014, the notice shall also contain a statement showing the amount of interest, if any, paid by the foreign country on the refund. Finally, the person filing the notice shall furnish the district director such additional information as he may request. Any Federal estate tax found to be due by reason of the refund is payable by the person or persons receiving it, upon notice and demand, even though the refund is received after the expiration of the period of limitations set forth in section 6501 (see section 6501(c)(5)). If the tax found to be due results from a refund of foreign death tax claimed as a credit under section 2014, such tax shall not bear interest for any period before the receipt of the refund, except to the extent that interest was paid by the foreign country on the refund.

GROSS ESTATE

§ 20.2031 STATUTORY PROVISIONS; DEFINITION OF GROSS ESTATE.

SEC. 2031. DEFINITION OF GROSS ESTATE.

(a) GENERAL.—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, 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.

(b) VALUATION OF UNLISTED STOCK AND SECURITIES.—In the case of stock and securities of a corporation the value of which, by reason of their not being listed on an exchange and by reason of the absence of sales thereof, cannot be determined with reference to bid and asked prices or with reference to sales prices, the value thereof shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on an exchange.

§ 20.2031–1 DEFINITION OF GROSS ESTATE; VALUATION OF PROPERTY.—(a) *Definition of gross estate.*—The value of the gross estate of a decedent who was a citizen or resident of the United States at the time of his death is the total value of the interests described in sections 2033 through 2044, other than real property situated outside of the United States (as defined in paragraph (b) (1) (i) of § 20.0–1) valued as described in §§ 20.2031–1 through 20.2031–9 and § 20.2032–1. The contents of sections 2033 through 2044 are, in general, as follows:

(1) Sections 2033 and 2034 are concerned mainly with interests in property passing through the decedent's probate estate. Section 2033 includes in the decedent's gross estate any interest that the decedent had in property at the time of his death. Section 2034 provides that any interest of the decedent's surviving spouse in the decedent's property, such as dower or curtesy, does not prevent the inclusion of such property in the decedent's gross estate.

(2) Sections 2035 through 2038 deal with interests in property transferred by the decedent during his life under such circumstances as to bring the interests within the decedent's gross estate. Section 2035 includes in the decedent's gross estate property transferred in contemplation of death, even though the decedent had no interest in, or control over, the property at the time of his death. Section 2036 provides for the inclusion of transferred property with respect to which the decedent retained the income or the power to designate who shall enjoy the income. Section 2037 includes in the decedent's gross estate certain transfers under which the beneficial enjoyment of the property could be obtained only by surviving the decedent. Section 2038 provides for the inclusion of transferred property if the decedent had at the time of his death the power to change the beneficial enjoyment of the property. It should be noted that there is considerable overlap in the application of sections 2036 through 2038 with respect to reserved powers, so that transferred property may be includible in the decedent's gross estate in varying degrees under more than one of those sections.

(3) Sections 2039 through 2042 deal with special kinds of property and powers. Sections 2039 and 2040 concern annuities and jointly held property, respectively. Section 2041 deals with powers held by the decedent over the beneficial enjoyment of property not originating with the decedent. Section 2042 concerns insurance under policies on the life of the decedent.

(4) Section 2043 concerns the sufficiency of consideration for transfers made by the decedent during his life. This has a bearing on the amount to be included in the decedent's gross estate under sections 2035 through 2038, and 2041. Section 2044 deals with retroactivity.

(b) *Valuation of property in general.*—The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's

death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of the property. For example, in the case of shares of stocks or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall be considered in every case. See §§ 20.2031–2 through 20.2031–8 for further information concerning the valuation of particular kinds of property.

§ 20.2031–2 VALUATION OF STOCKS AND BONDS.—(a) *In general.*—The value of stocks and bonds is the fair market value per share or bond on the applicable valuation date.

(b) *Based on selling prices.*—If there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market, or otherwise, the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share or bond. If there were no sales on the valuation date, but there were sales on dates within a reasonable period both before and after the valuation date, the fair market value is determined by taking a weighted average of the means between the highest and lowest sales on the nearest date before and the nearest date after the valuation date. The average is to be weighted inversely by the respective numbers of trading days between the selling dates and the valuation date. For example, assume that sales of stock nearest the valuation date (Friday, June 15) occurred two trading days before (Wednesday, June 13) and three trading days after (Wednesday, June 20) and that on these days the mean sale prices per share were $10 and $15, respectively. The price of $12 is taken as representing the fair market value of a share of the stock as of the valuation date $\left(\frac{(3\times10)+(2\times15)}{5}\right)$. If, instead, the mean sale prices per share on June 13 and June 20 were $15 and $10, respectively, the price of $13 is taken as representing the fair market value $\left(\frac{(3\times15)+(2\times10)}{5}\right)$. As a further example, assume that the decedent died on Sunday, October 7, and that Saturday and Sunday were not trading days. If sales of stock occurred on Friday, October 5, at mean sale prices per share of $20 and on Monday, October 8, at mean sale prices per share of $23, then the fair market value per share of stock as of the valuation date is $21.50. If stocks or bonds are listed on more than one exchange, the records of the exchange where the

stocks or bonds are principally dealt in should be employed. In valuing listed securities, the executor should be careful to consult accurate records to obtain values as of the applicable valuation date. If quotations of unlisted securities are obtained from brokers, or evidence as to their sale is obtained from officers of the issuing companies, copies of the letters furnishing such quotations or evidence of sale should be attached to the return.

(c) *Based on bid and asked prices.*—If the provisions of paragraph (b) of this section are inapplicable because actual sales are not available during a reasonable period beginning before and ending after the valuation date, the fair market value may be determined by taking the mean between the bona fide bid and asked prices on the valuation date, or if none, by taking a weighted average of the means between the bona fide bid and asked prices on the nearest trading date before and the nearest trading date after the valuation date, if both such nearest dates are within a reasonable period. The average is to be determined in the manner described in paragraph (b) of this section.

(d) *Based on incomplete selling prices or bid and asked prices.*—If the provisions of paragraphs (b) and (c) of this section are inapplicable because no actual sale prices or bona fide bid and asked prices are available on a date within a reasonable period before the valuation date, but such prices are available on a date within a reasonable period after the valuation date, or vice versa, then the mean between the highest and lowest available sale prices or bid and asked prices may be taken as the value.

(e) *Where selling prices or bid and asked prices do not reflect fair market value.*—If it is established that the value of any bond or share of stock determined on the basis of selling or bid and asked prices as provided under paragraphs (b), (c), and (d) of this section does not reflect the fair market value thereof, then some reasonable modification of that basis or other relevant facts and elements of value are considered in determining the fair market value. Where sales at or near the date of death are few or of a sporadic nature, such sales alone may not indicate fair market value. In certain exceptional cases, the size of the block of stock to be valued in relation to the number of shares changing hands in sales may be relevant in determining whether selling prices reflect the fair market value of the block of stock to be valued. If the executor can show that the block of stock to be valued is so large in relation to the actual sales on the existing market that it could not be liquidated in a reasonable time without depressing the market, the price at which the block could be sold as such outside the usual market, as through an underwriter, may be a more accurate indication of value than market quotations. Complete data in support of any allowance claimed due to the size of the block of stock being valued shall be submitted with the return. On the other hand, if the block of stock to be valued represents a controlling interest, either actual or effective, in a going business, the price at which other lots change hands may have little relation to its true value.

(f) *Where selling prices or bid and asked prices are unavailable.*—If the provisions of paragraphs (b), (c), and (d) of this section are inapplicable because actual sale prices and bona fide bid and

asked prices are lacking, then the fair market value is to be determined by taking the following factors into consideration:

(1) In the case of corporate or other bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors; and

(2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some of the "other relevant factors" referred to in subparagraphs (1) and (2) of this paragraph are: the good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers, or any technical experts as of or near the applicable valuation date.

(g) *Pledged securities.*—The full value of securities pledged to secure an indebtedness of the decedent is included in the gross estate. If the decedent had a trading account with a broker, all securities belonging to the decedent and held by the broker at the date of death must be included at their fair market value as of the applicable valuation date. Securities purchased on margin for the decedent's account and held by a broker must also be returned at their fair market value as of the applicable valuation date. The amount of the decedent's indebtedness to a broker or other person with whom securities were pledged is allowed as a deduction from the gross estate in accordance with the provisions of § 20.2053–1 or § 20.2106–1 (for estates of nonresidents not citizens).

(h) *Securities subject to an option or contract to purchase.*—Another person may hold an option or a contract to purchase securities owned by a decedent at the time of his death. The effect, if any, that is given to the option or contract price in determining the value of the securities for estate tax purposes depends upon the circumstances of the particular case. Little weight will be accorded a price contained in an option or contract under which the decedent is free to dispose of the underlying securities at any price he chooses during his lifetime. Such is the effect, for example, of an agreement on the part of a shareholder to purchase whatever shares of stock the decedent may own at the time of his death. Even if the decedent is not free to dispose of the underlying securities at other than the option or contract price, such price will be disregarded in determining the value of the securities unless it is determined under the circumstances of the particular case that the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth.

(j) *Stock sold "ex-dividend."*—In any case where a dividend is declared on a share of stock before the decedent's death but payable to stockholders of record on a date after his death and the stock is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the stock as of the date of the decedent's death.

§ 20.2031–3 VALUATION OF INTERESTS IN BUSINESSES.—The fair market value of any interest of a decedent in a business, whether a partnership or a proprietorship, is the net amount which a willing purchaser, whether an individual or a corporation, would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The net value is determined on the basis of all relevant factors including—

(a) A fair appraisal as of the applicable valuation date of all the assets of the business, tangible and intangible, including good will;

(b) The demonstrated earning capacity of the business; and

(c) The other factors set forth in paragraph (f) and (h) of § 20.2031–2 relating to the valuation of corporate stock, to the extent applicable.

Special attention should be given to determining an adequate value of the good will of the business in all cases in which the decedent has not agreed, for an adequate and full consideration in money or money's worth, that his interest passes at his death to, for example, his surviving partner or partners. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of examinations of the business made by accountants, engineers, or any technical experts as of or near the applicable valuation date.

§ 20.2031–4 VALUATION OF NOTES.—The fair market value of notes, secured or unsecured, is presumed to be the amount of unpaid principal, plus interest accrued to the date of death, unless the executor establishes that the value is lower or that the notes are worthless. However, items of interest shall be separately stated on the estate tax return. If not returned at face value, plus accrued interest, satisfactory evidence must be submitted that the note is worth less than the unpaid amount (because of the interest rate, date of maturity, or other cause), or that the note is uncollectible, either in whole or in part (by reason of the insolvency of the party or parties liable, or for other cause), and that any property pledged or mortgaged as security is insufficient to satisfy the obligation.

§ 20.2031–5 VALUATION OF CASH ON HAND OR ON DEPOSIT.—The amount of cash belonging to the decedent at the date of his death, whether in his possession or in the possession of another, or deposited with a bank, is included in the decedent's gross estate. If bank checks outstanding at the time of the decedent's death and given in discharge of bona fide legal obligations of the decedent incurred for an adequate and full consideration in money or money's worth are subsequently honored by the bank and charged to the decedent's account, the balance

remaining in the account may be returned, but only if the obligations are not claimed as deductions from the gross estate.

§ 20.2031–6 Valuation of Household and Personal Effects.—(a) *General rule.*—The fair market value of the decedent's household and personal effects is the price which a willing buyer would pay to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. A room by room itemization of household and personal effects is desirable. All the articles should be named specifically, except that a number of articles contained in the same room, none of which has a value in excess of $100 may be grouped. A separate value should be given for each article named. In lieu of an itemized list, the executor may furnish a written statement, containing a declaration that it is made under penalties of perjury, setting forth the aggregate value as appraised by a competent appraiser or appraisers of recognized standing and ability, or by a dealer or dealers in the class of personalty involved.

(b) *Special rule in cases involving a substantial amount of valuable articles.*—Nothwithstanding the provisions of paragraph (a) of this section, if there are included among the household and personal effects articles having marked artistic or intrinsic value of a total in excess of $3,000 (e. g., jewelry, furs, silverware, paintings, etching, engravings, antiques, books, statuary, vases, oriental rugs, coin or stamp collections), the appraisal of an expert or experts, under oath, shall be filed with the return. The appraisal shall be accompanied by a written statement of the executor containing a declaration that it is made under the penalties of perjury as to the completeness of the itemized list of such property and as to the disinterested character and the qualifications of the appraiser or appraisers.

(c) *Disposition of household effects prior to investigation.*—If it is desired to effect distribution or sale of any portion of the household or personal effects of the decedent in advance of an investigation by an officer of the Internal Revenue Service, information to that effect shall be given to the district director. The statement to the district director shall be accompanied by an appraisal of such property, under oath, and by written statement of the executor, containing a declaration that it is made under the penalties of perjury, regarding the completeness of the list of such property and the qualifications of the appraiser, as heretofore described. If a personal inspection by an officer of the Internal Revenue Service is not deemed necessary, the executor will be so advised. This procedure is designed to facilitate disposition of such property and to obviate future expense and inconvenience to the estate by affording the district director an opportunity to make an investigation should one be deemed necessary prior to sale or distribution.

(d) *Additional rules if an appraisal involved.*—If, pursuant to paragraphs (a), (b), and (c) of this section, expert appraisers are employed, care shall be taken to see that they are reputable and of recognized competency to appraise the particular class of property involved. In the appraisal, books in sets by standard authors shall be listed in separate groups. In listing paintings having artistic value, the size, subject, and artist's name shall be stated. In the case of oriental rugs, the size, make, and general condition shall be given. Sets of silverware shall be listed in separate groups. Groups or indi-

vidual pieces of silverware shall be weighed and the weights given in troy ounces. In arriving at the value of silverware, the appraisers shall take into consideration its antiquity, utility, desirabilty, conditon, and obsolescence.

§ 20.2031–7 VALUATION OF ANNUITIES, LIFE ESTATES, TERMS FOR YEARS, REMAINDERS AND REVERSIONS.—(a) *In general.*—(1) The fair market value of annuities, life estates, terms for years, remainders and reversions is their present value, determined under this section, except in case of annuities under contracts issued by companies regularly engaged in their sale. The valuation of such commercial annuity contracts, and of insurance policies on the lives of persons other than the decedent, is determined under § 20.2031–8. (See § 20.2042–1 with respect to insurance policies on the decedent's life.)

(2) The present value of an annuity, life estate, remainder or reversion determined under this section which is dependent on the continuation or termination of the life of one person is computed by the use of Table I in paragraph (f) of this section. The present value of an annuity, term for years, remainder or reversion dependent on a term certain is computed by the use of Table II in paragraph (f). If the interest to be valued is dependent upon more than one life or there is a term certain concurrent with one or more lives, see paragraph (e) of this section. For purposes of the computations described in this section, the age of a person is to be taken as the age of that person at his nearest birthday.

(b) *Annuities.*—(1) *Payable annually at end of year.*—If an annuity is payable annually at the end of each year during the life of an individual (as, for example, if the first payment is due one year after decedent's death), the amount payable annually is multiplied by the figure in column 2 of Table I opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. If the annuity is payable annually at the end of each year for a definite number of years, the amount payable annually is multiplied by the figure in column 2 of Table II opposite the number of years in column 1 representing the duration of the annuity. The application of this subparagraph may be illustrated by the following examples:

Example (1). The decedent received, under the terms of his father's will an annuity of $10,000 a year payable annually for the life of his elder brother. At the time he died, an annual payment had just been made. The brother at the decedent's death was 40 years 8 months old. By reference to Table I, the figure in column 2 opposite 41 years, the number nearest to the brother's actual age, is found to be 17.6853. The present value of the annuity at the date of the decedent's death is, therefore, $176,853 ($10,000×17.6853).

Example (2). The decedent was entitled to receive an annuity of $10,000 a year payable annually throughout a term certain. At the time he died, an annual payment had just been made and five more annual payments were still to be made. By reference to Table II, it is found that the figure in column 2 opposite 5 years is 4.5151. The present value of the annuity is, therefore, $45,151. ($10,000×4.5151).

(2) *Payable at the end of semiannual, quarterly, monthly, or weekly periods.*—If an annuity is payable at the end of semiannual, quarterly,

monthly, or weekly periods during the life of an individual (as for example if the first payment is due one month after the decedent's death), the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table I opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. The product so obtained is then multiplied by whichever of the following factors is appropriate:

1.0087 for semiannual payments,
1.0130 for quarterly payments,
1.0159 for monthly payments, or
1.0171 for weekly payments.

If the annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods for a definite number of years, the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table II opposite the number of years in column 1 representing the duration of the annuity. The product so obtained is then multiplied by whichever of the above factors is appropriate. The application of this subparagraph may be illustrated by the following example:

Example. The facts are the same as those contained in example (1) set forth in subparagraph (1) of this paragraph, except that the annuity is payable semiannually. The aggregate annual amount, $10,000, is multiplied by the factor 17.6853, and the product multiplied by 1.0087. The present value of the annuity at the date of the decedent's death is, therefore, $178,391.62 ($10,000×17.6853×1.0087).

(3) *Payable at the beginning of annual, semiannual, quarterly, monthly, or weekly periods.*—(i) If the first payment of an annuity for the life of an individual is due at the beginning of the annual or other payment period rather than at the end (as, for example, if the first payment is to be made immediately after the decedent's death), the value of the annuity is the sum of (*a*) the first payment plus (*b*) the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in subparagraph (1) or (2) of this paragraph. The application of this subdivision may be illustrated by the following example:

Example. The decedent was entitled to receive an annuity of $50 a month during the life of another. The decedent died on a day the payment was due. At the date of the decedent's death, the person whose life measures the duration of the annuity was 50 years of age. The value of the annuity at the date of the decedent's death is $50 plus the product of $50×12×14.8486 (see Table I)×1.0159 (see subparagraph (2) of this paragraph), or $9,100.82.

(ii) If the first payment of an annuity for a definite number of years is due at the beginning of the annual or other payment period, the applicable factor is the product of the factor shown in Table II multiplied by whichever of the following factors is appropriate:

1.0350 for annual payments,
1.0262 for semiannual payments,
1.0218 for quarterly payments,
1.0189 for monthly payments, or
1.0177 for weekly payments.

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The application of this subdivision may be illustrated by the following example:

Example. The decedent was the beneficiary of an annuity of $50 a month. On the day a payment was due, the decedent died. There were 300 payments to be made, including the payment due. The value of the annuity as of the date of decedent's death is the product of $50×12×16.4815 (see Table II)×1.0189, or $10,075.80.

(c) *Life estates and terms for years.*—If the interest to be valued is the right of a person for his life, or for the life of another person, to receive the income of certain property or to use nonincome-producing property, the value of the interest is the value of the property multiplied by the figure in column 3 of Table I opposite the number of years nearest to the actual age of the measuring life. If the interest to be valued is the right to receive income of property or to use nonincome-producing property for a term of years, column 3 of Table II is used. The application of this paragraph may be illustrated by the following example:

Example. The decedent or his estate was entitled to receive the income from a fund of $50,000 during the life of his elder brother. Upon the brother's death, the remainder is to go to X. The brother was 31 years 5 months old at the time of decedent's death. By reference to Table I, the figure in column 3 opposite 31 years is found to be 0.71068. The present value of decedent's interest is, therefore, $35,534 ($50,000×0.71068).

(d) *Remainders or reversionary interests.*—If a decedent had, at the time of his death, a remainder or a reversionary interest in property to take effect after an estate for the life of another, the present value of his interest is obtained by multiplying the value of the property by the figure in column 4 of Table I opposite the number of years nearest to the actual age of the person whose life measures the preceding estate. If the remainder or reversion is to take effect at the end of a term for years, column 4 of Table II is used. The application of this paragraph may be illustrated by the following example:

Example. The decedent was entitled to receive certain property worth $50,000 upon the death of his elder brother, to whom the income was bequeathed for life. At the time of the decedent's death, the elder brother was 31 years 5 months old. By reference to Table I, the figure in column 4 opposite 31 years is found to be 0.28932. The present value of the remainder interest at the date of decedent's death is, therefore, $14,466 ($50,000×0.28932).

(e) *Actuarial computations by the Internal Revenue Service.*—If the valuation of the interest involved is dependent upon the continuation or the termination of more than one life or upon a term certain concurrent with one or more lives, a special factor must be used. The factor is to be computed upon the basis of the Makehamized mortality table appearing as Table 38 of United States Life Tables and Actuarial Tables 1939–1941, published by the United States Department of Commerce, Bureau of Census, and interest at the rate of 3½ percent a year, compounded annually. Many such factors may be found in, or readily computed with the use of the tables contained in, a pamphlet entitled "Actuarial Values for Estate

and Gift Tax." This pamphlet may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington 25, D. C. However, if a special factor is required in the case of an actual decedent, the Commissioner will furnish the factor to the executor upon request. The request must be accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the interest, and by copies of the relevant instruments.

(f) The following tables shall be used in the application of the provisions of this section:

TABLE I

Table, single life, 3½ percent, showing the present worth of an annuity, of a life interest, and of a remainder interest

1 Age	2 Annuity	3 Life estate	4 Remainder	1 Age	Annuity	3 Life estate	4 Remainder
0	23. 9685	. 83890	. 16110	53	13. 8221	. 48377	. 51623
1	24. 9035	. 87162	. 12838	54	13. 4734	. 47157	. 52843
2	24. 8920	. 87122	. 12878	55	13. 1218	. 45926	. 54074
3	24. 8246	. 86886	. 13114	56	12. 7679	. 44688	. 55312
4	24. 7378	. 86582	. 13418	57	12. 4120	. 43442	. 56558
5	24. 6392	. 86237	. 13763	58	12. 0546	. 42191	. 57809
6	24. 5326	. 85864	. 14136	59	11. 6960	. 40936	. 59064
7	24. 4188	. 85466	. 14534	60	11. 3369	. 39679	. 60321
8	24. 2982	. 85044	. 14956	61	10. 9776	. 38422	. 61578
9	24. 1713	. 84600	. 15400	62	10. 6186	. 37165	. 62835
10	24. 0387	. 84135	. 15865	63	10. 2604	. 35911	. 64089
11	23. 9008	. 83653	. 16347	64	9. 9036	. 34663	. 65337
12	23. 7600	. 83160	. 16840	65	9. 5486	. 33420	. 66580
13	23. 6161	. 82656	. 17344	66	9. 1960	. 32186	. 67814
14	23. 4693	. 82143	. 17857	67	8. 8464	. 30962	. 69038
15	23. 3194	. 81618	. 18382	68	8. 5001	. 29750	. 70250
16	23. 1665	. 81083	. 18917	69	8. 1578	. 28552	. 71448
17	23. 0103	. 80536	. 19464	70	7. 8200	. 27370	. 72630
18	22. 8511	. 79979	. 20021	71	7. 4871	. 26205	. 73795
19	22. 6870	. 79404	. 20596	72	7. 1597	. 25059	. 74941
20	22. 5179	. 78813	. 21187	73	6. 8382	. 23934	. 76066
21	22. 3438	. 78203	. 21797	74	6. 5231	. 22831	. 77169
22	22. 1646	. 77576	. 22424	75	6. 2148	. 21752	. 78248
23	21. 9801	. 76930	. 23070	76	5. 9137	20698	. 79302
24	21. 7902	. 76266	. 23734	77	5. 6201	. 19670	. 80330
25	21. 5950	. 75582	. 24418	78	5. 3345	. 18671	. 81329
26	21. 3942	. 74880	. 25120	79	5. 0572	. 17700	. 82300
27	21. 1878	. 74157	. 25843	80	4. 7884	. 16759	. 83241
28	20. 9759	. 73416	. 26584	81	4. 5283	. 15849	. 84151
29	20. 7581	. 72653	. 27347	82	4. 2771	. 14970	. 85030
30	20. 5345	. 71871	. 28129	83	4. 0351	. 14123	. 85877
31	20. 3052	. 71068	. 28932	84	3. 8023	. 13308	. 86692
32	20. 0699	. 70245	. 29755	85	3. 5789	. 12526	. 87474
33	19. 8288	. 69401	. 30599	86	3. 3648	. 11777	. 88223
34	19. 5816	. 68536	. 31464	87	3. 1601	. 11060	. 88940
35	19. 3285	. 67650	. 32350	88	2. 9648	. 10377	. 89623
36	19. 0695	. 66743	. 33257	89	2. 7788	. 09726	. 90274
37	18. 8044	. 65815	. 34185	90	2. 6019	. 09107	. 90893
38	18. 5334	. 64867	. 35133	91	2. 4342	. 08520	. 91480
39	18. 2566	. 63898	. 36102	92	2. 2754	. 07964	. 92036
40	17. 9738	. 62908	. 37092	93	2. 1254	. 07439	. 92561
41	17. 6853	. 61899	. 38101	94	1. 9839	. 06944	. 93056
42	17. 3911	. 60869	. 39131	95	1. 8507	. 06477	. 93523
43	17. 0913	. 59820	. 40180	96	1. 7256	. 06040	. 93960
44	16. 7860	. 58751	. 41249	97	1. 6082	. 05629	. 94371
45	16. 4754	. 57664	. 42336	98	1. 4982	. 05244	. 94756
46	16. 1596	. 56559	. 43441	99	1. 3949	. 04882	. 95118
47	15. 8388	. 55436	. 44564	100	1. 2973	. 04541	. 95459
48	15. 5133	. 54297	. 45703	101	1. 2033	. 04212	. 95788
49	15. 1831	. 53141	. 46859	102	1. 1078	. 03877	. 96123
50	14. 8486	. 51970	. 48030	103	. 9973	. 03491	. 96509
51	14. 5101	. 50785	. 49215	104	. 8318	. 02911	. 97089
52	14. 1678	. 49587	. 50413	105	. 4831	. 01691	. 98309

TABLE II

Table showing the present worth at 3½ percent of an annuity for a term certain, of an income interest for a term certain, and of a remainder interest postponed for a term certain

1 Number of years	2 Annuity	3 Term certain	4 Remainder	1 Number of years	2 Annuity	3 Term certain	4 Remainder
1	0. 9662	. 033816	. 966184	16	12. 0941	. 423294	. 576706
2	1. 8997	. 066489	. 933511	17	12. 6513	. 442796	. 557204
3	2. 8016	. 098057	. 901943	18	13. 1897	. 461639	. 538361
4	3. 6731	. 128558	. 871442	19	13. 7098	. 479844	. 520156
5	4. 5151	. 158027	. 841973	20	14. 2124	. 497434	. 502566
6	5. 3286	. 186499	. 813501	21	14. 6980	. 514429	. 485571
7	6. 1145	. 214009	. 785991	22	15. 1671	. 530849	. 469151
8	6. 8740	. 240588	. 759412	23	15. 6204	. 546714	. 453286
9	7. 6077	. 266269	. 733731	24	16. 0584	. 562043	. 437957
10	8. 3166	. 291081	. 708919	25	16. 4815	. 576853	. 423147
11	9. 0016	. 315054	. 684946	26	16. 8904	. 591162	. 408838
12	9. 6633	. 338217	. 661783	27	17. 2854	. 604988	. 395012
13	10. 3027	. 360596	. 639404	28	17. 6670	. 618346	. 381654
14	10. 9205	. 382218	. 617782	29	18. 0358	. 631252	. 368748
15	11. 5174	. 403109	. 596891	30	18. 3920	. 643722	. 356278

§ 20.2031–8 VALUATION OF CERTAIN LIFE INSURANCE AND ANNUITY CONTRACTS.—(a) The value of a contract for the payment of an annuity, or an insurance policy on the life of a person other than the decedent, issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts. An annuity payable under a combination annuity contract and life insurance policy on the decedent's life (e. g., a "retirement income" policy with death benefit) under which there was no insurance element at the time of the decedent's death (see paragraph (d) of § 20.2039–1) is treated like a contract for the payment of an annuity for purposes of this section.

(b) As valuation of an insurance policy through sale of comparable contracts is not readily ascertainable when, at the date of the decedent's death, the contract has been in force for some time and further premium payments are to be made, the value may be approximated by adding to the interpolated terminal reserve at the date of the decedent's death the proportionate part of the gross premium last paid before the date of the decedent's death which covers the period extending beyond that date. If, however, because of the unusual nature of the contract such an approximation is not reasonably close to the full value of the contract, this method may not be used.

(c) The application of this section may be illustrated by the following examples. In each case involving an insurance contract, it is assumed that there are no accrued dividends or outstanding indebtedness on the contract.

Example (1). X purchased from a life insurance company a joint and survivor annuity contract under the terms of which X was to receive payments of $1,200 annually for his life and, upon X's

death, his wife was to receive payments of $1,200 annually for her life. Five years after such purchase, when his wife was 50 years of age, X died. The value of the annuity contract at the date of X's death is the amount which the company would charge for an annuity providing for the payment of $1,200 annually for the life of a female 50 years of age.

Example (2). Y died holding the incidents of ownership in a life insurance policy on the life of his wife. The policy was one on which no further payments were to be made to the company (e. g., a single premium policy or a paid-up policy). The value of the insurance policy at the date of Y's death is the amount which the company would charge for a single premium contract of the same specified amount on the life of a person of the age of the insured.

Example (3). Z died holding the incidents of ownership in a life insurance policy on the life of his wife. The policy was an ordinary life policy issued nine years and four months prior to Z's death and at a time when Z's wife was 35 years of age. The gross annual premium is $2,811 and the decedent died four months after the last premium due date. The value of the insurance policy at the date of Z's death is computed as follows:

Terminal reserve at end of tenth year	$14,601.00
Terminal reserve at end of ninth year	12,965.00
Increase	1,636.00
One-third of such increase (Z having died four months following the last preceding premium due date) is	545.33
Terminal reserve at end of ninth year	12,965.00
Interpolated terminal reserve at date of Z's death	13,510.33
Two-thirds of gross premium (⅔ × $2,811)	1,874.00
Value of the insurance policy	15,384.33

§ 20.2031–9 VALUATION OF OTHER PROPERTY.—The valuation of any property not specifically described in §§ 20.2031–2 through 20.2031–8 is made in accordance with the general principles set forth in § 20.2031–1. For example, a future interest in property not subject to valuation in accordance with the actuarial principles set forth in § 20.2031–7 is to be valued in accordance with the general principles set forth in § 20.2031–1.

§ 20.2032 STATUTORY PROVISIONS; ALTERNATE VALUATION.

SEC. 2032. ALTERNATE VALUATION.

(a) GENERAL.—The value of the gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows:

(1) In the case of property distributed, sold, exchanged, or otherwise disposed of, within 1 year after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

(2) In the case of property not distributed, sold, exchanged, or otherwise disposed of, within 1 year after the decedent's death such property shall be valued as of the date 1 year after the decedent's death.

(3) Any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time.

(b) SPECIAL RULES.—No deduction under this chapter of any item shall be allowed if allowance for such item is in effect given by the alternate valuation provided by this section. Wherever in any other subsection or section of this chapter reference is made to the value of property at the time of the decedent's death, such reference shall be deemed to refer to the value of such property used in determining the value of the gross estate. In case of an election made by the executor under this section, then—

(1) For purposes of the charitable deduction under section 2055 or 2106(a)(2), any bequest, legacy, devise, or transfer enumerated therein, and

(2) For the purpose of the marital deduction under section 2056, any interest in property passing to the surviving spouse,

shall be valued as of the date of the decedent's death with adjustment for any difference in value (not due to mere lapse of time or the occurrence or nonoccurrence of a contingency) of the property as of the date 1 year after the decedent's death (substituting, in the case of property distributed by the executor or trustee, or sold, exchanged, or otherwise disposed of, during such 1-year period, the date thereof).

(c) TIME OF ELECTION.—The election provided for in this section shall be exercised by the executor on his return if filed within the time prescribed by law or before the expiration of any extension of time granted pursuant to law for the filing of the return.

§ 20.2032–1 ALTERNATE VALUATION.—(a) *In general.*—In general, section 2032 provides for the valuation of a decedent's gross estate at a date other than the date of the decedent's death. More specifically, if an executor elects the alternate valuation method under section 2032, the property included in the decedent's gross estate on the date of his death is valued as of whichever of the following dates is applicable:

(1) Any property distributed, sold, exchanged, or otherwise disposed of within one year after the decedent's death is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of;

(2) Any property not distributed, sold, exchanged, or otherwise disposed of within one year after the decedent's death is valued as of the date one year after the date of the decedent's death;

(3) Any property, interest, or estate which is affected by mere lapse of time is valued as of the date of the decedent's death, but adjusted for any difference in its value not due to mere lapse of time as of the date one year after the decedent's death, or as of the date of its distribution, sale, exchange, or other disposition, whichever date first occurs.

(b) *Method and effect of election.*—(1) While it is the purpose of section 2032 to permit a reduction in the amount of tax that would otherwise be payable if the gross estate has suffered a shrinkage in its aggregate value in the year following the decedent's death, the alternate valuation method is not automatic but must be elected.

Furthermore, the alternate valuation method may be elected whether or not there has been a shrinkage in the aggregate value of the estate. However, the election is not effective for any purpose unless the value of the gross estate at the time of the decedent's death exceeded $60,000, so that an estate tax return is required to be filed under section 6018.

(2) If the alternate valuation method under section 2032 is to be used, section 2032 (c) requires that the executor must so elect on the estate tax return required under section 6018, filed within 15 months from the date of the decedent's death or within the period of any extension of time granted by the district director under section 6081. In no case may the election be exercised, or a previous election changed, after the expiration of such time. If the election is made, it applies to all the property included in the gross estate, and cannot be applied to only a portion of the property.

(c) *Meaning of "distributed, sold, exchanged, or otherwise disposed of".*—(1) The phrase "distributed, sold, exchanged, or otherwise disposed of" comprehends all possible ways by which property ceases to form a part of the gross estate. For example, money on hand at the date of the decedent's death which is thereafter used in the payment of funeral expenses, or which is thereafter invested, falls within the term "otherwise disposed of." The term also includes the surrender of a stock certificate for corporate assets in complete or partial liquidation of a corporation pursuant to section 331. The term does not, however, extend to transactions which are mere changes in form. Thus, it does not include a transfer of assets to a corporation in exchange for its stock in a transaction with respect to which no gain or loss would be recognizable for income tax purposes under section 351. Nor does it include an exchange of stock or securities in a corporation for stock or securities in the same corporation or another corporation in a transaction, such as a merger, recapitalization, reorganization or other transaction described in section 368(a) or 355, with respect to which no gain or loss is recognizable for income tax purposes under section 354 or 355.

(2) Property may be "distributed" either by the executor, or by a trustee of property included in the gross estate under sections 2035 through 2038, or section 2041. Property is considered as "distributed" upon the first to occur of the following:

(i) The entry of an order or decree of distribution, if the order or decree subsequently becomes final;

(ii) The segregation or separation of the property from the estate or trust so that it becomes unqualifiedly subject to the demand or disposition of the distributee; or

(iii) The actual paying over or delivery of the property to the distributee.

(3) Property may be "sold, exchanged, or otherwise disposed of" by: (i) the executor; (ii) a trustee or other donee to whom the decedent during his lifetime transferred property included in his gross estate

under sections 2035 through 2038, or section 2041; (iii) an heir or devisee to whom title to property passes directly under local law; (iv) a surviving joint tenant or tenant by the entirety; or (v) any other person. If a binding contract for the sale, exchange, or other disposition of property is entered into, the property is considered as sold, exchanged, or otherwise disposed of on the effective date of the contract, unless the contract is not subsequently carried out substantially in accordance with its terms. The effective date of a contract is normally the date it is entered into (and not the date it is consummated, or the date legal title to the property passes) unless the contract specifies a different effective date.

(d) "*Included property*" *and* "*excluded property*".—If the executor elects the alternate valuation method under section 2032, all property interests existing at the date of decedent's death which form a part of his gross estate as determined under sections 2033 through 2044 are valued in accordance with the provisions of this section. Such property interests are hereinafter referred to in this section as "included property". Furthermore, such property interests remain "included property" for the purpose of valuing the gross estate under the alternate valuation method even though they change in form during the alternate valuation period by being actually received, or disposed of, in whole or in part, by the estate. On the other hand, property earned or accrued (whether received or not) after the date of the decedent's death and during the alternate valuation period with respect to any property interest existing at the date of the decedent's death, which does not represent a form of "included property" itself or the receipt of "included property", is excluded in valuing the gross estate under the alternate valuation method. Such property is hereinafter referred to in this section as "excluded property". Illustrations of "included property" and "excluded property" are contained in the subparagraphs that follow:

(1) *Interest-bearing obligations.* — Interest-bearing obligations, such as bonds or notes, may comprise two elements of "included property" at the date of the decedent's death, namely, (i) the principal of the obligation itself, and (ii) interest accrued to the date of death. Each of these elements is to be separately valued as of the applicable valuation date. Interest accrued after the date of death and before the subsequent valuation date constitutes "excluded property". However, any part payment of principal made between the date of death and the subsequent valuation date, or any advance payment of interest for a period after the subsequent valuation date made during the alternate valuation period which has the effect of reducing the value of the principal obligation as of the subsequent valuation date, will be included in the gross estate, and valued as of the date of such payment.

(2) *Leased property.*—The principles set forth in subparagraph (1) of this paragraph with respect to interest-bearing obligations also apply to leased realty or personalty which is included in the gross estate and with respect to which an obligation to pay rent has been

reserved. Both the realty or personalty itself and the rents accrued to the date of death constitute "included property", and each is to be separately valued as of the applicable valuation date. Any rent accrued after the date of death and before the subsequent valuation date is "excluded property". Similarly, the principle applicable with respect to interest paid in advance is equally applicable with respect to advance payments of rent.

(3) *Noninterest-bearing obligations.*—In the case of noninterest-bearing obligations sold at a discount, such as savings bonds, the principal obligation and the discount amortized to the date of death are property interests existing at the date of death and constitute "included property". The obligation itself is to be valued at the subsequent valuation date without regard to any further increase in value due to amortized discount. The additional discount amortized after death and during the alternate valuation period is the equivalent of interest accruing during that period and is, therefore, not to be included in the gross estate under the alternate valuation method.

(4) *Stock of a corporation.*—Shares of stock in a corporation and dividends declared to stockholders of record on or before the date of the decedent's death and not collected at the date of death constitute "included property" of the estate. On the other hand, ordinary dividends out of earnings and profits (whether in cash, shares of the corporation, or other property) declared to stockholders of record after the date of the decedent's death are "excluded property" and are not to be valued under the alternate valuation method. If, however, dividends are declared to stockholders of record after the date of the decedent's death with the effect that the shares of stock at the subsequent valuation date do not reasonably represent the same "included property" of the gross estate as existed at the date of the decedent's death, the dividends are "included property", except to the extent that they are out of earnings of the corporation after the date of the decedent's death. For example, if a corporation makes a distribution in partial liquidation to stockholders of record during the alternate valuation period which is not accompanied by a surrender of a stock certificate for cancellation, the amount of the distribution received on stock included in the gross estate is itself "included property", except to the extent that the distribution was out of earnings and profits since the date of the decedent's death. Similarly, if a corporation, in which the decedent owned a substantial interest and which possessed at the date of the decedent's death accumulated earnings and profits equal to its paid-in capital, distributed all of its accumulated earnings and profits as a cash dividend to shareholders of record during the alternate valuation period, the amount of the dividends received on stock includible in the gross estate will be included in the gross estate under the alternate valuation method. Likewise, a stock dividend distributed under such circumstances is "included property".

(e) *Illustrations of "included property" and "excluded property".*—The application of paragraph (d) of this section may be further

illustrated by the following example in which it is assumed that the decedent died on January 1, 1955:

Description	Subsequent valuation date	Alternate value	Value at date of death
Bond, par value $1,000, bearing interest at 4% payable quarterly on Feb. 1, May 1, Aug. 1, and Nov. 1. Bond distributed to legatee on Mar. 1, 1955	Mar. 1, 1955	$1,000.00	$1,000.00
Interest coupon of $10 attached to bond and not cashed at date of death although due and payable Nov. 1, 1954. Cashed by executor on Feb. 1, 1955	Feb. 1, 1955	10.00	10.00
Interest accrued from Nov. 1, 1954, to Jan. 1, 1955, collected on Feb. 1, 1955	Feb. 1, 1955	6.67	6.67
Real estate, not disposed of within year following death. Rent of $300 due at the end of each quarter, Feb. 1, May 1, Aug. 1, and Nov. 1	Jan. 1, 1956	11,000.00	12,000.00
Rent due for quarter ending Nov. 1, 1954, but not collected until Feb. 1, 1955	Feb. 1, 1955	300.00	300.00
Rent accrued for November and December 1954, collected on Feb. 1, 1955	Feb. 1, 1955	200.00	200.00
Common stock, X Corporation, 500 shares, not disposed of within year following decedent's death	Jan. 1, 1956	47,500.00	50,000.00
Dividend of $2 per share declared Dec. 10, 1954, and paid on Jan. 10, 1955, to holders of record on Dec. 30, 1954	Jan. 10, 1955	1,000.00	1,000.00

(f) *Mere lapse of time.*—In order to eliminate changes in value due only to mere lapse of time, section 2032(a)(3) provides that any interest or estate "affected by mere lapse of time" is included in a decedent's gross estate under the alternate valuation method at its value as of the date of the decedent's death, but with adjustment for any difference in its value as of the subsequent valuation date not due to mere lapse of time. Properties, interests, or estates which are "affected by mere lapse of time" include patents, estates for the life of a person other than the decedent, remainders, reversions, and other like properties, interests, or estates. The phrase "affected by mere lapse of time" has no reference to obligations for the payment of money, whether or not interest-bearing, the value of which changes with the passing of time. However, such an obligation, like any other property, may become affected by lapse of time when made the subject of a bequest or transfer which itself is creative of an interest or estate so affected. The application of this paragraph is illustrated in the following subparagraphs:

(1) *Life estates, remainders, and similar interests.*—The values of life estates, remainders, and similar interests are to be obtained by applying the methods prescribed in § 20.2031-7, using (i) the age of

each person, the duration of whose life may affect the value of the interest, as of the date of the decedent's death, and (ii) the value of the property as of the alternate date. For example, assume that the decedent or his estate was entitled to receive property upon the death of his elder brother who was entitled to receive the income therefrom for life. At the date of the decedent's death, the property was worth $50,000 and the elder brother was 31 years old. The value of the decedent's remainder interest at the date of his death would, as explained in § 20.2031–7(d), be $14,466 ($50,000 × 0.28932). If, because of economic conditions, the property declined in value and was worth only $40,000 one year after the date of the decedent's death, the value of the remainder interest as of the alternate date would be $11,572.80 ($40,000 × 0.28932).

(2) *Patents.*—To illustrate the alternate valuation of a patent, assume that the decedent owned a patent which, on the date of the decedent's death, had an unexpired term of ten years and a value of $78,000. Six months after the date of the decedent's death, the patent was sold, because of lapse of time and other causes, for $60,000. The alternate value thereof would be obtained by dividing $60,000 by 0.95 (ratio of the remaining life of the patent at the alternate date to the remaining life of the patent at the date of the decedent's death), and would, therefore, be $63,157.89.

(g) *Effect of election on deductions.*—If the executor elects the alternate valuation method under section 2032, any deduction for administration expenses under section 2053(b) (pertaining to property not subject to claims) or losses under section 2054 (or section 2106(a)(1), relating to estates of nonresidents not citizens) is allowed only to the extent that it is not otherwise in effect allowed in determining the value of the gross estate. Furthermore, the amount of any charitable deduction under section 2055 (for section 2106(a)(2), relating to the estates of nonresidents not citizens) or the amount of any marital deduction under section 2056 is determined by the value of the property with respect to which the deduction is allowed as of the date of the decedent's death, adjusted, however, for any difference in its value as of the date one year after death, or as of the date of its distribution, sale, exchange, or other disposition, whichever first occurs. However, no such adjustment may take into account any difference in value due to lapse of time or to the occurrence or nonoccurrence of a contingency.

§ 20.2033 Statutory Provisions; Property in Which the Decedent Had an Interest.

SEC. 2033. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death.

§ 20.2033–1 Property in Which the Decedent Had an Interest.—(a) *In general.*—The gross estate of a decedent who was a citizen or resident of the United States at the time of his death includes under section 2033 the value of all property, whether real or personal, tangible or intangible, and wherever situated, beneficially owned by

the decedent at the time of his death, except real property situated outside of the United States. Real property situated in the United States is included whether it came into the possession and control of the executor or administrator or passed directly to heirs or devisees. Various statutory provisions which exempt bonds, notes, bills, and certificates of indebtedness of the Federal Government or its agencies and the interest thereon from taxation are generally not applicable to the estate tax, since such tax is an excise tax on the transfer of property at death and is not a tax on the property transferred.

(b) *Miscellaneous examples.*—A cemetery lot owned by the decedent is part of his gross estate, but its value is limited to the salable value of that part of the lot which is not designed for the interment of the decedent and the members of his family. Property subject to homestead or other exemptions under local law is included in the gross estate. Notes or other claims held by the decedent are likewise included even though they are cancelled by the decedent's will. Interest and rents accrued at the date of the decedent's death constitute a part of the gross estate. Similarly, dividends which are payable to the decedent or his estate by reason of the fact that on or before the date of the decedent's death he was a stockholder of record (but which have not been collected at death) constitute a part of the gross estate.

§ 20.2034 STATUTORY PROVISIONS; DOWER OR CURTESY INTERESTS.

SEC. 2034. DOWER OR CURTESY INTERESTS.

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of any interest therein of the surviving spouse, existing at the time of the decedent's death as dower or curtesy, or by virtue of a statute creating an estate in lieu of dower or curtesy.

§ 20.2034–1 DOWER OR CURTESY INTERESTS.—A decedent's gross estate includes under section 2034 any interest in property of the decedent's surviving spouse existing at the time of the decedent's death as dower or curtesy, or any interest created by statute in lieu thereof (although such other interest may differ in character from dower or curtesy). Thus, the full value of property is included in the decedent's gross estate, without deduction of such an interest of the surviving husband or wife, and without regard to when the right to such an interest arose.

§ 20.2035 STATUTORY PROVISIONS; TRANSACTIONS IN CONTEMPLATION OF DEATH.

SEC. 2035. TRANSACTIONS IN CONTEMPLATION OF DEATH.

(a) GENERAL RULE.—The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, in contemplation of his death.

(b) APPLICATION OF GENERAL RULE.—If the decedent within a period of 3 years ending with the date of his death (except in case of a bona fide sale for an adequate and full consideration in money or money's worth) transferred an interest in property, relinquished a power, or exercised or released a general power of appointment, such transfer, relinquishment, exercise, or release shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this section and sections 2038 and 2041 (relating to revocable

transfers and powers of appointment) ; but no such transfer, relinquishment, exercise, or release made before such 3-year period shall be treated as having been made in contemplation of death.

§ 20.2035–1 TRANSACTION IN CONTEMPLATION OF DEATH.—(a) *In general.*—A decedent's gross estate includes under section 2035 the value of any interest in property transferred by a decedent in contemplation of death within 3 years before his death, except to the extent that the transfer was for a full and adequate consideration in money or money's worth (see § 20.2043–1). With the exception noted in the preceding sentence, the decedent's gross estate includes as a transfer in contemplation of death the value of any interest in property transferred within 3 years before the decedent's death, unless the transfer is shown not to have been made in contemplation of death. The result is not affected by the fact that at the time of the transfer the decedent parted absolutely and immediately with his enjoyment of and title to the property.

(b) *Application of other sections.*—If a decedent transfers an interest in property or relinquishes a power in contemplation of death, the decedent's gross estate includes the property subject to the interest or power to the extent that it would be included under section 2036, 2037, or 2038 if the decedent had retained the interest or power until his death. If a decedent exercises or releases a general power of appointment in contemplation of death, the property subject to the power is included in the decedent's gross estate to the extent provided in section 2041 and the regulations thereunder.

(c) *Definition.*—The phrase "in contemplation of death", as used in this section, does not have reference to that general expectation of death such as all persons entertain. On the other hand, its meaning is not restricted to an apprehension that death is imminent or near. A transfer "in contemplation of death" is a disposition of property prompted by the thought of death (although it need not be solely so prompted). A transfer is prompted by the thought of death if (1) made with a purpose of avoiding death taxes, (2) made as a substitute for a testamentary disposition of the property, or (3) made for any other motive associated with death. The bodily and mental condition of the decedent and all other attendant facts and circumstances are to be scrutinized in order to determine whether or not such thought prompted the disposition.

(d) *Presumptions.*—Any transfer of an interest in property, relinquishment of a power, or exercise or release of a general power of appointment by a decedent within a period of 3 years ending with the date of his death is deemed to have been made "in contemplation of death", unless shown to the contrary. No transfer, relinquishment, exercise, or release made by a decedent more than 3 years before his death is treated as having been made "in contemplation of death".

(e) *Valuation.*—The value of an interest in transferred property includible in a decedent's gross estate under this section is the value of the interest as of the applicable valuation date. In this connection, see sections 2031, 2032, and the regulations thereunder. However, if the transferee has made improvements or additions to the property, any resulting enhancement in the value of the property is not considered in ascertaining the value of the gross estate. Similarly,

neither income received subsequent to the transfer nor property purchased with such income is considered.

§ 20.2036 STATUTORY PROVISIONS; TRANSFERS WITH RETAINED LIFE ESTATE.

SEC. 2036. TRANSFERS WITH RETAINED LIFE ESTATE.

(a) GENERAL RULE.—The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) The possession or enjoyment of, or the right to the income from, the property, or

(2) The right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

(b) LIMITATION ON APPLICATION OF GENERAL RULE.—This section shall not apply to a transfer made before March 4, 1931; nor to a transfer made after March 3, 1931, and before June 7, 1932, unless the property transferred would have been includible in the decedent's gross estate by reason of the amendatory language of the joint resolution of March 3, 1931 (46 Stat. 1516).

§ 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.

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.

(b) *Meaning of terms.*—(1) A reservation by the decedent "for any period not ascertainable without reference to his death" may be illustrated by the following examples:

(i) A decedent reserved the right to receive the income from transferred property in quarterly payments, with the proviso that no part of the income between the last quarterly payment and the date of the decedent's death was to be received by the decedent or his estate; and

(ii) A decedent reserved the right to receive the income from transferred property after the death of another person who was in fact enjoying the income at the time of the decedent's death. In such a case, the amount to be included in the decedent's gross estate under this section does not include the value of the outstanding income interest of the other person. It may be noted that if the other person predeceased the decedent, the reservation by the decedent may be considered to be either for his life, or for a period which does not in fact end before his death.

(2) The "use, possession, right to the income, or other enjoyment of the transferred property" is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit. The term "legal obligation" includes a legal obligation to support a dependent during the decedent's lifetime.

(3) The phrase "right . . . to designate the person or persons who shall possess or enjoy the transferred property or the income therefrom" includes a reserved power to designate the person or persons to receive the income from the transferred property, or to possess or enjoy nonincome-producing property, during the decedent's life or during any other period described in paragraph (a) of this section. With respect to such a power, it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e. g., the death of another person during the decedent's lifetime). The phrase, however, does not include a power over the transferred property itself which does not affect the enjoyment of the income received or earned during the decedent's life. (See, however, section 2038 for the inclusion of property in the gross estate on account of such a power.) Nor does the phrase apply to a power held solely by a person other than the decedent. But, for example, if the decedent reserved the unrestricted power to remove or discharge a trustee at any time and appoint himself as trustee, the decedent is considered as having the powers of the trustee.

§ 20.2037 STATUTORY PROVISIONS; TRANSFERS TAKING EFFECT AT DEATH.

SEC. 2037. TRANSFERS TAKING EFFECT AT DEATH.

(a) GENERAL RULE.—The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if—

(1) Possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and

(2) The decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

(b) SPECIAL RULES.—For purposes of this section, the term "reversionary interest" includes a possibility that property transferred by the decedent—

(1) May return to him or his estate, or

(2) May be subject to a power of disposition by him,

but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him. The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, under regulations prescribed by the Secretary or his delegate. In determining the value of a possibility that property may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such property may return to the decedent or his estate. Notwithstanding the foregoing, an interest so transferred shall not be included in the decedent's gross estate under this section if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a general power of appointment (as defined in section 2041) which in fact was exercisable immediately before the decedent's death.

§ 20.2037–1 TRANSFERS TAKING EFFECT AT DEATH.—(a) *In general.*—A decedent's gross estate includes under section 2037 the value of any interest in property transferred by the decedent after September 7, 1916, 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—

(1) Possession or enjoyment of the property could, through ownership of the interest, have been obtained only by surviving the decedent,

(2) The decedent had retained a possibility (hereinafter referred to as a "reversionary interest") that the property, other than the income alone, would return to the decedent or his estate or would be subject to a power of disposition by him, and

(3) The value of the reversionary interest immediately before the decedent's death exceeded 5 percent of the value of the entire property.

However, if the transfer was made before October 8, 1949, section 2037 is applicable only if the reversionary interest arose by the express terms of the instrument of transfer and not by operation of law (see paragraph (f) of this section). See also paragraph (g) of this section with respect to transfers made between November 11, 1935, and January 29, 1940. The provisions of section 2037 do not apply to transfers made before September 8, 1916.

(b) *Condition of survivorship.*—As indicated in paragraph (a) of this section, the value of an interest in transferred property is not included in a decedent's gross estate under section 2037 unless possession or enjoyment of the property could, through ownership of such interest, have been obtained only by surviving the decedent. Thus,

property is not included in the decedent's gross estate if, immediately before the decedent's death, possession or enjoyment of the property could have been obtained by any beneficiary either by surviving the decedent or through the occurrence of some other event such as the expiration of a term of years. However, if a consideration of the terms and circumstances of the transfer as a whole indicates that the "other event" is unreal and if the death of the decedent does, in fact, occur before the "other event", the beneficiary will be considered able to possess or enjoy the property only by surviving the decedent. Notwithstanding the foregoing, an interest in transferred property is not includible in a decedent's gross estate under section 2037 if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a general power of appointment (as defined in section 2041) which in fact was exercisable immediately before the decedent's death. See example (5) and (6) in paragraph (e) of this section.

(c) *Retention of reversionary interest.*—(1) As indicated in paragraph (a) of this section, the value of an interest in transferred property is not included in a decedent's gross estate under section 2037 unless the decedent had retained a reversionary interest in the property, and the value of the reversionary interest immediately before the death of the decedent exceeded 5 percent of the value of the property.

(2) For purposes of section 2037, the term "reversionary interest" includes a possibility that property transferred by the decedent may return to him or his estate and a possibility that property transferred by the decedent may become subject to a power of disposition by him. The term is not used in a technical sense, but has reference to any reserved right under which the transferred property shall or may be returned to the grantor. Thus, it encompasses an interest arising either by the express terms of the instrument of transfer or by operation of law. (See, however, paragraph (f) of this section with respect to transfers made before October 8, 1949.) The term "reversionary interest" does not include rights to income only, such as the right to receive the income from a trust after the death of another person. (However, see section 2036 for the inclusion of property in the gross estate on account of such rights.) Nor does the term "reversionary interest" include the possibility that the decedent during his lifetime might have received back an interest in transferred property by inheritance through the estate of another person. Similarly, a statutory right of a spouse to receive a portion of whatever estate a decedent may leave at the time of his death is not a "reversionary interest".

(3) For purposes of this section, the value of the decedent's reversionary interest is computed as of the moment immediately before his death, without regard to whether or not the executor elects the alternate valuation method under section 2032 and without regard to the fact of the decedent's death. The value is ascertained in accordance with recognized valuation principles for determining the value for estate tax purposes of future or conditional interests in property. (See §§ 20.2031–1, 20.2031–7, and 20.2031–9.) For example, if the decedent's reversionary interest was subject to an outstanding life estate in his wife, his interest is valued according to the actuarial rules set forth in § 20.2031–7. On the other hand, if the decedent's rever-

sionary interest was contingent on the death of his wife without issue surviving and if it cannot be shown that his wife is incapable of having issue (so that his interest is not subject to valuation according to the § 20.2031–7 actuarial rules), his interest is valued according to the general rules set forth in § 20.2031–1. A possibility that the decedent may be able to dispose of property under certain conditions is considered to have the same value as a right of the decedent to the return of the property under those same conditions.

(4) In order to determine whether or not the decedent retained a reversionary interest in transferred property of a value in excess of 5 percent, the value of the reversionary interest is compared with the value of the transferred property, including interests therein which are not dependent upon survivorship of the decedent. For example, assume that the decedent, A, transferred property in trust with the income payable to B for life and with the remainder payable to C if A predeceases B, but with the property to revert to A if B predeceases A. Assume further that A does, in fact, predecease B. The value of A's reversionary interest immediately before his death is compared with the value of the trust corpus, without deduction of the value of B's outstanding life estate. If, in the above example, A had retained a reversionary interest in one-half only of the trust corpus, the value of his reversionary interest would be compared with the value of one-half of the trust corpus, again without deduction of any part of the value of B's outstanding life estate.

(d) *Transfers partly taking effect at death.*—If separate interests in property are transferred to one or more beneficiaries, paragraphs (a) through (c) of this section are to be separately applied with respect to each interest. For example, assume that the decedent transferred an interest in Blackacre to A which could be possessed or enjoyed only by surviving the decedent, and that the decedent transferred an interest in Blackacre to B which could be possessed or enjoyed only on the occurrence of some event unrelated to the decedent's death. Assume further that the decedent retained a reversionary interest in Blackacre of a value in excess of 5 percent. Only the value of the interest transferred to A is includible in the decedent's gross estate. Similar results would obtain if possession or enjoyment of the entire property could have been obtained only by surviving the decedent, but the decedent had retained a reversionary interest in a part only of such property.

(e) *Examples.*—The provisions of paragraphs (a) through (d) of this section may be further illustrated by the following examples. It is assumed that the transfers were made on or after October 8, 1949; for the significance of this date, see paragraphs (f) and (g) of this section:

Example (1). The decedent transferred property in trust with the income payable to his wife for life and, at her death, remainder to the decedent's then surviving children, or if none, to the decedent or his estate. Since each beneficiary can possess or enjoy the property without surviving the decedent, no part of the property is includible in the decedent's gross estate under section 2037, regardless of the value of the decedent's reversionary interest. (However, see section 2033 for inclusion of the value of the reversionary interest in the decedent's gross estate.)

Example (2). The decedent transferred property in trust with the income to be accumulated for the decedent's life, and at his death, principal and accumulated income to be paid to the decedent's then surviving issue, or if none, to A or A's estate. Since the decedent retained no reversionary interest in the property, no part of the property is includible in the decedent's gross estate, even though possession or enjoyment of the property could be obtained by the issue only by surviving the decedent.

Example (3). The decedent transferred property in trust with the income payable to his wife for life and with the remainder payable to the decedent or, if he is not living at his wife's death, to his daughter or her estate. The daughter cannot obtain possession or enjoyment of the property without surviving the decedent. Therefore, if the decedent's reversionary interest immediately before his death exceeded 5 percent of the value of the property, the value of the property, less the value of the wife's outstanding life estate, is includible in the decedent's gross estate.

Example (4). The decedent transferred property in trust with the income payable to his wife for life and with the remainder payable to his son or, if the son is not living at the wife's death, to the decedent or, if the decedent is not then living, to X or X's estate. Assume that the decedent was survived by his wife, his son, and X. Only X cannot obtain possession or enjoyment of the property without surviving the decedent. Therefore, if the decedent's reversionary interest immediately before his death exceeded 5 percent of the value of the property, the value of X's remainder interest (with reference to the time immediately after the decedent's death) is includible in the decedent's gross estate.

Example (5). The decedent transferred property in trust with the income to be accumulated for a period of 20 years or until the decedent's prior death, at which time the principal and accumulated income was to be paid to the decedent's son if then surviving. Assume that the decedent does, in fact, die before the expiration of the 20-year period. If, at the time of the transfer, the decedent was 30 years of age, in good health, etc., the son will be considered able to possess or enjoy the property without surviving the decedent. If, on the other hand, the decedent was 70 years of age at the time of the transfer, the son will not be considered able to possess or enjoy the property without surviving the decedent. In this latter case, if the value of the decedent's reversionary interest (arising by operation of law) immediately before his death exceeded 5 percent of the value of the property, the value of the property is includible in the decedent's gross estate.

Example (6). The decedent transferred property in trust with the income to be accumulated for his life and, at his death, the principal and accumulated income to be paid to the decedent's then surviving children. The decedent's wife was given the unrestricted power to alter, amend, or revoke the trust. Assume that the wife survived the decedent but did not, in fact, exercise her power during the decedent's lifetime. Since possession or enjoyment of the property could have been obtained by the wife during the decedent's lifetime under the exercise of a general power of appointment, which

was, in fact, exercisable immediately before the decedent's death, no part of the property is includible in the decedent's gross estate.

(f) *Transfers made before October 8, 1949.*—(1) Notwithstanding any provisions to the contrary contained in paragraphs (a) through (e) of this section, the value of an interest in property transferred by a decedent before October 8, 1949, is included in his gross estate under section 2037 only if the decedent's reversionary interest arose by the express terms of the instrument and not by operation of law. For example, assume that the decedent, on January 1, 1947, transferred property in trust with the income payable to his wife for the decedent's life and, at his death, remainder to his then surviving descendants. Since no provision was made for the contingency that no descendants of the decedent might survive him, a reversion to the decedent's estate existed by operation of law. The descendants cannot obtain possession or enjoyment of the property without surviving the decedent. However, since the decedent's reversionary interest arose by operation of law, no part of the property is includible in the decedent's gross estate under section 2037. If, in the above example, the transfer had been made on or after October 8, 1949, and if the decedent's reversionary interest immediately before his death exceeded 5 percent of the value of the property, the value of the property would be includible in the decedent's gross estate.

(2) The decedent's reversionary interest will be considered to have arisen by the express terms of the instrument of transfer and not by operation of law if the instrument contains an express disposition which affirmatively creates the reversionary interest, even though the terms of the disposition do not refer to the decedent or his estate, as such. For example, where the disposition is, in its terms, to the next of kin of the decedent and such a disposition, under applicable local law, constitutes a reversionary interest in the decedent's estate, the decedent's reversionary interest will be considered to have arisen by the express terms of the instrument of transfer and not by operation of law.

(g) *Transfers made after November 11, 1935, and before January 29, 1940.*—The provisions of paragraphs (a) through (f) of this section are fully applicable to transfers made after November 11, 1935 (the date on which the Supreme Court decided *Helvering* v. *St. Louis Union Trust Co.* (296 U. S. 39) and *Becker* v. *St. Louis Union Trust Co.* (296 U. S. 48)), and before January 29, 1940, (the date on which the Supreme Court decided *Helvering* v. *Hallock* and companion cases (309 U. S. 106)), except that the value of an interest in property transferred between these dates is not included in a decedent's gross estate under section 2037 if—

(1) The Commissioner, whose determination shall be final, determines that the transfer is classifiable with the transfers involved in the *St. Louis Union Trust Co.* cases, rather than with the transfer involved in the case of *Klein* v. *United States* (283 U. S. 231), previously decided by the Supreme Court, and

(2) The transfer shall have been finally treated for all gift tax purposes, both as to the calendar year of the transfer and as to subsequent calendar years, as a gift in an amount measured by the value of the property undiminished by reason of a provision in the instru-

ment of transfer by which the property, in whole or in part, is to revert to the decedent should he survive the donee or another person, or the reversion is conditioned upon some other contingency terminable by the decedent's death.

§ 20.2038. STATUTORY PROVISIONS; REVOCABLE TRANSFERS.

SEC. 2038. REVOCABLE TRANSFERS.

(a) IN GENERAL.—The value of the gross estate shall include the value of all property (except real property situated outside of the United States)—

(1) TRANSFERS AFTER JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.

(2) TRANSFERS ON OR BEFORE JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph.

(b) DATE OF EXISTENCE OF POWER.—For purposes of this section, the power to alter, amend, revoke, or terminate shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, revocation, or termination takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose, if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

§ 20.2038–1 REVOCABLE TRANSFERS.—(a) *In general.*—A decedent's gross estate includes under section 2038 the value of any interest in property transferred by the decedent, whether in trust or otherwise, if the enjoyment of the interest was subject at the date of the decedent's death to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate, or if the decedent relinquished such a power in contemplation of death. However, section 2038 does not apply—

(1) To the extent that the transfer was for an adequate and full consideration in money or money's worth (see § 20.2043–1);

(2) If the decedent's power could be exercised only with the consent of all parties having an interest (vested or contingent) in the transferred property, and if the power adds nothing to the rights of the parties under local law; or

(3) To a power held solely by a person other than the decedent. But, for example, if the decedent had the unrestricted power to remove or discharge a trustee at any time and appoint himself trustee, the decedent is considered as having the powers of the trustee. However, this result would not follow if he only had the power to appoint himself trustee under limited conditions which did not exist at the time of his death. (See last two sentences of paragraph (b) of this section.)

Except as provided above, it is immaterial (i) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; (ii) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest (unless the transfer was made before June 2, 1924; see paragraph (d) of this section); and (iii) at what time or from what source the decedent acquired his power (unless the transfer was made before June 23, 1936; see paragraph (c) of this section). Section 2038 is applicable to any power affecting the time or manner of enjoyment of property or its income, even though the identity of the beneficiary is not affected. For example, section 2038 is applicable to a power reserved by the grantor of a trust to accumulate income or distribute it to A, and to distribute corpus to A, even though the remainder is vested in A or his estate, and no other person has any beneficial interest in the trust. However, only the value of an interest in property subject to a power to which section 2038 applies is included in the decedent's gross estate under section 2038.

(b) *Date of existence of power.*—A power to alter, amend, revoke, or terminate will be considered to have existed at the date of the decedent's death even though the exercise of the power was subject to a precedent giving of notice or even though the alteration, amendment, revocation, or termination would have taken effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice had been given or the power had been exercised. In determining the value of the gross estate in such cases, the full value of the property transferred subject to the power is discounted for the period required to elapse between the date of the decedent's death and the date upon which the alteration, amendment, revocation, or termination could take effect. In this connection, see especially § 20.2031–7. However, section 2038 is not applicable to a power the exercise of which was subject to a contingency beyond the decedent's control which did not occur before his death (e. g., the death of another person during the decedent's life). See, however, section 2036(a)(2) for the inclusion of property in the decedent's gross estate on account of such a power.

(c) *Transfers made before June 23, 1936.*—Notwithstanding any thing to the contrary in paragraphs (a) and (b) of this section, the value of an interest in property transferred by a decedent before June 23, 1936, is not included in his gross estate under section 2038 unless the power to alter, amend, revoke, or terminate was reserved at the time of the transfer. For purposes of this paragraph, the phrase "reserved at the time of the transfer" has reference to a power

(arising either by the express terms of the instrument of transfer or by operation of law) to which the transfer was subject when made and which continued to the date of the decedent's death (see paragraph (b) of this section) to be exercisable by the decedent alone or by the decedent in conjunction with any other person or persons. The phrase also has reference to any understanding, express or implied, had in connection with the making of the transfer that the power would later be created or conferred.

(d) *Transfers made before June 2, 1924.*—Notwithstanding anything to the contrary in paragraphs (a) through (c) of this section, if an interest in property was transferred by a decedent before the enactment of the Revenue Act of 1924 (June 2, 1924, 4:01 p. m., eastern standard time), and if a power reserved by the decedent to alter, amend, revoke, or terminate was exercisable by the decedent only in conjunction with a person having a substantial adverse interest in the transferred property, or in conjunction with several persons some or all of whom held such an adverse interest, there is included in the decedent's gross estate only the value of any interest or interests held by a person or persons not required to join in the exercise of the power plus the value of any insubstantial adverse interest or interests of a person or persons required to join in the exercise of the power.

(e) *Powers relinquished in contemplation of death.*—(1) *In general.*—If a power to alter, amend, revoke, or terminate would have resulted in the inclusion of an interest in property in a decedent's gross estate under section 2038 if it had been held until the decedent's death, the relinquishment of the power in contemplation of the decedent's death within 3 years before his death results in the inclusion of the same interest in property in the decedent's gross estate, except to the extent that the power was relinquished for an adequate and full consideration in money or money's worth (see § 20.2043–1). For the meaning of the phrase "in contemplation of death", see paragraph (c) of § 20.2035–1.

(2) *Transfers before June 23, 1936.*—In the case of a transfer made before June 23, 1936, section 2038 applies only to a relinquishment made by the decedent. However, in the case of a transfer made after June 22, 1936, section 2038 also applies to a relinquishment made by a person or persons holding the power in conjunction with the decedent, if the relinquishment was made in contemplation of the decedent's death and had the effect of extinguishing the power.

§ 20.2039 Statutory Provisions; Annuities.

SEC. 2039. ANNUITIES.

(a) General.—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b) Amount Includible.—Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such

contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension, annuity, retirement, bonus or profit sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

(c) EXEMPTION OF ANNUITIES UNDER CERTAIN TRUSTS AND PLANS.—Notwithstanding the provisions of this section or of any provision of law, there shall be excluded from the gross estate the value of an annuity or other payment receivable by any beneficiary (other than the executor) under—

(1) An employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of the decedent's separation from employment (whether by death or otherwise), or at the time of termination of the plan if earlier, met the requirements of section 401(a); or

(2) A retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan which, at the time of decedent's separation from employment (by death or otherwise), or at the time of termination of the plan if earlier, met the requirements of section 401(a)(3).

If such amounts payable after the death of the decedent under a plan described in paragraph (1) or (2) are attributable to any extent to payments or contributions made by the decedent, no exclusion shall be allowed for that part of the value of such amounts in the proportion that the total payments or contributions made by the decedent bears to the total payments or contributions made. For purposes of this subsection, contributions or payments made by the decedent's employer or former employer under a trust or plan described in this subsection shall not be considered to be contributed by the decedent. This subsection shall apply to all decedents dying after December 31, 1953.

§ 20.2039–1 ANNUITIES.—(a) *In general.*—A decedent's gross estate includes under section 2039 (a) and (b) the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under certain agreements or plans to the extent that the value of the annuity or other payment is attributable to contributions made by the decedent or his employer. Section 2039 (a) and (b), however, has no application to an amount which constitutes the proceeds of insurance under a policy on the decedent's life. Paragraph (b) of this section describes the agreements or plans to which section 2039 (a) and (b) applies; paragraph (c) provides rules for determining the amount includible in the decedent's gross estate; and paragraph (d) distinguishes proceeds of life insurance. The fact that an annuity or other payment is not includible in a decedent's gross estate under section 2039 (a) and (b) does not mean that it is not includible under some other section of part III of subchapter A of chapter 11. However, see section 2039(c) and § 20.2039–2 for rules relating to the exclusion from a decedent's gross estate of annuities and other payments under certain "qualified plans".

(b) *Agreements or plans to which section 2039 (a) and (b) applies.*—(1) Section 2039 (a) and (b) applies to the value of an annuity or other payment receivable by any beneficiary under any form of contract or agreement entered into after March 3, 1931, under which—

(i) An annuity or other payment was payable to the decedent, either alone or in conjunction with another person or persons, for his life or for any period not ascertainable without reference

to his death or for any period which does not in fact end before his death, or

(ii) The decedent possessed, for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death, the right to receive such an annuity or other payment, either alone or in conjunction with another person or persons.

The term "annuity or other payment" as used with respect to both the decedent and the beneficiary has reference to one or more payments extending over any period of time. The payments may be equal or unequal, conditional or unconditional, periodic or sporadic. The term "contract or agreement" includes any arrangement, understanding or plan, or any combination of arrangements, understandings or plans arising by reason of the decedent's employment. An annuity or other payment "was payable" to the decedent if, at the time of his death, the decedent was in fact receiving an annuity or other payment, whether or not he had an enforceable right to have payments continued. The decedent "possessed the right to receive" an annuity or other payment if, immediately before his death, the decedent had an enforceable right to receive payments at some time in the future, whether or not, at the time of his death, he had a present right to receive payments. In connection with the preceding sentence, the decedent will be regarded as having had "an enforceable right to receive payments at some time in the future" so long as he had complied with his obligations under the contract or agreement up to the time of his death. For the meaning of the phrase "for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death", see section 2036 and § 20.2036–1.

(2) The application of this paragraph is illustrated and more fully explained in the following examples. In each example: (i) it is assumed that all transactions occurred after March 3, 1931, and (ii) the amount stated to be includible in the decedent's gross estate is determined in accordance with the provisions of paragraph (c) of this section.

Example (1). The decedent purchased an annuity contract under the terms of which the issuing company agreed to pay an annuity to the decedent for his life and, upon his death, to pay a specified lump sum to his designated beneficiary. The decedent was drawing his annuity at the time of his death. The amount of the lump sum payment to the beneficiary is includible in the decedent's gross estate under section 2039 (a) and (b).

Example (2). Pursuant to a retirement plan, the employer made contributions to a fund which was to provide the employee, upon his retirement at age 60, with an annuity for life, and which was to provide the employee's wife, upon his death after retirement, with a similar annuity for life. The benefits under the plan were completely forfeitable during the employee's life, but, upon his death after retirement, the benefits to the wife were forfeitable only upon her remarriage. The employee had no right originally to designate or ever to change the employer's designation of the surviving beneficiary. The retirement plan at no time met the requirements of section 401 (a)

(relating to qualified plans). Assume that the employee died at age 61 after the employer started payment of his annuity as described above. The value of the wife's annuity is includible in the decedent's gross estate under section 2039 (a) and (b). Includibility in this case is based on the fact that the annuity to the decedent "was payable" at the time of his death. The fact that the decedent's annuity was forfeitable is of no consequence since, at the time of his death, he was in fact receiving payments under the plan. Nor is it important that the decedent had no right to choose the surviving beneficiary. The element of forfeitability in the wife's annuity may be taken into account only with respect to the valuation of the annuity in the decedent's gross estate.

Example (3). Pursuant to a retirement plan, the employer made contributions to a fund which was to provide the employee, upon his retirement at age 60, with an annuity of $100 per month for life, and which was to provide his designated beneficiary, upon the employee's death after retirement, with a similar annuity for life. The plan also provided that (a) upon the employee's separation from service before retirement, he would have a nonforfeitable right to receive a reduced annuity starting at age 60, and (b) upon the employee's death before retirement, a lump sum payment representing the amount of the employer's contributions credited to the employee's account would be paid to the designated beneficiary. The plan at no time met the requirements of section 401(a) (relating to qualified plans). Assume that the employee died at age 49 and that the designated beneficiary was paid the specified lump sum payment. Such amount is includible in the decedent's gross estate under section 2039 (a) and (b). Since, immediately before his death, the employee had an enforceable right to receive an annuity commencing at age 60, he is considered to have "possessed the right to receive" an annuity as that term is used in section 2039(a). If, in this example, the employee would not be entitled to any benefits in the event of his separation from service before retirement for any reason other than death, the result would be the same so long as the decedent had complied with his obligations under the contract up to the time of his death. In such case, he is considered to have had, immediately before his death, an enforceable right to receive an annuity commencing at age 60.

Example (4). Pursuant to a retirement plan, the employer made contributions to a fund which was to provide the employee, upon his retirement at age 60, with an annuity for life, and which was to provide his designated beneficiary, upon the employee's death after retirement, with a similar annuity for life. The plan provided, however, that no benefits were payable in the event of the employee's death before retirement. The retirement plan at no time met the requirements of section 401(a) (relating to qualified plans). Assume that the employee died at age 59 but that the employer nevertheless started payment of an annuity in a slightly reduced amount to the designated beneficiary. The value of the annuity is not includible in the decedent's gross estate under section 2039 (a) and (b). Since the employee died before reaching the retirement age, the employer was under no obligation to pay the annuity to the employee's designated beneficiary. Therefore, the annuity was not paid under a "contract

or agreement" as that term is used in section 2039(a). If, however, it can be established that the employer has consistently paid an annuity under such circumstances, the annuity will be considered as having been paid under a "contract or agreement".

Example (5). The employer made contributions to a retirement fund which were credited to the employee's individual account. Under the plan, the employee was to receive one-half the amount credited to his account upon his retirement at age 60, and his designated beneficiary was to receive the other one-half upon the employee's death after retirement. If the employee should die before reaching the retirement age, the entire amount credited to his account at such time was to be paid to the designated beneficiary. The retirement plan at no time met the requirements of section 401(a) (relating to qualified plans). Assume that the employee received one-half the amount credited to his account upon reaching the retirement age and that he died shortly thereafter. Since the employee received all that he was entitled to receive under the plan before his death, no amount was payable to him for his life or for any period not ascertainable without reference to his death, or for any period which did not in fact end before his death. Thus, the amount of the payment to the designated beneficiary is not includible in the decedent's gross estate under section 2039 (a) and (b). If, in this example, the employee died before reaching the retirement age, the amount of the payment to the designated beneficiary would be includible in the decedent's gross estate under section 2039 (a) and (b). In this latter case, the decedent possessed the right to receive a lump sum payment for a period which did not in fact end before his death.

Example (6). The employer made contributions to two different funds set up under two different plans. One plan was to provide the employee, upon his retirement at age 60, with an annuity for life, and the other plan was to provide the employee's designated beneficiary, upon the employee's death, with a similar annuity for life. Each plan was established at a different time and each plan was administered separately in every respect. Neither plan at any time met the requirements of section 401(a) (relating to qualified plans). The value of the designated beneficiary's annuity is includible in the employee's gross estate. All rights and benefits accruing to an employee and to others by reason of the employment (except rights and benefits accruing under certain plans meeting the requirements of section 401 (a) (see § 20.2039–2)) are considered together in determining whether or not section 2039 (a) and (b) applies. The scope of section 2039 (a) and (b) cannot be limited by indirection.

(c) *Amount includible in the gross estate.*—The amount to be included in a decedent's gross estate under section 2039 (a) and (b) is an amount which bears the same ratio to the value at the decedent's death of the annuity or other payment receivable by the beneficiary as the contribution made by the decedent, or made by his employer (or former employer) for any reason connected with his employment, to the cost of the contract or agreement bears to its total cost. In applying this ratio, the value at the decedent's death of the annuity or other payment is determined in accordance with the rules set forth

in §§ 20.2031–1, 20.2031–7, 20.2031–8, and 20.2031–9. The application of this paragraph may be illustrated by the following examples:

Example (1). On January 1, 1945, the decedent and his wife each contributed $15,000 to the purchase price of an annuity contract under the terms of which the issuing company agreed to pay an annuity to the decedent and his wife for their joint lives and to continue the annuity to the survivor for his life. Assume that the value of the survivor's annuity at the decedent's death (computed under § 20.2031–8) is $20,000. Since the decedent contributed one-half of the cost of the contract, the amount to be included in his gross estate under section 2039 (a) and (b) is $10,000.

Example (2). Under the terms of an employment contract entered into on January 1, 1945, the employer and the employee made contributions to a fund which was to provide the employee, upon his retirement at age 60, with an annuity for life, and which was to provide his designated beneficiary, upon the employee's death after retirement, with a similar annuity for life. The retirement fund at no time formed part of a plan meeting the requirements of section 401(a) (relating to qualified plans). Assume that the employer and the employee each contributed $5,000 to the retirement fund. Assume, further, that the employee died after retirement at which time the value of the survivor's annuity was $8,000. Since the employer's contributions were made by reason of the decedent's employment, the amount to be included in his gross estate under section 2039 (a) and (b) is the entire $8,000. If, in the above example, only the employer made contributions to the fund, the amount to be included in the gross estate would still be $8,000.

(d) *Insurance under policies on the life of the decedent.*—If an annuity or other payment receivable by a beneficiary under a contract or agreement is in substance the proceeds of insurance under a policy on the life of the decedent, section 2039 (a) and (b) does not apply. For the extent to which such an annuity or other payment is includible in a decedent's gross estate, see section 2042 and § 20.2042–1. A combination annuity contract and life insurance policy on the decedent's life (e. g., a "retirement income" policy with death benefits) which matured during the decedent's lifetime so that there was no longer an insurance element under the contract at the time of the decedent's death is subject to the provisions of section 2039 (a) and (b). On the other hand, the treatment of a combination annuity contract and life insurance policy on the decedent's life which did not mature during the decedent's lifetime depends upon the nature of the contract at the time of the decedent's death. The nature of the contract is generally determined by the relation of the reserve value of the policy to the value of the death benefit at the time of the decedent's death. If the decedent dies before the reserve value equals the death benefit, there is still an insurance element under the contract. The contract is therefore considered, for estate tax purposes, to be an insurance policy subject to the provisions of section 2042. However, if the decedent dies after the reserve value equals the death benefit, there is no longer an insurance element under the contract. The contract is therefore considered to be a contract for an annuity or other payment subject to the provisions of section 2039 (a) and (b) or some other section

of part III of subchapter A of chapter 11. Notwithstanding the relation of the reserve value to the value of the death benefit, a contract under which the death benefit could never exceed the total premiums paid, plus interest, contains no insurance element.

Example. Pursuant to a retirement plan established January 1, 1945, the employer purchased a contract from an insurance company which was to provide the employee, upon his retirement at age 65, with an annuity of $100 per month for life, and which was to provide his designated beneficiary, upon the employee's death after retirement, with a similar annuity for life. The contract further provided that if the employee should die before reaching the retirement age, a lump sum payment of $20,000 would be paid to his designated beneficiary in lieu of the annuity described above. The plan at no time met the requirements of section 401(a) (relating to qualified plans). Assume that the reserve value of the contract at the retirement age would be $20,000. If the employee died after reaching the retirement age, the death benefit to the designated beneficiary would constitute an annuity, the value of which would be includible in the employee's gross estate under section 2039 (a) and (b). If, on the other hand, the employee died before reaching his retirement age, the death benefit to the designated beneficiary would constitute insurance under a policy on the life of the decedent since the reserve value would be less than the death benefit. Accordingly, its includibility would depend upon section 2042 and § 20.2042–1.

§ 20.2039–2 ANNUITIES UNDER "QUALIFIED PLANS".—(a) *In general.*—Section 2039(c) excludes from a decedent's gross estate the value of an annuity or other payment receivable under certain "qualified plans" to the extent provided in paragraph (c) of this section. Section 2039(c) applies to estates of all persons dying after December 31, 1953.

(b) *Plans to which section 2039(c) applies.*—Section 2039(c) excludes from a decedent's gross estate, to the extent provided in paragraph (c) of this section, the value of an annuity or other payment receivable by any beneficiary (except the value of an annuity or other payment receivable by or for the benefit of the decedent's estate) under—

(1) An employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of the decedent's separation from employment (whether by death or otherwise), or at the time of the earlier termination of the plan, met the requirements of section 401(a), or

(2) A retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan which, at the time of decedent's separation from employment (by death or otherwise), or at the time of the earlier termination of the plan, met the requirements of section 401(a) (3) through (6).

For the meaning of the term "annuity or other payment", see paragraph (b) of § 20.2039–1. For the meaning of the phrase "receivable by or for the benefit of the decedent's estate", see paragraph (b) of § 20.2042–1. The application of this paragraph may be illustrated by the following examples in each of which it is assumed that the

amount stated to be excludable from the decedent's gross estate is determined in accordance with paragraph (c) of this section:

Example (1). Pursuant to a pension plan, the employer made contributions to a trust which was to provide the employee, upon his retirement at age 60, with an annuity for life, and which was to provide his wife, upon the employee's death after retirement, with a similar annuity for life. At the time of the employee's retirement, the pension trust formed part of a plan meeting the requirements of section 401(a). Assume that the employee died at age 61 after the trustee started payment of his annuity as described above. Since the wife's annuity was receivable under a qualified pension plan, no part of the value of such annuity is includible in the decedent's gross estate by reason of the provisions of section 2039(c). If, in this example, the employer provided other benefits under nonqualified plans, the result would be the same since the exclusion under section 2039(c) is confined to the benefits provided for under the qualified plan.

Example (2). Pursuant to a profit-sharing plan, the employer made contributions to a trust which were allocated to the employee's individual account. Under the plan, the employee would, upon his retirement at age 60, receive a distribution of the entire amount credited to his account. If he should die before reaching the retirement age, the amount credited to his account would be distributed to his designated beneficiary. Assume that the employee died before reaching the retirement age and that at such time the plan met the requirements of section 401(a). Since the designated beneficiary's lump sum payment was receivable under a qualified profit-sharing plan, no part of such lump sum payment is includible in the decedent's gross estate by reason of the provisions of section 2039(c).

Example (3). Pursuant to a pension plan, the employer made contributions to a trust which were used by the trustee to purchase a contract from an insurance company for the benefit of an employee. The contract was to provide the employee, upon his retirement at age 65, with an annuity of $100 per month for life, and was to provide his designated beneficiary, upon the employee's death after retirement, with a similar annuity for life. The contract further provided that if the employee should die before reaching the retirement age, a lump sum payment equal to the greater of (a) $10,000 or (b) the reserve value of the policy would be paid to his designated beneficiary in lieu of the annuity described above. Assume that the employee died before reaching the retirement age and that at such time the plan met the requirements of section 401(a). Since the designated beneficiary's lump sum payment was receivable under a qualified pension plan, no part of such lump sum payment is includible in the decedent's gross estate by reason of the provisions of section 2039(c). It should be noted that for purposes of the exclusion under section 2039(c), it is immaterial whether or not such lump sum payment constitutes the proceeds of life insurance under the principles set forth in paragraph (d) of § 20.2039–1.

Example (4). Pursuant to a profit-sharing plan, the employer made contributions to a trust which were allocated to the employee's individual account. Under the plan, the employee would, upon his retirement at age 60, be given the option to have the amount credited

to his account (a) paid to him in a lump sum, (b) used to purchase a joint and survivor annuity for him and his designated beneficiary, or (c) left with the trustee under an arrangement whereby interest would be paid to him for his lifetime with the principal to be paid, at his death, to his designated beneficiary. The plan further provided that, if the third method of settlement were selected, the employee would retain the right to have the principal paid to himself in a lump sum up to the time of his death. At the time of the employee's retirement, the profit-sharing plan met the requirements of section 401(a). Assume that the employee, upon reaching his retirement age, elected to have the amount credited to his account left with the trustee under the interest arrangement. Assume, further, that the employee did not exercise his right to have such amount paid to him before his death. Under such circumstances, the employee is considered as having constructively received the amount credited to his account upon his retirement. Thus, such amount is not considered as receivable by the designated beneficiary under the profit-sharing plan and the exclusion of section 2039(c) is not applicable.

(c) *Amount excludable from the gross estate.*—(1) The amount to be excluded from a decedent's gross estate under section 2039(c) is an amount which bears the same ratio to the value at the decedent's death of the annuity or other payment receivable by the beneficiary as the employer's contribution (or a contribution made on his behalf) to the plan on the employee's account bears to the total contributions to the plan on the employee's account. In applying this ratio, the value at the decedent's death of the annuity or other payment is determined in accordance with the rules set forth in §§ 20.2031–1, 20.2031–7, 20.2031–8, and 20.2031–9.

(2) In certain cases, the employer's contribution (or a contribution made on his behalf) to a plan on the employee's account and thus the total contributions to the plan on the employee's account cannot be readily ascertained. In order to apply the ratio stated in subparagraph (1) of this paragraph in such a case, the method outlined in the following two sentences must be used unless a more precise method is presented. In such a case, the total contributions to the plan on the employee's account is the value of any annuity or other payment payable to the decedent and his survivor computed as of the time the decedent's rights first mature (or as of the time the survivor's rights first mature if the decedent's rights never mature) and computed in accordance with the rules set forth in §§ 20.2031–1, 20.2031–7, 20.2031–8, and 20.2031–9. By subtracting from such value the amount of the employee's contribution to the plan, the amount of the employer's contribution to the plan on the employee's account may be obtained. The application of this paragraph may be illustrated by the following example:

Example. Pursuant to a pension plan, the employer and the employee contributed to a trust which was to provide the employee, upon his retirement at age 60, with an annuity for life, and which was to provide his wife, upon the employee's death after retirement, with a similar annuity for life. At the time of the employee's retirement, the pension trust formed part of a plan meeting the requirements of

section 401(a). Assume the following: (i) that the employer's contributions to the fund were not credited to the accounts of individual employees; (ii) that the value of the employee's annuity and his wife's annuity, computed as of the time of the decedent's retirement, was $40,000; (iii) that the employee contributed $10,000 to the plan; and (iv) that the value at the decedent's death of the wife's annuity was $16,000. On the basis of these facts, the total contributions to the fund on the employee's account are presumed to be $40,000 and the employer's contribution to the plan on the employee's account is presumed to be $30,000 ($40,000 less $10,000). Since the wife's annuity was receivable under a qualified pension plan, that part of the value of such annuity which is attributable to the employer's contributions ($\frac{\$30,000}{\$40,000} \times \$16,000$, or $12,000) is excludable from the decedent's gross estate by reason of the provisions of section 2039(c). Compare this result with the results reached in the examples set forth in paragraph (b) of this section in which all contributions to the plans were made by the employer.

§ 20.2040 STATUTORY PROVISIONS; JOINT INTERESTS.

SEC. 2040. JOINT INTERESTS.

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein held as joint tenants by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: *Provided*, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: *Provided further*, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants and their interest are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants.

§ 20.2040–1 JOINT INTERESTS.—(a) *In general.*—A decedent's gross estate includes under section 2040 the value of property held jointly at the time of the decedent's death by the decedent and another person or persons with right of survivorship, as follows:

(1) To the extent that the property was acquired by the decedent and the other joint owner or owners by gift, devise, bequest, or inheritance, the decedent's fractional share of the property is included.

(2) In all other cases, the entire value of the property is included except such part of the entire value as is attributable to the amount of the consideration in money or money's worth furnished by the other joint owner or owners. See § 20.2043–1 with

respect to adequacy of consideration. Such part of the entire value is that portion of the entire value of the property at the decedent's death (or at the alternate valuation date described in section 2032) which the consideration in money or money's worth furnished by the other joint owner or owners bears to the total cost of acquisition and capital additions. In determining the consideration furnished by the other joint owner or owners, there is taken into account only that portion of such consideration which is shown not to be attributable to money or other property acquired by the other joint owner or owners from the decedent for less than a full and adequate consideration in money or money's worth.

The entire value of jointly held property is included in a decedent's gross estate unless the executor submits facts sufficient to show that property was not acquired entirely with consideration furnished by the decedent, or was acquired by the decedent and the other joint owner or owners by gift, bequest, devise, or inheritance.

(b) *Meaning of "property held jointly".*—Section 2040 specifically covers property held jointly by the decedent and any other person (or persons), property held by the decedent and spouse as tenants by the entirety, and a deposit of money, or a bond or other instrument, in the name of the decedent and any other person and payable to either or the survivor. The section applies to all classes of property, whether real or personal, and regardless of when the joint interests were created. Furthermore, it makes no difference that the survivor takes the entire interest in the property by right of survivorship and that no interest therein forms a part of the decedent's estate for purposes of administration. The section has no application to property held by the decedent and any other person (or persons) as tenants in common.

(c) *Examples.*—The application of this section may be explained in the following examples in each of which it is assumed that the other joint owner or owners survived the decedent:

(1) If the decedent furnished the entire purchase price of the jointly held property, the value of the entire property is included in his gross estate;

(2) If the decedent furnished a part only of the purchase price, only a corresponding portion of the value of the property is so included;

(3) If the decedent furnished no part of the purchase price, no part of the value of the property is so included;

(4) If the decedent, before the acquisition of the property by himself and the other joint owner, gave the latter a sum of money or other property which thereafter became the other joint owner's entire contribution to the purchase price, then the value of the entire property is so included, notwithstanding the fact that the other property may have appreciated in value due to market conditions between the time of the gift and the time of the acquisition of the jointly held property;

(5) If the decedent, before the acquisition of the property by himself and the other joint owner, transferred to the latter for less than an adequate and full consideration in money or money's worth other income-producing property, the income from which belonged to and became the other joint owner's entire contribution to the purchase

price, then the value of the jointly held property less that portion attributable to the income which the other joint owner did furnish is included in the decedent's gross estate;

(6) If the property originally belonged to the other joint owner and the decedent purchased his interest from the other joint owner, only that portion of the value of the property attributable to the consideration paid by the decedent is included;

(7) If the decedent and his spouse acquired the property by will or gift as tenants by the entirety, one-half of the value of the property is included in the decedent's gross estate; and

(8) If the decedent and his two brothers acquired the property by will or gift as joint tenants, one-third of the value of the property is so included.

§ 20.2041 STATUTORY PROVISIONS; POWERS OF APPOINTMENT.

SEC. 2041. POWERS OF APPOINTMENT.

(a) IN GENERAL.—The value of the gross estate shall include the value of all property (except real property situated outside of the United States)—

(1) POWERS OF APPOINTMENT CREATED ON OR BEFORE OCTOBER 21, 1942.—To the extent of any property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent—

(A) By will, or

(B) By a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive;

but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof. If a general power of appointment created on or before October 21, 1942, has been partially released so that it is no longer a general power of appointment, the exercise of such power shall not be deemed to be the exercise of a general power of appointment if—

(i) Such partial release occurred before November 1, 1951, or

(ii) The donee of such power was under a legal disability to release such power on October 21, 1942, and such partial release occurred not later than 6 months after the termination of such legal disability.

(2) POWERS CREATED AFTER OCTOBER 21, 1942.—To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. A disclaimer or renunciation of such a power of appointment shall not be deemed a release of such power. For purposes of this paragraph (2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

(3) CREATION OF ANOTHER POWER IN CERTAIN CASES.—To the extent of any property with respect to which the decedent—

(A) By will, or

(B) By a disposition which is of such nature that if it were a transfer of property owned by the decedent such property would be includible in the decedent's gross estate under section 2035, 2036, or 2037,

exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

(b) DEFINITIONS.—For purposes of subsection (a)—

(1) GENERAL POWER OF APPOINTMENT.—The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that—

(A) A power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

(B) A power of appointment created on or before October 21, 1942, which is exercisable by the decedent only in conjunction with another person shall not be deemed a general power of appointment.

(C) In the case of a power of appointment created after October 21, 1942, which is exercisable by the decedent only in conjunction with another person—

(i) If the power is not exercisable by the decedent except in conjunction with the creator of the power—such power shall not be deemed a general power of appointment.

(ii) If the power is not exercisable by the decedent except in conjunction with a person having a substantial interest in the property, subject to the power, which is adverse to exercise of the power in favor of the decedent—such power shall not be deemed a general power of appointment. For the purposes of this clause a person who, after the death of the decedent, may be possessed of a power of appointment (with respect to the property subject to the decedent's power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the decedent's power.

(iii) If (after the application of clauses (i) and (ii)) the power is a general power of appointment and is exercisable in favor of such other person—such power shall be deemed a general power of appointment only in respect of a fractional part of the property subject to such power, such part to be determined by dividing the value of such property by the number of such persons (including the decedent) in favor of whom such power is exercisable.

For purposes of clauses (ii) and (iii), a power shall be deemed to be exercisable in favor of a person if it is exercisable in favor of such person, his estate, his creditors, or the creditors of his estate.

(2) LAPSE OF POWER.—The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts:

(A) $5,000, or

(B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

(3) DATE OF CREATION OF POWER.—For purposes of this section, a power of appointment created by a will executed on or before October 21, 1942, shall be considered a power created on or before such date if the person executing such will dies before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.

§ 20.2041–1 POWERS OF APPOINTMENT; IN GENERAL.—(a) *Introduction.*—A decedent's gross estate includes under section 2041 the value of property in respect of which the decedent possessed, exercised, or released certain powers of appointment. This section contains rules of general application; § 20.2041–2 contains rules specifically applicable to general powers of appointment created on or before October 21, 1942; and § 20.2041–3 sets forth specific rules applicable to powers of appointment created after October 21, 1942.

(b) *Definition of "power of appointment".*—(1) *In general.*—The term "power of appointment" includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the principal of the trust, the power to consume or appropriate is a power of appointment. Similarly, a power given to a decedent to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust is a power of appointment. If the community property laws of a State confer upon the wife a power of testamentary disposition over property in which she does not have a vested interest she is considered as having a power of appointment. A power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. For example, if under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, the decedent is considered as having a power of appointment. However, the decedent is not considered to have a power of appointment if he only had the power to appoint a successor, including himself, under limited conditions which did not exist at the time of his death, without an accompanying unrestricted power of removal. Similarly, a power to amend only the administrative provisions of a trust instrument, which cannot substantially affect the beneficial enjoyment of the trust property or income, is not a power of appointment. The mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment. Further, the right in a beneficiary of a trust to assent to a periodic accounting, thereby relieving the trustee from further accountability, is not a power of appointment if the right of assent does not consist of any power or right to enlarge or shift the beneficial interest of any beneficiary therein.

(2) *Relation to other sections.*—For purposes of §§ 20.2041–1 through 20.2041–3, the term "power of appointment" does not include

powers reserved by the decedent to himself within the concept of sections 2036 through 2038. (See §§ 20.2036–1 through 20.2038–1.) No provision of section 2041 or of §§ 20.2041–1 through 20.2041–3 is to be construed as in any way limiting the application of any other section of the Internal Revenue Code or of these regulations. The power of the owner of a property interest already possessed by him to dispose of his interest, and nothing more, is not a power of appointment, and the interest is includible in his gross estate to the extent it would be includible under section 2033 or some other provision of part III of subchapter A of chapter 11. For example, if a trust created by S provides for payment of the income to A for life with power in A to appoint the remainder by will and, in default of such appointment for payment of the income to A's widow, W, for her life and for payment of the remainder to A's estate, the value of A's interest in the remainder is includible in his gross estate under section 2033 regardless of its includibility under section 2041.

(3) *Powers over a portion of property.*—If a power of appointment exists as to part of an entire group of assets or only over a limited interest in property, section 2041 applies only to such part or interest. For example, if a trust created by S provides for the payment of income to A for life, then to W for life, with power in A to appoint the remainder by will and in default of appointment for payment of the remainder to B or his estate, and if A dies before W, section 2041 applies only to the value of the remainder interest excluding W's life estate. If A dies after W, section 2041 would apply to the value of the entire property. If the power were only over one-half the remainder interest, section 2041 would apply only to one-half the value of the amounts described above.

(c) *Definition of "general power of appointment".*—(1) *In general.*—The term "general power of appointment" as defined in section 2041 (b) (1) means any power of appointment exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, except (i) joint powers, to the extent provided in §§ 20.2041–2 and 20.2041–3, and (ii) certain powers limited by an ascertainable standard, to the extent provided in subparagraph (2) of this paragraph. A power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the estate, is included within the meaning of a power of appointment exercisable in favor of the decedent's estate, his creditors, or the creditors of his estate. A power of appointment exercisable for the purpose of discharging a legal obligation of the decedent or for his pecuniary benefit is considered a power of appointment exercisable in favor of the decedent or his creditors. However, for purposes of §§ 20.2041–1 through 20.2041–3, a power of appointment not otherwise considered to be a general power of appointment is not treated as a general power of appointment merely by reason of the fact that an appointee may, in fact, be a creditor of the decedent or his estate. A power of appointment is not a general power if by its terms it is either—

(*a*) Exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or

(*b*) Expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate or the creditors of his estate.

A decedent may have two powers under the same instrument, one of which is a general power of appointment and the other of which is not. For example, a beneficiary may have a power to withdraw trust corpus during his life, and a testamentary power to appoint the corpus among his descendants. The testamentary power is not a general power of appointment.

(2) *Powers limited by an ascertainable standard.*—A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is, by reason of section 2041(b)(1)(A), not a general power of appointment. A power is limited by such a standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

(3) *Certain powers under wills of decedents dying between January 1 and April 2, 1948.*—Section 210 of the Technical Changes Act of 1953 provides that if a decedent died after December 31, 1947, but before April 3, 1948, certain property interests described therein may, if the decedent's surviving spouse so elects, be accorded special treatment in the determination of the marital deduction to be allowed the decedent's estate under the provisions of section 812(e) of the Internal Revenue Code of 1939. See § 81.47a(h) of Regulations 105 (26 CFR (1939) 81.47a(h)). The section further provides that property affected by the election shall, for the purpose of inclusion in the surviving spouse's gross estate, be considered property with respect to which she has a general power of appointment. Therefore, notwithstanding any other provision of law or of §§ 20.2041–1 through 20.2041–3, if the present decedent (in her capacity as surviving spouse of a prior decedent) has made an election under section 210 of the Technical Changes Act of 1953, the property which was the subject of the election shall be considered as property with respect to which the present decedent has a general power of appointment created after October 21, 1942, exercisable by deed or will, to the extent it was treated as an interest passing to the surviving spouse and not passing to any other person for the purpose of the marital deduction in the prior decedent's estate.

(d) *Definition of "exercise".*—Whether a power of appointment is in fact exercised may depend upon local law. For example, the residuary clause of a will may be considered under local law as an

exercise of a testamentary power of appointment in the absence of evidence of a contrary intention drawn from the whole of the testator's will. However, regardless of local law, a power of appointment is considered as exercised for purposes of section 2041 even though the exercise is in favor of the taker in default of appointment, and irrespective of whether the appointed interest and the interest in default of appointment are identical or whether the appointee renounces any right to take under the appointment. A power of appointment is also considered as exercised even though the disposition cannot take effect until the occurrence of an event after the exercise takes place, if the exercise is irrevocable and, as of the time of the exercise, the condition was not impossible of occurrence. For example, if property is left in trust to A for life, with a power in B to appoint the remainder by will, and B dies before A, exercising his power by appointing the remainder to C if C survives A, B is considered to have exercised his power if C is living at B's death. On the other hand, a testamentary power of appointment is not considered as exercised if it is exercised subject to the occurrence during the decedent's life of an express or implied condition which did not in fact occur. Thus, if in the preceding example, C dies before B, B's power of appointment would not be considered to have been exercised. Similarly, if a trust provides for income to A for life, remainder as A appoints by will, and A appoints a life estate in the property to B and does not otherwise exercise his power, but B dies before A, A's power is not considered to have been exercised.

(e) *Time of creation of power.*—A power of appointment created by will is, in general, considered as created on the date of the testator's death. However, section 2041(b)(3) provides that a power of appointment created by a will executed on or before October 21, 1942, is considered a power created on or before that date if the testator dies before July 1, 1949, without having republished the will, by codicil or otherwise, after October 21, 1942. Whether or not a power of appointment created by an intervivos instrument executed on or before October 21, 1942, is considered a power created on or before that date depends upon the facts and circumstances of the particular case. For example, assume that A created a revocable trust before October 21, 1942, providing for payment of income to B for life with remainder as B shall appoint by will. If A dies after October 21, 1942, without having exercised his power of revocation, B's power of appointment is considered a power created after October 21, 1942. On the other hand, assume that C created an irrevocable intervivos trust before October 21, 1942, naming T as trustee and providing for payment of income to D for life with remainder to E. Assume further that T was given the power to pay corpus to D and the power to appoint a successor trustee. If T resigns after October 21, 1942, and appoints D as successor trustee, D is considered to have a power of appointment created before October 21, 1942. As another example, assume that F created an irrevocable intervivos trust before October 21, 1942, providing for payment of income to G for life with remainder as G shall appoint by will, but in default of appointment income to H for life with remainder as H shall appoint by will. If G dies after October 21, 1942, without having exercised his power of

appointment, H's power of appointment is considered a power created before October 21, 1942, even though it was only a contingent interest until G's death. If, in this last example, G had exercised his power of appointment by creating a similar power in I, I's power of appointment would be considered a power created after October 21, 1942. A power of appointment is not considered as created after October 21, 1942, merely because the power is not exercisable or the identity of its holders is not ascertainable until after that date.

§ 20.2041–2 POWERS OF APPOINTMENT CREATED ON OR BEFORE OCTOBER 21, 1942.—(a) *In general.*—Property subject to a general power of appointment created on or before October 21, 1942, is includible in the gross estate of the holder of the power under section 2041 only if he exercised the power under specified circumstances. Section 2041(a)(1) requires that there be included in the gross estate of a decedent the value of property subject to such a power only if the power is exercised by the decedent either (1) by will, or (2) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under section 2035 (relating to transfers in contemplation of death), 2036 (relating to transfers with retained life estate), 2037 (relating to transfers taking effect at death), or 2038 (relating to revocable transfers). See paragraphs (b), (c), and (d) of § 20.2041–1 for the definition of various terms used in this section.

(b) *Joint powers created on or before October 21, 1942.*—Section 2041(b)(1)(B) provides that a power created on or before October 21, 1942, which at the time of the exercise is not exercisable by the decedent except in conjunction with another person, is not deemed a general power of appointment.

(c) *Exercise during life.*—The circumstances under which section 2041 applies to the exercise other than by will of a general power of appointment created on or before October 21, 1942, are set forth in paragraph (a) of this section. In this connection, the rules of sections 2035 through 2038 which are to be applied are those in effect on the date of the decedent's death which are applicable to transfers made on the date when the exercise of the power occurred. Those rules are to be applied in determining the extent to which and the conditions under which a disposition is considered a transfer of property. The application of this paragraph may be illustrated by the following examples:

Example (1). A decedent in 1951 exercised a general power of appointment created in 1940, reserving no interest in or power over the property subject to the general power. The decedent died in 1956. Since the exercise was not made within three years before the decedent's death, no part of the property is includible in his gross estate. See section 2035(b), relating to transfers in contemplation of death.

Example (2). S created a trust in 1930 to pay the income to A for life, remainder as B appoints by an instrument filed with the trustee during B's lifetime, and in default of appointment remainder to C. B exercised the power in 1955 by directing that after A's death the income be paid to himself for life with remainder to C. If B dies after A, the entire value of the trust property would be included in B's gross estate, since such a disposition if it were a transfer of property

owned by B would cause the property to be included in his gross estate under section 2036(a)(1). If B dies before A, the value of the trust property less the value of A's life estate would be included in B's gross estate for the same reason.

Example (3). S created a trust in 1940 to pay the income to A for life, remainder as A appoints by an instrument filed with the trustee during A's lifetime. A exercised the power in 1955, five years before his death, reserving the right of revocation. The exercise, if not revoked before death, will cause the property subject to the power to be included in A's gross estate under section 2041(a)(1), since such a disposition if it were a transfer of property owned by A would cause the property to be included in his gross estate under section 2038. However, if the exercise were completely revoked, so that A died still possessed of the power, the property would not be included in A's gross estate for the reason that the power will not be treated as having been exercised.

Example (4). A decedent exercised a general power of appointment created in 1940 by making a disposition in trust under which possession or enjoyment of the property subject to the exercise could be obtained only by surviving the decedent and under which the decedent retained a reversionary interest in the property of a value of more than five percent. The exercise will cause the property subject to the power to be included in the decedent's gross estate, since such a disposition if it were a transfer of property owned by the decedent would cause the property to be included in his gross estate under section 2037.

(d) *Release or lapse.*—A failure to exercise a general power of appointment created on or before October 21, 1942, or a complete release of such a power is not considered to be an exercise of a general power of appointment. The phrase "a complete release" means a release of all powers over all or a portion of the property subject to a power of appointment, as distinguished from the reduction of a power of appointment to a lesser power. Thus, if the decedent completely relinquished all powers over one-half of the property subject to a power of appointment, the power is completely released as to that one-half. If at or before the time a power of appointment is relinquished, the holder of the power exercises the power in such a manner or to such an extent that the relinquishment results in the reduction, enlargement, or shift in a beneficial interest in property, the relinquishment will be considered to be an exercise and not a release of the power. For example, assume that A created a trust in 1940 providing for payment of the income to B for life and, upon B's death, remainder to C. Assume further that B was given the unlimited power to amend the trust instrument during his lifetime. If B amended the trust in 1948 by providing that upon his death the remainder was to be paid to D, and if he further amended the trust in 1950 by deleting his power to amend the trust, such relinquishment will be considered an exercise and not a release of a general power of appointment. On the other hand, if the 1948 amendment became ineffective before or at the time of the 1950 amendment, or if B in 1948 merely amended the trust by changing the purely ministerial powers of the trustee, his relinquishment of the power in 1950 will be considered as a release of a power of appointment.

(e) *Partial release.*—If a general power of appointment created on or before October 21, 1942, is partially released so that it is not thereafter a general power of appointment, a subsequent exercise of the partially released power is not an exercise of a general power of appointment if the partial release occurs before whichever is the later of the following dates:

(1) November 1, 1951, or

(2) If the decedent was under a legal disability to release the power on October 21, 1942, the day after the expiration of 6 months following the termination of such legal disability.

However, if a general power created on or before October 21, 1942, is partially released on or after the later of these dates, a subsequent exercise of the power will cause the property subject to the power to be included in the holder's gross estate, if the exercise is such that if it were a disposition of property owned by the decedent it would cause the property to be included in his gross estate. The legal disability referred to in this paragraph is determined under local law and may include the disability of an insane person, a minor, or an unborn child. The fact that the type of general power of appointment possessed by the decedent actually was not generally releasable under the local law does not place the decedent under a legal disability within the meaning of this paragraph. In general, however, it is assumed that all general powers of appointment are releasable, unless the local law on the subject is to the contrary, and it is presumed that the method employed to release the power is effective, unless it is not in accordance with the local law relating specifically to releases or, in the absence of such local law, is not in accordance with the local law relating to similar transactions.

(f) *Partial exercise.*—If a general power of appointment created on or before October 21, 1942, is exercised only as to a portion of the property subject to the power, section 2041 is applicable only to the value of that portion. For example, if a decedent had a general power of appointment exercisable by will created on or before October 21, 1942, over a trust fund valued at $200,000 at the date of his death, and if the decedent exercised his power either to the extent of directing the distribution of one-half of the trust property to B or of directing the payment of $100,000 to B, the trust property would be includible in the decedent's gross estate only to the extent of $100,000.

§ 20.2041–3 Powers of Appointment Created After October 21, 1942.—(a) *In general.*—(1) Property subject to a power of appointment created after October 21, 1942, is includible in the gross estate of the holder of the power under varying conditions depending on whether the power is (i) general in nature, (ii) possessed at death, or (iii) exercised or released. See paragraphs (b), (c), and (d) of § 20.2041–1 for the definition of various terms used in this section. See paragraph (c) of this section for the rules applicable to determine the extent to which joint powers created after October 21, 1942, are to be treated as general powers of appointment.

(2) If the power is a general power of appointment, the value of an interest in property subject to such a power is includible in a decedent's gross estate under section 2041(a)(2) if either—

(i) The decedent has the power at the time of his death (and the interest exists at the time of his death), or

(ii) The decedent exercised or released the power, or the power lapsed, under the circumstances and to the extent described in paragraph (d) of this section.

(3) If the power is not a general power of appointment, the value of property subject to the power is includible in the holder's gross estate under section 2041(a)(3) only if it is exercised to create a further power under certain circumstances (see paragraph (e) of this section).

(b) *Existence of power at death.*—For purposes of section 2041(a)(2), a power of appointment is considered to exist on the date of a decedent's death even though the exercise of the power is subject to the precedent giving of notice, or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the decedent's death notice has been given or the power has been exercised. However, a power which by its terms is exercisable only upon the occurrence during the decedent's lifetime of an event or a contingency which did not in fact take place or occur during such time is not a power in existence on the date of the decedent's death. For example, if a decedent was given a general power of appointment exercisable only after he reached a certain age, only if he survived another person, or only if he died without descendants, the power would not be in existence on the date of the decedent's death if the condition precedent to its exercise had not occurred.

(c) *Joint powers created after October 21, 1942.*—The treatment of a power of appointment created after October 21, 1942, which is exercisable only in conjunction with another person is governed by section 2041(b)(1)(C), which provides as follows:

(1) Such a power is not considered a general power of appointment if it is not exercisable by the decedent except with the consent or joinder of the creator of the power.

(2) Such power is not considered a general power of appointment if it is not exercisable by the decedent except with the consent or joinder of a person having a substantial interest in the property subject to the power which is adverse to the exercise of the power in favor of the decedent, his estate, his creditors, or the creditors of his estate. An interest adverse to the exercise of a power is considered as substantial if its value in relation to the total value of the property subject to the power is not insignificant. For this purpose, the interest is to be valued in accordance with the actuarial principles set forth in § 20.2031–7 or, if it is not susceptible to valaution under those provisions, in accordance with the general principles set forth in § 20.2031–1. A taker in default of appointment under a power has an interest which is adverse to an exercise of the power. A coholder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the decedent's death and may exercise it at that time in favor of himself, his estate his creditors, or the creditors of his estate. Thus, for example, if X

Y, and Z held a power jointly to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y. The application of this subparagraph may be further illustrated by the following additional examples in each of which it is assumed that the value of the interest in question is substantial:

Example (1). The decedent and R were trustees of a trust under the terms of which the income was to be paid to the decedent for life and then to M for life, and the remainder was to be paid to R. The trustees had power to distribute corpus to the decedent. Since R's interest was substantially adverse to an exercise of the power in favor of the decedent the latter did not have a general power of appointment. If M and the decedent were the trustees, M's interest would likewise have been adverse.

Example (2). The decedent and L were trustees of a trust under the terms of which the income was to be paid to L for life and then to M for life, and the remainder was to be paid to the decedent. The trustees had power to distribute corpus to the decedent during L's life. Since L's interest was adverse to an exercise of the power in favor of the decedent, the decedent did not have a general power of appointment. If the decedent and M were the trustees, M's interest would likewise have been adverse.

Example (3). The decedent and L were trustees of a trust under the terms of which the income was to be paid to L for life. The trustees could designate whether corpus was to be distributed to the decedent or to A after L's death. L's interest was not adverse to an exercise of the power in favor of the decedent, and the decedent therefore had a general power of appointment.

(3) A power which is exercisable only in conjunction with another person, and which after application of the rules set forth in subparagraphs (1) and (2) of this paragraph constitutes a general power of appointment, will be treated as though the holders of the power who are permissible appointees of the property were joint owners of property subject to the power. The decedent, under this rule, will be treated as possessed of a general power of appointment over an aliquot share of the property to be determined with reference to the number of joint holders, including the decedent, who (or whose estates or creditors) are permissible appointees. Thus, for example, if X, Y, and Z hold an unlimited power jointly to appoint among a group of persons, including themselves, but on the death of X the power does not pass to Y and Z jointly, then Y and Z are not considered to have interests adverse to the exercise of the power in favor of X. In this case X is considered to possess a general power of appointment as to one-third of the property subject to the power.

(d) *Releases, lapses, and disclaimers of general powers of appointment.*—(1) Property subject to a general power of appointment created after October 21, 1942, is includible in the gross estate of a decedent under section 2041(a)(2) even though he does not have the power at the date of his death, if during his life he exercised or re-

leased the power under circumstances such that, if the property subject to the power had been owned and transferred by the decedent, the property would be includible in the decedent's gross estate under section 2035, 2036, 2037, or 2038. Further, section 2041(b)(2) provides that the lapse of a power of appointment is considered to be a release of the power to the extent set forth in subparagraph (3) of this paragraph. A release of a power of appointment need not be formal or express in character. The principles set forth in § 20.2041–2 for determining the application of the pertinent provisions of sections 2035 through 2038 to a particular exercise of a power of appointment are applicable for purposes of determining whether or not an exercise or release of a power of appointment created after October 21, 1942, causes the property to be included in a decedent's gross estate under section 2041(a)(2). If a general power of appointment created after October 21, 1942, is partially released, a subsequent exercise or release of the power under circumstances described in the first sentence of this subparagraph, or its possession at death, will nevertheless cause the property subject to the power to be included in the gross estate of the holder of the power.

(2) Section 2041(a)(2) is not applicable to the complete release of a general power of appointment created after October 21, 1942, whether exercisable during life or by will, if the release was not made in contemplation of death within the meaning of section 2035, and if after the release the holder of the power retained no interest in or control over the property subject to the power which would cause the property to be included in his gross estate under sections 2036 through 2038 if the property had been transferred by the holder.

(3) The failure to exercise a power of appointment created after October 21, 1942, within a specified time, so that the power lapses, constitutes a release of the power. However, section 2041(b)(2) provides that such a lapse of a power of appointment during any calendar year during the decedent's life is treated as a release for purposes of inclusion of property in the gross estate under section 2041(a)(2) only to the extent that the property which could have been appointed by exercise of the lapsed power exceeds the greater of (i) $5,000 or (ii) 5 percent of the aggregate value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could have been satisfied. For example, assume that a transferred $200,000 worth of securities in trust providing for payment of income to B for life with remainder to B's issue. Assume further that B was given a noncumulative right to withdraw $10,000 a year from the principal of the trust fund (which neither increased nor decreased in value prior to B's death). In such case, the failure of B to exercise his right of withdrawal will not result in estate tax with respect to the power to withdraw $10,000 which lapses each year before the year of B's death. At B's death there will be included in his gross estate the $10,000 which he was entitled to withdraw for the year in which his death occurs less any amount which he may have taken during that year. However, if in the above example B had possessed the right to withdraw $15,000 of the principal annually, the failure to exercise such power in any year will be considered a release of the power to the extent of the excess of the amount subject to withdrawal over 5 percent

of the trust fund (in this example, $5,000, assuming that the trust fund is worth $200,000 at the time of the lapse). Since each lapse is treated as though B had exercised dominion over the trust property by making a transfer of principal reserving the income therefrom for his life, the value of the trust property (but only to the extent of the excess of the amount subject to withdrawal over 5 percent of the trust fund) is includible in B's gross estate (unless before B's death he has disposed of his right to the income under circumstances to which sections 2035 through 2038 would not be applicable). The extent to which the value of the trust property is included in the decedent's gross estate is determined as provided in subparagraph (4) of this paragraph.

(4) The purpose of section 2041(b)(2) is to provide a determination, as of the date of the lapse of the power, of the proportion of the property over which the power lapsed which is an exempt disposition for estate tax purposes and the proportion which, if the other requirements of sections 2035 through 2038 are satisfied, will be considered as a taxable disposition. Once the taxable proportion of any disposition at the date of lapse has been determined, the valuation of that proportion as of the date of the decedent's death (or, if the executor has elected the alternate valuation method under section 2032, the value as of the date therein provided), is to be ascertained in accordance with the principles which are applicable to the valuation of transfers of property by the decedent under the corresponding provisions of sections 2035 through 2038. For example, if the life beneficiary of a trust had a right exercisable only during one calendar year to draw down $50,000 from the corpus of a trust, which he did not exercise, and if at the end of the year the corpus was worth $800,000, the taxable portion over which the power lapsed is $10,000 (the excess of $50,000 over 5 percent of the corpus), or $\frac{1}{80}$ of the total value. On the decedent's death, if the total value of the corpus of the trust (excluding income accumulated after the lapse of the power) on the applicable valuation date was $1,200,000, $15,000 ($\frac{1}{80}$ of $1,200,000) would be includible in the decedent's gross estate. However, if the total value was then $600,000, only $7,500 ($\frac{1}{80}$ of $600,000) would be includible.

(5) If the failure to exercise a power, such as a right of withdrawal, occurs in more than a single year, the proportion of the property over which the power lapsed which is treated as a taxable disposition will be determined separately for each such year. The aggregate of the taxable proportions for all such years, valued in accordance with the above principles, will be includible in the gross estate by reason of the lapse. The includible amount, however, shall not exceed the aggregate value of the assets out of which, or the proceeds of which, the exercise of the power could have been satisfied, valued as of the date of the decedent's death (or, if the executor has elected the alternate valuation method under section 2032, the value as of the date therein provided).

(6) A disclaimer or renunciation of a general power of appointment is not considered to be a release of the power. The disclaimer or renunciation must be unequivocal and effective under local law. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. There can be no disclaimer or renunciation of a power after its acceptance. In any case where a power is pur-

ported to be disclaimed or renounced as to only a portion of the property subject to the power, the determination as to whether or not there has been a complete and unqualified refusal to accept the rights to which one is entitled will depend on all the facts and circumstances of the particular case, taking into account the recognition and effectiveness of such a disclaimer under local law. Such rights refer to the incidents of the power and not to other interests of the decedent in the property. If effective under local law, the power may be disclaimed or renounced without disclaiming or renouncing such other interests. In the absence of facts to the contrary, the failure to renounce or disclaim within a reasonable time after learning of its existence will be presumed to constitute an acceptance of the power.

(e) *Successive powers.*—(1) Property subject to a power of appointment created after October 21, 1942, which is not a general power, is includible in the gross estate of the holder of the power under section 2041(a)(3) if the power is exercised, and if both of the following conditions are met:

(i) If the exercise is a (*a*) by will, or (*b*) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under sections 2035 through 2037; and

(ii) If the power is exercised by creating another power of appointment which, under the terms of the instruments creating and exercising the first power and under applicable local law, can be validly exercised so as to (*a*) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of the creation of the first power, or (*b*) (if the applicable rule against perpetuities is stated in terms of suspension of ownership or of the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

(2) For purposes of the application of section 2041(a)(3), the value of the property subject to the second power of appointment is considered to be its value unreduced by any precedent or subsequent interest which is not subject to the second power. Thus, if a decedent has a power to appoint by will $100,000 to a group of persons consisting of his children and grandchildren and exercises the power by making an outright appointment of $75,000 and by giving one appointee a power to appoint $25,000, no more than $25,000 will be includible in the decedent's gross estate under section 2041(a)(3). If, however, the decedent appoints the income from the entire fund to a beneficiary for life with power in the beneficiary to appoint the remainder by will, the entire $100,000 will be includible in the decedent's gross estate under section 2041(a)(3) if the exercise of the second power can validly postpone the vesting of any estate or interest in the property or can suspend the absolute ownership or power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

(f) *Examples.*—The application of this section may be further illustrated by the following examples, in each of which it is assumed, unless otherwise stated, that S has transferred property in trust after October 21, 1942, with the remainder payable to R at L's death, and

that neither L nor R has any interest in or power over the enjoyment of the trust property except as is indicated separately in each example:

Example (1). Income is directed to be paid to L during his lifetime at the end of each year, if living. L has an unrestricted power during his lifetime to cause the income to be distributed to any other person, but no power to cause it to be accumulated. At L's death, no part of the trust property is includible in L's gross estate since L had a power to dispose of only his income interest, a right otherwise possessed by him.

Example (2). Income is directed to be accumulated during L's life but L has a noncumulative power to distribute $10,000 of each year's income to himself. Unless L's power is limited by an ascertainable standard (relating to his health, etc.), as defined in paragraph (c)(2) of § 20.2041–1, he has a general power of appointment over $10,000 of each year's income, the lapse of which may cause a portion of any income not distributed to be included in his gross estate under section 2041. See subparagraphs (3), (4), and (5) of paragraph (d) of this section. Thus, if the trust income during the year amounts to $20,000, L's failure to distribute any of the income to himself constitutes a lapse as to $5,000 (i. e., the amount by which $10,000 exceeds $5,000). If L's power were cumulative (i. e., if the power did not lapse at the end of each year but lapsed only by reason of L's death), the total accumulations which L chose not to distribute to himself immediately before his death would be includible in his gross estate under section 2041.

Example (3). L is entitled to all the income during his lifetime and has an unrestricted power to cause corpus to be distributed to himself. L had a general power of appointment over the corpus of the trust, and the entire corpus as of the time of his death is includible in his gross estate under section 2041.

Example (4). Income was payable to L during his lifetime. R has an unrestricted power to cause corpus to be distributed to L. R dies before L. In such case, R has only a power to dispose of his remainder interest, the value of which is includible in his gross estate under section 2033, and nothing in addition would be includible under section 2041. If in this example R's remainder were contingent on his surviving L, nothing would be includible in his gross estate under either section 2033 or 2041. While R would have a power of appointment, it would not be a general power.

Example (5). Income was payable to L during his lifetime. R has an unrestricted power to cause corpus to be distributed to himself. R dies before L. While the value of R's remainder interest is includible in his gross estate under section 2033, R also has a general power of appointment over the entire trust corpus. Under such circumstances, the entire value of the trust corpus is includible in R's gross estate under section 2041.

§ 20.2042 Statutory Provisions; Proceeds of Life Insurance.

SEC. 2042. PROCEEDS OF LIFE INSURANCE.

The value of the gross estate shall include the value of all property—

(1) Receivable by the executor.—To the extent of the amount receivable by the executor as insurance under policies on 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 on the life of the decedent 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. For purposes of the preceding sentence, the term "incident of ownership" includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent. As used in this paragraph, the term "reversionary interest" includes a possibility that the policy, or the proceeds of the policy, may return to the decedent or his estate, or may be subject to a power of disposition by him. The value of a reversionary interest at any time shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Secretary or his delegate. In determining the value of a possibility that the policy or proceeds thereof may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such policy or proceeds may return to the decedent or his estate.

§ 20.2042–1 PROCEEDS OF LIFE INSURANCE.—(a) *In general.*—(1) Section 2042 provides for the inclusion in a decedent's gross estate of the proceeds of insurance on the decedent's life (i) receivable by or for the benefit of the estate (see paragraph (b) of this section), and (ii) receivable by other beneficiaries (see paragraph (c) of this section). The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies operating under the lodge system.

(2) Proceeds of life insurance which are not includible in the gross estate under section 2042 may, depending upon the facts of the particular case, be includible under some other section of part III of subchapter A of chapter 11. For example, if the decedent possessed incidents of ownership in an insurance policy on his life but gratuitously transferred all rights in the policy in contemplation of death, the proceeds would be includible under section 2035. Section 2042 has no application to the inclusion in the gross estate of the value of rights in an insurance policy on the life of a person other than the decedent, or the value of rights in a combination annuity contract and life insurance policy on the decedent's life (i. e., a "retirement income" policy with death benefit or an "endowment" policy) under which there was no insurance element at the time of the decedent's death (see paragraph (d) of § 20.2039–1).

(3) The amount to be included in the gross estate under section 2042 is the full amount receivable under the policy. If the proceeds of the policy are made payable to a beneficiary in the form of an annuity for life or for a term of years, the amount to be included in the gross estate is the one sum payable at death under an option which could have been exercised either by the insured or by the beneficiary, or if no option was granted, the sum used by the insurance company in determining the amount of the annuity.

(b) *Receivable by or for the benefit of the estate.*—(1) Section 2042 requires the inclusion in the gross estate of the proceeds of insurance on the decedent's life receivable by the executor or administrator, or

payable to the decedent's estate. It makes no difference whether or not the estate is specifically named as the beneficiary under the terms of the policy. Thus, if under the terms of an insurance policy the proceeds are receivable by another beneficiary but are subject to an obligation, legally binding upon the other beneficiary, to pay taxes, debts, or other charges enforceable against the estate, then the amount of such proceeds required for the payment in full (to the extent of the beneficiary's obligation) of such taxes, debts, or other charges is includible in the gross estate. Similarly, if the decedent purchased an insurance policy in favor of another person or a corporation as collateral security for a loan or other accommodation, its proceeds are considered to be receivable for the benefit of the estate. The amount of the loan outstanding at the date of the decedent's death, with interest accrued to that date, will be deductible in determining the taxable estate. See § 20.2053–4.

(2) If the proceeds of an insurance policy made payable to the decedent's estate are community assets under the local community property law and, as a result, one-half of the proceeds belongs to the decedent's spouse, then only one-half of the proceeds is considered to be receivable by or for the benefit of the decedent's estate.

(c) *Receivable by other beneficiaries.*—(1) Section 2042 requires the inclusion in the gross estate of the proceeds of insurance on the decedent's life not receivable by or for the benefit of the estate if the decedent possessed at the date of his death any of the incidents of ownership in the policy, exercisable either alone or in conjunction with any other person. However, if the decedent did not possess any of such incidents of ownership at the time of his death nor transfer them in contemplation of death, no part of the proceeds would be includible in his gross estate under section 2042. Thus, if the decedent owned a policy of insurance on his life and, 4 years before his death, irrevocably assigned his entire interest in the policy to his wife retaining no reversionary interest therein (see subparagraph (3) of this paragraph), the proceeds of the policy would not be includible in his gross estate under section 2042.

(2) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. Similarly, the term includes a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder.

(3) The term "incidents of ownership" also includes a reversionary interest in the policy or its proceeds, whether arising by the express terms of the policy or other instrument or by operation of law, but only if the value of the reversionary interest immediately before the death of the decedent exceeded 5 percent of the value of the policy. As used in this subparagraph, the term "reversionary interest" includes a possibility that the policy or its proceeds may return to the decedent or his estate and a possibility that the policy or its

proceeds may become subject to a power of disposition by him. In order to determine whether or not the value of a reversionary interest immediately before the death of the decedent exceeded 5 percent of the value of the policy, the principles contained in paragraph (c) (3) and (4) of § 20.2037–1, in so far as applicable, shall be followed under this subparagraph. In that connection, there must be specifically taken into consideration any incidents of ownership held by others immediately before the decedent's death which would affect the value of the reversionary interest. For example, the decedent would not be considered to have a reversionary interest in the policy of a value in excess of 5 percent if the power to obtain the cash surrender value existed in some other person immediately before the decedent's death and was exercisable by such other person alone and in all events. The terms "reversionary interest" and "incidents of ownership" do not include the possibility that the decedent might receive a policy or its proceeds by inheritance through the estate of another person, or as a surviving spouse under a statutory right of election or a similar right.

(4) A decedent is considered to have an "incident of ownership" in an insurance policy on his life held in trust if, under the terms of the policy, the decedent (either alone or in conjunction with another person or persons) has the power (as trustee or otherwise) to change the beneficial ownership in the policy or its proceeds, or the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust. Moreover, assuming the decedent created the trust, such a power may result in the inclusion in the decedent's gross estate under section 2036 or 2038 of other property transferred by the decedent to the trust if, for example, the decedent has the power to surrender the insurance policy and if the income otherwise used to pay premiums on the policy would become currently payable to a beneficiary of the trust in the event that the policy were surrendered.

(5) As an additional step in determining whether or not a decedent possessed any incidents of ownership in a policy or any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy. For example, assume that the decedent purchased a policy of insurance on his life with funds held by him and his surviving wife as community property, designating their son as beneficiary but retaining the right to surrender the policy. Under the local law, the proceeds upon surrender would have inured to the marital community. Assuming that the policy is not surrendered and that the son receives the proceeds on the decedent's death, the wife's transfer of her one-half interest in the policy was not considered absolute before the decedent's death. Upon the wife's prior death, one-half of the value of the policy would have been included in her gross estate. Under these circumstances, the power of surrender possessed by the decedent as agent for his wife with respect to one-half of the policy is not, for purposes of this section, an "incident of ownership", and the decedent is, therefore, deemed to possess an incident of ownership in only one-half of the policy.

§ 20.2043 STATUTORY PROVISIONS; TRANSFERS FOR INSUFFICIENT CONSIDERATION.

SEC. 2043. TRANSFERS FOR INSUFFICIENT CONSIDERATION.

(a) IN GENERAL.—If any one of the transfers, trusts, interests, rights, or powers enumerated and described in sections 2035 to 2038, inclusive, and section 2041 is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

(b) MARITAL RIGHTS NOT TREATED AS CONSIDERATION.—For purposes of this chapter, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

§ 20.2043–1 TRANSFERS FOR INSUFFICIENT CONSIDERATION.—(a) *In general.*—The transfers, trusts, interests, rights or powers enumerated and described in sections 2035 through 2038 and section 2041 are not subject to the Federal estate tax if made, created, exercised, or relinquished in a transaction which constituted a bona fide sale for an adequate and full consideration in money or money's worth. To constitute a bona fide sale for an adequate and full consideration in money or money's worth, the transfer must have been made in good faith, and the price must have been an adequate and full equivalent reducible to a money value. If the price was less than such a consideration, only the excess of the fair market value of the property (as of the applicable valuation date) over the price received by the decedent is included in ascertaining the value of his gross estate.

(b) *Marital rights and support obligations.*—For purposes of chapter 11, a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, is not to any extent a consideration in "money or money's worth."

§ 20.2044 STATUTORY PROVISIONS; PRIOR INTERESTS.

SEC. 2044. PRIOR INTERESTS.

Except as otherwise specifically provided therein, sections 2034 to 2042, inclusive, shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whenever made, created, arising, existing, exercised, or relinquished.

§ 20.2044–1 APPLICABILITY TO PRE-EXISTING TRANSFERS OR INTERESTS.—Sections 2034 through 2042 are applicable regardless of when the interests and events referred to in those sections were created or took place, except as otherwise provided in those sections and the regulations thereunder.

TAXABLE ESTATE

§ 20.2051 STATUTORY PROVISIONS; DEFINITION OF TAXABLE ESTATE.

SEC. 2051. DEFINITION OF TAXABLE ESTATE.

For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the exemption and deductions provided for in this part.

§ 20.2051–1 DEFINITION OF TAXABLE ESTATE.—The taxable estate of a decedent who was a citizen or resident (see paragraph (b)(1)(i) of § 20.0–1) of the United States at the time of his death is determined by subtracting the total amount of the deductions authorized by sections 2052 through 2056 from the total amount which must be included in the gross estate under sections 2031 through 2044. These deductions are in general as follows:

(1) An exemption of $60,000 (section 2052);

(2) Funeral and administration expenses and claims against the estate (including certain taxes and charitable pledges) (section 2053);

(3) Losses from casualty or theft during the administration of the estate (section 2054);

(4) Charitable transfers (section 2055); and

(5) The marital deduction (section 2056).

See section 2106 and the regulations thereunder for the computation of the taxable estate of a decedent who was not a citizen or resident of the United States. See also § 1.642(g)–1 concerning the disallowance for income tax purposes of certain deductions allowed for estate tax purposes.

§ 20.2052 STATUTORY PROVISIONS; EXEMPTION.

SEC. 2052. EXEMPTION.

For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate an exemption of $60,000.

§ 20.2052–1 EXEMPTION.—An exemption of $60,000 is allowed as a deduction under section 2052 from the gross estate of a decedent who was a citizen or resident of the United States at the time of his death. For the amount of the exemption allowed as a deduction from the gross estate of a decendent who was a nonresident not a citizen of the United States, see paragraph (a)(3) of § 20.2106–1.

§ 20.2053 STATUTORY PROVISIONS; EXPENSES, INDEBTEDNESS, AND TAXES.

SEC. 2053. EXPENSES, INDEBTEDNESS, AND TAXES.

(a) GENERAL RULE.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—

(1) For funeral expenses,

(2) For administration expenses,

(3) For claims against the estate, and

(4) For unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate.

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

(b) OTHER ADMINISTRATION EXPENSES.—Subject to the limitations in paragraph (1) of subsection (c), there shall be deducted in determining the taxable estate amounts representing expenses incurred in administering property not subject to claims which is included in the gross estate to the same extent such amounts would be allowable as a deduction under subsection (a) if such property were subject to claims, and such amounts are paid before the expiration of the period of limitation for assessment provided in section 6501.

(c) LIMITATIONS.—

(1) LIMITATIONS APPLICABLE TO SUBSECTIONS (A) AND (B).—

(A) CONSIDERATION FOR CLAIMS.—The deduction allowed by this section in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded on a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; except that in any case in which any such claim is founded on a promise or agreement of the decedent to make a contribution or gift to or for the use of any donee described in section 2055 for the purposes specified therein, the deduction for such claims shall not be so limited, but shall be limited to the extent that it would be allowable as a deduction under section 2055 if such promise or agreement constituted a bequest.

(B) CERTAIN TAXES.—Any income taxes on income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes, shall not be deductible under this section.

(2) LIMITATIONS APPLICABLE ONLY TO SUBSECTION (A).—In the case of the amounts described in subsection (a), there shall be disallowed the amount by which the deductions specified therein exceed the value, at the time of the decedent's death, of property subject to claims, except to the extent that such deductions represent amounts paid before the date prescribed for the filing of the estate tax return. For purposes of this section, the term "property subject to claims" means property includible in the gross estate of the decedent which, or the avails of which, would under the applicable law, bear the burden of the payment of such deductions in the final adjustment and settlement of the estate, except that the value of the property shall be reduced by the amount of the deduction under section 2054 attributable to such property.

(d) CERTAIN STATE DEATH TAXES.—

(1) GENERAL RULE.—Notwithstanding the provisions of subsection (c)(1)(B) of this section, for purposes of the tax imposed by section 2001 the value of the taxable estate may be determined, if the executor so elects before the expiration of the period of limitation for assessment provided in section 6501, by deducting from the value of the gross estate the amount (as determined in accordance with regulations prescribed by the Secretary or his delegate) of any estate, succession, legacy or inheritance tax imposed by a State or Territory or the District of Columbia, or any possession of the United States, upon a transfer by the decedent for public, charitable, or religious uses described in section 2055 or 2106(a)(2). The election shall be exercised in accordance with regulations prescribed by the Secretary or his delegate.

(2) CONDITION FOR ALLOWANCE OF DEDUCTION.—No deduction shall be allowed under paragraph (1) for a State death tax specified therein unless the decrease in the tax imposed by section 2001 which results from the deduction provided for in paragraph (1) will inure solely for the benefit of the public, charitable, or religious transferees described in section 2055 or section 2106(a)(2). In any case where the tax imposed by section 2001 is equitably apportioned among all the transferees of property included in the gross estate, including those described in sections 2055 and 2106(a)(2) (taking into account any exemptions, credits, or deductions allowed by this chapter), in determining such decrease, there shall be disregarded any decrease in the Federal estate tax which any transferees other than those described in sections 2055 and 2106(a)(2) are required to pay.

(3) EFFECT OF DEDUCTION ON CREDIT FOR STATE DEATH TAXES.—See section 2011(e) for the effect of a deduction taken under this subsection on the credit for State death taxes.

(e) MARITAL RIGHTS.—For provisions that relinquishment of marital rights shall not be deemed a consideration "in money or money's worth," see section 2043(b).

[Sec. 2053, as amended by sec. 2, Act of Feb. 20, 1956 (Pub. Law 414, 84th Cong., 70 Stat. 23, C. B. 1956–1, 855)]

§ 20.2053–1 DEDUCTIONS FOR EXPENSES, INDEBTEDNESS, AND TAXES; IN GENERAL.—(a) *General rule.*—In determining the taxable estate of a decedent who was a citizen or resident of the United States at the time of his death, there are allowed as deductions under section 2053 (a) and (b) amounts falling within the following two categories (subject to the limitations contained in this section and in §§ 20.2053–2 through 20.2053–9):

(1) *First category.*—Amounts which are payable out of property subject to claims and which are allowable by the law of the jurisdiction, whether within or without the United States, under which the estate is being administered for—

(i) Funeral expenses;

(ii) Administration expenses;

(iii) Claims against the estate (including taxes to the extent set forth in § 20.2053–6 and charitable pledges to the extent set forth in § 20.2053–5); and

(iv) Unpaid mortgages on, or any indebtedness in respect of, property, the value of the decedent's interest in which is included in the value of the gross estate undiminished by the mortgage or indebtedness.

As used in this subparagraph, the phrase "allowable by the law of the jurisdiction" means allowable by the law governing the administration of decedents' estates. The phrase has no reference to amounts allowable as deductions under a law which imposes a State death tax. See further §§ 20.2053–2 through 20.2053–7.

(2) *Second category.*—Amounts representing expenses incurred in administering property which is included in the gross estate but which is not subject to claims and which—

(i) Would be allowed as deductions in the first category if the property being administered were subject to claims; and

(ii) Were paid before the expiration of the period of limitation for assessment provided in section 6501.

See further § 20.2053–8.

(b) *Provisions applicable to both categories.*—(1) *In general.*—If the item is not one of those described in paragraph (a) of this section, it is not deductible merely because payment is allowed by the local law. If the amount which may be expended for the particular purpose is limited by the local law, no deduction in excess of that limitation is permissible.

(2) *Effect of court decree.*—The decision of a local court as to the amount and allowability under local law of a claim or administration expense will ordinarily be accepted if the court passes upon the facts upon which deductibility depends. If the court does not pass upon those facts, its decree will, of course, not be followed. For example, if the question before the court is whether a claim should be allowed, the decree allowing it will ordinarily be accepted as establishing the validity and amount of the claim. However, the decree will not necessarily be accepted even though it purports to decide the facts

upon which deductibility depends. It must appear that the court actually passed upon the merits of the claim. This will be presumed in all cases of an active and genuine contest. If the result reached appears to be unreasonable, this is some evidence that there was not such a contest, but it may be rebutted by proof to the contrary. If the decree was rendered by consent, it will be accepted, provided the consent was a bona fide recognition of the validity of the claim (and not a mere cloak for a gift) and was accepted by the court as satisfactory evidence upon the merits. It will be presumed that the consent was of this character, and was so accepted, if given by all parties having an interest adverse to the claimant. The decree will not be accepted if it is at variance with the law of the State; as, for example, an allowance made to an executor in excess of that prescribed by statute. On the other hand, a deduction for the amount of a bona fide indebtedness of the decedent, or of a reasonable expense of administration, will not be denied because no court decree has been entered if the amount would be allowable under local law.

(3) *Estimated amounts.*—An item may be entered on the return for deduction though its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate. If the amount of a liability was not ascertainable at the time of final audit of the return by the district director and, as a consequence, it was not allowed as a deduction in the audit, and subsequently the amount of the liability is ascertained, relief may be sought by a petition to the Tax Court or a claim for refund as provided by sections 6213(a) and 6511, respectively.

(c) *Provision applicable to first category only.*—Deductions of the first category (described in paragraph (a)(1) of this section) are limited under section 2053(a) to amounts which would be properly allowable out of property subject to claims by the law of the jurisdiction under which the decedent's estate is being administered. Further, the total allowable amount of deductions of the first category is limited by section 2053(c)(2) to the sum of—

(1) The value of property included in the decedent's gross estate and subject to claims, plus

(2) Amounts paid, out of property not subject to claims against the decedent's estate, within 15 months after the decedent's death (the period within which the estate tax return must be filed under section 6075), or within any extension of time for filing the return granted under section 6081.

The term "property subject to claims" is defined in section 2053(c)(2) as meaning the property includible in the gross estate which, or the avails of which, under the applicable law, would bear the burden of the payment of these deductions in the final adjustment and settlement of the decedent's estate. However, for the purposes of this definition, the value of property subject to claims is first reduced by the amount of any deduction allowed under section 2054 for any losses from casualty or theft incurred during the settlement of the estate attributable to such property. The application of this paragraph may be illustrated by the following examples:

Example (1). The only item in the gross estate is real property valued at $250,000 which the decedent and his surviving spouse held

as tenants by the entirety. Under the local law, this real property is not subject to claims. Funeral expenses of $1,200 and debts of the decedent in the amount of $1,500 are allowable under local law. Before the prescribed date for filing the estate tax return, the surviving spouse paid the funeral expenses and $1,000 of the debts. The remaining $500 of the debts was paid by her after the prescribed date for filing the return. The total amount allowable as deductions under section 2053 is limited to $2,200, the amount paid prior to the prescribed date for filing the return.

Example (2). The only two items in the gross estate were a bank deposit of $20,000 and insurance in the amount of $150,000. The insurance was payable to the decedent's surviving spouse and under local law was not subject to claims. Funeral expenses of $1,000 and debts in the amount of $29,000 were allowable under local law. A son was executor of the estate and before the prescribed date for filing the estate tax return he paid the funeral expenses and $9,000 of the debts, using therefor $5,000 of the bank deposit and $5,000 supplied by the surviving spouse. After the prescribed date for filing the return, the executor paid the remaining $20,000 of the debts, using for that purpose the $15,000 left in the bank account plus an additional $5,000 supplied by the surviving spouse. The total amount allowable as deductions under section 2053 is limited to $25,000 ($20,000 of property subject to claims plus the $5,000 additional amount which, before the prescribed date for filing the return, was paid out of property not subject to claims).

(d) *Disallowance of double deductions.*—See section 642(g) and § 1.642(g)-1 with respect to the disallowance for income tax purposes of certain deductions unless the right to take such deductions for estate tax purposes is waived.

§ 20.2053-2 Deduction for Funeral Expenses.—Such amounts for funeral expenses are allowed as deductions from a decedent's gross estate as (a) are actually expended, (b) would be properly allowable out of property subject to claims under the laws of the local jurisdiction, and (c) satisfy the requirements of paragraph (c) of § 20.2053-1. A reasonable expenditure for a tombstone, monument, or mausoleum, or for a burial lot, either for the decedent or his family, including a reasonable expenditure for its future care, may be deducted under this heading, provided such an expenditure is allowable by the local law. Included in funeral expenses is the cost of transportation of the person bringing the body to the place of burial.

§ 20.2053-3 Deduction for Expenses of Administering Estate.—(a) *In general.*—The amounts deductible from a decedent's gross estate as "administration expenses" of the first category (see paragraphs (a) and (c) of § 20.2053-1) are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the

estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include (1) executor's commissions; (2) attorney's fees; and (3) miscellaneous expenses. Each of these classes is considered separately in paragraphs (b) through (d) of this section.

(b) *Executor's commissions.*—(1) The executor or administrator, in filing the estate tax return, may deduct his commissions in such an amount as has actually been paid, or in an amount which at the time of filing the estate tax return may reasonably be expected to be paid, but no deduction may be taken if no commissions are to be collected. If the amount of the commissions has not been fixed by decree of the proper court, the deduction will be allowed on the final audit of the return, to the extent that all three of the following conditions are satisfied:

(i) The district director is reasonably satisfied that the commissions claimed will be paid;

(ii) The amount claimed as a deduction is within the amount allowable by the laws of the jurisdiction in which the estate is being administered; and

(iii) It is in accordance with the usually accepted practice in the jurisdiction to allow such an amount in estates of similar size and character.

If the deduction is disallowed in whole or in part on final audit, the disallowance will be subject to modification as the facts may later require. If the deduction is allowed in advance of payment and payment is thereafter waived, it shall be the duty of the executor to notify the district director and to pay the resulting tax, together with interest.

(2) A bequest or devise to the executor in lieu of commissions is not deductible. If, however, the decedent fixed by his will the compensation payable to the executor for services to be rendered in the administration of the estate, deduction may be taken to the extent that the amount so fixed does not exceed the compensation allowable by the local law or practice.

(3) Except to the extent that a trustee is in fact performing services with respect to property subject to claims which would normally be performed by an executor, amounts paid as trustees' commissions do not constitute expenses of administration under the first category, and are only deductible as expenses of the second category to the extent provided in § 20.2053–8.

(c) *Attorney's fees.*—(1) The executor or administrator, in filing the estate tax return, may deduct such an amount of attorney's fees as has actually been paid, or an amount which at the time of filing may reasonably be expected to be paid. If on the final audit of a return the fees claimed have not been awarded by the proper court and paid, the deduction will, nevertheless, be allowed, if the district director is reasonably satisfied that the amount claimed will be paid and that it does not exceed a reasonable remuneration for the services rendered, taking into account the size and character of the estate and the local law and practice. If the deduction is disallowed in whole or in part on final audit, the disallowance will be subject to modification as the facts may later require.

(2) A deduction for attorneys' fees incurred in contesting an asserted deficiency or in prosecuting a claim for refund should be claimed at the time the deficiency is contested or the refund claim is prosecuted. A deduction for reasonable attorneys' fees actually paid in contesting an asserted deficiency or in prosecuting a claim for refund will be allowed even though the deduction, as such, was not claimed in the estate tax return or in the claim for refund. A deduction for these fees shall not be denied, and the sufficiency of a claim for refund shall not be questioned, solely by reason of the fact that the amount of the fees to be paid was not established at the time that the right to the deduction was claimed.

(3) Attorneys' fees incurred by beneficiaries incident to litigation as to their respective interests do not constitute a proper deduction, inasmuch as expenses of this character are incurred on behalf of the beneficiaries personally and are not administration expenses.

(d) *Miscellaneous administration expenses.*—Miscellaneous administration expenses include such expenses as court costs, surrogates' fees, accountants' fees, appraisers' fee, clerk hire, etc. Expenses necessarily incurred in preserving and distributing the estate are deductible, including the cost of storing or maintaining property of the estate, if it is impossible to effect immediate distribution to the beneficiaries. Expenses for preserving and caring for the property may not include outlays for additions or improvements; nor will such expenses be allowed for a longer period than the executor is reasonably required to retain the property. A brokerage fee for selling property of the estate is deductible if the sale is necessary in order to (1) pay the decedent's debts, the expenses of administration, or taxes, (2) preserve the estate, or (3) effect distribution. Other expenses attending the sale are deductible, such as the fees of an auctioneer if it is reasonably necessary to employ one.

§ 20.2053–4 Deduction for Claims Against the Estate; in General.—The amounts that may be deducted as claims against a decedent's estate are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. Only interest accrued at the date of the decedent's death is allowable even though the executor elects the alternate valuation method under section 2032. Only claims enforceable against the decedent's estate may be deducted. Except as otherwise provided in § 20.2053–5 with respect to pledges or subscriptions, section 2053(c)(1)(A) provides that the allowance of a deduction for a claim founded upon a promise or agreement is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. See § 20.2043–1. Liabilities imposed by law or arising out of torts are deductible.

§ 20.2053–5 Deductions for Charitable, etc., Pledges or Subscriptions.—A pledge or a subscription, evidenced by a promissory note or otherwise, even though enforceable against the estate, is deductible only to the extent that—

(a) Liability therefor was contracted bona fide and for an adequate and full consideration in cash or its equivalent, or

(b) It would have constituted an allowable deduction under section 2055 (relating to charitable, etc., deductions) if it had been a bequest.

§ 20.2053–6 DEDUCTION FOR TAXES.—(a) *In general.*—Taxes are deductible in computing a decedent's gross estate only as claims against the estate (except to the extent that excise taxes may be allowable as administration expenses), and only to the extent not disallowed by section 2053(c)(1)(B) (see the remaining paragraphs of this section). However, see § 20.2053–9 with respect to the deduction allowed for certain State death taxes on charitable, etc., transfers.

(b) *Property taxes.*—Property taxes are not deductible unless they accrued before the decedent's death. However, they are not deductible merely because they have accrued in an accounting sense. Property taxes in order to be deductible must be an enforceable obligation of the decedent at the time of his death.

(c) *Death taxes.*—No estate, succession, legacy or inheritance tax payable by reason of the decedent's death is deductible, except as provided in § 20.2053–9 with respect to certain State death taxes on charitable, etc., transfers. However, see sections 2011 and 2014 and the regulations thereunder with respect to credits for death taxes.

(d) *Gift taxes.*—Unpaid gift taxes on gifts made by a decedent before his death are deductible. If a gift is considered as made one-half by the decedent and one-half by his spouse under section 2513, the entire amount of the gift tax, unpaid at the decedent's death, attributable to a gift in fact made by the decedent is deductible. No portion of the tax attributable to a gift in fact made by the decedent's spouse is deductible except to the extent that the obligation is enforced against the decedent's estate and his estate has no effective right of contribution against his spouse. (See section 2012 and § 20.2012–1 with respect to credit for gift taxes paid upon gifts of property included in a decedent's gross estate.)

(e) *Excise taxes.*—Excise taxes incurred in selling property of a decedent's estate are deductible as an expense of administration if the sale is necessary in order to (1) pay the decedent's debts, expenses of administration, or taxes, (2) preserve the estate, or (3) effect distribution. Excise taxes incurred in distributing property of the estate in kind are also deductible.

(f) *Income taxes.*—Unpaid income taxes are deductible if they are on income properly includible in an income tax return of the decedent for a period before his death. Taxes on income received after the decedent's death are not deductible. If income received by a decedent during his lifetime is included in a joint income tax return filed by the decedent and his spouse, or by the decedent's estate and his surviving spouse, the portion of the joint liability for the period covered by the return for which a deduction will be allowed is the amount for which the decedent's estate would be liable under local law, as between the decedent and his spouse, after enforcement of any effective right of reimbursement or contribution. In the absence of evidence to the contrary, the deductible amount is presumed to be an amount bearing the same ratio to the total joint tax liability for the period covered by the return that the amount of income tax for which the decedent would have been liable if he had filed a separate

return for that period bears to the total of the amounts for which the decedent and his spouse would have been liable if they had both filed separate returns for that period. Thus, in the absence of evidence to the contrary, the deductible amount equals

$$\frac{\text{decedent's separate tax}}{\text{both separate taxes}} \times \text{joint tax.}$$

However, the deduction cannot in any event exceed the lesser of—

(1) The decedent's liability for the period (as determined in this paragraph) reduced by the amounts already contributed by the decedent toward payment of the joint liability, or

(2) If there is an enforceable agreement between the decedent and his spouse or between the executor and the spouse relative to the payment of the joint liability, the amount which pursuant to the agreement is to be contributed by the estate toward payment of the joint liability.

If the decedent's estate and his surviving spouse are entitled to a refund on account of an overpayment of a joint income tax liability, the overpayment is an asset includible in the decedent's gross estate under section 2033 in the amount to which the estate would be entitled under local law, as between the estate and the surviving spouse. In the absence of evidence to the contrary, the includible amount is presumed to be the amount by which the decedent's contributions toward payment of the joint tax exceeds his liability determined in accordance with the principles set forth in this paragraph (other than subparagraph (1)).

§ 20.2053–7 Deduction for Unpaid Mortgages.—A deduction is allowed from a decedent's gross estate of the full unpaid amount of a mortgage upon, or of any other indebtedness in respect of, any property of the gross estate, including interest which had accrued thereon to the date of death, provided the value of the property, undiminished by the amount of the mortgage or indebtedness, is included in the value of the gross estate. If the decedent's estate is liable for the amount of the mortgage or indebtedness, the full value of the property subject to the mortgage or indebtedness must be included as part of the value of the gross estate; the amount of the mortgage or indebtedness being in such case allowed as a deduction. But if the decedent's estate is not so liable, only the value of the equity of redemption (or the value of the property, less the mortgage or indebtedness) need be returned as part of the value of the gross estate. In no case may the deduction on account of the mortgage or indebtedness exceed the liability therefor contracted bona fide and for an adequate and full consideration in money or money's worth. See § 20.2043–1. Only interest accrued to the date of the decedent's death is allowable even though the alternate valuation method under section 2032 is selected. Inasmuch as real property outside of the United States does not form a part of the gross estate, no deduction may be taken of any mortgage thereon or any other indebtedness in respect thereof.

§ 20.2053–8 Deduction for Expenses in Administering Property Not Subject to Claims.—(a) Expenses incurred in administer-

ing property included in a decedent's gross estate but not subject to claims fall within the second category of deductions set forth in § 20.2053–1, and may be allowed as deductions if they—

(1) Would be allowed as deductions in the first category if the property being administered were subject to claims; and

(2) Were paid before the expiration of the period of limitation for assessment provided in section 6501.

Usually, these expenses are incurred in connection with the administration of a trust established by a decedent during his lifetime. They may also be incurred in connection with the collection of other assets or the transfer or clearance of title to other property included in a decedent's gross estate for estate tax purposes but not included in his probate estate.

(b) These expenses may be allowed as deductions only to the extent that they would be allowed as deductions under the first category if the property were subject to claims. See § 20.2053–3. The only expenses in administering property not subject to claims which are allowed as deductions are those occasioned by the decedent's death and incurred in settling the decedent's interest in the property or vesting good title to the property in the beneficiaries. Expenses not coming within the description in the preceding sentence but incurred on behalf of the transferees are not deductible.

(c) The principles set forth in paragraphs (b), (c), and (d) of § 20.2053–3 (relating to the allowance of executor's commissions, attorney's fees, and miscellaneous administration expenses of the first category) are applied in determining the extent to which trustee's commissions, attorney's and accountant's fees, and miscellaneous administration expenses are allowed in connection with the administration of property not subject to claims.

(d) The application of this section may be illustrated by the following examples:

Example (1). In 1940, the decedent made an irrevocable transfer of property to the X Trust Company, as trustee. The instrument of transfer provided that the trustee should pay the income from the property to the decedent for the duration of his life and, upon his death, distribute the corpus of the trust among designated beneficiaries. The property was included in the decedent's gross estate under the provisions of section 2036. Three months after the date of death, the trustee distributed the trust corpus among the beneficiaries, except for $6,000 which it withheld. The amount withheld represented $5,000 which it retained as trustee's commissions in connection with the termination of the trust and $1,000 which it had paid to an attorney for representing it in connection with the termination. Both the trustee's commissions and the attorney's fees were allowable under the law of the jurisdiction in which the trust was being administered, were reasonable in amount, and were in accord with local custom. Under these circumstances, the estate is allowed a deduction of $6,000.

Example (2). In 1945, the decedent made an irrevocable transfer of property to Y Trust Company, as trustee. The instrument of transfer provided that the trustee should pay the income from the property to the decedent during his life. If the decedent's wife survived him, the trust was to continue for the duration of her life, with

Y Trust Company and the decedent's son as co-trustees, and with income payable to the decedent's wife for the duration of her life. Upon the death of both the decedent and his wife, the corpus is to be distributed among designated remaindermen. The decedent was survived by his wife. The property was included in the decedent's gross estate under the provisions of section 2036. In accordance with local custom, the trustee made an accounting to the court as of the date of the decedent's death. Following the death of the decedent, a controversy arose among the remaindermen as to their respective rights under the instrument of transfer, and a suit was brought in court to which the trustee was made a party. As a part of the accounting, the court approved the following expenses which the trustee had paid within 3 years following the date of death: $10,000, trustee's commissions; $5,000, accountant's fees; $25,000, attorney's fees; and $2,500, representing fees paid to the guardian of a remainderman who was a minor. The trustee's commissions and accountant's fees were for services in connection with the usual issues involved in a trust accounting as also were one-half of the attorney's and guardian's fees. The remainder of the attorney's and guardian's fees were for services performed in connection with the suit brought by the remaindermen. The amount allowed as a deduction is the $28,750 ($10,000, trustee's commissions; $5,000, accountant's fees; $12,500, attorney's fees; and $1,250, guardian's fees) incurred as expenses in connection with the usual issues involved in a trust accounting. The remaining expenses are not allowed as deductions since they were incurred on behalf of the transferees.

Example (3). Decedent in 1950 made an irrevocable transfer of property to the Z Trust Company, as trustee. The instrument of transfer provided that the trustee should pay the income from the property to the decedent's wife for the duration of her life. If the decedent survived his wife the trust corpus was to be returned to him but if he did not survive her, then upon the death of the wife the trust corpus was to be distributed among their children. The decedent predeceased his wife and the transferred property, less the value of the wife's outstanding life estate, was included in his gross estate under the provisions of section 2037 since his reversionary interest therein immediately before his death was in excess of 5 percent of the value of the property. At the wife's request, the court ordered the trustee to render an accounting of the trust property as of the date of the decedent's death. No deduction will be allowed the decedent's estate for any of the expenses incurred in connection with the trust accounting, since the expenses were incurred on behalf of the wife.

Example (4). If, in the preceding example, the decedent died without other property and no executor or administrator of his estate was appointed, so that it was necessary for the trustee to prepare an estate tax return and participate in its audit, or if the trustee required accounting proceedings for its own protection in accordance with local custom, trustees', attorneys', and guardians' fees in connection with the estate tax or accounting proceedings would be deductible to the same extent that they would be deductible if the property were subject to claims. Deductions incurred under similar circumstances by a surviving joint tenant or the recipient of life insurance proceeds would also be deductible.

§ 20.2053–9 Deduction for Certain State Death Taxes.—(a) *General rule.*—A deduction is allowed a decedent's estate under section 2053(d) for the amount of any estate, succession, legacy, or inheritance tax imposed by a State, Territory, the District of Columbia, or any possession of the United States upon a transfer by the decedent for charitable, etc., uses described in section 2055 or 2106(a)(2) (relating to the estates of nonresidents not citizens), but only if (1) the conditions stated in paragraph (b) of this section are met, and (2) an election is made in accordance with the provisions of paragraph (c) of this section. See section 2011 (e) and § 20.2011–2 for the effect which the allowance of this deduction has upon the credit for State death taxes.

(b) *Condition for allowance of deduction.*—(1) The deduction is not allowed unless either—

(i) The entire decrease in the Federal estate tax resulting from the allowance of the deduction inures solely to the benefit of a charitable, etc., transferee described in section 2055 or 2106(a)(2), or

(ii) The Federal estate tax is equitably apportioned among all the transferees (including the decedent's surviving spouse and the charitable, etc., transferees) of property included in the decedent's gross estate.

For allowance of the credit, it is sufficient if either of these conditions is satisfied. Thus, in a case where the entire decrease in Federal estate tax inures to the benefit of a charitable transferee, the deduction is allowable even though the Federal estate tax is not equitably apportioned among all the transferees of property included in the decedent's gross estate. Similarly, if the Federal estate tax is equitably apportioned among all the transferees of property included in the decedent's gross estate, the deduction is allowable even though a noncharitable transferee receives some benefit from the allowance of the deduction.

(2) For purposes of this paragraph, the Federal estate tax is considered to be equitably apportioned among all the transferees (including the decedent's surviving spouse and the charitable, etc., transferees) of property included in the decedent's gross estate only if each transferee's share of the tax is based upon the net amount of his bequest subjected to the tax (taking into account any exemptions, credits, or deductions allowed by chapter 11). See examples (2) through (5) of paragraph (e) of this section.

(c) *Exercise of election.*—The election to take a deduction for a State death tax imposed upon a transfer for charitable, etc., uses shall be exercised by the executor by the filing of a written notification to that effect with the district director of internal revenue in whose district the estate tax return for the decedent's estate was filed. The notification shall be filed before the expiration of the period of limitation for assessment provided in section 6501 (usually 3 years from the last day for filing the return). The election may be revoked by the executor by the filing of a written notification to that effect with the district director at any time before the expiration of such period.

(d) *Amount of State death tax imposed upon a transfer.*—If a State death tax is imposed upon the transfer of the decedent's entire

estate and not upon the transfer of a particular share thereof, the State death tax imposed upon a transfer for charitable, etc., uses is deemed to be an amount, E, which bears the same ratio to F (the amount of the State death tax imposed with respect to the transfer of the entire estate) as G (the value of the charitable, etc., transfer, reduced as provided in the next sentence) bears to H (the total value of the properties, interests, and benefits subjected to the State death tax received by all persons interested in the estate, reduced as provided in the last sentence of this paragraph). In arriving at amount G of the ratio, the value of the charitable, etc., transfer is reduced by the amount of any deduction or exclusion allowed with respect to such property in determining the amount of the State death tax. In arriving at amount H of the ratio, the total value of the properties, interests, and benefits subjected to State death tax received by all persons interested in the estate is reduced by the amount of all deductions and exclusions allowed in determining the amount of the State death tax on account of the nature of a beneficiary or a beneficiary's relationship to the decedent.

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

Example (1). The decedent's gross estate was valued at $200,000. He bequeathed $90,000 to a newphew, $10,000 to Charity A, and the remainder of his estate to Charity B. State inheritance tax in the amount of $13,500 was imposed upon the bequest to the nephew, $1,500 upon the bequest to Charity A, and $15,000 upon the bequest to Charity B. Under the will and local law, each legatee is required to pay the State inheritance tax on his bequest, and the Federal estate tax is to be paid out of the residuary estate. Since the entire burden of paying the Federal estate tax falls on Charity B, it follows that the decrease in the Federal estate tax resulting from the allowance of deductions for State death taxes in the amounts of $1,500 and $15,000 would inure solely for the benefit of Charity B. Therefore, deductions of $1,500 and $15,000 are allowable under section 2053(d). If, in this example, the State death taxes as well as the Federal estate tax were to be paid out of the residuary estate, the result would be the same.

Example (2). The decedent's gross estate was valued at $350,000. Expenses, indebtedness, etc., amounted to $50,000. The entire estate was bequeathed in equal shares to a son, a daughter, and Charity C. State inheritance tax in the amount of $2,000 was imposed upon the bequest to the son, $2,000 upon the bequest to the daughter, and $5,000 upon the bequest to Charity C. Under the will and local law, each legatee is required to pay his own State inheritance tax and his proportionate share of the Federal estate tax determined by taking into consideration the net amount of his bequest subjected to the tax. Since each legatee's share of the Federal estate tax is based upon the net amount of his bequest subjected to the tax (note that the deductions under sections 2053(d) and 2055 will have the effect of reducing Charity C's proportionate share of the tax), the tax is considered to be equitably apportioned. Thus, a deduction of $5,000 is allowable under section 2053(d). This deduction together with a deduction of $95,000 under section 2055 (charitable deduction) will mean that

none of Charity C's bequest is subjected to Federal estate tax. Hence, the son and the daughter will bear the entire estate tax.

Example (3). The decedent bequeathed his property in equal shares, after payment of all expenses, to a son, a daughter, and a charity. State inheritance tax of $2,000 was imposed upon the bequest to the son, $2,000 upon the bequest to the daughter, and $15,000 upon the bequest to the charity. Under the will and local law, each beneficiary pays the State inheritance tax on his bequest and the Federal estate tax is to be paid out of the estate as an administration expense. If the deduction for State death tax on the charitable bequest is allowed in this case, some portion of the decrease in the Federal estate tax would inure to the benefit of the son and the daughter. The Federal estate tax is not considered to be equitably apportioned in this case since each legatee's share of the Federal estate tax is not based upon the net amount of his bequest subjected to the tax (note that the deductions under sections 2053(d) and 2055 will not have the effect of reducing the charity's proportionate share of the tax). Inasmuch as some of the decrease in the Federal estate tax payable would inure to the benefit of the son and the daughter, and inasmuch as there is no equitable apportionment of the tax, no deduction is allowable under section 2053(d).

Example (4). The decedent bequeathed his entire residuary estate in trust to pay the income to X for life with remainder to charity. The State imposed inheritance taxes of $2,000 upon the bequest to X and $10,000 upon the bequest to charity. Under the will and local law, all State and Federal taxes are payable out of the residuary estate and therefore they would reduce the amount which would become the corpus of the trust. If the deduction for the State death tax on the charitable bequest is allowed in this case, some portion of the decrease in the Federal estate tax would inure to the benefit of X since the allowance of the deduction would increase the size of the corpus from which X is to receive the income for life. Also, the Federal estate tax is not considered to be equitably apportioned in this case since each legatee's share of the Federal estate tax is not based upon the net amount of his bequest subjected to the tax (note that the deductions under sections 2053(d) and 2055 will not have the effect of reducing the charity's proportionate share of the tax). Inasmuch as some of the decrease in the Federal estate tax payable would inure to the benefit of X, and inasmuch as there is no equitable apportionment of the tax, no deduction is allowable under section 2053(d).

Example (5). The decedent's gross estate was valued at $750,000. Expenses, indebtedness, etc, amounted to $50,000. The decedent bequeathed $350,000 of his estate to his surviving spouse and the remainder of his estate equally to his son and Charity D. State inheritance tax in the amount of $7,000 was imposed upon the bequest to the surviving spouse, $26,250 upon the bequest to the son, and $26,250 upon the bequest to Charity D. The will was silent concerning the payment of taxes. In such a case, the local law provides that each legatee shall pay his own State inheritance tax. The local law further provides for an apportionment of the Federal estate tax among the legatees of the estate. Under the apportionment provisions, the surviving spouse is not required to bear any part of the Federal estate

tax with respect to her $350,000 bequest. It should be noted, however, that the marital deduction allowed to the decedent's estate by reason of the bequest to the surviving spouse is limited to $343,000 ($350,000 bequest less $7,000 State inheritance tax payable by the surviving spouse). Thus, the bequest to the surviving spouse is subjected to the Federal estate tax in the net amount of $7,000. If the deduction for State death tax on the charitable bequest is allowed in this case, some portion of the decrease in the Federal estate tax would inure to the benefit of the son. The Federal estate tax is not considered to be equitably apportioned in this case since each legatee's share of the Federal estate tax is not based upon the net amount of his bequest subjected to the tax (note that the surviving spouse is to pay no tax). Inasmuch as some of the decrease in the Federal estate tax payable would inure to the benefit of the son, and inasmuch as there is no equitable apportionment of the tax, no deduction is allowable under section 2053(d).

§ 20.2054 STATUTORY PROVISIONS; LOSSES.

SEC. 2054. LOSSES.

For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate losses incurred during the settlement of estates arising from fires, storms, shipwrecks, or other casualties, or from theft, when such losses are not compensated for by insurance or otherwise.

§ 20.2054–1 DEDUCTION FOR LOSSES FROM CASUALTIES OR THEFT.—A deduction is allowed for losses incurred during the settlement of the estate arising from fires, storms, shipwrecks, or other casualties, or from theft, if the losses are not compensated for by insurance or otherwise. If the loss is partly compensated for, the excess of the loss over the compensation may be deducted. Losses which are not of the nature described are not deductible. In order to be deductible a loss must occur during the settlement of the estate. If a loss with respect to an asset occurs after its distribution to the distributee it may not be deducted. Notwithstanding the foregoing, no deduction is allowed under this section if the estate has waived its right to take such a deduction pursuant to the provisions of section 642(g) in order to permit its allowance for income tax purposes. See further § 1.642(g)–1.

§ 20.2055 STATUTORY PROVISIONS; TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.

SEC. 2055. TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.

(a) IN GENERAL.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers (including the interest which falls into any such bequest, legacy, devise, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer, or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

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

(2) To or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educa-

tional purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings which inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) To a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, and no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda, or otherwise attempting, to influence legislation; or

(4) To or for the use of any veterans' organization incorporated by Act of Congress, or of its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

For purposes of this subsection, the complete termination before the date prescribed for the filing of the estate tax return of a power to consume, invade, or appropriate property for the benefit of an individual before such power has been exercised by reason of the death of such individual or for any other reason shall be considered and deemed to be an irrevocable disclaimer with the same full force and effect as though he had filed such irrevocable disclaimer.

(b) POWERS OF APPOINTMENT.—

(1) GENERAL RULE.—Property includible in the decedent's gross estate under section 2041 (relating to powers of appointment) received by a donee described in this section shall, for purposes of this section, be considered a bequest of such decedent.

(2) SPECIAL RULE FOR CERTAIN BEQUESTS SUBJECT TO POWER OF APPOINTMENT.—For purposes of this section, in the case of a bequest in trust, if the surviving spouse of the decedent is entitled for life to all of the net income from the trust and such surviving spouse has a power of appointment over the corpus of such trust exercisable by will in favor of, among others, organizations described in subsection (a)(2), such bequest in trust, reduced by the value of the life estate, shall, to the extent such power is exercised in favor of such organizations, be deemed a transfer to such organizations by the decedent if—

(A) No part of the corpus of such trust is distributed to a beneficiary during the life of the surviving spouse;

(B) Such surviving spouse was over 80 years of age at the date of the decedent's death;

(C) Such surviving spouse by affidavit executed within one year after the death of the decedent specifies the organizations described in subsection (a)(2) in favor of which he intends to exercise the power of appointment and indicates the amount or proportion each such organization is to receive; and

(D) The power of appointment is exercised in favor of such organizations and in the amounts or proportions specified in the affidavit required under subparagraph (C).

The affidavit referred to in subparagraph (C) shall be attached to the estate tax return of the decedent and shall constitute a sufficient basis for the allowance of the deduction under this paragraph in the first instance subject to a later disallowance of the deduction if the conditions herein specified are not complied with.

(c) DEATH TAXES PAYABLE OUT OF BEQUESTS.—If the tax imposed by section 2001, or any estate, succession, legacy, or inheritance taxes, are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this section, then the amount deductible under this section shall be the amount of such bequests, legacies, or devises reduced by the amount of such taxes.

(d) LIMITATION ON DEDUCTION.—The amount of the deduction under this section for any transfer shall not exceed the value of the transferred property required to be included in the gross estate.

(e) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—For disallowance of certain charitable, etc., deductions otherwise allowable under this section, see sections 504 and 681.

(f) OTHER CROSS REFERENCES.—

(1) For option as to time for valuation for purpose of deduction under this section, see section 2032.

(2) For exemption of bequests to or for benefit of Library of Congress, see section 5 of the Act of March 3, 1925, as amended (56 Stat. 765; 2 U. S. C. 161).

(3) For construction of bequests for benefit of the library of the Post Office Department as bequests to or for the use of the United States, see section 2 of the Act of August 8, 1946 (60 Stat. 924; 5 U. S. C. 393).

(4) For exemption of bequests for benefit of Office of Naval Records and Library, Navy Department, see section 2 of the Act of March 4, 1937 (50 Stat. 25; 5 U. S. C. 419b).

(5) For exemption of bequests to or for benefit of National Park Service, see section 5 of the Act of July 10, 1935 (49 Stat. 478; 16 U. S. C. 19c).

(6) For construction of devises or bequests accepted by the Secretary of State under the Foreign Service Act of 1946 as devises or bequests to or for the use of the United States, see section 1021(e) of that Act (60 Stat. 1032; 22 U. S. C. 809).

(7) For construction of gifts or bequests of money accepted by the Attorney General for credit to "Commissary Funds, Federal Prisons" as gifts or bequests to or for the use of the United States, see section 2 of the Act of May 15, 1952, 66 Stat. 73, as amended by the Act of July 9, 1952, 66 Stat. 479 (31 U. S. C. 725s–4).

(8) For payment of tax on bequests of United States obligations to the United States, see section 24 of the Second Liberty Bond Act, as amended (59 Stat. 48, § 4; 31 U. S. C. 757e).

(9) For construction of bequests for benefit of or use in connection with the Naval Academy as bequests to or for the use of the United States, see section 3 of the Act of March 31, 1944 (58 Stat. 135; 34 U. S. C. 1115b).

(10) For exemption of bequests for benefit of Naval Academy Museum, see section 4 of the Act of March 26, 1938 (52 Stat. 119; 34 U. S. C. 1119).

(11) For exemption of bequests received by National Archives Trust Fund Board, see section 7 of the National Archives Trust Fund Board Act (55 Stat. 582; 44 U. S. C. 300gg).

[Sec. 2055 as amended by sec. 1, Act of Aug. 6, 1956 (Pub. Law 1011, 84th Cong., 70 Stat. 1075, C. B. 1956–2, 1206)]

§ 20.2055–1 DEDUCTION FOR TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES; IN GENERAL.—(a) *General rule.*—A deduction is allowed under section 2055(a) from the gross estate of a decedent who was a citizen or resident of the United States at the time of his death for the value of property included in the decedent's gross estate and transferred by the decedent during his lifetime or by will—

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

(2) To or for the use of any corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), if no part of the net earnings of the corporation or association inures to the benefit of any private stockholder or individual (other than

as a legitimate object of such purposes), and no substantial part of its activities is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) To a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, if the transferred property is to be used exclusively for religious, charitable, scientific, literary, or educational purposes (or for the prevention of cruelty to children or animals), and if no substantial part of the activities of such transferee is carrying on propaganda, or otherwise attempting to influence legislation; or

(4) To or for the use of any veterans' organization incorporated by Act of Congress, or of any of its departments, local chapters, or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

The deduction is not limited, in the case of estates of citizens or residents of the United States, to transfers to domestic corporations or associations, or to trustees for use within the United States. Nor is the deduction subject to percentage limitations such as are applicable to the charitable deduction under the income tax. However, sections 503(e) and 681(b)(5) provide that no deduction is allowed for transfers to organizations or trusts described in subparagraphs (2) and (3) of this paragraph which have engaged in certain "prohibited transactions" (see § 20.2055–4).

(b) *Powers of appointment.*—(1) *General rule.*—A deduction is allowable under section 2055(b) for the value of property passing to or for the use of a transferee described in paragraph (a) of this section by the exercise, failure to exercise, release or lapse of a power of appointment by reason of which the property is includible in the decedent's gross estate under section 2041.

(2) *Certain bequests subject to power of appointment.*—For the allowance of a deduction in the case of a bequest in trust where the decedent's surviving spouse (i) was over 80 years of age at the date of the decedent's death, (ii) was entitled for life to all of the net income from the trust, and (iii) had a power of appointment over the corpus of the trust exercisable by will in favor of, among others, a charitable organization, see section 2055(b)(2). See also section 6503(e) for suspension of the period of limitations for assessment or collection of any deficiency attributable to the allowance of the deduction.

(c) *Submission of evidence.*—In establishing the right of the estate to the deduction authorized by section 2055, the executor should submit the following with the return:

(1) A copy of any instrument in writing by which the decedent made a transfer of property in his lifetime the value of which is required by statute to be included in his gross estate, for which a deduction under section 2055 is claimed. If the instrument is of record the copy should be certified, and if not of record, the copy should be verified.

(2) A written statement by the executor containing a declaration that it is made under penalties of perjury and stating whether any action has been instituted to construe or to contest the decedent's will or any provision thereof affecting the charitable deduction claimed and whether, according to his information and belief, any such action is designed or contemplated.

The executor shall also submit such other documents or evidence as may be requested by the district director.

§ 20.2055–2 TRANSFER NOT EXCLUSIVELY FOR CHARITABLE PURPOSES.—(a) *Remainders and similar interests.*—If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The present value of a remainder or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in § 20.2031–7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor from column 4 of Table I or Table II of § 20.2031–7, whichever is applicable. If the interest transferred is such that its value is to be determined by a special computation (see paragraph (e) of § 20.2031–7), a request for a specific factor, accompanied by a statement of the date of birth of each person the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments, may be submitted by the executor to the Commissioner who may, if conditions permit, supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph of § 20.2031–7.

(b) *Transfers subject to a condition or a power.*—If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power. The deduction is not allowed in the case of a transfer in trust conveying to charity a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust by the decedent consist of stock in a corporation the fiscal policies of which are controlled by the decedent and his family, that the trustees and remaindermen are likewise members of the decedent's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circum-

stances, no deduction will be allowed. Similarly, if the trustees are not members of the decedent's family but have no power to sell or otherwise dispose of the closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction will be allowed.

(c) *Disclaimers.*—The amount of a bequest, devise, or transfer, for which a deduction is allowable under section 2055, includes an interest which falls into the bequest, devise, or transfer as a result of either—

(1) A disclaimer of a bequest, devise, transfer, or power, if (i) the disclaimer is made within 15 months after the decedent's death (the period of time within which the estate tax return must be filed under section 6075) or within any extension of time for filing the return granted pursuant to section 6081, and (ii) the disclaimer is irrevocable at the time the deduction is allowed, or

(2) The complete termination of a power to consume, invade, or appropriate property for the benefit of an individual (whether the termination occurs by reason of the death of the individual, or otherwise) if the termination occurs (i) within the period described in subparagraph (1)(i) of this paragraph, and (ii) before the power has been exercised.

Ordinarily, a disclaimer made by a person not under any legal disability will be considered irrevocable when filed with the probate court. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. Thus, if a beneficiary uses these rights for his own purposes, as by receiving a consideration for his formal disclaimer, he has not refused the rights to which he was entitled. There can be no disclaimer after an acceptance of these rights, expressly or impliedly. The disclaimer of a power is to be distinguished from the release or exercise of a power. The release or exercise of a power by the donee of the power in favor of a person or object described in paragraph (a) of § 20.2055–1 does not result in any deduction under section 2055 in the estate of the donor of a power (but see paragraph (b)(1) of § 20.2055–1 with respect to the donee's estate).

(d) *Payments in compromise.*—If a charitable organization assigns or surrenders a part of a transfer to it pursuant to a compromise agreement in settlement of a controversy, the amount so assigned or surrendered is not deductible as a transfer to that charitable organization.

§ 20.2055–3 Death Taxes Payable Out of Charitable Transfers.—(a) If under the terms of the will or other governing instrument, the law of the jurisdiction under which the estate is administered, or the law of the jurisdiction imposing the particular tax, the Federal estate tax, or any estate, succession, legacy, or inheritance tax is payable in whole or in part out of any property the transfer of which would otherwise be allowable as a deduction under section 2055, section 2055(c) provides that the sum deductible is the amount of the transferred property reduced by the amount of the tax. Section 2055(c) in effect provides that the deduction is based on the amount actually available for charitable uses, that is, the amount of the fund remaining after the payment of all death taxes. Thus, if $50,000 is bequeathed for a charitable purpose and is subjected to a State inheritance tax of $5,000, payable out of the $50,000, the amount

deductible is $45,000. If a life estate is bequeathed to an individual with remainder over to a charitable organization, and by the local law the inheritance tax upon the life estate is paid out of the corpus with the result that the charitable organization will be entitled to receive only the amount of the fund less the tax, the deduction is limited to the present value, as of the date of the testator's death, of the remainder of the fund so reduced. If a testator bequeaths his residuary estate, or a portion of it, to charity, and his will contains a direction that certain inheritance taxes, otherwise payable from legacies upon which they were imposed, shall be payable out of the residuary estate, the deduction may not exceed the bequest to charity thus reduced pursuant to the direction of the will. If a residuary estate, or a portion of it, is bequeathed to charity, and by the local law the Federal estate tax is payable out of the residuary estate, the deduction may not exceed that portion of the residuary estate bequeathed to charity as reduced by the Federal estate tax. The return should fully disclose the computation of the amount to be deducted. If the amount to be deducted is dependent upon the amount of any death tax which has not been paid before the filing of the return, there should be submitted with the return a computation of that tax.

(b) It should be noted that if the Federal estate tax is payable out of a charitable transfer so that the amount of the transfer otherwise passing to charity is reduced by the amount of the tax, the resultant decrease in the amount passing to charity will further reduce the allowable deduction. In such a case, the amount of the charitable deduction can be obtained only by a series of trial-and-error computations, or by a formula. If, in addition, interdependent State and Federal taxes are involved, the computation becomes highly complicated. Examples of methods of computation of the charitable deduction and the marital deduction (with which similar problems are encountered) in various situations are contained in supplemental instructions to the estate tax return.

(c) For the allowance of a deduction to a decedent's estate for certain State death taxes imposed upon charitable transfers, see section 2053(d) and § 20.2053–9.

§ 20.2055–4 Disallowance of Charitable, Etc., Deductions Because of "Prohibited Transactions".—(a) Sections 503(e) and 681(b)(5) provide that no deduction which would otherwise be allowable under section 2055 for the value of property transferred by the decedent during his lifetime or by will for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals) is allowed if (1) the transfer is made in trust, and, for income tax purposes for the taxable year of the trust in which the transfer is made, the deduction otherwise allowable to the trust under section 642(c) is limited by section 681(b)(1) by reason of the trust having engaged in a prohibited transaction described in section 681(b)(2), or (2) the transfer is made to a corporation, community chest, fund or foundation which, for its taxable year in which the transfer is made, is not exempt from income tax under section 501(a) by reason of having engaged in a prohibited transaction described in section 503(c).

(b) For purposes of section 681(b)(5) and section 503(e), the term "transfer" includes any gift, contribution, bequest, devise, legacy, or other disposition. In applying such sections for estate tax purposes, a transfer, whether made during the decedent's lifetime or by will, is considered as having been made at the moment of the decedent's death.

(c) The income tax regulations contain the rules for the determination of the taxable year of the trust for which the deduction under section 642(c) is limited by section 681(b) and for the determination of the taxable year of the organization for which an exemption is denied under section 503(a). Generally, such taxable year is a taxable year subsequent to the taxable year during which the trust or organization has been notified by the Commissioner of Internal Revenue that it has engaged in a prohibited transaction. However, if the trust or organization during or prior to the taxable year entered into the prohibited transaction for the purpose of diverting its corpus or income from the charitable or other purposes by reason of which it is entitled to a deduction or exemption, and the transaction involves a substantial part of the income or corpus, then the deduction of the trust under section 642(c) for such taxable year is limited by section 681(b), or exemption of the organization for such taxable year is denied under section 503(a), whether or not the organization has previously received notification by the Commissioner of Internal Revenue that it is engaged in a prohibited transaction. In certain cases, the limitation of sections 681 or 503 may be removed or the exemption may be reinstated for certain subsequent taxable years under the rules set forth in the income tax regulations under sections 681 and 503. In cases in which prior notification by the Commissioner of Internal Revenue is not required in order to limit the deduction of the trust under section 681(b) or to deny exemption of the organization under section 503, the deduction otherwise allowable under section 2055 is not disallowed in respect of transfers made during the same taxable year of the trust or organization in which a prohibited transaction occurred or in a prior taxable year unless the decedent or a member of his family was a party to the prohibited transaction. For the purpose of the preceding sentence, the members of the decedent's family include only his brothers and sisters, whether by whole or half blood, spouse, ancestors, and lineal descendants.

§ 20.2056(a) STATUTORY PROVISIONS; BEQUESTS, ETC., TO SURVIVING SPOUSE; ALLOWANCE OF MARITAL DEDUCTION.

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) ALLOWANCE OF MARITAL DEDUCTION.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

§ 20.2056(a)-1 MARITAL DEDUCTION; IN GENERAL.—(a) A deduction is allowed under section 2056 from the gross estate of a decedent who was a citizen or resident of the United States at the time of his death for the value of any property interest which passed from the decedent to his surviving spouse, if the interest is a "deductible inter-

est" as defined in § 20.2056(a)-2, and if the total of such interests does not exceed the percentage limitation set forth in §§ 20.2056(c)-1 and 20.2056(c)-2. This deduction is referred to as the "marital deduction". The marital deduction is generally not available if the decedent's gross estate consists exclusively of property held by the decedent and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or any foreign country. See § 20.2056(c)-2. Except as otherwise provided by a death tax convention with a foreign country, the marital deduction is not allowed in the case of an estate of a nonresident who was not a citizen of the United States at the time of his death. However, if the decedent was a citizen or resident, his estate is not deprived of the right to the marital deduction by reason of the fact that his surviving spouse was neither a resident nor a citizen. For convenience, the surviving spouse is generally referred to in the feminine gender, but if the decedent was a woman the reference is to her surviving husband. Sections 20.2056(b)-1 through 20.2056(b)-6 contain miscellaneous rules for determining the amount of "deductible interests"; §§ 20.2056(c)-1 and 20.2056(c)-2 provide a percentage limitation on the allowable amount of the marital deduction; § 20.2056(d)-1 states special rules concerning disclaimers of interests in property; and §§ 20.2056(e)-1 through 20.2056(e)-3 define various terms used in the aforementioned sections.

(b) In order to obtain the marital deduction with respect to any property interest, the executor must establish the following facts:

(1) That the decedent was survived by his spouse (see paragraph (e) of § 20.2056(e)-2);

(2) That the property interest passed from the decedent to his spouse (see §§ 20.2056(b)-5, 20.2056(b)-6, 20.2056(d)-1, and 20.2056(e)-1 through 20.2056(e)-3);

(3) That the property interest is a "deductible interest" (see § 20.2056(a)-2);

(4) The value of the property interest (see § 20.2056(b)-4); and

(5) The value of the decedent's "adjusted gross estate" (see §§ 20.2056(c)-1 and 20.2056(c)-2).

The executor must submit such proof as is necessary to establish these facts, including any evidence requested by the district director.

§ 20.2056(a)-2 Marital Deduction; "Deductible Interests" and "Nondeductible Interests".—(a) Property interests which passed from a decedent to his surviving spouse fall within two general categories: (1) those with respect to which the marital deduction is authorized, and (2) those with respect to which the marital deduction is not authorized. These categories are referred to in this section and other sections of the regulations under section 2056 as "deductible interests" and "nondeductible interests", respectively (see paragraph (b) of this section). Subject to the percentage limitation set forth in §§ 20.2056(c)-1 and 20.2056(c)-2, the marital deduction is equal in amount to the aggregate value of the "deductible interests".

(b) An interest passing to a decedent's surviving spouse is a "deductible interest" if it does not fall within one of the following categories of "nondeductible interests":

(1) Any property interest which passed from the decedent to his surviving spouse is a "nondeductible interest" to the extent it is not included in the decedent's gross estate.

(2) If a deduction is allowed under section 2053 (relating to deductions for expenses and indebtedness) by reason of the passing of a property interest from the decedent to his surviving spouse, such interest is, to the extent of the deduction under section 2053, a "nondeductible interest". Thus, a property interest which passed from the decedent to his surviving spouse in satisfaction of a deductible claim of the spouse against the estate is, to the extent of the claim, a "nondeductible interest" (see § 20.2056(b)–4). Similarly, amounts deducted under section 2053(a)(2) for commissions allowed to the surviving spouse as executor are "nondeductible interests". As to the valuation, for the purpose of the marital deduction, of any property interest which passed from the decedent to his surviving spouse subject to a mortgage or other encumbrance, see § 20.2056(b)–4.

(3) If during settlement of the estate a loss deductible under section 2054 occurs with respect to a property interest, then that interest is, to the extent of the deductible loss, a "nondeductible interest" for the purpose of the marital deduction.

(4) A property interest passing to a decedent's surviving spouse which is a "terminable interest", as defined in § 20.2056(b)–1, is a "nondeductible interest" to the extent specified in that section.

§ 20.2056(b) STATUTORY PROVISION; BEQUESTS, ETC., TO SURVIVING SPOUSE; LIMITATION IN THE CASE OF LIFE ESTATE OR OTHER TERMINABLE INTEREST.

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE. * * *

(b) LIMITATION IN THE CASE OF LIFE ESTATE OR OTHER TERMINABLE INTEREST.—

(1) GENERAL RULE.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

(A) If an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(B) If by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))—

(C) If such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this paragraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

(2) INTEREST IN UNIDENTIFIED ASSETS.—Where the assets (included in the decedent's gross estate) out of which, or the proceeds of which, an interest passing to the surviving spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets passed from the

decedent to such spouse, then the value of such interest passing to such spouse shall, for purposes of subsection (a), be reduced by the aggregate value of such particular assets.

(3) INTEREST OF SPOUSE CONDITIONAL ON SURVIVAL FOR LIMITED PERIOD.—For purposes of this subsection, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if—

(A) Such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and

(B) Such termination or failure does not in fact occur.

(4) VALUATION OF INTEREST PASSING TO SURVIVING SPOUSE.—In determining for purposes of subsection (a) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this section—

(A) There shall be taken into account the effect which the tax imposed by section 2001, or any estate, succession, legacy, or inheritance tax, has on the net value to the surviving spouse of such interest; and

(B) Where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

(5) LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) The interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) No part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(6) LIFE INSURANCE OR ANNUITY PAYMENTS WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, on the termination of any interest payments, are payable in a lump sum or in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than 13 months after the decedent's death, and all amounts, or a specific portion of all such amounts, payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts, or such specific portion, payable under such contract (exercisable in favor of such surviving spouse, or of

the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint such amounts to any person other than the surviving spouse—

(A) Such amounts shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) No part of such amounts shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if, under the terms of the contract, such power in the surviving spouse to appoint such amounts, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

§ 20.2056(b)-1 MARITAL DEDUCTION; LIMITATION IN CASE OF LIFE ESTATE OF OTHER "TERMINABLE INTEREST."—(a) *In general.*—Section 2056(b) provides that no marital deduction is allowed with respect to certain property interests, referred to generally as "terminable interests", passing from a decedent to his surviving spouse. The phrase "terminable interest" is defined in paragraph (b) of this section. However, the fact that an interest in property passing to a decedent's surviving spouse is a "terminable interest" makes it nondeductible only (1) under the circumstances described in paragraph (c) of this section, and (2) if it does not come within one of the exceptions referred to in paragraph (d) of this section.

(b) *"Terminable interests".*—A "terminable interest" in property is an interest which will terminate or fail on the lapse of time or on the occurrence or the failure to occur of some contingency. Life estates, terms for years, annuities, patents, and copyrights are therefore terminable interests. However, a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity or a term for years, is not a terminable interest.

(c) *Nondeductible terminable interests.*—(1) A property interest which constitutes a terminable interest, as defined in paragraph (b) of this section, is nondeductible if—

(i) Another interest in the same property passed from the decedent to some other person for less than an adequate and full consideration in money or money's worth, and

(ii) By reason of its passing, the other person or his heirs or assigns may possess or enjoy any part of the property after the termination or failure of the spouse's interest.

(2) Even though a property interest which constitutes a terminable interest is not nondeductible by reason of the rules stated in subparagraph (1) of this paragraph, such an interest is nondeductible if—

(i) The decedent has directed his executor or a trustee to acquire such an interest for the decedent's surviving spouse (see further paragraph (f) of this section), or

(ii) Such an interest passing the decedent's surviving spouse may be satisfied out of a group of assets which includes a nondeductible interest (see further § 20.2056(b)-2). In this case, however, full nondeductibility may not result.

(d) *Exceptions.*—A property interest passing to a decedent's surviving spouse is deductible (if it is not otherwise disqualified under § 20.2056(a)-2) even though it is a terminable interest, and even though an interest therein passed from the decedent to another person, if it is a terminable interest only because—

(1) It is conditioned on the spouse's surviving for a limited period, in the manner described in § 20.2056(b)-3;

(2) It is a right to income for life with a general power of appointment, meeting the requirements set forth in § 20.2056(b)-5; or

(3) It consists of life insurance or annuity payments held by the insurer with a general power of appointment in the spouse, meeting the requirements set forth in § 20.2056(b)-6.

(e) *Miscellaneous principles.*—(1) In determining whether an interest passed from the decedent to some other person, it is immaterial whether interests in the same property passed to the decedent's spouse and another person at the same time, or under the same instrument.

(2) In determining whether an interest in the same property passed from the decedent both to his surviving spouse and to some other person, a distinction is to be drawn between "property", as such term is used in section 2056, and an "interest in property". The term "property" refers to the underlying property in which various interests exist; each such interest is not for this purpose to be considered as "property".

(3) Whether or not an interest is nondeductible because it is a terminable interest is to be determined by reference to the property interests which actually passed from the decedent. Subsequent conversions of the property are immaterial for this purpose. Thus, where a decedent bequeathed his estate to his wife for life with remainder to his children, the interest which passed to his wife is a nondeductible interest, even though the wife agrees with the children to take a fractional share of the estate in fee in lieu of the life interest in the whole, or sells the life estate for cash, or acquires the remainder interest of the children either by purchase or gift.

(4) The terms "passed from the decedent", "passed from the decedent to his surviving spouse", and "passed from the decedent to a person other than his surviving spouse" are defined in §§ 20.2056(e)-1 through 20.2056(e)-3.

(f) *Direction to acquire a terminable interest.*—No marital deduction is allowed with respect to a property interest which a decedent directs his executor or a trustee to convert after his death into a terminable interest for his surviving spouse. The marital deduction is not allowed even though no interest in the property subject to the terminable interest passes to another person and even though the interest would otherwise come within the exceptions described in § 20.2056(b)-5 and § 20.2056(b)-6 (relating to life estates and life insurance and annuity payments with powers of appointment). However, a general investment power, authorizing investments in both terminable interests and other property, is not a direction to invest in a terminable interest.

(g) *Examples.*—The application of this section may be illustrated by the following examples, in each of which it is assumed that the property interest which passed from the decedent to a person other than his surviving spouse did not pass for an adequate and full consideration in money or money's worth:

Example (1). H (the decedent) devised real property to W (his surviving wife) for life, with remainder to A and his heirs. The interest which passed from H to W is a nondeductible interest since

it will terminate upon her death and A (or his heirs or assigns) will thereafter possess or enjoy the property.

Example (2). H bequeathed the residue of his estate in trust for the benefit of W and A. The trust income is to be paid to W for life, and upon her death the corpus is to be distributed to A or his issue. However, if A should die without issue, leaving W surviving, the corpus is then to be distributed to W. The interest which passed from H to W is a nondeductible interest since it will terminate in the event of her death if A or his issue survive, and A or his issue will thereafter possess or enjoy the property.

Example (3). H during his lifetime purchased an annuity contract providing for payments to himself for life and then to W for life if she should survive him. Upon the death of the survivor of H and W, the excess, if any, of the cost of the contract over the annuity payments theretofore made was to be refunded to A. The interest which passed from H to W is a nondeductible interest since A may possess or enjoy a part of the property following the termination of the interest of W. If, however, the contract provided for no refund upon the death of the survivor of H and W, or provided that any refund was to go to the estate of the survivor, then the interest which passed from H to W is (to the extent it is included in H's gross estate) a deductible interest.

Example (4). H, in contemplation of death, transferred a residence to A for life with remainder to W provided W survives A, but if W predeceases A, the property is to pass to B and his heirs. If it is assumed that H died during A's liftime, and the value of the residence was included in determining the value of his gross etsate, the interest which passed from H to W is a nondeductible interest since it will terminate if W predeceases A and the property will thereafter be possessed or enjoyed by B (or his heirs or assigns). This result is not affected by B's assignment of his interest during H's lifetime, whether made in favor of W or another person, since the term "assigns" (as used in section 2056(b)(1)(B)) includes such an assignee. However, if it is assumed that A predeceased H, the interest of B in the property was extinguished, and, viewed as of the time of the subsequent death of H, the interest which passed from him to W is the entire interest in the property and, therefore, a deductible interest.

Example (5). H transferred real property to A by gift, reserving the right to the rentals of the property for a term of 20 years. H died within the 20-year term, bequeathing the right to the remaining rentals to a trust for the benefit of W. The terms of the trust satisfy the five conditions stated in § 20.2056(b)–5, so that the property interest which passed in trust is considered to have passed from H to W. However, the interest is a nondeductible interest since it will terminate upon the expiration of the term and A will thereafter possess or enjoy the property.

Example (6). H bequeathed a patent to W and A as tenants in common. In this case, the interest of W will terminate upon the expiration of the term of the patent, but possession or enjoyment of the property by A must necessarily cease at the same time. Therefore,

since A's possession or enjoyment cannot outlast the termination of W's interest, the latter is a deductible interest.

Example (7). A decedent bequeathed $100,000 to his wife, subject to a direction to his executor to use the bequest for the purchase of an annuity for the wife. The bequest is a nondeductible interest.

Example (8). Assume that pursuant to local law an allowance for support is payable to the decedent's surviving spouse during the period of the administration of the decedent's estate, but that upon her death or remarriage during such period her right to any further allowance will terminate. Assume further that the surviving spouse is sole beneficiary of the decedent's estate. Under such circumstances, the allowance constitutes a deductible interest since any part of the allowance not receivable by the surviving spouse during her lifetime will pass to her estate under the terms of the decedent's will. If, in this example, the decedent bequeathed only one-third of his residuary estate to his surviving spouse, then two-thirds of the allowance for support would constitute a nondeductible terminable interest.

§ 20.2056(b)–2 MARITAL DEDUCTION; INTEREST IN UNIDENTIFIED ASSETS.—(a) Section 2056(b)(2) provides that if an interest passing to a decedent's surviving spouse may be satisfied out of assets (or their proceeds) which include a particular asset that would be a nondeductible interest if it passed from the decedent to his spouse, the value of the interest passing to the spouse is reduced, for the purpose of the marital deduction, by the value of the particular asset.

(b) In order for section 2056(b)(2) to apply, two circumstances must coexist, as follows:

(1) The property interest which passed from the decedent to his surviving spouse must be payable out of a group of assets included in the gross estate. Examples of property interests payable out of a group of assets are a general legacy, a bequest of the residue of the decedent's estate or of a portion of the residue, and a right to a share of the corpus of a trust upon its termination.

(2) The group of assets out of which the property interest is payable must include one or more particular assets which, if passing specifically to the surviving spouse, would be nondeductible interests. Therefore, section 2056(b)(2) is not applicable merely because the group of assets includes a terminable interest, but would only be applicable if the terminable interest were nondeductible under the provisions of § 20.2056(b)–1.

(c) If both of the circumstances set forth in paragraph (b) of this section are present, the property interest payable out of the group of assets is (except as to any excess of its value over the aggregate value of the particular asset or assets which would not be deductible if passing specifically to the surviving spouse) a nondeductible interest.

(d) The application of this section may be illustrated by the following example:

Example. A decedent bequeathed one-third of the residue of his estate to his wife. The property passing under the decedent's will included a right to the rentals of an office building for a term of years, reserved by the decedent under a deed of the building by way of gift to his son. The decedent did not make a specific bequest of the right to such rentals. Such right, if passing specifically to the

wife, would be a nondeductible interest (see example (5) of paragraph (g) of § 20.2056(b)–1). It is assumed that the value of the bequest of one-third of the residue of the estate to the wife was $85,000, and that the right to the rentals was included in the gross estate at a value of $60,000. If the decedent's executor had the right under the decedent's will or local law to assign the entire lease in satisfaction of the bequest, the bequest is a nondeductible interest to the extent of $60,000. If the executor could only assign a one-third interest in the lease in satisfaction of the bequest, the bequest is a nondeductible interest to the extent of $20,000. If the decedent's will provided that his wife's bequest could not be satisfied with a nondeductible interest, the entire bequest is a deductible interest. If, in this example, the asset in question had been foreign real estate not included in the decedent's gross estate, the results would be the same.

§ 20.2056(b)–3 MARITAL DEDUCTION; INTEREST OF SPOUSE CONDITIONED ON SURVIVAL FOR LIMITED PERIOD.—(a) *In general.*—Generally, no marital deduction is allowable if the interest passing to the surviving spouse is a terminable interest as defined in paragraph (b) of § 20.2056(b)–1. However, section 2056(b)(3) provides an exception to this rule so as to allow a deduction if (1) the only condition under which it will terminate is the death of the surviving spouse within 6 months after the decedent's death, or her death as a result of a common disaster which also resulted in the decedent's death, and (2) the condition does not in fact occur.

(b) *Six months' survival.*—If the only condition which will cause the interest taken by the surviving spouse to terminate is the death of the surviving spouse and the condition is of such nature that it can occur only within 6 months following the decedent's death, the exception provided by section 2056(b)(3) will apply, provided the condition does not in fact occur. However, if the condition (unless it relates to death as a result of a common disaster) is one which may occur either within the 6-month period or thereafter, the exception provided by section 2056(b)(3) will not apply.

(c) *Common disaster.*—If a property interest passed from the decedent to his surviving spouse subject to the condition that she does not die as a result of a common disaster which also resulted in the decedent's death, the exception provided by section 2056(b)(3) will not be applied in the final audit of the return if there is still a possibility that the surviving spouse may be deprived of the property interest by operation of the common disaster provision as given effect by the local law.

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

Example (1). A decedent bequeathed his entire estate to his spouse on condition that she survive him by 6 months. In the event his spouse failed to survive him by 6 months, his estate was to go to his niece and her heirs. The decedent was survived by his spouse. It will be observed that, as of the time of the decedent's death, it was possible that the niece would, by reason of the interest which passed to her from the decedent, possess or enjoy the estate after the termination of the interest which passed to the spouse. Hence, under the general rule set forth in § 20.2056(b)–1, the interest which passed to the

spouse would be regarded as a nondeductible interest. If the surviving spouse in fact died within 6 months after the decedent's death, that general rule is to be applied, and the interest which passed to the spouse is a nondeductible interest. However, if the spouse in fact survived the decedent by 6 months, thus extinguishing the interest of the niece, the case comes within the exception provided by section 2056(b)(3), and the interest which passed to the spouse is a deductible interest. (It is assumed for the purpose of this example that no other factor which would cause the interest to be nondeductible is present.)

Example (2). The facts are the same as in example (1) except that the will provided that the estate was to go to the niece either in case the decedent and his spouse should both die as a result of a common disaster, or in case the spouse should fail to survive the decedent by 3 months. It is assumed that the decedent was survived by his spouse. In this example, the interest which passed from the decedent to his surviving spouse is to be regarded as a nondeductible interest if the surviving spouse in fact died either within 3 months after the decedent's death or as a result of a common disaster which also resulted in the decedent's death. However, if the spouse in fact survived the decedent by 3 months, and did not thereafter die as a result of a common disaster which also resulted in the decedent's death, the exception provided under section 2056(b)(3) will apply and the interest will be deductible.

Example (3). The facts are the same as in example (1) except that the will provided that the estate was to go to the niece if the decedent and his spouse should both die as a result of a common disaster and if the spouse failed to survive the decedent by 3 months. If the spouse in fact survived the decedent by 3 months, the interest of the niece is extinguished, and the interest passing to the spouse is a deductible interest.

Example (4). A decedent devised and bequeathed his residuary estate to his wife if she was living on the date of distribution of his estate. The devise and bequest is a nondeductible interest even though distribution took place within 6 months after the decedent's death and the surviving spouse in fact survived the date of distribution.

§ 20.2056(b)–4 MARITAL DEDUCTION; VALUATION OF INTEREST PASSING TO SURVIVING SPOUSE.—(a) *In general.*—The value, for the purpose of the marital deduction, of any deductible interest which passed from the decedent to his surviving spouse is to be determined as of the date of the decedent's death, except that if the executor elects the alternate valuation method under section 2032 the valuation is to be determined as of the date of the decedent's death but with the adjustment described in paragraph (a)(3) of § 20.2032–1. The marital deduction may be taken only with respect to the net value of any deductible interest which passed from the decedent to his surviving spouse, the same principles being applicable as if the amount of a gift to the spouse were being determined. In determining the value of the interest in property passing to the spouse account must be taken of the effect of any material limitations upon her right to income from the property. An example of a case in which this rule may be applied is a bequest of property in trust for the benefit of the decedent's spouse

but the income from the property from the date of the decedent's death until distribution of the property to the trustee is to be used to pay expenses incurred in the administration of the estate.

(b) *Property interest subject to an encumbrance or obligation.*—If a property interest passed from the decedent to his surviving spouse subject to a mortgage or other encumbrance, or if an obligation is imposed upon the surviving spouse by the decedent in connection with the passing of a property interest, the value of the property interest is to be reduced by the amount of the mortgage, other encumbrance, or obligation. However, if under the terms of the decedent's will or under local law the executor is required to discharge, out of other assets of the decedent's estate, a mortgage or other encumbrance on property passing from the decedent to his surviving spouse, or is required to reimburse the surviving spouse for the amount of the mortgage or other encumbrance, the payment or reimbursement constitutes an additional interest passing to the surviving spouse. The passing of a property interest subject to the imposition of an obligation by the decedent does not include a bequest, devise, or transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate. The passing of a property interest subject to the imposition of an obligation by the decedent does, however, include a bequest, etc., in lieu of the interest of his surviving spouse under community property laws unless such interest was, immediately prior to the decedent's death, a mere expectancy. (As to the circumstances under which the interest of the surviving spouse is regarded as a mere expectancy, see § 20.2056(c)-2.) The following examples are illustrative of property interests which passed from the decedent to his surviving spouse subject to the imposition of an obligation by the decedent:

Example (1). A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000.

Example (2). A decedent devised real property to his wife in satisfaction of a debt owing to her. The debt is a deductible claim under section 2053. Since the wife is obligated to relinquish the claim as a condition to acceptance of the devise, the value of the devise is, for the purpose of the marital deduction, to be reduced by the amount of the claim.

Example (3). A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife.

(c) *Effect of death taxes.*—(1) In the determination of the value of any property interest which passed from the decedent to his surviving spouse, there must be taken into account the effect which the Federal estate tax, or any estate, succession, legacy, or inheritance tax, has upon the net value to the surviving spouse of the property interest.

(2) For example, assume that the only bequest to the surviving spouse is $100,000 and the spouse is required to pay a State inheritance

tax in the amount of $1,500. If no other death taxes affect the net value of the bequest, the value, for the purpose of the marital deduction, is $98,500.

(3) As another example, assume that a decedent devised real property to his wife having a value for Federal estate tax purposes of $100,000 and also bequeathed to her a nondeductible interest for life under a trust. The State of residence valued the real property at $90,000 and the life interest at $30,000, and imposed an inheritance tax (at graduated rates) of $4,800 with respect to the two interests. If it is assumed that the inheritance tax on the devise is required to be paid by the wife, the amount of tax to be ascribed to the devise is

$$\frac{90,000}{120,000} \times \$4,800 = \$3,600.$$

Accordingly, if no other death taxes affect the net value of the bequest, the value, for the purpose of the marital deduction, is $100,000 less $3,600, or $96,400.

(4) If the decedent bequeaths his residuary estate, or a portion of it, to his surviving spouse, and his will contains a direction that all death taxes shall be payable out of the residuary estate, the value of the bequest, for the purpose of the marital deduction, is based upon the amount of the residue as reduced pursuant to such direction. If the residuary estate, or a portion of it, is bequeathed to the surviving spouse, and by the local law the Federal estate tax is payable out of the residuary estate, the value of the bequest, for the purpose of the marital deduction, may not exceed its value as reduced by the Federal estate tax. Methods of computing the deduction, under such circumstances, are set forth in supplemental instructions to the estate tax return.

(d) *Remainder interests.*—If the income from property is made payable to another individual for life, or for a term of years, with remainder absolutely to the surviving spouse or to her estate, the marital deduction is based upon the present value of the remainder. The present value of the remainder is to be determined in accordance with the rules stated in § 20.2031–7. For example, if the surviving spouse is to receive $50,000 upon the death of a person aged 31 years, the present value of the remainder is $14,466. If the remainder is such that its value is to be determined by a special computation (see paragraph (e) of § 20.2031–7), a request for a specific factor may be submitted to the Commissioner. The request should be accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the remainder, and copies of the relevant instruments. The Commissioner may, if conditions permit, supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraphs of § 20.2031–7.

§ 20.2056(b)–5 MARITAL DEDUCTION; LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—(a) *In general.*—Section 2056(b)(5) provides that if an interest in property passes from the decedent to his surviving spouse (whether or not in trust) and the spouse is entitled for life to all the income from the entire interest or all the income from a specific portion of the entire interest, with a

power in her to appoint the entire interest or the specific portion, the interest which passes to her is a deductible interest, to the extent that it satisfies all five of the conditions set forth below (see paragraph (b) of this section if one or more of the conditions is satisfied as to only a portion of the interest):

(1) The surviving spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest.

(2) The income payable to the surviving spouse must be payable annually or at more frequent intervals.

(3) The surviving spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate.

(4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the surviving spouse.

(b) *Specific portion; deductible amount.*—If either the right to income or the power of appointment passing to the surviving spouse pertains only to a specific portion of a property interest passing from the decedent, the marital deduction is allowed only to the extent that the rights in the surviving spouse meet all of the five conditions described in paragraph (a) of this section. While the rights over the income and the power must coexist as to the same interest in property, it is not necessary that the rights over the income or the power as to such interest be in the same proportion. However, if the rights over income meeting the required conditions set forth in paragraph (a) (1) and (2) of this section extend over a smaller share of the property interest than the share with respect to which the power of appointment requirements set forth in paragraph (a) (3) through (5) of this section are satisfied, the deductible interest is limited to the smaller share. Correspondingly, if a power of appointment meeting all the requirements extends to a smaller portion of the property interest than the portion over which the income rights pertain, the deductible interest cannot exceed the value of the portion to which such power of appointment applies. Thus, if the decedent leaves to his surviving spouse the right to receive annually all of the income from a particular property interest and a power of appointment meeting the specifications prescribed in paragraph (a) (3) through (5) of this section as to only one-half of the property interest, then only one-half of the property interest is treated as a deductible interest. Correspondingly, if the income interest of the spouse satisfying the requirements extends to only one-fourth of the property interest and a testamentary power of appointment satisfying the requirements extends to all of the property interest, then only one-fourth of the interest in the spouse qualifies as a deductible interest. Further, if the surviving spouse has no right to income from a specific portion of a property interest but a testamentary power of appointment which meets the necessary conditions over the entire interest, then none of the interest qualifies for the deduction. In addition, if, from the time of the decedent's death, the surviving

spouse has a power of appointment meeting all of the required conditions over three-fourths of the entire property interest and the prescribed income rights over the entire interest, but with a power in another person to appoint one-half of the entire interest, the value of the interest in the surviving spouse over only one-half of the property interest will qualify as a deductible interest.

(c) *Definition of "specific portion".*—A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extent to one-half or a specified percentage of the property, or the equivalent, the interest is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest. Even though the rights in the surviving spouse may not be expressed in terms of a definite fraction or percentage, a deduction may be allowable if it is shown that the effect of local law is to give the spouse rights which are identical to those she would have acquired if the size of the share had been expressed in terms of a definite fraction or percentage. The following examples illustrate the application of this and the preceding paragraphs of this section:

Example (1). The decedent transferred to a trustee 500 identical shares of X Company stock. He provided that during the lifetime of the surviving spouse the trustees should pay her annually one-half of the trust income or $6,000, whichever is the larger. The spouse was also given a general power of appointment, exercisable by her last will over the sum of $160,000 or over three-fourths of the trust corpus, whichever should be of larger value. Since there is no certainty that the trust income will not vary from year to year, for purposes of paragraphs (a) and (b) of this section, an annual payment of a specified sum, such as the $6,000 provided for in this case, is not considered as representing the income from a definite fraction or a specific portion of the entire interest if that were the extent of the spouse's interest. However, since the spouse is to receive annually at least one-half of the trust income, she will, for purposes of paragraphs (a) and (b) of this section, be considered as receiving all of the income from one-half of the entire interest in the stock. Inasmuch as there is no certainty that the value of the stock will be the same on the date of the surviving spouse's death as it was on the date of the decedent's death, for purposes of paragraphs (a) and (b) of this section, a specified sum, such as the $160,000 provided for in this case, is not considered to be a definite fraction of the entire interest. However, since the surviving spouse has a general power of appointment over at least three-fourts of the trust corpus, she is considered as having a general power of appointment over three-fourths of the entire interest in the stock.

Example (2). The decedent bequeathed to a trustee an office building and 250 identical shares of Y Company stock. He provided that

during the lifetime of the surviving spouse the trustee should pay her annually three-fourths of the trust income. The spouse was given a general power of appointment, exercisable by will, over the office building and 100 shares of the stock. By the terms of the decedent's will the spouse is given all the income from a definite fraction of the entire interest in the office building and in the stock. She also has a general power of appointment over the entire interest in the office building. However, since the amount of property represented by a single share of stock would be altered if the corporation split its stock, issued stock dividends, made a distribution of capital, etc., a power to appoint 100 shares at the time of the surviving spouse's death is not the same necessarily as a power to appoint 100/250 of the entire interest which the 250 shares represented on the date of the decedent's death. If it is shown in this case that the effect of local law is to give the spouse a general power to appoint not only the 100 shares designated by the decedent but also 100/250 of any shares or amounts which are distributed by the corporation and included in the corpus, the requirements of this paragraph will be satisfied and the surviving spouse will be considered as having a general power to appoint 100/250 of the entire interest in the 250 shares.

(d) *Definition of "entire interest".*—Since a marital deduction is allowed for each qualifying separate interest in property passing from the decedent to his surving spouse (subject to the percentage limitation contained in §§ 20.2056(c)–1 and 20.2056(c)–2 concerning the aggregate amount of the deductions), for purposes of paragraphs (a) and (b) of this section, each property interest with respect to which the surviving spouse received some rights is considered separately in determining whether her rights extend to the entire interest or to a specific portion of the entire interest. A property interest which consists of several identical units of property (such as a block of 250 shares of stock, whether the ownership is evidenced by one or several certificates) is considered one property interest, unless certain of the units are to be segregated and accorded different treatment, in which case each segregated group of items is considered a separate property interest. The bequest of a specified sum of money constitutes the bequest of a separate property interest if immediately following distribution by the executor and thenceforth it, and the investments made with it, must be so segregated or accounted for as to permit its identification as a separate item of property. The application of this paragraph may be illustrated by the following examples:

Example (1). The decedent transferred to a trustee three adjoining farms, Blackacre, Whiteacre, and Greenacre. His will provided that during the lifetime of the surviving spouse the trustee should pay her all of the income from the trust. Upon her death, all of Blackacre, a one-half interest in Whiteacre, and a one-third interest in Greenacre were to be distributed to the person or persons appointed by her in her will. The surviving spouse is considered as being entitled to all of the income from the entire interest in Blackacre, all of the income from the entire interest in Whiteacre, and all of the income from the entire interest in Greenacre. She also is considered as having a power of appointment over the entire interest in Blackacre, over one-half of the entire interest in Whiteacre, and over one-third of the entire interest in Greenacre.

Example (*2*). The decedent bequeathed $250,000 to C, as trustee. C is to invest the money and pay all of the income from the investments to W, the decedent's surviving spouse, annually. W was given a general power, exercisable by will, to appoint one-half of the corpus of the trust. Here, immediately following distribution by the executor, the $250,000 will be sufficiently segregated to permit its identification as a separate item, and the $250,000 will constitute an entire property interest. Therefore, W has a right to income and a power of appointment such that one-half of the entire interest is a deductible interest.

Example (*3*). The decedent bequeathed 100 shares of Z Corporation stock to D, as trustee. W, the decedent's surviving spouse, is to receive all of the income of the trust annually and is given a general power, exercisable by will, to appoint out of the trust corpus the sum of $25,000. In this case the $25,000 is not, immediately following distribution, sufficiently segregated to permit its identification as a separate item of property in which the surviving spouse has the entire interest. Therefore, the $25,000 does not constitute the entire interest in a property for the purpose of paragraphs (a) and (b) of this section.

(e) *Application of local law.*—In determining whether or not the conditions set forth in paragraph (a) (1) through (5) of this section are satisfied by the instrument of transfer, regard is to be had to the applicable provisions of the law of the jurisdiction under which the interest passes and, if the transfer is in trust, the applicable provisions of the law governing the administration of the trust. For example, silence of a trust instrument as to the frequency of payment will not be regarded as a failure to satisfy the condition set forth in paragraph (a) (2) of this section that income must be payable to the surviving spouse annually or more frequently unless the applicable law permits payment to be made less frequently than annually. The principles outlined in this paragraph and paragraphs (f) and (g) of this section which are applied in determining whether transfers in trust meet such conditions are equally applicable in ascertaining whether, in the case of interests not in trust, the surviving spouse has the equivalent in rights over income and over the property.

(f) *Right to income.*—(1) If an interest is transferred in trust, the surviving spouse is "entitled for life to all of the income from the entire interest or a specific portion of the entire interest", for the purpose of the condition set forth in paragraph (a) (1) of this section, if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the decedent's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the surviving spouse during her life such an income, or that the spouse should have such use of the trust property as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life of the entire interest or a specific portion of the entire interest will be sufficient to qualify the trust unless the terms of the trust and the surrounding circumstances considered as a whole evidence an intention

to deprive the spouse of the requisite degree of enjoyment. In determining whether a trust evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for the administration of the trust.

(2) If the over-all effect of a trust is to give to the surviving spouse such enforceable rights as will preserve to her the requisite degree of enjoyment, it is immaterial whether that result is effected by rules specifically stated in the trust instrument, or, in their absence, by the rules for the management of the trust property and the allocation of receipts and expenditures supplied by the State law. For example, a provision in the trust instrument for amortization of bond premium by appropriate periodic charges to interest will not disqualify the interest passing in trust even though there is no State law specifically authorizing amortization, or there is a State law denying amortization which is applicable only in the absence of such a provision in the trust instrument.

(3) In the case of a trust, the rules to be applied by the trustee in allocation of receipts and expenses between income and corpus must be considered in relation to the nature and expected productivity of the assets passing in trust, the nature and frequency of occurrence of the expected receipts, and any provisions as to change in the form of investments. If it is evident from the nature of the trust assets and the rules provided for management of the trust that the allocation to income of such receipts as rents, ordinary cash dividends, and interest will give to the spouse the substantial enjoyment during life required by the statute, provisions that such receipts as stock dividends and proceeds from the conversion of trust assets shall be treated as corpus will not disqualify the interest passing in trust. Similarly, provision for a depletion charge against income in the case of trust assets which are subject to depletion will not disqualify the interest passing in trust, unless the effect is to deprive the spouse of the requisite beneficial enjoyment. The same principle is applicable in the case of depreciation, trustees' commissions, and other charges.

(4) Provisions granting administrative powers to the trustee will not have the effect of disqualifying an interest passing in trust unless the grant of powers evidences the intention to deprive the surviving spouse of the beneficial enjoyment required by the statute. Such an intention will not be considered to exist if the entire terms of the instrument are such that the local courts will impose reasonable limitations upon the exercise of the powers. Among the powers which if subject to reasonable limitations will not disqualify the interest passing in trust are the power to determine the allocation or apportionment of receipts and disbursements between income and corpus, the power to apply the income or corpus for the benefit of the spouse, and the power to retain the assets passing to the trust. For example, a power to retain trust assets which consist substantially of unproductive property will not disqualify the interest if the applicable rules for the administration of the trust require, or permit the spouse to require, that the trustee either make the property productive or convert it within a reasonable time. Nor will such a power disqualify the interest if the applicable rules for administration of the trust require

the trustee to use the degree of judgment and care in the exercise of the power which a prudent man would use if he were owner of the trust assets. Further, a power to retain a residence or other property for the personal use of the spouse will not disqualify the interest passing in trust.

(5) An interest passing in trust will not satisfy the condition set forth in paragraph (a) (1) of this section that the surviving spouse be entitled to all the income if the primary purpose of the trust is to safeguard property without providing the spouse with the required beneficial enjoyment. Such trusts include not only trusts which expressly provide for the accumulation of the income but also trusts which indirectly accomplish a similar purpose. For example, assume that the corpus of a trust consists substantially of property which is not likely to be income producing during the life of the surviving spouse and that the spouse cannot compel the trustee to convert or otherwise deal with the property as described in subparagraph (4) of this paragraph. An interest passing to such a trust will not qualify unless the applicable rules for the administration require, or permit the spouse to require, that the trustee provide the required beneficial enjoyment, such as by payments to the spouse out of other assets of the trust.

(6) If a trust is created during the decedent's life, it is immaterial whether or not the interest passing in trust satisfied the conditions set forth in paragraph (a) (1) through (5) of this section prior to the decedent's death. If a trust may be terminated during the life of the surviving spouse, under her exercise of a power of appointment or by distribution of the corpus to her, the interest passing in trust satisfies the condition set forth in paragraph (a) (1) of this section (that the spouse be entitled to all the income) if she (i) is entitled to the income until the trust terminates, or (ii) has the right, exercisable in all events, to have the corpus distributed to her at any time during her life.

(7) An interest passing in trust fails to satisfy the condition set forth in paragraph (a) (1) of this section, that the spouse be entitled to all the income, to the extent that the income is required to be accumulated in whole or in part or may be accumulated in the discretion of any person other than the surviving spouse; to the extent that the consent of any person other than the surviving spouse is required as a condition precedent to distribution of the income; or to the extent that any person other than the surviving spouse has the power to alter the terms of the trust so as to deprive her of her right to the income. An interest passing in trust will not fail to satisfy the condition that the spouse be entitled to all the income merely because its terms provide that the right of the surviving spouse to the income shall not be subject to assignment, alienation, pledge, attachment or claims of creditors.

(8) In the case of an interest passing in trust, the terms "entitled for life" and "payable annually or at more frequent intervals", as used in the conditions set forth in paragraph (a) (1) and (2) of this section, require that under the terms of the trust the income referred to must be currently (at least annually; see paragraph (e) of this section) distributable to the spouse or that she must have such command over the income that it is virtually hers. Thus, the conditions in paragraph (a) (1) and (2) of this section are satisfied in this respect if,

under the terms of the trust instrument, the spouse has the right exercisable annually (or more frequently) to require distribution to herself of the trust income, and otherwise the trust income is to be accumulated and added to corpus. Similarly, as respects the income for the period between the last distribution date and the date of the spouse's death, it is sufficient if that income is subject to the spouse's power to appoint. Thus, if the trust instrument provides that income accrued or undistributed on the date of the spouse's death is to be disposed of as if it had been received after her death, and if the spouse has a power of appointment over the trust corpus, the power necessarily extends to the undistributed income.

(9) An interest is not to be regarded as failing to satisfy the conditions set forth in paragraph (a) (1) and (2) of this section (that the spouse be entitled to all the income and that it be payable annually or more frequently) merely because the spouse is not entitled to the income from estate assets for the period before distribution of those assets by the executor, unless the executor is, by the decedent's will, authorized or directed to delay distribution beyond the period reasonably required for administration of the decedent's estate. As to the valuation of the property interest passing to the spouse in trust where the right to income is expressly postponed, see § 20.2056(b)–4.

(g) *Power of appointment in surviving spouse.*—(1) The conditions set forth in paragraph (a) (3) and (4) of this section, that is, that the surviving spouse must have a power of appointment exercisable in favor of herself or her estate and exercisable alone and in all events, are not met unless the power of the surviving spouse to appoint the entire interest or a specific portion of it falls within one one of the following categories:

(i) A power so to appoint fully exercisable in her own favor at any time following the decedent's death (as, for example, an unlimited power to invade); or

(ii) A power so to appoint exercisable in favor of her estate. Such a power, if exercisable during life, must be fully exercisable at any time during life, or, if exercisable by will, must be fully exercisable irrespective of the time of her death (subject in either case to the provisions of § 20.2053(b)–3, relating to interests conditioned on survival for a limited period); or

(iii) A combination of the powers described under subparagraphs (i) and (ii) of this subparagraph. For example, the surviving spouse may, until she attains the age of 50 years, have a power to appoint to herself and thereafter have a power to appoint to her estate. However, the condition that the spouse's power must be exercisable in all events is not satisfied unless irrespective of when the surviving spouse may die the entire interest or a specific portion of it will at the time of her death be subject to one power or the other (subject to the exception in § 20.2053(b)–3, relating to interests contingent on survival for a limited period).

(2) The power of the surviving spouse must be a power to appoint the entire interest or a specific portion of it as unqualified owner (and free of the trust if a trust is involved, or free of the joint tenancy if a joint tenancy is involved) or to appoint the entire interest or a specific portion of it as a part of her estate (and free of the trust if a trust is involved), that is, in effect, to dispose of it to whomsoever

she pleases. Thus, if the decedent devised property to a son and the surviving spouse as joint tenants with right of survivorship and under local law the surviving spouse has a power of severance exercisable without consent of the other joint tenant, and by exercising this power could acquire a one-half interest in the property as a tenant in common, her power of severance will satisfy the condition set forth in paragraph (a)(3) of this section that she have a power of appointment in favor of herself or her estate. However, if the surviving spouse entered into a binding agreement with the decedent to exercise the power only in favor of their issue, that condition is not met. An interest passing in trust will not be regarded as failing to satisfy the condition merely because takers in default of the surviving spouse's exercise of the power are designated by the decedent. The decedent may provide that, in default of exercise of the power, the trust shall continue for an additional period.

(3) A power is not considered to be a power exercisable by a surviving spouse alone and in all events as required by paragraph (a)(4) of this section if the exercise of the power in the surviving spouse to appoint the entire interest or a specific portion of it to herself or to her estate requires the joinder or consent of any other person. The power is not "exercisable in all events", if it can be terminated during the life of the surviving spouse by any event other than her complete exercise or release of it. Further, a power is not "exercisable in all events" if it may be exercised for a limited purpose only. For example, a power which is not exercisable in the event of the spouse's remarriage is not exercisable in all events. Likewise, if there are any restrictions, either by the terms of the instrument or under applicable local law, on the exercise of a power to consume property (whether or not held in trust) for the benefit of the spouse, the power is not exercisable in all events. Thus, if a power of invasion is exercisable only for the spouse's support, or only for her limited use, the power is not exercisable in all events. In order for a power of invasion to be exercisable in all events, the surviving spouse must have the unrestricted power exercisable at any time during her life to use all or any part of the property subject to the power, and to dispose of it in any manner, including the power to dispose of it by gift (whether or not she has power to dispose of it by will).

(4) The power in the surviving spouse is exercisable in all events only if it exists immediately following the decedent's death. For example, if the power given to the surviving spouse is exercisable during life, but cannot be effectively exercised before distribution of the assets by the executor, the power is not exercisable in all events. Similarly, if the power is exercisable by will, but cannot be effectively exercised in the event the surviving spouse dies before distribution of the assets by the executor, the power is not exercisable in all events. However, an interest will not be disqualified by the mere fact that, in the event the power is exercised during administration of the estate, distribution of the property to the appointee will be delayed for the period of administration. If the power is in existence at all times following the decedent's death, limitations of a formal nature will not disqualify an interest. Examples of formal limitations on a power exercisable during life are requirements that an exercise must be in a

particular form, that it must be filed with a trustee during the spouse's life, that reasonable notice must be given, or that reasonable intervals must elapse between successive partial exercises. Examples of formal limitations on a power exercisable by will are that it must be exercised by a will executed by the surviving spouse after the decedent's death or that exercise must be by specific reference to the power.

(5) If the surviving spouse has the requisite power to appoint to herself or her estate, it is immaterial that she also has one or more lesser powers. Thus, if she has a testamentary power to appoint to her estate, she may also have a limited power of withdrawal or of appointment during her life. Similarly, if she has an unlimited power of withdrawal, she may have a limited testamentary power.

(h) *Requirement of survival for a limited period.*—A power of appointment in the surviving spouse will not be treated as failing to meet the requirements of paragraph (a)(3) of this section even though the power may terminate, if the only conditions which would cause the termination are those described in paragraph (a) of § 20.2056(b)–3, and if those conditions do not in fact occur. Thus, the entire interest or a specific portion of it will not be disqualified by reason of the fact that the exercise of the power in the spouse is subject to a condition of survivorship described in § 20.2056(b)–3 if the terms of the condition, that is, the survivorship of the surviving spouse, or the failure to die in a common disaster, are fulfilled.

(j) *Existence of a power in another.*—Paragraph (a)(5) of this section provides that a transfer described in paragraph (a) is nondeductible to the extent that the decedent created a power in the trustee or in any other person to appoint a part of the interest to any person other than the surviving spouse. However, only powers in other persons which are in opposition to that of the surviving spouse will cause a portion of the interest to fail to satisfy the condition set forth in paragraph (a)(5) of this section. Thus, a power in a trustee to distribute corpus to or for the benefit of a surviving spouse will not disqualify the trust. Similarly, a power to distribute corpus to the spouse for the support of minor children will not disqualify the trust if she is legally obligated to support such children. The application of this paragraph may be illustrated by the following examples:

Example (1). Assume that a decedent created a trust, designating his surviving spouse as income beneficiary for life with an unrestricted power in the spouse to appoint the corpus during her life. The decedent further provided that in the event the surviving spouse should die without having exercised the power, the trust should continue for the life of his son with a power in the son to appoint the corpus. Since the power in the son could become exercisable only after the death of the surviving spouse, the interest is not regarded as failing to satisfy the condition set forth in paragraph (a)(5) of this section.

Example (2). Assume that the decedent created a trust, designating his surviving spouse as income beneficiary for life and as donee of a power to appoint by will the entire corpus. The decedent further provided that the trustee could distribute 30 percent of the corpus to the decedent's son when he reached the age of 35 years. Since the trustee has a power to appoint 30 percent of the entire interest for the benefit of a person other than the surviving spouse, only 70 percent

of the interest placed in trust satisfied the condition set forth in paragraph (a)(5) of this section. If, in this case, the surviving spouse had a power, exercisable by her will, to appoint only one-half of the corpus as it was constituted at the time of her death, it should be noted that only 35 percent of the interest placed in the trust would satisfy the condition set forth in paragraph (a)(3) of this section.

§ 20.2056(b)–6 MARITAL DEDUCTION; LIFE INSURANCE OR ANNUITY PAYMENTS WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—(a) *In general.*—Section 2056(b)(6) provides that an interest in property passing from a decedent to his surviving spouse, which consists of proceeds held by an insurer under the terms of a life insurance, endowment, or annuity contract, is a "deductible interest" to the extent that it satisfied all five of the following conditions (see paragraph (b) of this section if one or more of the conditions is satisfied as to only a portion of the proceeds):

(1) The proceeds, or a specific portion of the proceeds, must be held by the insurer subject to an agreement either to pay the entire proceeds or a specific portion thereof in installments, or to pay interest thereon, and all or a specific portion of the installments or interest payable during the life of the surviving spouse must be payable only to her.

(2) The installments or interest payable to the surviving spouse must be payable annually, or more frequently, commencing not later than 13 months after the decedent's death.

(3) The surviving spouse must have the power to appoint all or a specific portion of the amounts so held by the insurer to either herself or her estate.

(4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The amounts or the specific portion of the amounts payable under such contract must not be subject to a power in any other person to appoint any part thereof to any person other than the surviving spouse.

(b) *Specific portion; deductible interest.*—If the right to receive interest or installment payments or the power of appointment passing to the surviving spouse pertains only to a specific portion of the proceeds held by the insurer, the marital deduction is allowed only to the extent that the rights of the surviving spouse in the specific portion meet the five conditions described in paragraph (a) of this section. While the rights to interest, or to receive payment in installments, and the power must coexist as to the proceeds of the same contract, it is not necessary that the rights to each be in the same proportion. If the rights to interest meeting the required conditions set forth in paragraph (a)(1) and (2) of this section extend over a smaller share of the proceeds than the share with respect to which the power of appointment requirements set forth in paragraph (a)(3) through (5) of this section are satisfied, the deductible interest is limited to the smaller share. Similarly, if the portion of the proceeds payable in installments is a smaller portion of the proceeds than the portion to which the power of appointment meeting such requirements relates, the deduction is limited to the smaller portion. In addition, if a

power of appointment meeting all the requirements extends to a smaller portion of the proceeds than the portion over which the interest or installment rights pertain, the deductible interest cannot exceed the value of the portion to which such power of appointment applies. Thus, if the contract provides that the insurer is to retain the entire proceeds and pay all of the interest thereon annually to the surviving spouse and if the surviving spouse has a power of appointment meeting the specifications prescribed in paragraph (a)(3) through (5) of this section, as to only one-half of the proceeds held, then only one-half of the proceeds may be treated as a deductible interest. Correspondingly, if the rights of the spouse to receive installment payments or interest satisfying the requirements extend to only one-fourth of the proceeds and a testamentary power of appointment satisfying the requirements of paragraph (a)(3) through (5) of this section extends to all of the proceeds, then only one-fourth of the proceeds qualifies as a deductible interest. Further, if the surviving spouse has no right to installment payments (or interest) over any portion of the proceeds but a testamentary power of appointment which meets the necessary conditions over the entire remaining proceeds, then none of the proceeds qualifies for the deduction. In addition, if, from the time of the decedent's death, the surviving spouse has a power of appointment meeting all of the required conditions over three-fourths of the proceeds and the right to receive interest from the entire proceeds, but with a power in another person to appoint one-half of the entire proceeds, the value of the interest in the surviving spouse over only one-half of the proceeds will qualify as a deductible interest.

(c) *Applicable principles.*—(1) The principles set forth in paragraph (c) of § 20.2056(b)–5 for determining what constitutes a "specific portion of the entire interest" for the purpose of section 2056(b)(5) are applicable in determining what constitutes a "specific portion of all such amounts" for the purpose of section 2056(b)(6). However, the interest in the proceeds passing to the surviving spouse will not be disqualified by the fact that the installment payments or interest to which the spouse is entitled or the amount of the proceeds over which the power of appointment is exercisable may be expressed in terms of a specific sum rather than a fraction or a percentage of the proceeds provided it is shown that such sums are a definite or fixed percentage or fraction of the total proceeds.

(2) The provisions of paragraph (a) of this section are applicable with respect to a property interest which passed from the decedent in the form of proceeds of a policy of insurance upon the decedent's life, a policy of insurance upon the life of a person who predeceased the decedent, a matured endowment policy, or an annuity contract, but only in case the proceeds are to be held by the insurer. With respect to proceeds under any such contract which are to be held by a trustee, with power of appointment in the surviving spouse, see § 20.2056(b)–5. As to the treatment of proceeds not meeting the requirements of § 20.2056(b)–5 or of this section, see § 20.2056(a)–2.

(3) In the case of a contract under which payments by the insurer commenced during the decedent's life, it is immaterial whether or not the conditions in subparagraphs (1) through (5) of paragraph (a) of this section were satisfied prior to the decedent's death.

(d) *Payments of installments or interest.*—The conditions in subparagraphs (1) and (2) of paragraph (a) of this section relative to the payments of installments or interest to the surviving spouse are satisfied if, under the terms of the contract, the spouse has the right exercisable annually (or more frequently) to require distribution to herself of installments of the proceeds or a specific portion thereof, as the case may be, and otherwise such proceeds or interest are to be accumulated and held by the insurer pursuant to the terms of the contract. A contract which otherwise requires the insurer to make annual or more frequent payments to the surviving spouse following the decedent's death, will not be disqualified merely because the surviving spouse must comply with certain formalities in order to obtain the first payment. For example, the contract may satisfy the conditions in subparagraphs (1) and (2) of paragraph (a) of this section even though it requires the surviving spouse to furnish proof of death before the first payment is made. The condition in paragraph (a)(1) of this section is satisfied where interest on the proceeds or a specific portion thereof is payable, annually or more frequently, for a term, or until the occurrence of a specified event, following which the proceeds or a specific portion thereof are to be paid in annual or more frequent installments.

(e) *Powers of appointment.*—(1) In determining whether the terms of the contract satisfy the conditions in subparagraph (3), (4), or (5) of paragraph (a) of this section relating to a power of appointment in the surviving spouse or any other person, the principles stated in § 20.2056(b)–5 are applicable. As stated in § 20.2056(b)–5, the surviving spouse's power to appoint is "exercisable in all events" only if it is in existence immediately following the decedent's death, subject, however, to the operation of § 20.2056(b)–3 relating to interests conditioned on survival for a limited period.

(2) For examples of formal limitations on the power which will not disqualify the contract, see paragraph (g)(4) of § 20.2056(b)–5. If the power is exercisable from the moment of the decedent's death, the contract is not disqualified merely because the insurer may require proof of the decedent's death as a condition to making payment to the appointee. If the submission of proof of the decedent's death is a condition to the exercise of the power, the power will not be considered "exercisable in all events" unless in the event the surviving spouse had died immediately following the decedent, her power to appoint would have been considered to exist at the time of her death, within the meaning of section 2041(a)(2). See paragraph (b) of § 20.2041–3.

(3) It is sufficient for the purposes of the condition in paragraph (a)(3) of this section that the surviving spouse have the power to appoint amounts held by the insurer to herself or her estate if the surviving spouse has the unqualified power, exercisable in favor of herself or her estate, to appoint amounts held by the insurer which are payable after her death. Such power to appoint need not extend to installments or interest which will be paid to the spouse during her life. Further, the power to appoint need not be a power to require payment in a single sum. For example, if the proceeds of a policy are payable in installments, and if the surviving spouse has the power to direct that all installments payable after her death be paid to her estate, she has the requisite power.

(4) It is not necessary that the phrase "power to appoint" be used in the contract. For example, the condition in paragraph (a)(3) of this section that the surviving spouse have the power to appoint amounts held by the insurer to herself or her estate is satisfied by terms of a contract which give the surviving spouse a right which is, in substance and effect, a power to appoint to herself or her estate, such as a right to withdraw the amount remaining in the fund held by the insurer, or a right to direct that any amount held by the insurer under the contract at her death shall be paid to her estate.

§ 20.2056(c) STATUTORY PROVISIONS; BEQUESTS, ETC., TO SURVIVING SPOUSE; LIMITATION ON AGGREGATE OF DEDUCTIONS.

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE. * * *

(c) LIMITATION ON AGGREGATE OF DEDUCTIONS.—

(1) GENERAL RULE.—The aggregate amount of the deductions allowed under this section (computed without regard to this subsection) shall not exceed 50 percent of the value of the adjusted gross estate, as defined in paragraph (2).

(2) COMPUTATION OF ADJUSTED GROSS ESTATE.—

(A) GENERAL RULE.—Except as provided in subparagraph (B) of this paragraph, the adjusted gross estate shall, for purposes of subsection (c)(1), be computed by subtracting from the entire value of the gross estate the aggregate amount of the deductions allowed by sections 2053 and 2054.

(B) SPECIAL RULE IN CASES INVOLVING COMMUNITY PROPERTY.—If the decedent and his surviving spouse at any time, held property as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, then the adjusted gross estate shall, for purposes of subsection (c)(1), be determined by subtracting from the entire value of the gross estate the sum of—

(i) The value of property which is at the time of the death of the decedent held as such community property; and

(ii) The value of property transferred by the decedent during his life, if at the time of such transfer the property was held as such community property; and

(iii) The amount receivable as insurance under policies on the life of the decedent, to the extent purchased with premiums or other consideration paid out of property held as such community property; and

(iv) An amount which bears the same ratio to the agreegate of the deductions allowed under sections 2053 and 2054 which the value of the property included in the gross estate, diminished by the amount subtracted under clauses (i), (ii), and (iii) of this subparagraph, bears to the entire value of the gross estate.

For purposes of clauses (i), (ii), and (iii), community property (except property which is considered as community property solely by reason of the provisions of subparagraph (c) of this paragraph) shall be considered as not "held as such community property" as of any moment of time, if, in case of the death of the decedent at such moment, such property (and not merely one-half thereof) would be or would have been includible in determining the value of his gross estate without regard to the provisions of section 402(b) of the Revenue Act of 1942. The amount to be subtracted under clauses (i), (ii), or (iii) shall not exceed the value of the interest in the property described therein which is included in determining the value of the gross estate.

(C) COMMUNITY PROPERTY-CONVERSION INTO SEPARATE PROPERTY.—

(i) AFTER DECEMBER 31, 1941.—If after December 31, 1941, property held as such community property (unless considered by reason of subparagraph (B) of this paragraph as not so held) was by the decedent and the surviving spouse converted, by one transaction or a series of transactions, into separate property of the decedent and his spouse (including any form of coownership by them), the separate property so acquired by the decedent and any property acquired at any time by the decedent in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clauses (i), (ii), and (iii) of subparagraph (B), be considered as "held as such community property."

(ii) LIMITATION.—Where the value (at the time of such conversion) of the separate property so acquired by the decedent exceeded the value (at such time) of the separate property so acquired by the decedent's spouse, the rule in clause (i) shall be applied only with respect to the same portion of such separate property of the decedent as the portion which the value (as of such time) of such separate property so acquired by the decedent's spouse is of the value (as of such time) of the separate property so acquired by the decedent.

§ 20.2056(c)-1 MARITAL DEDUCTION; LIMITATION ON AGGREGATE OF DEDUCTIONS; IN GENERAL.—(a) *In general.*—The allowable marital deduction is limited to the smaller of the following amounts:

(1) The aggregate value of the "deductible interests" which passed from the decedent to his surviving spouse (see paragraph (a) of § 20.2056(a)-2).

(2) Fifty percent of the value of the decedent's "adjusted gross estate."

(b) "*Adjusted gross estate*".—The "adjusted gross estate" is the entire value of the decedent's gross estate less the aggregate amount of the deductions allowed for expenses, indebtedness, taxes, and losses under sections 2053 and 2054, unless the decedent and his spouse at any time held any property as community property (see § 20.2056(c)-2). In determining the adjusted gross estate, the gross estate is not reduced by the exemption allowable under section 2052, or by the amount of any charitable deduction allowable under section 2055.

Example. The value of a decedent's gross estate is $200,000 and the aggregate amount of the deductions allowed by sections 2053 and 2054 for expenses, debts, taxes and losses is $30,000. (It is assumed for the purpose of this example that the decedent and his spouse never held any property as community property.) The decedent left $10,000 to a charitable organization for which a deduction is allowable under section 2055, and left the balance of his estate to his surviving spouse. The value of the adjusted gross estate is, therefore, $200,000 less $30,000, or $170,000. It is assumed that the aggregate value of the deductible interests which passed from the decedent to his surviving spouse is $100,000. The allowable marital deduction is limited to $85,000 (50 percent of the value of the adjusted gross estate).

§ 20.2056(c)-2 MARITAL DEDUCTION IN CASES INVOLVING COMMUNITY PROPERTY.—(a) If the decedent and his surviving spouse at any time held property as "community property", as defined in this section, the "adjusted gross estate" referred to in § 20.2056(c)-1 is the entire value of the gross estate less the sum of the following values and amounts:

(1) The value of any property included in the gross estate which was at the time of the decedent's death held by him and his surviving spouse as "community property", as defined in this section.

(2) The value of property (to the extent included in the gross estate) transferred by the decedent during his life, if at the time of such transfer the property was held by him and his surviving spouse as "community property", as defined in this section.

(3) The amount (to the extent included in the gross estate) receivable as insurance under policies upon the life of the decedent, to the extent purchased with premiums or other consideration paid out of property then held by him and his surviving spouse as "community property", as defined in this section.

(4) An amount which bears the same ratio to the aggregate amount of the deductions for expenses, indebtedness, taxes and losses allowed by sections 2053 and 2054 as the value of the gross estate, reduced by the aggregate amount subtracted under subparagraphs (1), (2), and (3) of this paragraph, bears to the entire value of the gross estate. The amount to be subtracted under this subparagraph is gross estate, less

$$\frac{\text{community property}}{\text{entire gross estate}} \times \text{deductions for expenses, indebtedness, taxes, and losses.}$$

(b) If a policy of insurance upon the life of the decedent was purchased partly with property held by him and his surviving spouse as "community property", as defined in this section, and partly with other property, the amount receivable under the policy is considered, for the purpose of paragraph (a)(3) of this section, to have been purchased with such "community property" in the proportion that the payments made with such "community property" bear to the total amount paid.

(c) In determining the "adjusted gross estate" under this section, property held by the decedent and his surviving spouse as "community property", at the time of the death of the decedent (for the purpose of paragraph (a)(1) of this section), at the time of the transfer (for the purpose of paragraph (a)(2) of this section), or at the time of the payment of insurance premiums or other consideration (for the purpose of paragraph (a)(3) of this section), is considered to include—

(1) Any property held by them at such time as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, except property in which the surviving spouse had at such time merely an expectant interest.

(2) Separate property acquired by the decedent as a result of a "conversion" after December 31, 1941, of property held by him and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country (except such property in which the surviving spouse had at the time of the "conversion" merely an expectant interest), into their separate property, subject to the limitation with respect to value contained in paragraph (h) of this section.

(3) Property acquired by the decedent in exchange (by one exchange or a series of exchanges) for separate property acquired as set forth under subparagraph (2) of this paragraph.

The burden of establishing the extent to which separate property of the decedent was acquired other than as described in subparagraphs (2) and (3) of this section rests upon the executor.

(d) The surviving spouse is regarded as having merely an expectant interest in property held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country (1) at the time of the decedent's death, if the entire value of such property (and not merely one-half of it) is includible in the decedent's gross estate, or (2) at the time of any transfer, payment of insurance premiums or other consideration, or "conversion", if, in case of the death of the decedent at such time, the entire value of the property involved in the transfer, payment, or "conversion" (and not merely one-half of it) would have been so includible without regard to the provisions of section 402(b) of the Revenue Act of 1942 (56 Stat. 942).

(e) The characteristics of property which acquired a noncommunity instead of a community status by reason of an agreement (whether antenuptial or postnuptial) are such that section 2056(c)(2)(C) classifies the property as community property of the decedent and his surviving spouse in the computation of the "adjusted gross estate". In distinguishing property which thus acquired a noncommunity status from property which acquired such a status solely by operation of the applicable property law, section 2056(c)(2)(C) refers to the former category of property as "separate property" acquired as a result of a "conversion" of "property held as such community property". As used in section 2056(c)(2)(C), the phrase "property held as such community property" is used to denote the body of property comprehended within the community property system; the term "separate property" includes any noncommunity property (whether held in joint tenancy, tenancy by the entirety, tenancy in common, or otherwise); and the term "conversion" includes any transaction or agreement which transforms property from a community status into a noncommunity status.

(f) The separate property which section 2056(c)(2)(C) classifies as community property is not limited to that which was in existence at the time of the conversion. The following are illustrative of the scope of section 2056(c)(2)(C): (1) A partition of community property between husband and wife, in which a portion of such property became the separate property of each, is a conversion of such property; (2) a transfer of community property into some other form of coownership, such as a joint tenancy, is a conversion of such property; (3) an agreement (whether made before or after marriage) that future earnings and gains which would otherwise be community property shall be shared by the spouses as separate property effects a conversion of such earnings and gains; and (4) a change in the form of ownership of property which causes the future rentals therefrom, which would otherwise have been acquired as community property, to be acquired as separate property effects a conversion of the rentals.

(g) The rules of section 2056(c)(2)(C) are applicable, however, only if the conversion took place after December 31, 1941, and only to the extent stated in this section.

(h) If the value of the separate property acquired by the decedent as a result of a conversion did not exceed the value of the separate property thus acquired by the surviving spouse, the entire separate property thus acquired by the decedent is to be considered, for the purpose of this section, as held by him and his surviving spouse as community property. If the value (at the time of the conversion) of the separate property so acquired by the decedent exceeded the value (at that time) of the separate property so acquired by the spouse, only a part of the separate property so acquired by the decedent (and only the same fractional part of the property acquired by him in exchange for such separate property) is to be considered, for the purposes of this section, as held by him and his surviving spouse as community property. The part of such separate property (or property acquired in exchange therefore) which is considered as so held is the same proportion of it which the value (at the time of the conversion) of the separate property so acquired by the spouse is of the value (at that time) of the separate property so acquired by the decedent.

(j) The application of this section may be illustrated by the following examples:

Example (1). The value of a decedent's gross estate is $300,000, of which $200,000 represents his separate property and $100,000 represents his one-half interest in community property. The decedent's separate property was inherited from his father. The deductions allowed under sections 2053 and 2054 total $45,000. The adjusted gross estate is computed as follows.

Value of gross estate		$300,000
Reduction under paragraph (a)(1)	$100,000	
Reduction under paragraph (a)(4) $\frac{\$200,000}{\$300,000} \times \$45,000$	30,000	
Total reduction		130,000
Adjusted gross estate		170,000

The marital deduction will be $85,000 (one-half the value of the adjusted gross estate) in case the aggregate value of the deductible interests which passed from the decedent to his surviving spouse equals or exceeds that amount.

Example (2). The facts are the same as in example (1) except that the decedent's separate property was not inherited from his father, but was acquired under the following transaction: On November 1, 1942, the decedent and his surviving spouse partitioned certain community property then having a value of $224,000. A portion of such property, then having a value of $160,000, was converted into the decedent's separate property, and the remaining portion then having a value of $64,000, was converted into his spouse's separate property. The portion of the separate property so acquired by the decedent which is considered as held as community property at the time of his death is represented by that proportion of $200,000 (the value, at the time of death, of such separate property) which $64,000 (the value, at the time of the conversion, of the separate

property so acquired by his spouse) bears to $160,000 (the value, at the time of the conversion, of the separate property so acquired by the decedent), which proportion equals $80,000. The adjusted gross estate is computed as follows:

Value of gross estate		$300,000
Reduction under paragraph (a)(1) ($100,000+$80,000)	$180,000	
Reduction under paragraph (a)(4) $\frac{\$120,000}{\$300,000}\times\$45,000$	18,000	
Total reduction		198,000
Adjusted gross estate		102,000

The marital reduction will be $51,000 (one-half the value of the adjusted gross estate) in case the aggregate value of the deductible interests which passed from the decedent to his surviving spouse equals or exceeds that amount.

§ 20.2056(d) STATUTORY PROVISIONS; BEQUESTS; ETC., TO SURVIVING SPOUSE; DISCLAIMERS.

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE. * * *

(d) DISCLAIMERS.—

(1) BY SURVIVING SPOUSE.—If under this section an interest would, in the absence of a disclaimer by the surviving spouse, be considered as passing from the decedent to such spouse, and if a disclaimer of such interest is made by such spouse, then such interest shall, for the purposes of this section, be considered as passing to the person or persons entitled to receive such interest as a result of the disclaimer.

(2) BY ANY OTHER PERSON.—If under this section an interest would, in the absence of a disclaimer by any person other than the surviving spouse, be considered as passing from the decedent to such person, and if a disclaimer of such interest is made by such person and as a result of such disclaimer the surviving spouse is entitled to receive such interest, then such interest shall, for purposes of this section, be considered as passing, not to the surviving spouse, but to the person who made the disclaimer, in the same manner as if the disclaimer had not been made.

§ 20.2056(d)-1 MARITAL DEDUCTION; EFFECT OF DISCLAIMERS.—(a) *By a surviving spouse.*—If a decedent's surviving spouse makes a disclaimer of any property interest which would otherwise be considered as having passed from the decedent to her, the disclaimed interest is to be considered as having passed from the decedent to the person or persons entitled to receive the interest as a result of the disclaimer. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. It is, therefore, necessary to distinguish between the surviving spouse's disclaimer of a property interest and her acceptance and subsequent disposal of a property interest. For example, if proceeds of insurance are payable to the surviving spouse and she refuses them so that they consequently pass to an alternate beneficiary designated by the decedent, the proceeds are considered as having passed from the decedent to the alternate beneficiary. On the other hand, if the surviving spouse directs the insurance company to hold the proceeds at interest during her life and, upon her death, to pay the principal sum to another person designated by her, thus effecting a transfer of a remainder interest, the proceeds are considered as having passed from the decedent to his spouse. See paragraph (c)

of § 20.2056(e)–2 with respect to a spouse's exercise or failure to exercise a right to take against a decedent's will.

(b) *By a person other than a surviving spouse.*—It is unnecessary to distinguish, for the purpose of the marital deduction, between a disclaimer by a person other than the surviving spouse and a transfer by such person. If the surviving spouse becomes entitled to receive an interest in property from the decedent as a result of a disclaimer made by some other person, the interest is, nevertheless, considered as having passed from the decedent, not to the surviving spouse, but to the person who made the disclaimer, as though the disclaimer had not been made. If, as a result of a disclaimer made by a person other than the surviving spouse, a property interest passes to the surviving spouse under circumstances which meet the conditions set forth in § 20.2056(b)–5 (relating to a life estate with a power of appointment), the rule stated in the preceding sentence applies, not only with respect to the portion of the interest which beneficially vests in the surviving spouse, but also with respect to the portion over which she acquires a power to appoint. The rule applies also in the case of proceeds under a life insurance, endowment, or annuity contract, which, as a result of a disclaimer made by a person other than the surviving spouse, are held by the insurer subject to the conditions set forth in § 20.2056(b)–6.

§ 20.2056(e) STATUTORY PROVISIONS; BEQUESTS, ETC., TO SURVIVING SPOUSE; DEFINITION.

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE. * * *

(e) DEFINITION.—For purposes of this section, an interest in property shall be considered as passing from the decedent to any person if and only if—

(1) Such interest is bequeathed or devised to such person by the decedent;

(2) Such interest is inherited by such person from the decedent;

(3) Such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent;

(4) Such interest has been transferred to such person by the decedent at any time;

(5) Such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship;

(6) The decedent had a power (either alone or in conjunction with any person) to appoint such interest and if he appoints or has appointed such interest to such person, or if such person takes such interest in default on the release or nonexercise of such power; or

(7) Such interest consists of proceeds of insurance on the life of the decedent receivable by such person.

Except as provided in paragraph (5) or (6) of subsection (b), where at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall, for purposes of subparagraphs (A) and (B) of subsection (b)(1), be considered as passing from the decedent to a person other than the surviving spouse.

§ 20.2056(e)–1 MARITAL DEDUCTION; DEFINITION OF "PASSED FROM THE DECEDENT".—(a) The following rules are applicable in determining the person to whom any property interest "passed from the decedent":

(1) Property interests devolving upon any person (or persons) as surviving co-owner with the decedent under any form of joint owner-

ship under which the right of survivorship existed are considered as having passed from the decedent to such person (or persons).

(2) Property interests at any time subject to the decedent's power to appoint (whether alone or in conjunction with any person) are considered as having passed from the decedent to the appointee under his exercise of the power, or, in case of the lapse, release or non-exercise of the power, as having passed from the decedent to the taker in default of exercise.

(3) The dower or curtesy interest (or statutory interest in lieu thereof) of the decedent's surviving spouse is considered as having passed from the decedent to his spouse.

(4) The proceeds of insurance upon the life of the decedent are considered as having passed from the decedent to the person who, at the time of the decedent's death, was entitled to receive the proceeds.

(5) Any property interest transferred during life, bequeathed or devised by the decedent, or inherited from the decedent, is considered as having passed to the person to whom he transferred, bequeathed, or devised the interest, or to the person who inherited the interest from him.

(6) The survivor's interest in an annuity or other payment described in section 2039 (see §§ 20.2039–1 and 20.2039–2) is considered as having passed from the decedent to the survivor only to the extent that the value of such interest is included in the decedent's gross estate under that section. If only a portion of the entire annuity or other payment is included in the decedent's gross estate and the annuity or other payent is payable to more than one beneficiary, then the value of the interest considered to have passed to each beneficiary is that portion of the amount payable to each beneficiary that the amount of the annuity or other payment included in the decedent's gross estate bears to the total value of the annuity or other payment payable to all beneficiaries.

(b) If before the decedent's death the decedent's surviving spouse had merely an expectant interest in property held by her and the decedent under community property laws, that interest is considered as having passed from the decedent to the spouse. As to the circumstances under which the interest of the surviving spouse under community property laws is regarded as merely expectant, see paragraph (d) of § 20.2056(c)–2.

§ 20.2056(e)–2 MARITAL DEDUCTION; DEFINITION OF "PASSED FROM THE DECEDENT TO HIS SURVIVING SPOUSE".—(a) *In general.*—In general, the definition stated in § 20.2056(e)–1 is applicable in determining the property interests which "passed from the decedent to his surviving spouse". Special rules are provided, however, for the following:

(1) In the case of certain interests with income for life to the surviving spouse with power of appointment in her (see § 20.2056(b)–5);

(2) In the case of proceeds held by the insurer under a life insurance, endowment, or annuity contract with power of appointment in the surviving spouse (see § 20.2056(b)–6);

(3) In case of the disclaimer of an interest by the surviving spouse or by any other person (see § 20.2056(d)–1);

(4) In case of an election by the surviving spouse (see paragraph (c) of this section); and

(5) In case of a controversy involving the decedent's will, see paragraph (d) of this section.

A property interest is considered as passing to the surviving spouse only if it passed to her as beneficial owner, except to the extent otherwise provided in §§ 20.2056(b)–5 and 20.2056(b)–6 in the case of certain life estates and insurance and annuity contracts with powers of appointment. For this purpose, where a property interest passed from the decedent in trust, such interest is considered to have passed from him to his surviving spouse to the extent of her beneficial interest therein. The deduction may not be taken with respect to a property interest which passed to such spouse merely as trustee, or subject to a binding agreement by the spouse to dispose of the interest in favor of a third person. An allowance or award paid to a surviving spouse pursuant to local law for her support during the administration of the decedent's estate constitutes a property interest passing from the decedent to his surviving spouse. In determining whether or not such an interest is deductible, however, see generally the terminable interest rules of § 20.2056(b)–1 and especially example (8) of paragraph (g) of that section.

(b) *Examples.*—The following illustrate the provisions of paragraph (a) of this section:

(1) A property interest bequeathed in trust by H (the decedent) is considered as having passed from him to W (his surviving spouse)—

(i) If the trust income is payable to W for life and upon her death the corpus is distributable to her executors or administrators;

(ii) If W is entitled to the trust income for a term of years following which the corpus is to be paid to W or her estate;

(iii) If the trust income is to be accumulated for a term of years or for W's life and the augmented fund paid to W or her estate; or

(iv) If the terms of the transfer satisfy the requirements of § 20.2056(b)–5.

(2) If H devised property—

(i) To A for life with remainder absolutely to W or her estate, the remainder interest is considered to have passed from H to W;

(ii) To W for life with remainder to her estate, the entire property is considered as having passed from H to W; or

(iii) Under conditions which satisfy the provisions of § 20.2056(b)–5, the entire property is considered as having passed from H to W.

(3) Proceeds of insurance upon the life of H are considered as having passed from H to W if the terms of the contract—

(i) Meet the requirements of § 20.2056(b)–6;

(ii) Provide that the proceeds are payable to W in a lump sum;

(iii) Provide that the proceeds are payable in installments to W for life and after her death any remaining installments are payable to her estate;

(iv) Provide that interest on the proceeds is payable to W for life and upon her death the principal amount is payable to her estate; or

(v) Provide that the proceeds are payable to a trustee under an arrangement whereby the requirements of section 2056(b)(5) are satisfied.

(c) *Effect of election by surviving spouse.*—This paragraph contains rules applicable if the surviving spouse may elect between a property interest offered to her under the decedent's will or other instrument and a property interest to which she is otherwise entitled (such as dower, a right in the decedent's estate, or her interest under community property laws) of which adverse disposition was attempted by the decedent under the will or other instrument. If the surviving spouse elects to take against the will or other instrument, then the property interests offered thereunder are not considered as having "passed from the decedent to his surviving spouse" and the dower or other property interest retained by her is considered as having so passed (if it otherwise so qualifies under this section). If the surviving spouse elects to take under the will or other instrument, then the dower or other property interest relinquished by her is not considered as having "passed from the decedent to his surviving spouse" (irrespective of whether it otherwise comes within the definition stated in paragraph (a) of this section) and the interest taken under the will or other instrument is considered as having so passed (if it otherwise so qualifies). As to the valuation of the property interest taken under the will or other instrument, see paragraph (b) of § 20.2056(b)–4.

(d) *Will contests.*—(1) If as a result of a controversy involving the decedent's will, or involving any bequest or devise thereunder, his surviving spouse assigns or surrenders a property interest in settlement of the controversy, the interest so assigned or surrendered is not considered as having "passed from the decedent to his surviving spouse."

(2) If as a result of the controversy involving the decedent's will, or involving any bequest or devise thereunder, a property interest is assigned or surrendered to the surviving spouse, the interest so acquired will be regarded as having "passed from the decedent to his surviving spouse" only if the assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate. Such a bona fide recognition will be presumed where the assignment or surrender was pursuant to a decision of a local court upon the merits in an adversary proceeding following a genuine and active contest. However, such a decree will be accepted only to the extent that the court passed upon the facts upon which deductibility of the property interests depends. If the assignment or surrender was pursuant to a decree rendered by consent, or pursuant to an agreement not to contest the will or not to probate the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse.

(e) *Survivorship.*—If the order of deaths of the decedent and his spouse cannot be established by proof, a presumption (whether supplied by local law, the decedent's will, or otherwise) that the decedent was survived by his spouse will be recognized as satisfying paragraph (b)(1) of § 20.2056(a)–1, but only to the extent that it has the effect of giving to the spouse an interest in property includible in her gross estate under part III of subchapter A of chapter 11. Under these circumstances, if an estate tax return is required to be

filed for the estate of the decedent's spouse, the marital deduction will not be allowed in the final audit of the estate tax return of the decedent's estate with respect to any property interest which has not been finally determined to be includible in the gross estate of his spouse.

§ 20.2056(e)–3 MARITAL DEDUCTION; DEFINITION OF "PASSED FROM THE DECEDENT TO A PERSON OTHER THAN HIS SURVIVING SPOUSE".—The expression "passed from the decedent to a person other than his surviving spouse" refers to any property interest which, under the definition stated in § 20.2056(e)–1 is considered as having "passed from the decedent" and which under the rules referred to in § 20.2056(e)–2 is not considered as having "passed from the decedent to his surviving spouse." Interests which passed to a person other than the surviving spouse include interests so passing under the decedent's exercise, release, or nonexercise of a nontaxable power to appoint. It is immaterial whether the property interest which passed from the decedent to a person other than his surviving spouse is included in the decedent's gross estate. The term "person other than his surviving spouse" includes the possible unascertained takers of a property interest, as, for example, the members of a class to be ascertained in the future. As another example, assume that the decedent created a power of appointment over a property interest, which does not come within the purview of §§ 20.2055(b)–5 or 20.2056(b)–6. In such a case, the term "person other than his surviving spouse" refers to the possible appointees and possible takers in default (other than the spouse) of such property interest. Whether or not there is a possibility that the "person other than his surviving spouse" (or the heirs or assigns of such person) may possess or enjoy the property following termination or failure of the interest therein which passed from the decedent to his surviving spouse is to be determined as of the time of the decedent's death.

ESTATES OF NONRESIDENTS NOT CITIZENS

§ 20.2101 STATUTORY PROVISIONS; TAX IMPOSED.

SEC. 2101. TAX IMPOSED.

(a) IN GENERAL.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this title.

(b) PROPERTY HELD BY ALIEN PROPERTY CUSTODIAN.—For taxes in connection with property or interests transferred to or vested in the Alien Property Custodian, see section 36 of the Trading with the Enemy Act, as added by the act of August 8, 1946 (60 Stat. 929; 50 U. S. C. App. 36 [C. B. 1946–2, 286]).

§ 20.2101–1 ESTATES OF NONRESIDENTS NOT CITIZENS; TAX IMPOSED.—Section 2101 imposes a tax on the transfer of the taxable estate of a nonresident who was not a citizen of the United States at the time of his death. The tax is computed at the same rates as the tax which is imposed on the transfer of the taxable estate of a citizen or resident of the United States. See section 2001. For a general description of the method to be used in determining the

net estate tax payable in the case of an estate of a nonresident not a citizen, see paragraph (c) of § 20.0–2. For the meanings of the terms "resident", "nonresident," and "United States," see paragraph (b) (1) and (2) of § 20.0–1. For the presumption applying to the residence of missionaries, see section 2202. For the liability of the executor for payment of the tax, see section 2002.

§ 20.2102 STATUTORY PROVISIONS; CREDITS AGAINST TAX.

SEC. 2102. CREDITS AGAINST TAX.

The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers).

§ 20.2102–1 ESTATES OF NONRESIDENTS NOT CITIZENS; CREDITS AGAINST TAX.—In arriving at the net estate tax payable with respect to the transfer of an estate of a nonresident who was not a citizen of the United States at the time of his death, the following credits are subtracted from the tax imposed by section 2101:

(a) The State death tax credit under section 2011;

(b) The gift tax credit under section 2012; and

(c) The credit for tax on prior transfers under section 2013.

The amount of each of these credits is determined in the same manner as that prescribed for its determination in the estates of citizens and residents of the United States. See §§ 20.2011–1 through 20.2013–6. The provisions of sections 2015 and 2016, relating respectively to the credit for death taxes on remainders and the recovery of taxes claimed as a credit, are applicable with respect to the credit for State death taxes in the case of the estates of nonresidents not citizens. However, the credit for foreign death taxes under section 2014 is not allowed.

§ 20.2103 STATUTORY PROVISIONS; DEFINITION OF GROSS ESTATE.

SEC. 2103. DEFINITION OR GROSS ESTATE.

For the purpose of the tax imposed by section 2101, the value of the gross estate of every decedent nonresident not a citizen of the United States shall be that part of his gross estate (determined as provided in section 2031) which at the time of his death is situated in the United States.

§ 20.2103–1 ESTATES OF NONRESIDENTS NOT CITIZENS; "ENTIRE GROSS ESTATE".—The "entire gross estate" wherever situated of a nonresident who was not a citizen of the United States at the time of his death is made up in the same way as the "gross estate" of a citizen or resident of the United States. See §§ 20.2031–1 through 20.2044–1. As in the case of a citizen or resident of the United States, it does not include real property situated outside the United States. However, in the case of a nonresident not a citizen, only that part of the entire gross estate which is situated in the United States is included in his taxable estate. In fact, property situated outside the United States need not be disclosed on the return unless certain deductions are claimed or information is specifically requested. See §§ 20.2106–1 and 20.2106–2. For a description of property considered to be situated in the United States, see § 20.2104–1. For a description of property considered to be situated outside the United States, see § 20.2105–1.

§ 20.2104 STATUTORY PROVISIONS; PROPERTY WITHIN THE UNITED STATES.

SEC. 2104. PROPERTY WITHIN THE UNITED STATES.

(a) STOCK IN CORPORATION.—For purposes of this subchapter shares of stock owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States only if issued by a domestic corporation.

(b) REVOCABLE TRANSFERS AND TRANSFERS IN CONTEMPLATION OF DEATH.—For purposes of this subchapter, any property of which the decedent has made a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, shall be deemed to be situated in the United States, if so situated either at the time of the transfer or at the time of the decedent's death.

§ 20.2104–1 ESTATES OF NONRESIDENTS NOT CITIZENS; PROPERTY WITHIN THE UNITED STATES.—(a) *In general.*—Property of a nonresident who was not a citizen of the United States at the time of his death is considered to be situated in the United States if it is—

(1) Real property located in the United States.

(2) Tangible personal property located in the United States, except certain works of art on loan for exhibition (see paragraph (b) of § 20.2105–1).

(3) Written evidence of intangible personal property which is treated as being the property itself, such as a bond for the payment of money, if it is physically located in the United States, except obligations of the United States (but not its instrumentalities) issued before March 1, 1941, if the decedent was not engaged in business in the United States at the time of his death.

(4) Except as specifically provided otherwise in this section or in § 20.2105–1, intangible personal property the written evidence of which is not treated as being the property itself, if it is issued by or enforceable against a resident of the United States or a domestic corporation or governmental unit.

(5) Shares of stock issued by a domestic corporation, regardless of the location of the certificates.

(6) Moneys deposited in the United States by or for the decedent with any person carrying on the banking business, if the decedent was engaged in business in the United States at the time of his death.

(b) *Transfers.*—Property of which the decedent has made a transfer taxable under sections 2035 through 2038 is deemed to be situated in the United States if it is determined, under the provisions of paragraph (a) of this section, to be so situated either at the time of the transfer or at the time of the decedent's death. See §§ 20.35–1 through 20.2038–1.

(c) *Death tax convention.*—It should be noted that the situs rules described in this section may be modified for various purposes under the provisions of an applicable death tax convention with a foreign country.

§ 20.2105 STATUTORY PROVISIONS; PROPERTY WITHOUT THE UNITED STATES.

SEC. 2105. PROPERTY WITHOUT THE UNITED STATES.

(a) PROCEEDS OF LIFE INSURANCE.—For purposes of this subchapter, the amount receivabale as insurance on the life of a nonresident not a citizen of the United States shall not be deemed property within the United States.

(b) BANK DEPOSITS.—For purposes of this subchapter, any moneys deposited with any person carrying on the banking business, by or for a nonresident not a citizen of the United States who was not engaged in business in the United States at the time of his death shall not be deemed property within the United States.

(c) WORKS OF ART ON LOAN FOR EXHIBITION.—For purposes of this subchapter, works of art owned by a nonresident not a citizen of the United States shall not be deemed property within the United States if such works of art are—

(1) Imported into the United States solely for exhibition purposes,

(2) Loaned for such purposes, to a public gallery or museum, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and

(3) At the time of the death of the owner, on exhibition, or en route to or from exhibition, in such a public gallery or museum.

§ 20.2105–1 ESTATES OF NONRESIDENTS NOT CITIZENS; PROPERTY WITHOUT THE UNITED STATES.—Property of a nonresident who was not a citizen of the United States at the time of his death is considered to be situated outside the United States if it is—

(a) Tangible personal propery located outside the United States.

(b) Works of art owned by the decedent if they were—

(1) Imported into the United States solely for exhibition purposes,

(2) Loaned for those purposes to a public gallery or museum, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and

(3) At the time of the death of the owner, on exhibition, or en route to or from exhibition, in such a public gallery or museum.

(c) Written evidence of intangible personal property which is treated as being the property itself, such as a bond for the payment of money, if it is not physically located in the United States.

(d) Obligations of the United States issued before March 1, 1941, even though physically located in the United States, if the decedent was not engaged in business in the United States at the time of his death.

(e) Except as specifically provided otherwise in this section or in § 20.2104–1, intangible personal property the written evidence of which is not treated as being the property itself, if it is not issued by or enforceable against a resident of the United States or a domestic corporation or governmental unit.

(f) Shares of stock issued by a corporation which is not a domestic corporation, regardless of the location of the certificates.

(g) Amounts receivable as insurance on the decedent's life.

(h) Moneys deposited in the United States by or for the decedent with any person carrying on the banking business, if the decedent was not engaged in business in the United States at the time of his death.

§ 20.2106 STATUTORY PROVISIONS; TAXABLE ESTATE.

SEC. 2106. TAXABLE ESTATE.

(a) DEFINITION OF TAXABLE ESTATE.—For purposes of the tax imposed by section 2101, the value of the taxable estate of every decedent nonresident not a citizen of the United States shall be determined by deducting from the value of that part of his gross estate which at the time of his death is situated in the United States—

(1) EXPENSES, LOSSES, INDEBTEDNESS, AND TAXES.—That proportion of the deductions specified in sections 2053 and 2054 (other than the

deductions described in the following sentence) which the value of such part bears to the value of his entire gross estate, wherever situated. Any deduction allowable under section 2053 in the case of a claim against the estate which was founded on a promise or agreement but was not contracted for an adequate and full consideration in money or money's worth shall be allowable under this paragraph to the extent that it would be allowable as a deduction under paragraph (2) if such promise or agreement constituted a bequest.

(2) TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.—

(A) IN GENERAL.—The amount of all bequests, legacies, devices, or transfers (including the interest which falls into any such bequest, legacy, device, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer, or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

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

(ii) To or for the use of any domestic corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislations; or

(iii) To a trustee or trustees, or a fraternal society, order, or association operation under the lodge system, but only if such contributions or gifts are to be used within United States by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, and no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda, or otherwise attempting, to influence legislation.

(B) POWERS OF APPOINTMENT.—Property includible in the decedent's gross estate under section 2041 (relating to powers of appointment) received by a donee described in this paragraph shall, for purposes of this paragraph, be considered a bequest of such decedent.

(C) DEATH TAXES PAYABLE OUT OF BEQUESTS.—If the tax imposed by section 2101, or any estate, succession, legacy, or inheritance taxes, are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this paragraph, then the amount deductible under this paragraph shall be the amount of such bequests, legacies, or devises reduced by the amount of such taxes.

(D) LIMITATION ON DEDUCTION.—The amount of the deduction under this paragraph for any transfer shall not exceed the value of the transferred property required to be included in the gross estate.

(E) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—For disallowance of certain charitable, etc., deductions otherwise allowable under this paragraph, see sections 504 and 681.

(F) OTHER CROSS REFERENCES.—(1) For option as to time for valuation for purpose of deduction under this paragraph, see section 2032.

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(2) For exemption of bequests to or for benefit of Library of Congress, see section 5 of the Act of March 3, 1925, as amended (56 Stat. 765; 2 U. S. C. 161).

(3) For construction of bequests for benefit of the library of the Post Office Department as bequests to or for the use of the United States, see section 2 of the Act of August 8, 1946 (60 Stat. 924; 5 U. S. C. 393).

(4) For exemption of bequests for benefit of Office of Naval Records and Library, Navy Department, see section 2 of the Act of March 4, 1937 (50 Stat. 25; 5 U. S. C. 419b).

(5) For exemption of bequests to or for benefit of National Park Service, see section 5 of the Act of July 10, 1935 (49 Stat. 478; 16 U. S. C. 19c).

(6) For construction of devises or bequests accepted by the Secretary of State under the Foreign Service Act of 1946 as devises or bequests to or for the use of the United States, see section 1021 (e) of that Act (60 Stat. 1032; 22 U. S. C. 809).

(7) For construction of gifts or bequests of money accepted by the Attorney General for credit to "Commissary Funds, Federal Prisons" as gifts or bequests to or for the use of the United States, see section 2 of the Act of May 15, 1952, 66 Stat. 73, as amended by the Act of July 9, 1952, 66 Stat. 479 (31 U. S. C. 725s–4).

(8) For payment of tax on bequests of United States obligations to the United States, see section 24 of the Second Liberty Bond Act, as amended (59 Stat. 48, § 4; 31 U. S. C. 757e).

(9) For construction of bequests for benefit of or use in connection with the Naval Academy as bequests to or for the use of the United States, see section 3 of the Act of March 31, 1944 (58 Stat. 135; 34 U. S. C. 1115b).

(10) For exemption of bequests for benefit of Naval Academy Museum, see section 4 of the Act of March 26, 1938 (52 Stat. 119; 34 U. S. C. 1119).

(11) For exemption of bequests received by National Archives Trust Fund Board, see section 7 of the National Archives Trust Fund Board Act (55 Stat. 582; 44 U. S. C. 300gg).

(3) EXEMPTION.—An exemption of $2,000.

(b) CONDITION OF ALLOWANCE OF DEDUCTIONS.—No deduction shall be allowed under paragraphs (1) and (2) of subsection (a) in the case of a nonresident not a citizen of the United States unless the executor includes in the return required to be filed under section 6018 the value at the time of his death of that part of the gross estate of such nonresident not situated in the United States.

(c) UNITED STATES BONDS.—For purposes of section 2103, the value of the gross estate (determined as provided in section 2031) of a decedent who was not engaged in business in the United States at the time of his death—

(1) Shall not include obligations issued by the United States before March 1, 1941; and

(2) Shall include obligations issued by the United States on or after March 1, 1941.

§ 20.2106–1 ESTATES OF NONRESIDENTS NOT CITIZENS; TAXABLE ESTATE; DEDUCTIONS IN GENERAL.—(a) Section 2106(a) provides that the taxable estate of a nonresident who was not a citizen of the United States at the time of his death is determined by subtracting from the value of that part of his gross estate which, at the time of his death, is situated in the United States the total amount of the following deductions:

(1) The deductions allowed in the case of estates of decedents who were citizens or residents of the United States under sections 2053 and

2054 (see §§ 20.2053–1 through 20.2053–9 and § 20.2054–1) for expenses, indebtedness and taxes, and for losses, to the extent provided in § 20.2106–2.

(2) A deduction computed in the same manner as the one allowed under section 2055 (see §§ 20.2055–1 through 20.2055–4) for charitable, etc., transfers, except—

(i) That the deduction is allowed only for transfers to corporations and associations created or organized in the United States, and to trustees for use within the United States, and

(ii) That the provisions contained in paragraph (c) (2) of § 20.2055–2 relating to termination of a power to consume are not applicable.

(3) An exemption of $2,000, unless a death tax convention provides for another amount, such as a prorated part of the exemption allowed in the case of estates of citizens and residents of the United States under section 2052.

(b) Section 2106(b) provides that no deduction is allowed under paragraph (a) (1) or (2) of this section unless the executor discloses in the estate tax return the value of that part of the gross estate not situated in the United States. See § 20.2105–1. Such part must be valued as of the date of the decedent's death, or if the alternate valuation method under section 2032 is elected, as of the applicable valuation date. No marital deduction under section 2056 is allowed.

(c) In connection with the provisions of section 2106(c), see paragraph (a)(3) of § 20.2104–1 and paragraph (d) of § 20.2105–1.

§ 20.2106–2 Estates of Nonresidents Not Citizens; Deductions for Expenses, Losses, Etc.—(a) In computing the taxable estate of a nonresident who was not a citizen of the United States at the time of his death, deductions are allowed under sections 2053 and 2054 for expenses, indebtedness and taxes, and for losses, to the following extent:

(1) A pledge or subscription is deductible if it is an enforceable claim against the estate and if it would constitute an allowable deduction under paragraph (a)(2) of § 20.2106–1, relating to charitable, etc., transfers, if it had been a bequest.

(2) That proportion of other deductions under sections 2053 and 2054 is allowed which the value of that part of the decedent's gross estate situated in the United States at the time of his death bears to the value of the decedent's entire gross estate wherever situated. It is immaterial whether the amounts to be deducted were incurred or expended within or without the United States.

No deduction is allowed under this paragraph unless the value of the decedent's entire gross estate is disclosed in the estate tax return. See paragraph (b) of § 20.2106–1.

(b) In order that the Internal Revenue Service may properly pass upon the items claimed as deductions, the executor should submit a certified copy of the schedule of liabilities, claims against the estate, and expenses of administration filed under any applicable foreign death duty act. If no such schedule was filed, the executor should submit a certified copy of the schedule of these liabilities, claims and expenses filed with the foreign court in which administration was

had. If the items of deduction allowable under section 2106(a)(1) were not included in either such schedule, or if no such schedules were filed, then there should be submitted a written statement of the foreign executor containing a declaration that it is made under the penalties of perjury setting forth the facts relied upon as entitling the estate to the benefit of the particular deduction or deductions.

(c) The application of this section and of § 20.2106–1 may be illustrated by the following example:

Example. The decedent was a nonresident not a citizen of the United States at the time of his death. His gross estate, wherever situated, amounts to $1,000,000, of which $200,000 (or 20 percent) represents the value of the property having its situs within the United States. The funeral expenses, administration expenses, and claims against the estate aggregate $150,000, and there are charitable bequests, for use within the United States, amounting to $25,000. The decedent's taxable estate is determined as follows:

That part of the entire gross estate situated in the United States		$200,000
Deductions for expenses and claims (20 percent of $150,000)	$30,000	
Charitable deduction	25,000	
Exception	2,000	
		57,000
Taxable estate		143,000

For the manner of computing the tax on the taxable estate, see § 20.2001–2.

MISCELLANEOUS

§ 20.2201 STATUTORY PROVISIONS; MEMBERS OF THE ARMED FORCES DYING DURING AN INDUCTION PERIOD.

SEC. 2201. MEMBERS OF THE ARMED FORCES DYING DURING AN INDUCTION PERIOD.

The additional estate tax as defined in section 2011(d) shall not apply to the transfer of the taxable estate of a citizen or resident of the United States dying during an induction period (as defined in sec. 112(c)(5)), while in active service as a member of the Armed Forces of the United States, if such decedent—

(1) Was killed in action while serving in a combat zone, as determined under section 112(c); or

(2) Died as a result of wounds, disease, or injury suffered, while serving in a combat zone (as determined under section 112(c)), and while in line of duty, by reason of a hazard to which he was subjected as an incident of such service.

§ 20.2201–1 MEMBERS OF THE ARMED FORCES DYING DURING AN INDUCTION PERIOD.—(a) The additional estate tax as defined in section 2011(d) does not apply to the transfer of the taxable estate of a citizen or resident of the United States dying during an induction period as defined in section 112(c)(5) (see paragraph (b) of this section) and while in active service as a member of the Armed Forces of the United States, if the decedent—

(1) Was killed in action while serving in a combat zone, as determined under section 112(c)(2) and (3) (see paragraph (c) of this section), or

(2) Died as a result of wounds, disease, or injury suffered while serving in such a combat zone and while in line of duty, by reason of a hazard to which he was subject as an incident of such service.

(b) Section 112(c)(5) defines the term "induction period" as meaning any period during which individuals are liable for induction, for reasons other than prior deferment, for training and service in the Armed Forces of the United States.

(c) Section 112(c)(2) and (3) provides that service is performed in a combat zone only—

(1) If it is performed in an area which the President of the United States has designated by Executive order for purposes of section 112(c) as an area in which the Armed Forces of the United States are, or have, engaged in combat, and

(2) If it is performed on or after the date designated by the President by Executive order as the date of the commencing of combatant activities in such zone and on or before the date designated by the President by Executive order as the date of termination of combatant activities in such zone.

(d) If the official record of the branch of the Armed Forces of which the decedent was a member at the time of his death states that the decedent was killed in action while serving in a combat zone, or that death resulted from wounds or injuries received or disease contracted while in line of duty in a combat zone, this fact shall, in the absence of evidence establishing the contrary, be presumed to be established for the purposes of the exemption. Moreover, wounds, injuries or disease suffered while in line of duty will be considered to have been caused by a hazard to which the decedent was subjected as an incident of service as a member of the Armed Forces, unless the hazard which caused the wounds, injuries, or disease was clearly unrelated to such service.

(e) A person was in active service as a member of the Armed Forces of the United States if he was at the time of his death actually serving in such forces. A member of the Armed Forces in active service in a combat zone who thereafter becomes a prisoner of war or missing in action, and occupies such status at death or when the wounds, disease, or injury resulting in death were incurred, is considered for purposes of this section as serving in a combat zone.

(f) The exemption from tax granted by section 2201 does not apply to the basic estate tax as defined in section 2011(d).

§ 20.2202 STATUTORY PROVISIONS; MISSIONARIES IN FOREIGN SERVICE.

SEC. 2202. MISSIONARIES IN FOREIGN SERVICE.

Missionaries duly commissioned and serving under boards of foreign missions of the various religious denominations in the United States, dying while in the foreign missionary service of such boards, shall not, by reason merely of their intention to permanently remain in such foreign service, be deemed nonresidents of the United States, but shall be presumed to be residents of the State, the District of Columbia, Alaska, or Hawaii wherein they respectively resided at the time of their commission and their departure for such foreign service.

§ 20.2202–1 MISSIONARIES IN FOREIGN SERVICE.—Section 2202 provides that a duly commissioned missionary, dying while in foreign missionary service under a board of foreign missions of a religious denomination in the United States, is presumed to have retained a United States residence (see paragraph (b)(1) of § 20.0–1) held

at the time of his commission and departure for foreign service, in the absence of relevant facts other than his intention to remain permanently in such foreign service.

§ 20.2203 STATUTORY PROVISION; DEFINITION OF EXECUTOR.

SEC. 2203. DEFINITION OF EXECUTOR.

The term "executor" wherever it is used in this title in connection with the estate tax imposed by this chapter means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.

§ 20.2203–1 DEFINITION OF EXECUTOR.—The term "executor" means the executor or administrator of the decedent's estate. However, if there is no executor or administrator appointed, qualified and acting within the United States, the term means any person in actual or constructive possession of any property of the decedent. The term "person in actual or constructive possession of any property of the decedent" includes, among others, the decedent's agents and representatives; safe-deposit companies, warehouse companies, and other custodians of property in this country; brokers holding, as collateral, securities belonging to the decedent; and debtors of the decedent in this country.

§ 20.2204 STATUTORY PROVISIONS; DISCHARGE OF EXECUTOR FROM PERSONAL LIABILITY.

SEC. 2204. DISCHARGE OF EXECUTOR FROM PERSONAL LIABILITY.

If the executor makes written application to the Secretary or his delegate for determination of the amount of the tax and discharge from personal liability therefor, the Secretary or his delegate (as soon as possible), and in any event within 1 year after the making of such application, or, if the application is made before the return is filed, then within 1 year after the return is filed, but not after the expiration of the period prescribed for the assessment of the tax in section 6501) shall notify the executor of the amount of the tax. The executor, on payment of the amount of which he is notified, shall be discharged from personal liability for any deficiency in tax thereafter found to be due and shall be entitled to a receipt or writing showing such discharge.

§ 20.2204–1 DISCHARGE OF EXECUTOR FROM PERSONAL LIABILITY.—The executor of a decedent's estate may make written application to the district director for the district in which the estate tax return is filed for determination of the Federal estate tax and discharge from personal liability therefor. Within one year after receipt of the application, or if the application is made before the return is filed then within one year after the return is filed, the executor will be notified of the amount of the tax and, upon payment thereof, he will be discharged from personal liability for any deficiency in the tax thereafter found to be due. If no such notification is received, the executor is discharged at the end of such one year period from personal liability for any deficiency thereafter found to be due.

§ 20.2205 STATUTORY PROVISIONS; REIMBURSEMENT OUT OF ESTATE.

SEC. 2205. REIMBURSEMENT OUT OF ESTATE.

If the tax or any part thereof is paid by, or collected out of, that part of the estate passing to or in the possession of any person other than the executor in his capacity as such, such person shall be entitled

to reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate, it being the purpose and intent of this chapter that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution.

§ 20.2205–1 REIMBURSEMENT OUT OF ESTATE.—If any portion of the tax is paid by or collected out of that part of the estate passing to, or in the possession of, any person other than the duly qualified executor or administrator, that person may be entitled to reimbursement, either out of the undistributed estate or by contribution from other beneficiaries whose shares or interests in the estate would have been reduced had the tax been paid before distribution of the estate, or whose shares or interests are subject either to an equal or prior liability for the payment of taxes, debts, or other charges against the estate. For specific provisions giving the executor the right to reimbursement from life insurance beneficiaries and from recipients of property over which the decedent had a power of appointment, see sections 2206 and 2207. These provisions, however, are not designed to curtail the right of the district director to collect the tax from any person, or out of any property, liable for its payment. The district director cannot be required to apportion the tax among the persons liable nor to enforce any right of reimbursement or contribution.

§ 20.2206 STATUTORY PROVISIONS; LIABILITY OF LIFE INSURANCE BENEFICIARIES.

SEC. 2206. LIABILITY OF LIFE INSURANCE BENEFICIARIES.

Unless the decedent directs otherwise in his will, if any part of the gross estate on which tax has been paid consists of proceeds of policies of insurance on the life of the decedent receivable by a beneficiary other than the executor, the executor shall be entitled to recover from such beneficiary such portion of the total tax paid as the proceeds of such policies bear to the sum of the taxable estate and the amount of the exemption allowed in computing the taxable estate, determined under section 2051. If there is more than one such beneficiary, the executor shall be entitled to recover from such beneficiaries in the same ratio. In the case of such proceeds receivable by the surviving spouse of the decedent for which a deduction is allowed under section 2056 (relating to marital deduction), this section shall not apply to such proceeds except as to the amount thereof in excess of the aggregate amount of the marital deductions allowed under such section.

§ 20.2206–1 LIABILITY OF LIFE INSURANCE BENEFICIARIES.—With respect to the right of the district director to collect the tax without regard to the provisions of section 2206, see § 20.2205–1.

§ 20.2207 STATUTORY PROVISIONS; LIABILITY OF RECIPIENT OF PROPERTY OVER WHICH DECEDENT HAD POWER OF APPOINTMENT.

SEC. 2207. LIABILITY OF RECIPIENT OF PROPERTY OVER WHICH DECEDENT HAD POWER OF APPOINTMENT.

Unless the decedent directs otherwise in his will, if any part of the gross estate on which the tax has been paid consists of the value of property included in the gross estate under section 2041, the executor shall be entitled to recover from the person receiving such property by reason of the exercise, nonexercise, or release of a power of appointment such portion of the total tax paid as the value of such property bears to the sum of the taxable estate and the amount of the exemp-

tion allowed in computing the taxable estate, determined under section 2052, or section 2106(a), as the case may be. If there is more than one such person, the executor shall be entitled to recover from such persons in the same ratio. In the case of such property received by the surviving spouse of the decedent for which a deduction is allowed under section 2056 (relating to marital deduction), this section shall not apply to such property except as to the value thereof reduced by an amount equal to the excess of the aggregate amount of the marital deductions allowed under section 2056 over the amount of proceeds of insurance upon the life of the decedent receivable by the surviving spouse for which proceeds a marital deduction is allowed under such section.

§ 20.2207–1 LIABILITY OF RECIPIENT OF PROPERTY OVER WHICH DECEDENT HAD POWER OF APPOINTMENT.—With respect to the right of the district director to collect the tax without regard to the provisions of section 2207, see § 20.2205–1.

PROCEDURE AND ADMINISTRATION

§ 20.6001 STATUTORY PROVISIONS; NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS.

SEC. 6001. NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS.

Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary or his delegate may from time to time prescribe. Whenever in the judgment of the Secretary or his delegate it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary or his delegate deems sufficient to show whether or not such person is liable for tax under this title.

§ 20.6001–1 PERSONS REQUIRED TO KEEP RECORDS AND RENDER STATEMENTS.—(a) It is the duty of the executor to keep such complete and detailed records of the affairs of the estate for which he acts as will enable the district director to determine accurately the amount of the estate tax liability. All documents and vouchers used in preparing the estate tax return (§ 20.6018–1) shall be retained by the executor so as to be available for inspection whenever required.

(b) In addition to filing a preliminary notice (see § 20.6036–1) and an estate tax return (see § 20.6018–1), the executor shall furnish such supplemental data as may be necessary to establish the correct estate tax. It is therefore the duty of the executor (1) to furnish, upon request, copies of any documents in his possession (or on file in any court having jurisdiction over the estate) relating to the estate, appraisal lists of any items included in the gross estate, copies of balance sheets or other financial statements obtainable by him relating to the value of stock, and any other information obtainable by him that may be found necessary in the determination of the tax, and (2) to render any written statement, containing a declaration that it is made under penalties of perjury, of facts within his knowledge which the district director may require for the purpose of determining whether a tax liability exists and, if so, the extent thereof. Failure to comply with such a request will render the executor liable to penalties (see section 7269), and proceedings may be instituted in the proper court of the United States to secure compliance therewith (see section 7604).

(c) Persons having possession or control of any records or documents containing or supposed to contain any information concerning the estate, or having knowledge of or information about any fact or facts which have a material bearing upon the liability, or the extent of liability, of the estate for the estate tax, shall, upon request of the district director, make disclosure thereof. Failure on the part of any person to comply with such request will render him liable to penalties (section 7269), and compliance with the request may be enforced in the proper court of the United States (section 7604).

(d) Upon notification from the Internal Revenue Service, a corporation (organized or created in the United States) or its transfer agent is required to furnish the following information pertaining to stocks or bonds registered in the name of a nonresident decedent (regardless of citizenship): (1) The name of the decedent as registered; (2) the date of the decedent's death; (3) the decedent's residence and his place of death; (4) the names and addresses of executors, attorneys, or other representatives of the estate, within and without the United States; and (5) a description of the securities, the number of shares or bonds and the par values thereof.

§ 20.6011 STATUTORY PROVISIONS; GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

SEC. 6011. GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

(a) GENERAL RULE.—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

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(c) INCOME, ESTATE, AND GIFT TAXES.—For requirement that returns of income, estate, and gift taxes be made whether or not there is tax liability, see sections 6012 to 6019, inclusive.

§ 20.6011–1 GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.—(a) *General rule.*—Every person made liable for any tax imposed by subtitle B of the Code shall make such returns or statements as are required by the regulations in this part. The return or statement shall include therein the information required by the applicable regulations or forms.

(b) *Use of prescribed forms.*—Copies of the forms prescribed by §§ 20.6018–1 and 20.6036–1 may be obtained from district directors. The fact that an executor has not been furnished with copies of these forms will not excuse him from filing a preliminary notice or making a return. Application for a form shall be made to the district director in ample time for the executor to have the form prepared, verified, and filed with the district director on or before the date prescribed for the filing thereof (see §§ 20.6071–1 and 20.6075–1). The executor shall carefully prepare the preliminary notice and the return so as to set forth fully and clearly the data called for therein. A preliminary notice or a return which has not been so prepared will not be accepted as meeting the requirements of §§ 20.6018–1 through 20.6018–4 and § 20.6036–1.

§ 20.6018 Statutory Provisions; Estate Tax Returns.

SEC. 6018. ESTATE TAX RETURNS.

(a) Returns by Executor.—

(1) Citizens or residents.—In all cases where the gross estate at the death of a citizen or resident exceeds $60,000, the executor shall make a return with respect to the estate tax imposed by subtitle B.

(2) Nonresidents not citizens of the United States.—In the case of the estate of every nonresident not a citizen of the United States if that part of the gross estate which is situated in the United States exceeds $2,000, the executor shall make a return with respect to the estate tax imposed by subtitle B.

(b) Returns by Beneficiaries.—If the executor is unable to make a complete return as to any part of the gross estate of the decedent, he shall include in his return a description of such part and the name of every person holding a legal or beneficial interest therein. Upon notice from the Secretary or his delegate such person shall in like manner make a return as to such part of the gross estate.

§ 20.6018–1 Returns.—(a) *Estates of citizens or residents.*—A return must be filed on Form 706 for the estate of every citizen or resident of the United States whose gross estate exceeded $60,000 in value on the date of his death. The value of the gross estate at the date of death governs with respect to the filing of the return regardless of whether the value of the gross estate is, at the executor's election, finally determined as of a date subsequent to the date of death pursuant to the provisions of section 2032. Duplicate copies of the return are not required to be filed. For the contents of the return, see § 20.6018–3.

(b) *Estates of nonresidents not citizens.*—A return must be filed on Form 706 or 706NA for the estate of every nonresident not a citizen if the value of the part of the gross estate situated in the United States exceeded $2,000 on the date of his death. Under certain conditions the return may be made only on Form 706. See the instructions on Form 706NA for circumstances under which that form may not be used. Duplicate copies of the return are not required to be filed. For the contents of the return, see § 20.6018–3.

(c) *Place for filing.*—See § 20.609–1 for the place where the return shall be filed.

(d) *Time for filing.*—See § 20.6075–1 for the time for filing the return.

§ 20.6018–2 Returns; Person Required To File Return.—It is required that the duly qualified executor or administrator shall file the return. If there is more than one executor or administrator, the return must be made jointly by all. If there is no executor or administrator appointed, qualified and acting within the United States, every person in actual or constructive possession of any property of the decedent situated in the United States is constituted an executor for purposes of the tax (see § 20.2203–1), and is required to make and file a return. If in any case the executor is unable to make a complete return as to any part of the gross estate, he is required to give all the information he has as to such property, including a full description, and the name of every person holding a legal or beneficial interest in the property. If the executor is unable to make a return as to any property, every person holding a legal or beneficial interest therein shall, upon notice from the district director, make a return

as to that part of the gross estate. For delinquency penalty for failure to file return, see section 6651 and § 301.6651–1 of this chapter (Regulations on Procedure and Administration). For criminal penalties for failure to file a return and filing a false or fradulent return, see sections 7203, 7206, 7207, and 7269.

§ 20.6018–3 RETURNS; CONTENTS OF RETURNS.—(a) *Citizens or residents.*—The return of an estate of a decedent who was a citizen or resident of the United States at the time of his death must contain an itemized inventory by schedule of the property constituting the gross estate and lists of the deductions under the proper schedules. The return shall set forth (1) the value of the gross estate (see §§ 20.2031–1 through 20.2044–1), (2) the deductions claimed (see §§ 20.2052–1 through 20.2056(e)–3), (3) the taxable estate (see § 20.2051–1), and (4) the gross estate tax, reduced by any credits (see §§ 20.2011–1 through 20.2014–6) against the tax. In listing upon the return the property constituting the gross estate (other than household and personal effects for which see § 20.2031–6), the description of it shall be such that the property may be readily identified for the purpose of verifying the value placed on it by the executor.

(b) *Nonresidents not citizens.*—The return of an estate of a decedent who was not a citizen or resident of the United States at the time of his death must contain the following information: (1) An itemized list of that part of the gross estate situated in the United States (see § 20.2104–1), (2) an itemized list of any deductions claimed (see §§ 20.2106–1 and 20.2106–2), (3) the amount of the taxable estate (see § 20.2106–1), and (4) the gross estate tax, reduced by any credits (see § 20.2102–1) against the tax. For the disallowance of certain deductions if the return does not disclose that part of the gross estate not situated in the United States, see §§ 20.2106–1 and 20.2106–2.

(c) *Provisions applicable to returns described in paragraphs (a) and (b) of this section.*—(1) A legal description shall be given of each parcel of real estate, and, if located in a city, the name of the street and number, its area, and, if improved, a short statement of the character of the improvements.

(2) A description of bonds shall include the number held, principal amount, name of obligor, date of maturity, rate of interest, date or dates on which interest is payable, series number if there is more than one issue, and the principal exchange upon which listed, or the principal business office of the obligor, if unlisted. A description of stocks shall include number of shares, whether common or preferred, and, if preferred, what issue, par value, quotation at which returned, exact name of corporation, and, if the stock is unlisted, the location of the principal business office and State in which incorporated and the date of incorporation, or if the stock is listed, the principal exchange upon which sold. A description of notes shall include name of maker, date on which given, date of maturity, amount of principal, amount of principal unpaid, rate of interest and whether simple or compound, date to which interest has been paid and amount of unpaid interest. A description of the seller's interest in land contracts shall include name of buyer, date of contract, description of property, sale price, initial payment, amounts of installment payments,

unpaid balance of principal and accrued interest, interest rate and date prior to decedent's death to which interest had been paid.

(3) A description of bank accounts shall disclose the name and address of depository, amount on deposit, whether a checking, savings, or a time-deposit account, rate of interest, if any payable, amount of interest accrued and payable, and serial number. A description of life insurance shall give the name of the insurer, number of policy, name of the beneficiary, and the amount of the proceeds.

(4) In describing an annuity, the name and address of the grantor of the annuity shall be given, or, if the annuity is payable out of a trust or other funds, such a description as will fully identify it. If the annuity is payable for a term of years, the duration of the term and the date on which it began shall be given, and if payable for the life of a person other than the decedent, the date of birth of such person shall be stated. If the executor has not included in the gross estate the full value of an annuity or other payment described in section 2039, he shall nevertheless fully describe the annuity and state its total purchase price and the amount of the contribution made by each person (including the decedent's employer) toward the purchase price. If the executor believes that any part of the annuity or other payment is excludable from the gross estate under the provisions of section 2039, or for any other reason, he shall state in the return the reason for his belief.

(5) Judgments should be described by giving the title of the cause and the name of the court in which rendered, date of judgment, name and address of the judgment debtor, amount of judgment, and rate of interest to which subject, and by stating whether any payments have been made thereon, and, if so, when and in what amounts.

(6) If, pursuant to section 2032, the executor elects to have the estate valued at a date or dates subsequent to the time of the decedent's death, there must be set forth on the return: (i) An itemized description of all property included in the gross estate on the date of the decedent's death, together with the value of each item as of that date; (ii) an itemized disclosure of all distributions, sales, exchanges, and other dispositions of any property during the 1-year period after the date of the decedent's death, together with the dates thereof; and (iii) the value of each item of property in accordance with the provisions of section 2032 (see § 20.2032–1). Interest and rents accrued at the date of the decedent's death and dividends declared to stockholders of record on or before the date of the decendent's death and not collected at that date are to be shown separately. (See also paragraph (e) of § 20.6018–4 with respect to documents required to be filed with the return.)

(7) All transfers made by the decedent within 3 years before the date of his death of a value of $1,000 or more and all transfers (other than outright transfers not in trust) made by the decedent at any time during his life of a value of $5,000 or more, except bona fide sales for an adequate and full consideration in money or money's worth, must be disclosed in the return, whether or not the executor regards the transfers as subject to the tax. If the executor believes that such a transfer is not subject to the tax, a brief statement of the pertinent facts shall be made.

§ 20.6018–4 RETURNS; DOCUMENTS TO ACCOMPANY THE RETURN.—(a) A certified copy of the will, if the decedent died testate, must be submitted with the return, together with copies of such other documents as are required in Form 706 and in the applicable sections of these regulations. There may also be filed copies of any documents which the executor may desire to submit in explanation of the return.

(b) In the case of an estate of a nonresident citizen, the executor shall also file the following documents with the return: (1) A copy of any inventory of property and schedule of liabilities, claims against the estate and expenses of administration filed with the foreign court of probate jurisdiction, certified by a proper official of the court; and (2) a copy of any return filed under any applicable foreign inheritance, estate, legacy, or succession tax act, certified by a proper official of the foreign tax department.

(c) In the case of an estate of a nonresident not a citizen, the executor must also file with the return, but only if deductions are claimed, a copy of the inventory of property filed under the foreign death duty act; or, if no such inventory was filed, a certified copy of the inventory filed with the foreign court of probate jurisdiction.

(d) For every policy of life insurance listed on the return, the executor must procure a statement, on Form 712, by the company issuing the policy and file it with the return.

(e) If, pursuant to section 2032, the executor elects to have the estate valued at a date or dates subsequent to the time of the decedent's death, the executor shall file with the return evidence in support of any statements made by him in the return as to distributions, sales, exchanges, or other dispositions of property during the 1-year period which followed the decedent's death. If the court having jurisdiction over the estate makes an order or decree of distribtuion during that period, a certified copy thereof must be submitted as part of the evidence. The district director may require the submission of such additional evidence as is deemed necessary.

(f) In any case where a transfer, by trust or otherwise, was made by a written instrument, a copy thereof shall be filed with the return if (1) the property is included in the gross estate, or (2) the executor pursuant to the provisions of paragraph (c)(7) of § 20.6018–3 has made a disclosure of the transfer on the return but has not included its value in the gross estate in the belief that it is not so includible. If the written instrument is of public record, the copy shall be certified, or if it is not of record, the copy shall be verified. If the decedent was a nonresident not a citizen at the time of his death, the copy may be either certified or verified.

(g) If the executor contends that the value of property transferred by the decedent within a period of three years ending with the date of the decedent's death should not be included in the gross estate because he considers that the transfer was not made in contemplation of death, he shall file with the return (1) a copy of the death certificate, and (2) a statement, containing a declaration that it is made under the penalties of perjury, of all the material facts and circumstances, including those directly or indirectly indicating the decedent's motive in making

the transfer and his mental and physical condition at that time. However, this data need not be furnished with respect to transfers of less than $1,000 in value unless requested by the district director.

§ 20.6036 STATUTORY PROVISIONS; NOTICE OF QUALIFICATION AS EXECUTOR OR RECEIVER.

SEC. 6036. NOTICE OF QUALIFICATION AS EXECUTOR OR RECEIVER.

Every receiver, trustee in bankruptcy, assignee for benefit of creditors, or other like fiduciary, and every executor (as defined in section 2203), shall give notice of his qualification as such to the Secretary or his delegate in such manner and at such time as may be required by regulations of the Secretary or his delegate. The Secretary or his delegate may by regulation provide such exemptions from the requirements of this section as the Secretary or his delegate deems proper.

§ 20.6036–1 NOTICE OF QUALIFICATION AS EXECUTOR.—(a) *Preliminary notice.*—A preliminary notice is required to be filed on Form 704 in the case of every citizen or resident of the United States whose gross estate exceeded $60,000 in value at the date of death, and on Form 705 in the case of every nonresident who is not a citizen if that part of his gross estate which was situated in the United States (see § 20.2104–1) exceeded $2,000 in value at the date of death. The value of the gross estate at the date of death governs with respect to the filing of the notice regardless of whether the value of the gross estate is, at the executor's election, finally determined as of a date subsequent to the date of death pursuant to the provisions of section 2032. If there is doubt as to whether the gross estate exceeds $60,000 or $2,000, as the case may be, the notice shall be filed as a matter of precaution in order to avoid the possibility of penalties attaching. The primary purpose of the notice is to advise the Internal Revenue Service of the existence of taxable estates, and filing shall not be delayed beyond the period provided for in § 20.6071–1 merely because of uncertainty as to the exact value of the assets. The estimate of the gross estate called for by the notice shall be the best approximation of value which can be made within the time allowed. Duplicate copies of the preliminary notice are not required to be filed. For criminal penalties for failure to file a notice and filing a false or fraudulent notice, see sections 7203, 7207, and 7269. See § 20.6091–1 for the place for filing the notice. See § 20.6071–1 for the time for filing the notice.

(b) *Persons required to file.*—In the case of an estate of a citizen or resident of the United States the preliminary notice must be filed by the duly qualified executor or administrator, or if none qualifies within 2 months after the decedent's death, by every person in actual or constructive possession of any property of the decedent at or after the time of the decedent's death. The signature of one executor or administrator on the preliminary notice is sufficient. In the case of a nonresident not a citizen, the notice must be filed by every duly qualified executor or administrator within the United States, or if none qualifies within two months after the decedent's death, by every person in actual or constructive possession of any property of the decedent at or after the time of the decedent's death.

§ 20.6071 STATUTORY PROVISIONS; TIME FOR FILING RETURNS AND OTHER DOCUMENTS.

SEC. 6071. TIME FOR FILING RETURNS AND OTHER DOCUMENTS.

(a) GENERAL RULE.—When not otherwise provided for by this title, the Secretary or his delegate shall by regulations prescribe the time for filing any return, statement, or other document required by this title or by regulations.

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§ 20.6071–1 TIME FOR FILING OF PRELIMINARY NOTICE.—If a duly qualified executor or administrator of the estate of a decedent who was a resident or a citizen of the United States qualifies within two months after a decedent's death, or if a duly qualified executor or administrator of the estate of a nonresident not a citizen qualifies within the United States within two months after the decedent's death, the preliminary notice required by § 20.6036–1 must be filed within two months after his qualification. If no such executor or administrator qualifies within that period, the preliminary notice must be filed within two months of the decedent's death.

§ 20.6075 STATUTORY PROVISIONS; TIME FOR FILING ESTATE TAX RETURN.

SEC. 6075. TIME FOR FILING ESTATE AND GIFT TAX RETURNS.

(a) ESTATE TAX RETURNS.—Returns made under section 6918(a) (relating to estate taxes) shall be filed within 15 months after the date of the decedent's death.

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§ 20.6075–1 RETURNS; TIME FOR FILING ESTATE TAX RETURN.—The estate tax return required by section 6018 must be filed on or before the due date. The due date is the date on or before which the return is required to be filed in accordance with the provisions of section 6075(a) or the last day of the period covered by an extension of time granted by the district director as provided in § 20.6081–1. Unless an extension of time for filing has been granted, the due date is the day of the fifteenth calendar month after the decedent's death numerically corresponding to the day of the calendar month on which death occurred, except that, if there is no numerically corresponding day in such fifteenth month, the last day of the fifteenth month is the due date. For example, if the decedent died on August 31, 1955, the due date is November 30, 1956. When the due date falls on Saturday, Sunday, or a legal holiday, the due date for filing the return is the next succeeding day which is not Saturday, Sunday, or a legal holiday. For definition of a legal holiday, see section 7503 and § 301.7503–1 of this chapter (Regulations on Procedure and Administration). As to additions to the tax in the case of failure to file the return within the prescribed time, see section 6651 and § 301.6651–1 of this chapter (Regulations on Procedure and Administration). For rules with respect to the right to elect to have the property valued as of a date or dates subsequent to the decedent's death, see § 20.2032–1, and section 7502 and § 301.7502–1 of this chapter (Regulations on Procedure and Administration).

§ 20.6081 STATUTORY PROVISIONS; EXTENSION OF TIME FOR FILING RETURNS.

SEC. 6081. EXTENSION OF TIME FOR FILING RETURNS.

(a) GENERAL RULE.—The Secretary or his delegate may grant a reasonable extension of time for filing any return, declaration, statement, or other document required by this title or by regulations. Except in the case of taxpayers who are abroad, no such extension shall be for more than 6 months.

* * * * * * *

(c) POSTPONEMENT BY REASON OF WAR.—For time for performing certain acts postponed by reason of war, see section 7508.

§ 20.6081–1 EXTENSION OF TIME FOR FILING THE RETURN.—(a) In case it is impossible or impracticable for the executor to file a reasonably complete return within 15 months from the date of death, the district director may, upon a showing of good and sufficient cause, grant a reasonable extension of time for filing the return required by section 6018. Unless the executor is abroad, the extension may not be for more than six months from the date for filing provided by section 6075(a). Therefore, unless the executor is abroad, the due date for filing the return under any extension granted by a district director may not be later than 21 months from the date of the decedent's death. The extension may, of course, be for a lesser period of time.

(b) The application for an extension of time for filing the return shall be addressed to the district director for the district in which the return is to be filed, and must contain a full recital of the causes for the delay. It must be made before the expiration of the time within which the return otherwise must be filed. It shall, where possible, be made sufficiently early to permit the district director to consider the matter and reply before what otherwise would be the due date of the return.

(c) A return as complete as possible must be filed before the expiration of the extension period granted. The return thus filed will be the return required by section 6018(a) and any tax shown thereon will be the "amount determined by the executor as the tax" referred to in section 6161(a)(2), or the "amount shown as the tax by the taxpayer upon his return" referred to in section 6211(a)(1)(A). The return cannot be amended after the expiration of the extension period although supplemental information may subsequently be filed that may result in a finally determined tax different from the amount shown as the tax by the executor on the return. An extension of time for filing the return does not operate to extend the time for payment of the tax. See § 20.6151–1 for the time for payment of the tax, and §§ 20.6161–1 and 20.6163–1 for extensions of time for payment of the tax.

§ 20.6091 STATUTORY PROVISIONS; PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

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—

* * * * * * *

(3) ESTATE TAX RETURNS.—Returns of estate tax required under section 6018 shall be made to the Secretary or his delegate in the internal revenue district in which was the domicile of the decedent at the time of his death or, if there was no such domicile in an internal revenue district, then at such place as the Secretary or his delegate may by regulations prescribe.

* * * * * * *

§ 20.6091–1 PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.—If the decedent was a resident of the United States, the preliminary notice required by § 20.6036–1 and the estate tax return required by § 20.6018–1 must be filed with the district director in whose district the decedent had his domicile at the time of death. If the decedent was a nonresident (whether a citizen or not a citizen), the notice and the return must be filed with the office of the Director of International Operations, Internal Revenue Service, Washington 25, D. C., or with such other office as the Commissioner may designate.

§ 20.6151 STATUTORY PROVISIONS; TIME AND PLACE FOR PAYING TAX SHOWN ON RETURNS.

SEC. 6151. TIME AND PLACE FOR PAYING TAX SHOWN ON RETURNS.

(a) GENERAL RULE.—Except as otherwise provided in this section, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary or his delegate, pay such tax to the principal internal revenue officer for the internal revenue district in which the return is required to be filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

* * * * * * *

(c) DATE FIXED FOR PAYMENT OF TAX.—In any case in which a tax is required to be paid on or before a certain date, or within a certain period, any reference in this title to the date fixed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax).

§ 20.6151–1 TIME AND PLACE FOR PAYING TAX SHOWN ON THE RETURN.—(a) *General rule.*—The tax shown on the estate tax return is to be paid at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return). For provisions relating to the time and place for filing the return, see §§ 20.6075–1 and 20.6091–1. For the duty of the executor to pay the tax, see § 20.2002–1.

(b) *Extension of time for paying.*—(1) *In general.*—For general provisions relating to extension of time for paying the tax, see § 20.6161–1.

(2) *Reversionary or remainder interests.*—For provisions relating to extension of time for payment of estate tax on the value of a reversionary or remainder interest in property, see § 20.6163–1.

(c) *Payment with obligations of the United States.*—Treasury bonds of certain issues which were owned by the decedent at the time of his death or which were treated as part of his gross estate

under the rules contained in § 306.28 of Treasury Department Circular No. 300, Revised (31 CFR Part 306), may be redeemed at par plus accrued interest for the purpose of payment of the estate tax, as provided in said section. Whether bonds of particular issues may be redeemed for this purpose will depend on the terms of the offering circulars cited on the face of the bonds. A current list of eligible issues may be obtained from any Federal reserve bank or branch, or from the Bureau of Public Debt, Washington, D. C. See section 6312 and §§ 301.6312–1 and 301.6312–2 of this chapter (Regulations on Procedure and Administration) for provisions relating to the payment of taxes with United States Treasury obligations.

(d) *Receipt for payment.*—For provisions relating to duplicate receipts for payment of the tax, see § 20.6314–1.

§ 20.6161 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.

(2) ESTATE TAX.—If the Secretary or his delegate finds that the payment on the due date of any part of the amount determined by the executor as the tax imposed by chapter 11 would result in undue hardship to the estate, he may extend the time for payment for a reasonable period not in excess of 10 years from the date fixed for payment of the tax.

(b) AMOUNT DETERMINED AS DEFICIENCY.—Under regulations prescribed by the Secretary or his delegate, the Secretary or his delegate may extend, to the extent provided below, the time for payment of the amount determined as a deficiency:

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(2) In the case of a tax imposed by chapter 11, for a period not to exceed 4 years from the date otherwise fixed for payment of the deficiency.

An extension under this subsection may be granted only where it is shown to the satisfaction of the Secretary or his delegate that the payment of a deficiency upon the date fixed for the payment thereof will result in undue hardship to the taxpayer in the case of a tax imposed by chapter 1, to the estate in the case of a tax imposed by chapter 11, or to the donor in the case of a tax imposed by chapter 12. No extension shall be granted if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

* * * * * * *

§ 20.6161–1 EXTENSION OF TIME FOR PAYING TAX SHOWN ON THE RETURN.—(a) In any case in which the district director finds that payment, on the due date, of any part of the tax shown on the return would impose undue hardship upon the estate, he may extend the time for payment for a period or periods not to exceed one year for any one period and for all periods not to extend more than 10 years from the due date.

(b) The extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an incon-

venience to the estate. It must appear that substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the estate from making payment of the tax at the due date. If a market exists, a sale of property at the current market price is not ordinarily considered as resulting in an undue hardship.

(c) An application for such an extension must be in writing and must contain, or be supported by, information in a written statement declaring that it is made under penalties of perjury, showing the undue hardship that would result to the estate if the requested extension were refused. The application, with the supporting information, must be filed with the district director. When received, it will be examined, and, if possible, within 30 days will be denied, granted, or tentatively granted subject to certain conditions of which the executor will be notified. The district director will not consider an application for such an extension unless it is applied for on or before the due date for payment of the tax. If the executor desires to obtain an additional extension, it must be applied for on or before the date of the expiration of the previous extension. The granting of the extension of time for paying the tax is discretionary with the district director and his authority will be exercised under such conditions as he may deem advisable.

(d) The amount of the tax for which an extension is granted, with the additions thereto, shall be paid on or before the expiration of the period of extension without the necessity of notice and demand from the district director.

(e) The granting of an extension of time for paying the tax will not relieve the executor from the duty of filing the return on or before the date provided for in § 20.6075–1, nor will it operate to prevent the running of interest. See section 6601. An extension of time to pay the tax may extend the period within which State and foreign death taxes allowed as a credit under sections 2011 and 2014 are required to be paid and the credit therefor claimed. See paragraph (c) of § 20.2011–1 and § 20.2014–6.

(f) For provisions requiring the furnishing of security for the payment of the tax for which an extension is granted, see paragraph (a) of § 20.6165–1. For provisions relating to extensions of time for payment of tax on the value of a reversionary or remainder interest in property, see § 20.6163–1.

§ 20.6161–2 Extension of Time for Paying Deficiency in Tax.—(a) In any case in which the district director finds that payment, on the date prescribed therefor, of any part of a deficiency would impose undue hardship upon the estate, he may extend the time for payment for a period or periods not to exceed one year for any one period and for all periods not to exceed four years from the date prescribed for payment thereof.

(b) The extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an inconvenience to the estate. It must appear that a substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the estate from making payment of the deficiency at the date prescribed therefor. If a market exists, a sale of property at the current market price is not ordinarily considered as resulting

in an undue hardship. No extension will be granted if the deficiency is due to negligence or intentional disregard of rules and regulations or to fraud with intent to evade the tax.

(c) An application for such an extension must be in writing and must contain, or be supported by, information in a written statement declaring that it is made under penalties of perjury showing the undue hardship that would result to the estate if the extension were refused. The application, with the supporting information, must be filed with the district director. When received, it will be examined, and, if possible, within thirty days will be denied, granted, or tentatively granted subject to certain conditions of which the executor will be notified. The district director will not consider an application for such an extension unless it is applied for on or before the date prescribed for payment of the deficiency, as shown by the notice and demand from the district director. If the executor desires to obtain an additional extension, it must be applied for on or before the date of the expiration of the previous extension. The granting of the extension of time for paying the deficiency is discretionary with the district director.

(d) The amount of the deficiency for which an extension is granted, with the additions thereto, shall be paid on or before the expiration of the period of extension without the necessity of notice and demand from the district director.

(e) The granting of an extension of time for paying the deficiency will not operate to prevent the running of interest. See section 6601. An extension of time to pay the deficiency may extend the period within which State and foreign death taxes allowed as a credit under sections 2011 and 2014 are required to be paid and the credit therefor claimed. See paragraph (c) of § 20.2011–1 and § 20.2014–6.

(f) For provisions requiring the furnishing of security for the payment of the deficiency for which an extension is granted, see § 20.6165–1.

§ 20.6163 Statutory Provisions; Extension of Time for Payment of Estate Tax on Value of Reversionary or Remainder Interest in Property.

SEC. 6163. EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX ON VALUE OF REVERSIONARY OR REMAINDER INTEREST IN PROPERTY.

(a) Extension Permitted.—If the value of a reversionary or remainder interest in property is included under chapter 11 in the value of the gross estate, the payment of the part of the tax under chapter 11 attributable to such interest may, at the election of the executor, be postponed until 6 months after the termination of the precedent interest or interests in the property, under such regulations as the Secretary or his delegate may prescribe.

(b) Cross References.—

(1) Interest.—For provisions requiring the payment of interest for the period of such extension, see section 6601(b).

(2) Security.—For authority of the Secretary or his delegate to require security in the case of such extension, see section 6165.

§ 20.6163–1 Extension of Time for Payment of Estate Tax on Value of Reversionary or Remainder Interest in Property.—(a) In case there is included in the gross estate a reversionary or remainder interest in property, the payment of the part of the tax attributable to that interest may, at the elecion of the executor, be postponed until six

months after the termination of the precedent interest or interests in the property. This provision is limited to cases in which the reversionary or remainder interest is included in the decedent's gross estate as such and does not extend to cases in which the decedent creates future interests by his own testamentary act.

(b) Notice of the exercise of the election to postpone the payment of the tax attributable to a reversionary or remainder interest should be filed with the district director before the date prescribed for payment of the tax. The notice of election may be made in the form of a letter addressed to the district director. There shall be filed with the notice of election a certified copy of the will or other instrument under which the reversionary or remainder interest was created, or a copy verified by the executor if the instrument is not filed of record. The district director may require the submission of such additional proof as he deems necessary to disclose the complete facts. If the duration of the precedent interest is dependent upon the life of any person, the notice of election must show the date of birth of that person.

(c) If the decedent's gross estate consists of both a reversionary or remainder interest in property and other property, the tax attributable to the reversionary or remainder interest, within the meaning of this section, is an amount which bears the same ratio to the total tax as the value of the reversionary or remainder interest (reduced as provided in the following sentence) bears to the entire gross estate (reduced as provided in the last sentence of this paragraph). In applying this ratio, the value of the reversionary or remainder interest is reduced by (1) the amount of claims, mortgages, and indebtedness which is a lien upon such interest; (2) losses in respect of such interest during the settlement of the estate which are deductible under the provisions of section 2054 or section 2106(a)(1); (3) any amount deductible in respect of such interest under section 2055 or 2106(a)(2) for charitable, etc., transfers; and (4) the portion of the marital deduction allowed under the provisions of section 2056 on account of bequests, etc., of such interests to the decedent's surviving spouse. Likewise, in applying the ratio, the value of the gross estate is reduced by such deductions having similar relationship to the items comprising the gross estate.

(d) For provisions requiring the payment of interest for the period of the extension, see section 6601(b). For provisions requiring the furnishing of security for the payment of the tax for which the extension is granted, see paragraph (b) of § 20.6165–1. For provisions concerning the time within which credit for State and foreign death taxes on such a reversionary or remainder interest may be taken, see section 2015 and the regulations thereunder.

§ 20.6165 Statutory Provisions; Bonds Where Time to Pay Tax or Deficiency Has Been Extended.

SEC. 6165. BONDS WHERE TIME TO PAY TAX OR DEFICIENCY HAS BEEN EXTENDED.

In the event the Secretary or his delegate grants any extension of time within which to pay any tax or any deficiency therein, the Secretary or his delegate may require the taxpayer to furnish a bond in such amount (not exceeding double the amount with respect to which the extension is granted) conditioned upon the payment of the amount extended in accordance with the terms of such extension.

§ 20.6165–1 BONDS WHERE TIME TO PAY TAX OR DEFICIENCY HAS BEEN EXTENDED.—(a) *Extensions under section 6161 of time to pay tax or deficiency.*—If an extension of time for payment of tax or deficiency is granted under section 6161, the district director may, if he deems it necessary, require the executor to furnish a bond for the payment of the amount in respect of which the extension is granted in accordance with the terms of the extension. However, such bond shall not exceed double the amount with respect to which the extension is granted For other provisions relating to bonds required where extensions of time to pay estate taxes or deficiencies are granted under section 6161, see the regulations under sections 6165 and 7101 contained in part 301 of this chapter (Regulations on Procedure and Administration).

(b) *Extensions under section 6163 of time to pay estate tax attributable to reversionary or remainder interests.*—As a prerequisite to the postponement of the payment of the tax attributable to a reversionary or remainder interest as provided in § 20.6163–1, a bond must be furnished in an amount which is double the amount of the tax and interest for the estimated duration of the precedent interest, conditioned upon the payment of the tax and interest accrued thereon within six months after the termination of the precedent interest. If after the acceptance of a bond it is determined that the amount of the tax attributable to the reversionary or remainder interest was understated in the bond, a new bond or a supplemental bond may be required, or the tax, to the extent of the understatement, may be collected. The bond must be conditioned upon the principal or surety promptly notifying the district director when the precedent interest terminates and upon the principal or surety notifying the district director during the month of September of each year as to the continuance of the precedent interest, if the duration of the precedent interest is dependent upon the life or lives of any person or persons, or is otherwise indefinite. For other provisions relating to bonds where an extension of time has been granted for paying the tax, see the regulations under sections 6165 and 7101 contained in part 301 of this chapter (Regulations on Procedure and Administration).

§ 20.6314 STATUTORY PROVISIONS; RECEIPT FOR TAXES.

SEC. 6314. RECEIPT FOR TAXES.

(a) GENERAL RULE.—The Secretary or his delegate shall, upon request, give receipts for all sums collected by him, excepting only when the same are in payment for stamps sold and delivered; but no receipt shall be issued in lieu of a stamp representing a tax.

(b) DUPLICATE RECEIPTS FOR PAYMENT OF ESTATE TAXES.—The Secretary or his delegate shall, upon request, give to the person paying the tax under chapter 11 (relating to the estate tax) duplicate receipts, either of which shall be sufficient evidence of such payment, and shall entitle the executor to be credited and allowed the amount thereof by any court having jurisdiction to audit or settle his accounts.

(c) CROSS REFERENCES. * * *

(2) For receipt of discharge of executor from personal liability, see section 2204.

§ 20.6314–1 DUPLICATE RECEIPTS FOR PAYMENT OF ESTATE TAXES.—The district director will, upon request, give to the person paying the tax duplicate receipts, either of which will be sufficient evidence of such payment and entitle the executor to be credited with the amount by any court having jurisdiction to audit or settle his accounts.

§ 20.6321 STATUTORY PROVISIONS; LIEN FOR TAXES.

SEC. 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.

§ 20.6321–1 LIEN FOR TAXES.—For regulations concerning the lien for taxes, see § 301.6321–1 of this chapter (Regulations on Procedure and Administration).

§ 20.6322 STATUTORY PROVISIONS; PERIOD OF LIEN.

SEC. 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.

§ 20.6323 STATUTORY PROVISIONS; VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) INVALIDITY OF LIEN WITHOUT NOTICE.—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) UNDER STATE OR TERRITORIAL LAWS.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) WITH CLERK OF DISTRICT COURT.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) WITH CLERKS OF DISTRICT COURT FOR DISTRICT OF COLUMBIA.—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) FORM OF NOTICE.—If the notice filed pursuant to subsection (a) (1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a) (2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) EXCEPTION IN CASE OF SECURITIES.—

(1) EXCEPTION.—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

(2) DEFINITION OF SECURITY.—As used in this subsection, the term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certifi-

cate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(d) DISCLOSURE OF AMOUNT OF OUTSTANDING LIEN.—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

§ 20.6323–1 VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.—For regulations concerning the validity of liens against mortgagees, pledgees, purchasers, and judgment creditors, see § 301.6323–1 of this chapter (Regulations on Procedure and Administration).

§ 20.6324 STATUTORY PROVISIONS; SPECIAL LIENS FOR ESTATE AND GIFT TAXES.

SEC. 6324. SPECIAL LIENS FOR ESTATE AND GIFT TAXES.

(a) LIENS FOR ESTATE TAX.—Except as otherwise provided in subsection (c) (relating to transfers of securities)—

(1) UPON GROSS ESTATE.—Unless the estate tax imposed by chapter 11 is sooner paid in full, it shall be a lien for 10 years upon the gross estate of the decedent, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien.

(2) LIABILITY OF TRANSFEREES AND OTHERS.—If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employee's trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession of property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, to a bona fide purchaser, mortgagee, or pledgee, for an adequate and full consideration in money or money's worth shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, beneficiary, or transferee of any such person, except any part transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth.

(3) CONTINUANCE AFTER DISCHARGE OF EXECUTOR.—The provisions of section 2204 (relating to discharge of executor from personal liability) shall not operate as a release of any part of the gross estate from the lien for any deficiency that may thereafter be determined to be due, unless such part of the gross estate (or any interest therein) has been transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money, or money's worth, in which case such part (or such interest) shall not be subject to a lien or to any claim or demand for any such deficiency, but the lien shall attach to the consideration received from such purchaser, mortgagee, or pledgee by the heirs, legatees, devisees, or distributees.

* * * * * * *

(c) EXCEPTION IN CASE OF SECURITIES.—The lien imposed by subsection (a) or (b) shall not be valid with respect to a security, as defined in section 6323(c)(2), as against any mortgagee, pledgee, or purchaser of any such security, for an adequate and full consideration in money or money's

worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

§ 20.6324–1 SPECIAL LIEN FOR ESTATE TAX.—For regulations concerning the special lien for the estate tax, see § 301.6324–1 of this chapter (Regulations on Procedure and Administration).

§ 20.6325 STATUTORY PROVISIONS; RELEASE OF LIEN OR PARTIAL DISCHARGE OF PROPERTY.

SEC. 6325. RELEASE OF LIEN OR PARTIAL DISCHARGE OF PROPERTY.

(a) RELEASE OF LIEN.—Subject to such rules or regulations as the Secretary or his delegate may prescribe, the Secretary or his delegate may issue a certificate of release of any lien imposed with respect to any internal revenue tax if—

(1) LIABILITY SATISFIED OR UNENFORCEABLE.—The Secretary or his delegate finds that the liability for the amount assessed, together with all interest in respect thereof, has been fully satisfied, has become legally unenforceable, or, in the case of the estate tax imposed by chapter 11 or the gift tax imposed by chaper 12, has been fully satisfied or provided for; or

(2) BOND ACCEPTED.—There is furnished to the Secretary or his delegate and accepted by him a bond that is conditioned upon the payment of the amount assessed, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified by such rules or regulations.

(b) PARTIAL DISCHARGE OF PROPERTY.—

(1) PROPERTY DOUBLE THE AMOUNT OF THE LIABILITY.—Subject to such rules or regulations as the Secretary or his delegate may prescribe, the Secretary or his delegate may issue a certificate of discharge of any part of the property subject to any lien imposed under this chapter if the Secretary or his delegate finds that the fair market value of that part of such property remaining subject to the lien is at least double the amount of the unsatisfied liability secured by such lien and the amount of all other liens upon such property which have priority to such lien.

(2) PART PAYMENT OR INTEREST OF UNITED STATES VALUELESS.—Subject to such rules or regulations as the Secretary or his delegate may prescribe, the Secretary or his delegate may issue a certificate of discharge of any part of the property subject to the lien if—

(A) There is paid over to the Secretary or his delegate in part satisfaction of the liability secured by the lien an amount determined by the Secretary or his delegate, which shall not be less than the value, as determined by the Secretary or his delegate, of the interest of the United States in the part to be so discharged, or

(B) The Secretary or his delegate determines at any time that the interest of the United States in the part to be so discharged has no value.

In determining the value of the interest of the United States in the part to be so discharged, the Secretary or his delegate shall give consideration to the fair market value of such part and to such liens thereon as have priority to the lien of the United States.

(c) EFFECT OF CERTIFICATE OF RELEASE OR PARTIAL DISCHARGE.—A certificate of release or of partial discharge issued under this section shall be held conclusive that the lien upon the property covered by the certificate is extinguished.

(d) CROSS REFERENCES.—

(1) For single bond complying with the requirements of both subsection (a) (2) and section 6165, see section 7102.

(2) For other provisions relating to bonds, see generally chapter 73.

(3) For provisions relating to suits to enforce lien, see section 7403.

(4) For provisions relating to suits to clear title to realty, see section 7424.

§ 20.6325–1 Release of Lien or Partial Discharge of Property; Transfer Certificates in Nonresident Estates.—(a) A transfer certificate is a certificate permitting the transfer of property of a nonresident decedent without liability. Except as provided in paragraph (b) of this section, no domestic corporation or its transfer agent should transfer stock registered in the name of a nonresident decedent (regardless of citizenship) except such shares which have been submitted for transfer by a duly qualified executor or administrator who has been appointed and is acting in the United States, without first requiring a transfer certificate covering all of the decedent's stock of the corporation and showing that the transfer may be made without liability. Corporations, transfer agents of domestic corporations, transfer agents of foreign corporations (except as to shares held in the name of a nonresident decedent not a citizen of the United States), banks, trust companies, or other custodians in actual or constructive possession of property of such a decedent can insure avoidance of liability for taxes and penalties only by demanding and receiving transfer certificates before transfer of property of nonresident decedents.

(b) A transfer certificate is not required in the case of a nonresident decedent not a citizen of the United States if, as of the date of the decedent's death, the total value of his gross estate situated in the United States is not in excess of $2,000. In this connection, a corporation, transfer agent, bank, trust company or other custodian will not incur liability for a transfer of the decedent's property if the corporation or other person, having no information to the contrary, first receives from the executor or other responsible person, who may be reasonably regarded as in possession of the pertinent facts, a statement that the total value, as of the date of the decedent's death, of that part of his gross estate situated in the United States is not in excess of $2,000. Also, a transfer certificate is not required for bonds owned by a nonresident decedent who was not a citizen of the United States at the time of his death if it is shown that the bonds were not physically situated in the United States at the time of his death.

(c) A transfer certificate will be issued by the district director when he is satisfied that the tax imposed upon the estate, if any, has been fully discharged or provided for. The tax will be considered fully discharged for purposes of the issuance of a transfer certificate only when investigation has been completed and payment of the tax, including any deficiency finally determined, has been made. If the tax liability has not been fully discharged, transfer certificates may be issued permitting the transfer of particular items of property without liability upon the filing with the district director of such security as he may require. No transfer certificate is required in an estate of a resident decedent. Further, in the case of an estate of a nonresident decedent (regardless of citizenship) a transfer certificate is not required with respect to property which is being administered by an

executor or administrator appointed, qualified, and acting within the United States. For additional regulations under section 6325, see § 301.6325–1 of this chapter (Regulations on Procedure and Administration).

§ 20.6601 STATUTORY PROVISIONS; INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) GENERAL RULE.—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

(b) EXTENSIONS OF TIME FOR PAYMENT OF ESTATE TAX.—If the time for payment of an amount of tax imposed by chapter 11 is extended as provided in section 6161(a)(2) or if postponement of the payment of an amount of such tax is permitted by section 6163(a), interest shall be paid at the rate of 4 percent, in lieu of 6 percent as provided in subsection (a).

* * * * * * *

§ 20.6601–1 INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.—For regulations concerning interest on underpayments, etc., see § 301.6601–1 of this chapter (Regulations on Procedure and Administration).

§ 20.7101 STATUTORY PROVISIONS; FORM OF BONDS.

SEC. 7101. FORM OF BONDS.

Whenever, pursuant to the provisions of this title (other than sections 7485 and 6083 (a) (1)), or rules or regulations prescribed under authority of this title, a person is required to furnish a bond or security—

(1) GENERAL RULE.—Such bond or security shall be in such form and with such surety or sureties as may be prescribed by regulations issued by the Secretary or his delegate.

(2) UNITED STATES BONDS AND NOTES IN LIEU OF SURETY BONDS.—The person required to furnish such bond or security may, in lieu thereof, deposit bonds or notes of the United States as provided in 6 U. S. C. 15.

§ 20.7101–1 FORM OF BONDS.—See paragraph (b) of § 20.6165–1 for the form of the bond required in any case in which the payment of the tax attributable to a reversionary or remainder interest has been postponed under the provisions of § 20.6163–1. For further provisions relating to bonds, see § 20.6165–1 of these regulations and the regulations under sections 6165 and 7101 contained in part 301 of this chapter (Regulations on Procedure and Administration).

§ 20.7404 STATUTORY PROVISIONS; AUTHORITY TO BRING CIVIL ACTION FOR ESTATE TAXES.

SEC. 7404. AUTHORITY TO BRING CIVIL ACTION FOR ESTATE TAXES.

If the estate tax imposed by chapter 11 is not paid on or before the due date thereof, the Secretary or his delegate shall proceed to collect the tax under the provisions of general law; or appropriate proceedings in the name of the United States may be commenced in any court of the United States having jurisdiction to subject the property of the decedent to be sold under the judgment or decree of the court. From the proceeds

of such sale the amount of the tax, together with the costs and expenses of every description to be allowed by the court, shall be first paid, and the balance shall be deposited according to the order of the court, to be paid under its direction to the person entitled thereto. This section insofar as it applies to the collection of a deficiency shall be subject to the provisions of sections 6213 and 6601.

REGULATIONS ON PROCEDURE AND ADMINISTRATION
(26 CFR Part 301)

PAR. 2. Section 301.6503 (e) of the Regulations on Procedure and Admiinstration (26 CFR Part 301) is amended—

(A) By redesignating such section as § 301.6503(f).

(B) By redesignating subsection (e) of section 6503, set forth therein, as subsection (f).

(C) By adding at the end of the section a historical note reading:

[Sec. 6503(f) as redesignated by sec. 2, Act of Aug. 6, 1956 (Pub. Law 1011, 84th Cong., 70 Stat. 1075, C. B. 1956-2, 1206)]

PAR. 3. There is inserted after § 301.6503(d)-1 the following new sections:

§ 301.6503(e) STATUTORY PROVISIONS; SUSPENSION OF RUNNING OF PERIOD OF LIMITATION; CERTAIN POWERS OF APPOINTMENT.

SEC. 6503. SUSPENSION OF RUNNING OF PERIOD OF LIMITATION. * * *

(e) CERTAIN POWERS OF APPOINTMENT.—The running of the period of limitations for assessment or collection of any tax imposed by chapter 11 shall be suspended in respect of the estate of a decedent claiming a deduction under section 2055(b)(2) until 30 days after the expiration of the period for assessment or collection of the tax imposed by chapter 11 on the estate of the surviving spouse.

[Sec. 6503(e) as added by sec. 2, Act of Aug. 6, 1956 (Pub. Law 1011, 84th Cong., 70 Stat. 1075, C. B. 1956-2, 1206)]

§ 301.6503(e)-1 SUSPENSION OF RUNNING OF PERIOD OF LIMITATION; CERTAIN POWERS OF APPOINTMENT.—Where the estate of a decedent is allowed an estate tax charitable deduction under the provisions of section 2055(b)(2) (with respect to property over which the decedent's surviving spouse was given a power of appointment exercisable in favor of charitable organizations) subject to the later disallowance of the deduction if all conditions set forth in section 2055 (b)(2) are not complied with, the running of the period of limitation for assessment or collection of any estate tax imposed on the decedent's estate is suspended until 30 days after the expiration of the period for assessment or collection of the estate tax imposed on the estate of the decedent's surviving spouse.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved June 16, 1958.

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

(Filed by the Division of the Federal Register on June 23, 1958, 8:45 a. m., and published in the issue of the Federal Register for June 24, 1958, 23 F. R. 4529.)

PART III.—GROSS ESTATE

SECTION 2032.—ALTERNATE VALUATION

26 CFR 20.2032–1: Alternate valuation. Rev. Rul. 58–576

Valuation to be used where the executors of an estate elect the alternate valuation method under section 2032 of the Internal Revenue Code of 1954 in certain factual situations involving stock rights, stock dividends, insurance proceeds, and interest bearing obligations received or disposed of within the year following the decedent's death.

Advice has been requested with respect to the valuation to be used in certain situations where the alternate valuation method is elected pursuant to section 2032 of the Internal Revenue Code of 1954.

Section 20.2032–1 of the Estate Tax Regulations, relates to the alternate valuation date and it provides that in valuing the gross estate under the optional valuation method, all of the property interests existing at the date of death which are determined to be a part of the decedent's gross estate constitute the property to be valued as of one year after the date of the decedent's death, or as of the date of the decedent's death, or as of some intermediate date. Such property is referred to as "included property." Property which is "included property" as of the date of the decedent's death remains "included property" for the purpose of valuing the gross estate under the optional valuation method even though it is changed in form during the optional valuation period by being actually received, or disposed of, in whole or in part, by the estate. However, property earned or accrued (whether received or not) after the decedent's death and during the alternate valuation period with respect to any property interest existing at the date of death, which does not represent a form of "included property" itself or the receipt thereof, is to be excluded in valuing the gross estate at the subsequent valuation date and is referred to as "excluded property."

The factual situations with respect to which advice is requested are as follows:

Situation No. 1.

Rights to subscribe to stock where the rights are sold before the year expires.

Answer.

Proceeds of rights to subscribe to additional stock which are not income within the meaning of the Sixteenth Amendment to the Constitution, issued subsequent to the decedent's death in respect of stock owned by the decedent at the date of death, are includible in the decedent's gross estate where the optional valuation method has been elected inasmuch as such rights are substantively "included property" as that phrase is used in section 20.2032–1 of the regulations. See *Miles* v. *Safe Deposit and Trust Company of Baltimore*, 259 U. S. 247, T. D. 3365 (Ct. D. 29), C. B. I–1, 72; *Macy, et al.* v. *Helvering*, 82 F. 2d 183; *Blair* v. *Dustin*, 30 F. 2d 774.

Situation No. 2.

Rights to subscribe to stock where the rights are exercised before the year expires.

Answer.

An exercise of stock rights is a "disposition" thereof within the meaning of section 2032 of the 1954 Code. Therefore the rights, which are "included property" within the meaning of section 20.2032–1 of the regulations are valued as of the date of disposition. Their value is equal to the excess, if any, of the fair market value of the stock acquired by such rights at the time the rights are exercised over the subscription price.

Situation No. 3.

Additional stock received as a result of a stock dividend before the year expires, but after the death of the decedent.

Answer.

A stock dividend which is not income within the meaning of the Sixteenth Amendment to the Constitution received subsequent to the decedent's death must be included in the gross estate where the alternate valuation method has been elected. The declaration of the stock dividend after the decedent's death directly affects the value of the shares of stock at the subsequent valuation date so that the decedent's shares of stock in the corporation at the subsequent valuation date no longer reasonably represent the same property interest in the corporation possessed by the decedent at the time of his death. Such a dividend is "included property" as that term is defined in section 20.2032–1 of the regulations.

Situation No. 4.

Insurance policies where the beneficiary exercises her right to receive monthly payments instead of a lump sum payment.

Answer.

The same value is used for alternate valuation purposes as that reported for the date of death value of the insurance proceeds. However, in determining the value of the proceeds of the insurance for Federal estate tax purposes, section 20.2032–1 of the regulations states in part that if insurance proceeds are payable to a beneficiary in the form of an annuity for life or years, the amount to be reported is the one sum payable at death under the lump sum option, or if there is no option, the sum used in determining the amount of the annuity.

Situation No. 5.

Mortgages where principal payments are received in accordance with the terms of the note between the date of death and the expiration of the year.

Answer.

The mortgages should be returned at their value as of one year after the date of the decedent's death for alternate valuation purposes. However, it is necessary to include in the gross estate any payments on principal of these mortgages since such payments are "included property." Any part payment of principal made after the date of the decedent's death and on or before the subsequent valuation date reduces the value of the mortgages as of the subsequent valuation date so that such mortgages would not reasonably represent the same property existing at the date of the decedent's death.

Appreciation of property after date of death and during alternate valuation period. See Rev. Rul. 58–436, page 366.

CHAPTER 12.—GIFT TAX

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

SECTION 2501.—IMPOSITION OF TAX

26 CFR 25.2501: Statutory provisions; imposition of tax. T. D. 6334 [1]

TITLE 26—INTERNAL REVENUE, 1954—CHAPTER I, SUBCHAPTER B, PART 25.—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Regulations under provisions of the Internal Revenue Code of 1954 relating to the gift 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:

On January 3, 1957, notice of proposed rulemaking regarding the Gift Tax Regulations (26 CFR Part 25) under chapter 12 of subtitle B of the Internal Revenue Code of 1954 and under certain sections of subtitle F of the Internal Revenue Code of 1954 was published in the Federal Register (22 F. R. 53). 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 to gifts made during the calendar year 1955 and subsequent calendar years:

GIFT TAX REGULATIONS

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[1] 23 F. R. 8904.

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AUTHORITY: §§ 25.0–1 to 25.7101–1, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

GIFT TAX

INTRODUCTION

§ 25.0–1 INTRODUCTION.—(a) *In general.*—The regulations in this part (part 25, subchapter B, chapter I, Title 26, Code of Federal Regulations) are designated "Gift Tax Regulations." These regulations pertain to (1) the gift tax imposed by chapter 12 of subtitle B of the Internal Revenue Code on the transfer of property by gift by individuals in the calendar year 1955 and subsequent calendar years, and (2) certain related administrative provisions of subtitle F of the Code. It should be noted that the application of some of the provisions of these regulations may be affected by the provisions of an applicable gift tax convention with a foreign country. Unless otherindicated, references in these regulations to the "Internal Revenue Code" or the "Code" are references to the Internal Revenue Code of 1954, as amended, and references to a section or other provision of the Internal Revenue Code of 1954, as amended. The Gift Tax Regulations are applicable to the transfer of property by gift by individuals in the calendar year 1955 and subsequent calendar years, and supersede the regulations contained in part 86, subchapter B, chapter I, Title 26, Code of Federal Regulations (1939) (Regulations 108, Gift Tax), as prescribed and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, signed August 16, 1954 (19 F.R. 5167, Aug. 17, 1954).

(b) *Nature of tax.*—The gift tax is not a property tax. It is a tax imposed upon the transfer of property by individuals. It is not applicable to transfers by corporations or persons other than individuals. However, see paragraphs (h) (1) of § 25.2511–1 with respect to the extent to which a transfer by or to a corporation is considered a transfer by or to its shareholders.

(c) *Scope of regulations.*—(1) *Determination of tax liability.*—Subchapter A of chapter 12 of the Code pertains to the determination of tax liability. The regulations pursuant to subchapter A are set forth in §§ 25.2501–1 through 25.2504–2 of this part.

(2) *Transfer.*—Subchapter B of chapter 12 of the Code pertains to the transfers which constitute the making of gifts. The regulations pursuant to subchapter B are set forth in §§ 25.2511–1 through 25.2516–2 of this part.

(3) *Deductions.*—Subchapter C of chapter 12 of the Code pertains to the deductions which are allowed in determining the amount of taxable gifts. The regulations pursuant to subchapter C are set forth in §§ 25.2521–1 through 25.2524–1 of this part.

(4) *Procedure and administration provisions.*—Subtitle F of the Internal Revenue Code contains some sections which are applicable to the gift tax. The regulations pursuant to those sections are set forth in §§ 25.6001–1 through 25.7101–1. Such regulations do not purport to be all the regulations on procedure and administration which are pertinent to gift tax matters. For the remainder of the regulations on procedure and administration which are pertinent to gift tax matters, see part 301 of this chapter (Regulations on Procedure and Administration).

(d) *Arrangement and numbering.*—Each section of the Gift Tax Regulations (except this section) is preceded by the section or subsection of the Internal Revenue Code which it interprets. The sections of the regulations can readily be distinguished from sections of the Code since—

(1) The sections of the regulations are printed in large type;

(2) The sections of the regulations are preceded by a section symbol and the part number arabic number 25 followed by a decimal point (§ 25.); and

(3) The sections of the Code are preceded by "Sec.".

Each section of the regulations setting forth law or regulations is designated by a number composed of the part number followed by a decimal point (25.) and the number of the corresponding section of the Internal Revenue Code. In the case of a section setting forth regulations, this designation is followed by a hyphen (-) and a number identifying such section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. Thus, the section of the regulations setting forth section 2521 of the Internal Revenue Code is designated § 25.2521 and the regulations pertaining to section 2521 are designated § 25.2521–1.

DETERMINATION OF TAX LIABILITY

§ 25.2501 STATUTORY PROVISIONS; IMPOSITION OF TAX.

SEC. 2501. IMPOSITION OF TAX.

(a) GENERAL RULE.—For the calendar year 1955 and each calendar year thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar year by an individual, resident or nonresident, except transfers of intangible property by a nonresident who is not a citizen of the United States and who was not engaged in business in the United States during such calendar year.

(b) CROSS REFERENCE.—For exclusion of transfers of property outside the United States by a nonresident who is not a citizen of the United States, see section 2511 (a).

§ 25.2501–1 IMPOSITION OF TAX.—(a) *In general.*—The tax applies to all transfers by gift of property, wherever situated, by an individual who is a citizen or resident of the United States, to the extent the value of the transfers exceeds the amount of the exclusions authorized by section 2503 and the deductions authorized by sections 2521, 2522, and 2523. The tax does not apply to a transfer of intangible property by a nonresident who is not a citizen of the United States and who was not engaged in business in the United States during the calendar year in which the transfer was made. For additional rules relating to the application of the tax to transfers by nonresidents not citizens of the United States, see section 2511 and § 25.2511–3.

(b) *Resident.*—A resident is an individual who has his domicile in the United States at the time of the gift. For this purpose the United States includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia. See section 7701(a)(9). All other in-

dividuals are nonresidents. A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of moving therefrom. Residence without the requisite intention to remain indefinitely will not constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.

§ 25.2502 Statutory Provisions; Rate of Tax.

SEC. 2502. RATE OF TAX.

(a) Computation of Tax.—The tax imposed by section 2501 for each calendar year shall be an amount equal to the excess of—

(1) A tax, computed in accordance with the rate schedule set forth in this subsection, on the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar years, over

(2) A tax, computed in accordance with such rate schedule, on the aggregate sum of the taxable gifts for each of the preceding calendar years.

RATE SCHEDULE

If the taxable gifts are:	The tax shall be:
Not over $5,000	2¼% of the taxable gifts.
Over $5,000 but not over $10,000	$112.50, plus 5¼% of excess over $5,000.
Over $10,000 but not over $20,000	$375, plus 8¼% of excess over $10,000.
Over $20,000 but not over $30,000	$1,200, plus 10½% of excess over $20,000.
Over $30,000 but not over $40,000	$2,250, plus 13½% of excess over $30,000.
Over $40,000 but not over $50,000	$3,600, plus 16½% of excess over $40,000.
Over $50,000 but not over $60,000	$5,250, plus 18¾% of excess over $50,000.
Over $60,000 but not over $100,000	$7,125, plus 21% of excess over $60,000.
Over $100,000 but not over $250,000	$15,525, plus 22½% of excess over $100,000.
Over $250,000 but not over $500,000	$49,275, plus 24% of excess over $250,000.
Over $500,000 but not over $750,000	$109,275, plus 26¼% of excess over $500,000.
Over $750,000 but not over $1,000,000	$174,900, plus 27¾% of excess over $750,000.
Over $1,000,000 but not over $1,250,000.	$244,275, plus 29¼% of excess over $1,000,000.
Over $1,250,000 but not over $1,500,000.	$317,400, plus 31½% of excess over $1,250,000.
Over $1,500,000 but not over $2,000,000.	$396,150, plus 33¾% of excess over $1,500,000.
Over $2,000,000 but not over $2,500,000.	$564,900, plus 36¾% of excess over $2,000,000.
Over $2,500,000 but not over $3,000,000.	$748,650, plus 39¾% of excess over $2,500,000.
Over $3,000,000 but not over $3,500,000.	$947,400, plus 42% of excess over $3,000,000.
Over $3,500,000 but not over $4,000,000.	$1,157,400, plus 44¼% of excess over $3,500,000.

If the taxable gifts are:	The tax shall be:
Over $4,000,000 but not over $5,000,000.	$1,378,650, plus 47¼% of excess over $4,000,000.
Over $5,000,000 but not over $6,000,000.	$1,851,150, plus 50¼% of excess over $5,000,000.
Over $6,000,000 but not over $7,000,000.	$2,353,650, plus 52½% of excess over $6,000,000.
Over $7,000,000 but not over $8,000,000.	$2,878,650, plus 54¾% of excess over $7,000,000.
Over $8,000,000 but not over $10,000,000.	$3,426,150, plus 57% of excess over $8,000,000.
Over $10,000,000	$4,566,150, plus 57¾% of excess over $10,000,000.

(b) CALENDAR YEAR.—The term "calendar year" includes only the calendar year 1932 and succeeding calendar years, and, in the case of the calendar year 1932, includes only the portion of such year after June 6, 1932.

(c) PRECEDING CALENDAR YEARS.—The term "preceding calendar years" means the calendar year 1932 and all calendar years intervening between the calendar year 1932 and the calendar year for which the tax is being computed.

(d) TAX TO BE PAID BY DONOR.—The tax imposed by section 2501 shall be paid by the donor.

§ 85.2502–1. RATE OF TAX.—(a) *Computation of tax.*—While the gift tax is imposed separately for each calendar year on the total taxable gifts made by a donor during such a year, the rate of tax is determined by the total of all gifts made by the donor during such a year and in all previous years since June 6, 1932. The following subparagraphs set forth the six steps to be followed in computing the tax:

(1) *First step.*—Ascertain the amount of the "taxable gifts" for the calendar year for which the return is being prepared. For the meaning of this term see § 25.2503–1.

(2) *Second step.*—Ascertain "the aggregate sum of the taxable gifts for each of the preceding calendar years," considering only those gifts made after June 6, 1932. For the meaning of this term see § 25.2504–1.

(3) *Third step.*—Ascertain the total amount of the taxable gifts, which is the sum of the amounts determined in the first and second steps.

(4) *Fourth step.*—Compute the tax on the total amount of taxable gifts (as determined in the third step) using the rate schedule set forth in paragraph (b) of this section.

(5) *Fifth step.*—Compute the tax on "the aggregate sum of the taxable gifts for each of the preceding calendar years" (as determined in the second step), using the rate schedule set forth in paragraph (b) of this section.

(6) *Sixth step.*—Subtract the amount determined in the fifth step from the amount determined in the fourth step. The amount remaining is the gift tax for the calendar year for which the return is being prepared.

(b) *Rate of tax.*—The tax is computed in accordance with the following table:

Table for computing gift tax

(A) Amount of taxable gifts equal to or more than—	(B) Amount of taxable gifts less than—	(C) Tax on amount in column (A)	(D) Rate of tax on excess over amount in column (A)
			Percent
	$5,000		2¼
$5,000	10,000	$112.50	5¼
10,000	20,000	375.00	8¼
20,000	30,000	1,200.00	10½
30,000	40,000	2,250.00	13½
40,000	50,000	3,600.00	16½
50,000	60,000	5,250.00	18¾
60,000	100,000	7,125.00	21
100,000	250,000	15,525.00	22½
250,000	500,000	49,275.00	24
500,000	750,000	109,275.00	26¼
750,000	1,000,000	174,900.00	27¾
1,000,000	1,250,000	244,275.00	29¼
1,250,000	1,500,000	317,400.00	31½
1,500,000	2,000,000	396,150.00	33¾
2,000,000	2,500,000	564,900.00	36¾
2,500,000	3,000,000	748,650.00	39¾
3,000,000	3,500,000	947,400.00	42
3,500,000	4,000,000	1,157,400.00	44¼
4,000,000	5,000,000	1,378,650.00	47¼
5,000,000	6,000,000	1,851,150.00	50¼
6,000,000	7,000,000	2,353,650.00	52½
7,000,000	8,000,000	2,878,650.00	54¾
8,000,000	10,000,000	3,426,150.00	57
10,000,000		4,566,150.00	57¾

(c) *Examples.*—The following examples illustrate the application of this section with respect to gifts made by citizens or residents of the United States:

Example (1). Assume that the donor made taxable gifts, as ascertained under the first step (paragraph (a)(1) of this section), of $62,500 and that there were no taxable gifts for prior years, with the result that the amount ascertained under the third step is $62,500. Under the fourth step a tax is computed on this amount. Reference to the table discloses that the specified amount in column (A) nearest to and less than $62,500 is $60,000. The tax on this amount, as shown in column (C), is $7,125. The amount by which the taxable gifts exceeds the specified amount is $2,500 and the tax on such excess amount, computed at the rate of 21 percent as shown in column (D), is $525. The tax on taxable gifts of $62,500 is the sum of $7,125 and $525, or $7,650.

Example (2). A donor makes gifts (other than gifts of future interests in property) during the calendar year 1955 of $30,000 to A and $33,000 to B. Two exclusions of $3,000 each are allowable, in accordance with the provisions of section 2503(b), which results in included gifts for 1955 of $57,000. Specific exemption was claimed and allowed in a total amount of $50,000 in the donor's gift tax returns for the calendar years 1934 and 1935 so there remains no specific exemption available for the donor to claim for 1955. The total

amount of gifts made by the donor during preceding years, after excluding $5,000 for each donee for each calendar year in accordance with the provisions of section 1003(b)(1) of the 1939 Code, is computed as follows:

Calendar year 1934	$120,000
Calendar year 1935	25,000
Total amount of included gifts for preceding calendar years	145,000

The aggregate sum of the taxable gifts for preceding calendar years is $115,000, which is determined by deducting a specific exemption of $30,000 from $145,000, the total amount of included gifts for preceding calendar years. The deduction from the 1934 and 1935 gifts for the specific exemption cannot exceed $30,000 for purposes of computing the tax on the 1955 gifts even though a specific exemption in a total amount of $50,000 was allowed in computing the donor's gift tax liability for 1934 and 1935. See paragraph (b) of § 25.2504–1. The computation of the tax for the calendar year 1955 (following the steps set forth in paragraph (a) of this section) is shown below:

(1) Amount of taxable gifts for year	$57,000
(2) Total amount of taxable gifts for preceding years	115,000
(3) Total taxable gifts	172,000
(4) Tax computed on item 3 (in accordance with rate schedule in paragraph (b))	31,725
(5) Tax computed on item 2 (using same rate schedule)	18,900
(6) Tax for year 1955 (item 4 minus item 5)	12,825

Example (3). (i) *Facts.*—During the calendar year 1955, H makes the following gifts of present interests:

To his daughter	$40,000
To his son	5,000
To W, his wife	5,000
To a charitable organization	10,000

The gifts to W qualify for the marital deduction, and, pursuant to the provisions of section 2513 (see § 25.2513–1), H and W consent to treat the gifts to third parties as having been made one-half by each spouse. The amount of H's taxable gifts for preceding years is $50,000. Only $25,000 of H's specific exemption was claimed and allowed in preceding years. H's remaining specific exemption of $5,000 is claimed for the calendar year 1955. See § 25.2521–1. W made no gifts during the calendar year 1955 nor during any preceding calendar year. W claims sufficient specific exemption on her return to eliminate tax liability.

(ii) *Computation of H's tax for the calendar year 1955.*—(*a*) *H's taxable gifts for year.*

Total gifts of H	$60,000
Less: Portion of items to be reported by spouse (one-half of total gifts to daughter, son and charity)	27,500
Balance	32,500
Less: Exclusions (three of $3,000 each for daughter, wife and charity and one of $2,500 for son)	11,500
Total included amount of gifts for year	21,000

Less: Deductions:		
Charity	$2,000	
Marital	2,000	
Specific exemption	5,000	
Total deductions		$9,000
Amount of taxable gifts for year		12,000

(*b*) *Computation of tax.*—The steps set forth in paragraph (a) of this section are followed.

(*1*) Amount of taxable gifts for year	$12,000
(*2*) Total taxable gifts for preceding years	50,000
(*3*) Total taxable gifts (item (*1*) plus item (*2*))	62,000
(*4*) Tax computed on item d (using rate schedule in paragraph (b) of this section)	7,545
(*5*) Tax computed on item 2 (using rate schedule in paragraph (b) of this section)	5,250
(*6*) Tax for calendar year (item (*4*) minus item (*5*))	2,295

(iii) *Computation of W's tax for calendar year 1955.*—(*a*) *W's taxable gifts for year.*

Total gifts of W		80
Less: Portion of items to be reported by spouse		0
Balance		0
Gifts of spouse to be included		27,500
Total gifts for year		27,500
Less: Exclusions (two of $3,000 each for daughter and charity and one of $2,500 for son)		8,500
Balance		19,000
Less: Deductions:		
Charity	$2,000	
Marital	0	
Specific exemption	17,000	
Total deductions		19,000
Amount of taxable gifts for year		0

(*b*) *Computation of tax.*—Since W had no "taxable gifts" during the year, there is no tax.

Example (*4*). (i) *Facts.*—The facts are the same as in example (3) except that W made outright gifts of $10,000 to her niece and $20,000 to H at various times during the year. The amount of taxable gifts made by W in preceding calendar years is $75,000, and only $20,000 of her specific exemption was claimed and allowed for preceding years. See § 25.2521–1. The remaining specific exemption of $10,000 is claimed for the calendar year 1955.

(ii) *Computation of H's tax for the calendar year 1955.*—(*a*) *H's taxable gifts for year.*

Total gifts of H		$60,000
Less: Portion of items to be reported by spouse		27,500
Balance		32,500

Gifts of spouse to be included		$5,000
Total gifts for year		37,500
Less Exclusions ($11,500 as shown in example (3) plus $3,000 exclusion for gift to niece)		14,500
Total included amount of gifts for year		23,000
Deductions:		
Charity	$2,000	
Marital	2,000	
Specific exemption	5,000	
Total deductions		9,000
Amount of taxable gifts for year		14,000

(*b*) *Computation of tax.*

(*1*) Amount of taxable gifts for year		$14,000
(*2*) Total taxable gifts for preceding years		50,000
(*3*) Total taxable gifts (item (*1*) plus item (*2*))		64,000
(*4*) Tax computed on item 3		7,965
(*5*) Tax computed on item 2		5,250
(*6*) Tax for year (item (*4*) minus item (*5*))		2,715

(iii) *Computation of W's tax for the calendar year 1955.*—(*a*) *W's taxable gifts for year.*

Total gifts of W		$30,000
Less: Portion of items to be reported by spouse (one-half of gift to niece)		5,000
Balance		25,000
Gifts of spouse to be included		27,500
Total gifts for year		52,500
Less: Exclusions (four of $3,000 each for daughter, husband, niece and charity, and one of $2,500 for son)		14,500
Total included amount of gifts for year		38,000
Deductions:		
Charity	$2,000	
Marital	10,000	
Specific exemption	10,000	
Total deductions		22,000
Amount of taxable gifts for year		16,000

(*b*) *Computation of tax.*

(*1*) Amount of taxable gifts for year		$16,000
(*2*) Total taxable gifts for preceding years		75,000
(*3*) Total taxable gifts		91,000
(*4*) Tax computed on item 3		13,635
(*5*) Tax computed on item 2		10,275
(*6*) Tax for year (item 4 minus item 5)		3,360

§ 25.2502–2 Donor Primarily Liable for Tax.—Section 2502(d) provides that the donor shall pay the tax. If the donor dies before the tax is paid the amount of the tax is a debt due the United States from the decedent's estate and his executor or administrator is responsible for its payment out of the estate. (See § 25.6151–1 for the

time and place for paying the tax.) If there is no duly qualified executor or administrator, the heirs, legatees, devisees and distributees are liable for and required to pay the tax to the extent of the value of their inheritances, bequests, devises or distributive shares of the donor's estate. If a husband and wife effectively signify consent, under section 2513, to have gifts made to a third party during any calendar year considered as made one-half by each, the liability with respect to the gift tax of each spouse for that calendar year is joint and several (see § 25.2513–4). As to the personal liability of the donee, see paragraph (b) of § 301.6324–1 of part 301 of this chapter (Regulations on Procedure and Administration). As to the personal liability of the executor or administrator, see section 3467 of the Revised Statutes (31 U. S. S. 192), which reads as follows:

Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

As used in such section 3467, the word "debt" includes a beneficiary's distributive share of an estate. Thus if an executor pays a debt due by the estate which is being administered by him or distributes any portion of the estate before there is paid all of the gift tax which he has a duty to pay, the executor is personally liable, to the extent of the payment or distribution, for so much of the gift tax as remains due and unpaid.

§ 25.2503 Statutory Provisions; Taxable Gifts.

SEC. 2503. TAXABLE GIFTS.

(a) General Definition.—The term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (sec. 2521 and following).

(b) Exclusions From Gifts.—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1955 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.

(c) Transfer for the Benefit of Minor.—No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and the income therefrom—

(1) May be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and

(2) Will to the extent not so expended—

(A) Pass to the donee on his attaining the age of 21 years, and

(B) In the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c).

§ 25.2503–1 General Definition of "Taxable Gifts" and of "Total Amount of Gifts."—The term "taxable gifts" means the "total amount of gifts" made by the donor during the calendar year

less the deductions provided for in sections 2521, 2522, and 2523 (specific exemption, charitable, etc., gifts and the marital deduction, respectively). The "total amount of gifts" means the sum of the values of the gifts made during the calendar year less the amounts excludable under section 2503(b). See § 25.2503–2.

§ 25.2503–2 EXCLUSIONS FROM GIFTS.—Section 2503(b) provides that the first $3,000 of gifts made to any one donee during the calendar year 1955 or any calendar year thereafter, except gifts of future interests in property as defined in §§ 25.2503–3 and 25.2503–4, is excluded in determining the total amount of gifts for the calendar year. In the case of a gift in trust the beneficiary of the trust is the donee. The entire value of any gift of a future interest in property must be included in the total amount of gifts for the calendar year in which the gift is made.

§ 25.2503–3 FUTURE INTERESTS IN PROPERTY.—(a) No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift.

(b) An unrestricted right to the immediate use, possession, or enjoyment of property or the income from the property (such as a life estate or term certain) is a present interest in property. An exclusion is allowable with respect to a gift of such an interest (but not in excess of the value of the interest). If a donee has received a present interest in property, the possibility that such interest may be diminished by the transfer of a greater interest in the same property to the donee through the exercise of a power is disregarded in computing the value of the present interest, to the extent that no part of such interest will at any time pass to any other person (see example (4) of paragraph (c) of this section). For an exception to the rule disallowing an exclusion for gifts of future interests in the case of certain gifts to minors, see § 25.2503–4.

(c) The operation of this section may be illustrated by the following examples:

Example (1). Under the terms of a trust created by A the trustee is directed to pay the net income to B, so long as B shall live. The trustee is authorized in his discretion to withhold payments of income during any period he deems advisable and add such income to the trust corpus. Since B's right to receive the income payments is subject to the trustee's discretion, it is not a present interest and no exclusion is allowable with respect to the transfer in trust.

Example (2). C transfers certain insurance policies on his own life to a trust created for the benefit of D. Upon C's death the proceeds of the policies are to be invested and the net income therefrom

paid to D during his lifetime. Since the income payments to D will not begin until after C's death the transfer in trust represents a gift of a future interest in property against which no exclusion is allowable.

Example (3). Under the terms of a trust created by E the net income is to be distributed to E's three children in such shares as the trustee, in his uncontrolled discretion, deems advisable. While the terms of the trust provide that all of the net income is to be distributed, the amount of income any one of the three beneficiaries will receive rests entirely within the trustee's discretion and cannot be presently ascertained. Accordingly, no exclusions are allowable with respect to the transfers to the trust.

Example (4). Under the terms of a trust the net income is to be paid to F for life, with the remainder payable to G on F's death. The trustee has the uncontrolled power to pay over the corpus to F at any time. Although F's present right to receive the income may be terminated, no other person has the right to such income interest. Accordingly, the power in the trustee is disregarded in determining the value of F's present interest. The power would not be disregarded to the extent that the trustee during F's life could distribute corpus to persons other than F.

Example (5) The corpus of a trust created by J consists of certain real property, subject to a mortgage. The terms of the trust provide that the net income from the property is to be used to pay the mortgage. After the mortgage is paid in full the net income is to be paid to K during his lifetime. Since K's right to receive the income payments will not begin until after the mortgage is paid in full the transfer in trust represents a gift of a future interest in property against which no exclusion is allowable.

Example (6). L pays premiums on a policy of insurance on his life. All the incidents of ownership in the policy (including the right to surrender the policy) are vested in M. The payment of premiums by L constitutes a gift of a present interest in property.

§ 25.2503-4 TRANSFER FOR THE BENEFIT OF A MINOR.—(a) Section 2503(c) provides that no part of a transfer for the benefit of a donee who has not attained the age of 21 years on the date of the gift will be considered a gift of a future interest in property if the terms of the transfer satisfy all of the following conditions:

(1) Both the property itself and its income may be expended by or for the benefit of the donee before he attains the age of 21 years;

(2) Any portion of the property and its income not disposed of under subparagraph (1) of this paragraph will pass to the donee when he attains the age of 21 years; and

(3) Any portion of the property and its income not disposed of under subparagraph (1) of this paragraph will be payable either to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c) if he dies before attaining the age of 21 years.

(b) Either a power of appointment exercisable by the donee by will or a power of appointment exercisable by the donee during his lifetime will satisfy the conditions set forth in paragraph (a)(3) of this section. However, if the transfer is to qualify for the exclusion

under this section, there must be no restrictions of substance (as distinguished from formal restrictions of the type described in paragraph (g)(4) of § 25.2523(e)–1) by the terms of the instrument of transfer on the exercise of the power by the donee. However, if the minor is given a power of appointment exercisable during lifetime or is given a power of appointment exercisable by will, the fact that under the local law a minor is under a disability to exercise an inter-vivos power or to execute a will does not cause the transfer to fail to satisfy the conditions of section 2503(c). Further, a transfer does not fail to satisfy the conditions of section 2503(c) by reason of the mere fact that—

(1) There is left to the discretion of a trustee the determination of the amounts, if any, of the income or property to be expended for the benefit of the minor and the purpose for which the expenditure is to be made, provided there are no substantial restrictions under the terms of the trust instrument on the exercise of such discretion;

(2) The donee, upon reaching age 21, has the right to extend the term of the trust; or

(3) The governing instrument contains a disposition of the property or income not expended during the donee's minority to persons other than the donee's estate in the event of the default of appointment by the donee.

(c) A gift to a minor which does not satisfy the requirements of section 2503(c) may be either a present or a future interest under the general rules of § 25.2503–3. Thus, for example, a transfer of property in trust with income required to be paid annually to a minor beneficiary and corpus to be distributed to him upon his attaining the age of 25 is a gift of a present interest with respect to the right to income but is a gift of a future interest with respect to the right to corpus.

§ 25.2504 STATUTORY PROVISIONS; TAXABLE GIFTS FOR PRECEDING YEARS.

SEC. 2504. TAXABLE GIFTS FOR PRECEDING YEARS.

(a) IN GENERAL.—In computing taxable gifts for the calendar year 1954 and preceding calendar years for the purpose of computing the tax for the calendar year 1955 or any calendar year thereafter, there shall be treated as gifts such transfers as were considered to be gifts under the gift tax laws applicable to the years in which the transfers were made and there shall be allowed such deductions as were provided for under such laws, except that specific exemption in the amount, if any, allowable under section 2521 shall be applied in all computations in respect of the calendar year 1954 and previous calendar years for the purpose of computing the tax for the calendar year 1955 or any calendar year thereafter.

(b) EXCLUSIONS FROM GIFTS FOR PRECEDING YEARS.—In the case of gifts made to any person by the donor during the calendar year 1954 and preceding calendar years, the amount excluded, if any, by the provisions of gift tax laws applicable to the years in which the gifts were made shall not, for purposes of subsection (a), be included in the total amount of the gifts made during such year.

(c) VALUATION OF CERTAIN GIFTS FOR PRECEDING CALENDAR YEARS.—If the time has expired within which a tax may be assessed under this chapter or under corresponding provisions of prior laws, on the transfer of property by gift made during a preceding calendar year, as defined in section 2502 (c), and if a tax under this chapter or under corresponding provisions of prior laws has been assessed or paid for such preceding

calendar year, the value of such gift made in such preceding calendar year shall, for purposes of computing the tax under this chapter for the calendar year 1955 and subsequent calendar years, be the value of such gift which was used in computing the tax for the last preceding calendar year, for which a tax under this chapter or under corresponding provisions of prior laws was assessed or paid.

(d) NET GIFTS.—For years before the calendar year 1955, the term "net gifts" as used in corresponding provisions of prior laws shall be read as "taxable gifts" for purposes of this chapter.

§ 25.2504–1 TAXABLE GIFTS FOR PRECEDING YEARS.—(a) In order to determine the correct gift tax liability for the calendar year 1955 or any calendar year thereafter, it is necessary to ascertain the correct amount, if any, of the aggregate sum of the taxable gifts for each of the preceding calendar years. See paragraph (a) (2) of § 25.2502–1. The words "aggregate sum of the taxable gifts for each of the preceding calendar years" means the correct aggregate of such gifts, not necessarily that returned for those years and in respect of which tax was paid. All transfers which constituted gifts in prior calendar years under the laws, including the provisions of law relating to exclusions from gifts, in effect at the time the transfers were made are included in determining the amount of taxable gifts for preceding years. The deductions other than for the specific exemption (see paragraph (b) of this section) allowed by the laws in effect at the time the transfers were made also are taken into account in determining the aggregate sum of the taxable gifts for preceding years. (The allowable exclusion from a gift was $5,000 for years before 1939, $4,000 for calendar years 1939 through 1942, and $3,000 thereafter.)

(b) In determining the aggregate sum of the taxable gifts for preceding years, the total of the amounts allowed as deductions for the specific exemption, under section 2521 and the corresponding provisions of prior laws, shall not exceed $30,000. Thus, if the only preceding years during which the donor made gifts were 1940 and 1941 (at which time the specific exemption allowable was $40,000), and if in his returns for those years the donor claimed deductions totaling $40,000 for the specific exemption and reported taxable gifts totaling $110,000, then in determining the aggregate sum of the taxable gifts for preceding years the deductions for the specific exemption cannot exceed $30,000, and the aggregate sum of the donor's taxable gifts for preceding years will be $120,000 (instead of the $110,000 reported on his returns for preceding years). (The allowable deduction for the specific exemption was $50,000 for calendar years before 1936, $40,000 for calendar years 1936 through 1942, and $30,000 thereafter.)

(c) If, during any preceding calendar year, the donor and his spouse consented to have gifts made to third parties considered as made one-half by each spouse, pursuant to the provisions of section 2513 or section 1000 (f) of the Internal Revenue Code of 1939 (which corresponds to section 2513), these provisions shall be taken into account in determining the aggregate sum of the taxable gifts for that preceding calendar year.

(d) If interpretations of the gift tax law in prior calendar years resulted in the erroneous inclusion of property for gift tax purposes which should have been excluded, or the erroneous exclusion of property which should have been included, adjustments must be made in

order to arrive at the correct aggregate of taxable gifts for preceding years. However, see section 1000 (e) and (g) of the 1939 Code relating to certain discretionary trusts and reciprocal trusts.

§ 25.2504–2 VALUATION OF CERTAIN GIFTS FOR PRECEDING CALENDAR YEARS.—Section 2504(c) provides that if the valuation of a transfer for gift tax purposes with respect to a gift made in a preceding calendar year is at issue, and if the statutory period within which an assessment may be made with respect to the gift has expired and a tax has been actually assessed or paid for such prior calendar year, then the value of the gift for purposes of arriving at the correct amount of the taxable gifts for preceding years is the value which was used in computing the tax for the last preceding calendar year for which a tax was assessed or paid under chapter 12 of the Internal Revenue Code of 1954 or the corresponding provisions of prior laws. However, this rule will not prevent an adjustment in value where no tax was paid or assessed for the prior year. Furthermore, this rule does not apply to adjustments involving issues other than valuation. See paragraph (d) of § 25.2504–1.

TRANSFERS

§ 25.2511 STATUTORY PROVISIONS; TRANSFERS IN GENERAL.

SEC. 2511. TRANSFERS IN GENERAL.

(a) SCOPE.—Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

(b) STOCK IN CORPORATION.—Shares of stock owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States only if issued by a domestic corporation.

§ 25.2511–1 TRANSFER IN GENERAL.—(a) The gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. For example, a taxable transfer may be effected by the creation of a trust, the forgiving of a debt, the assignment of a judgment, the assignment of the benefits of an insurance policy, or the transfer of cash, certificate of deposit, or Federal, State or municipal bonds. Statutory provisions which exempt bonds, notes, bills and certificates of indebtedness of the Federal Government or its agencies and the interest thereon from taxation are not applicable to the gift tax, since the gift tax is an excise tax on the transfer, and is not a tax on the subject of the gift.

(b) In the case of a nonresident alien who was not engaged in business in the United States (see § 25.2501–1) during the calendar year, the tax is imposed only if the gift consisted of real estate or tangible personal property situated within the United States at the time of transfer. See §§ 25.2501–1 and 25.2511–3.

(c) The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the

means or device employed, constitute gifts subject to tax. See further § 25.2512–8. Where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decendent (whether the transfer is effected by the decedent's will or by the law of descent and distribution of intestate property), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable and effective under the local law. There can be no refusal of ownership of property after its acceptance. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. In illustration, if Blackacre was devised to A under the decedent's will (which also provided that all lapsed legacies and devises shall go to B, the residuary beneficiary), and under the local law A could refuse to accept ownership in which case title would be considered as never having passed to A, A's refusal to accept Blackacre within a reasonable time of learning of the devise will not constitute the making of a gift by A to B. However, if a decedent who owned Greenacre died intestate with C and D as his only heirs, and under local law the heir of an intestate cannot, by refusal to accept, prevent himself from becoming an owner of intestate property, any gratuitous disposition by C (by whatever term it is known) whereby he gives up his ownership of a portion of Greenacre and D acquires the whole thereof constitutes the making of a gift by C to D.

(d) If a joint income tax return is filed by a husband and wife for a taxable year, the payment by one spouse of all or part of the income tax liability for such year is not treated as resulting in a transfer which is subject to gift tax. The same rule is applicable to the payment of gift tax for a calendar year in the case of a husband and wife who have consented to have the gifts made considered as made half by each of them in accordance with the provision of section 2513.

(e) If a donor transfers by gift less than his entire interest in property, the gift tax is applicable to the interest transferred. The tax is applicable, for example, to the transfer of an undivided half interest in property, or to the transfer of a life estate when the grantor retains the remainder interest, or vice versa. However, if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift. Thus, if a donor, aged 65 years, transfers a life estate in property to A, aged 25 years, with

remainder to A's issue, or in default of issue, with reversion to the donor, the gift tax will normally be applicable to the entire value of the property.

(f) If a donor is the owner of only a limited interest in property, and transfers his entire interest, the interest is in every case to be valued by the rules set forth in §§ 25.2512–1 through 25.2512–7. If the interest is a remainder or reversion or other future interest, it is to be valued on the basis of actuarial principals set forth in § 25.2512–5, or if it is not susceptible of valuation in that manner, in accordance with the principles set forth in § 25.2512–1.

(g) (1) Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor. However, there are certain types of transfers to which the tax is not applicable. It is applicable only to a transfer of a beneficial interest in property. It is not applicable to a transfer of bare legal title to a trustee. A transfer by a trustee of trust property in which he has no beneficial interest does not constitute a gift by the trustee (but such a transfer may constitute a gift by the creator of the trust, if until the transfer he had the power to change the beneficiaries by amending or revoking the trust). The gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth, or to ordinary business transactions, described in § 25.2512–8.

(2) If a trustee has a beneficial interest in trust property, a transfer of the property by the trustee is not a taxable transfer if it is made pursuant to a fiduciary power the exercise or nonexercise of which is limited by a reasonably fixed or ascertainable standard which is set forth in the trust instrument. A clearly measurable standard under which the holder of a power is legally accountable is such a standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; to enable him to maintain his accustomed standard of living; or to meet an emergency, would be such a standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not such a standard. The entire context of a provision of a trust instrument granting a power must be considered in determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no such standard exists.

(h) The following are examples of transactions resulting in taxable gifts and in each case it is assumed that the transfers were not made for an adequate and full consideration in money or money's worth:

(1) A transfer of property by a corporation to B is a gift to B from the stockholders of the corporation. If B himself is a stockholder, the transfer is a gift to him from the other stockholders but

only to the extent it exceeds B's own interest in such amount as a shareholder. A transfer of property by B to a corporation generally represents gifts by B to the other individual shareholders of the corporation to the extent of their proportionate interests in the corporation. However, there may be an exception to this rule, such as a transfer made by an individual to a charitable, public, political or similar organization which may constitute a gift to the organization as a single entity, depending upon the facts and circumstances in the particular case.

(2) The transfer of property to B if there is imposed upon B the obligation of paying a commensurate annuity to C is a gift to C.

(3) The payment of money or the transfer of property to B in consideration of B's promise to render a service to C is a gift to C, or to both B and C, depending on whether the service to be rendered to C is or is not an adequate and full consideration in money or money's worth for that which is received by B. See section 2512(b) and the regulations thereunder.

(4) If A creates a joint bank account for himself and B (or a similar type of ownership by which A can regain the entire fund without B's consent), there is a gift to B when B draws upon the account for his own benefit, to the extent of the amount drawn without any obligation to account for a part of the proceeds to A. Similarly, if A purchases a United States savings bond registered as payable to "A or B," there is a gift to B when B surrenders the bond for cash without any obligation to account for a part of the proceeds to A.

(5) If A with his own funds purchases property and has the title conveyed to himself and B as joint owners, with rights of survivorship (other than a joint ownership described in example (4)) but which rights may be defeated by either party severing his interest, there is a gift to B in the amount of half the value of the property. However, see § 25.2515–1 relative to the creation of a joint tenancy (or tenancy by the entirety) between husband and wife in real property with rights of survivorship which, unless the donor elects otherwise, is not considered as a transfer includible for Federal gift tax purposes at the time of the creation of the joint tenancy. See § 25.2515–2 with respect to determining the extent to which the creation of a tenancy by the entirety constitutes a taxable gift if the donor elects to have the creation of the tenancy so treated. See also § 25.2523(d)–1 with respect to the marital deduction allowed in the case of the creation of a joint tenancy or a tenancy by the entirety.

(6) If A is possessed of a vested remainder interest in property, subject to being divested only in the event he should fail to survive one or more individuals or the happening of some other event, an irrevocable assignment of all or any part of his interest would result in a transfer includible for Federal gift tax purposes. See especially paragraph (e) of § 25.2512–5 for the valuation of an interest of this type.

(7) If A, without retaining a power to revoke the trust or to change the beneficial interests therein, transfers property in trust whereby B is to receive the income for life and at his death the trust is to terminate and the corpus is to be returned to A, provided A

survives, but if A predeceases B the corpus is to pass to C, A has made a gift equal to the total value of the property less the value of his retained interest. See paragraph (e) of § 25.2512–5 for the valuation of the donor's retained interest.

(8) If the insured purchases a life insurance policy, or pays a premium on a previously issued policy, the proceeds of which are payable to a beneficiary or beneficaries other than his estate, and with respect to which the insured retains no reversionary interest in himself or his estate and no power to revest the economic benefits in himself or his estate or to change the beneficiaries or their proportionate benefits (or if the insured relinquishes by assignment, by designation of a new beneficiary or otherwise, every such power that was retained in a previously issued policy), the insured has made a gift of the value of the policy, or to the extent of the premium paid, even though the right of the assignee or beneficiary to receive the benefits is conditioned upon his surviving the insured. For the valuation of life insurance policies see § 25.2512–6.

(9) Where property held by a husband and wife as community property is used to purchase insurance upon the husband's life and a third person is revocably designated as beneficiary and under the State law the husband's death is considered to make absolute the transfer by the wife, there is a gift by the wife at the time of the husband's death of half the amount of the proceeds of such insurance.

(10) If under a pension plan (pursuant to which he has an unqualified right to an annunity) an employee has an option to take either a retirement annuity for himself alone or a smaller annuity for himself with a survivorship annuity payable to his wife, an irrevocable election by the employee to take the reduced annuity in order that an annuity may be paid, after the employee's death, to his wife results in the making of a gift. However, see section 2517 and the regulations thereunder for the exemption from gift tax of amounts attributable to employers' contributions under qualified plans and certain other contracts.

§ 25.2511–2 Cessation of Donor's Dominion and Control.—(a) The gift is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. One the contrary, the tax is a primary and personal liability of the doner, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

(b) As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined. For example, if a donor

transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift. On the other hand, if the donor had not retained the testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift. However, if the exercise of the trustee's power in favor of the grantor is limited by a fixed or ascertainable standard (see paragraph (g) (2) of § 25.2511-1), enforceable by or on behalf of the grantor, then the gift is incomplete to the extent of the ascertainable value of any rights thus retained by the grantor.

(c) A gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. Thus, if an estate for life is transferred but, by an exercise of a power, the estate may be terminated or cut down by the donor to one of less value, and without restriction upon the extent to which the estate may be so cut down, the transfer constitutes an incomplete gift. If in this example the power was confined to the right to cut down the estate for life to one for a term of five years, the certainty of an estate for not less than that term results in a gift to that extent complete.

(d) A gift is not considered incomplete, however, merely because the donor reserves the power to change the manner or time of enjoyment. Thus, the creation of a trust the income of which is to be paid annually to the donee for a period of years, the corpus being distributable to him at the end of the period, and the power reserved by the donor being limited to a right to require that, instead of the income being so payable, it should be accumulated and distributed with the corpus to the donee at the termination of the period, constitutes a completed gift.

(e) A donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. A trustee, as such, is not a person having an adverse interest in the disposition of the trust property or its income.

(f) The relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event which completes the gift and causes the tax to apply. For example, if A transfers property in trust for the benefit of B and C but reserves the power as trustee to change the proportionate interests of B and C, and if A thereafter has another person appointed trustee in place of himself, such later relinquishment of the power by A to the new trustee completes the gift of the transferred property, whether or not the new trustee has a substantial adverse interest. The receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other

than by the donor himself) during the interim between the making of the initial transfer and the relinquishment or termination of the power operates to free such income or other enjoyment from the power, and constitutes a gift of such income or of such other enjoyment taxable as of the calendar year of its receipt. If property is transferred in trust to pay the income to A for life with remainder to B, powers to distribute corpus to A, and to withhold income from A for future distribution to B, are powers to change the beneficiaries of the transferred property.

(g) If a donor transfers property to himself as trustee (or to himself and some other person, not possessing a substantial adverse interest, as trustees), and retains no beneficial interest in the trust property and no power over it except fiduciary powers, the exercise or nonexercise of which is limited by a fixed or ascertainable standard, to change the beneficiaries of the transferred property, the donor has made a completed gift and the entire value of the transferred property is subject to the gift tax.

(h) If a donor delivers a properly indorsed stock certificate to the donee or the donee's agent, the gift is completed for gift tax purposes on the date of delivery. If the donor delivers the certificate to his bank or broker as his agent, or to the issuing corporation or its transfer agent, for transfer into the name of the donee, the gift is completed on the date the stock is transferred on the books of the corporation.

(j) If the donor contends that a power is of such nature as to render the gift incomplete, and hence not subject to the tax as of the calendar year of the initial transfer, the transaction shall be disclosed in the return and evidence showing all relevant facts, including a copy of the instrument of transfer, should be submitted.

§ 25.2511-3 Transfers by Nonresidents Not Citizens.—(a) *In general*—Sections 2511 and 2501 contain provisions relating to the taxation of transfers by nonresident alien donors. (See paragraph (b) of § 25.2501-1 for definition of the term "resident.") As combined these rules are—

(1) If the nonresident alien donor was not engaged in business in the United States during the calendar year in which the gift was made, the tax applies only to the transfer of real property and tangible personal property situated in the United States.

(2) If the nonresident alien donor was engaged in business in the United States during the calendar year in which the gift was made, the tax applies to the transfer of all property (whether real or personal, tangible or intangible) situated in the United States.

(b) *Situs of property.*—(1) Real property, tangible personal property, and, except as otherwise provided in subparagraph (2) of this paragraph (relating to shares of stock), the written evidence of intangible personal property which is treated as being the property itself are within the United States if physically situated therein. For example, a bond for the payment of money is not within the United States unless physically situated therein. Intangible personal property the written evidence of which is not treated as being the property itself constitutes property within the United States if consisting of a property right issuing from or enforceable against a resident of the

United States or a domestic corporation (public or private) irrespective of where such written evidence is physically located.

(2) Shares of stock owned and held by a nonresident alien donor constitute property within the United States if issued by a domestic corporation, irrespective of where the certificates are physically located. However, since a share of stock is intangible property, the transfer by a nonresident alien donor of a share of stock issued by a domestic corporation would, under the provisions of paragraph (a) of this section, be subject to the tax only if the donor was engaged in business in the United States during the calendar year in which the gift was made.

(3) Shares of stock owned and held by a nonresident alien donor do not constitute property within the United States if issued by a corporation which is not a domestic corporation, irrespective of where the certificates are physically located. Therefore, the tax will not under any circumstances apply to the transfer of a share of such stock by a nonresident alien donor.

§ 25.2512 STATUTORY PROVISIONS; VALUATION OF GIFTS.

SEC. 2512. VALUATION OF GIFTS.

(a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

(b) Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

§ 25.2512–1 VALUATION OF PROPERTY; IN GENERAL.—Section 2512 provides that if a gift is made in property, its value at the date of the gift shall be considered the amount of the gift. The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts. The value of a particular kind of property is not the price that a forced sale of the property would produce. The value is generally to be determined by ascertaining as a basis the fair market value at the time of the gift of each unit of the property. For example, in the case of shares of stock or bonds, such unit of property is generally a share or a bond. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value thereof on the date of the gift. All relevant facts and elements of value as of the time of the gift shall be considered. See §§ 25.2512–2 through 25.2512–6 for further information concerning the valuation of particular kinds of property.

§ 25.2512–2 STOCKS AND BONDS.—(a) *In general.*—The value of stocks and bonds is the fair market value per share or bond on the date of the gift.

(b) *Based on selling prices.*—If there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market, or otherwise, the mean between the highest and lowest quoted selling prices on the date of the gift is the fair market value per share or bond. If there were no sales on the date of the gift, but there were sales on

dates within a reasonable period both before and after the date of the gift, the fair market value is determined by taking a weighted average of the means between the highest and lowest sales on the nearest date before and the nearest date after the date of the gift. The average is to be weighted inversely by the respective numbers of trading days between the selling dates and the date of the gift. For example, assume that sales of stock nearest the date of the gift (Friday, June 15) occurred two trading days before (Wednesday, June 13) and three trading days after (Wednesday, June 20) and that on these days the mean sale prices per share were $10 and $15, respectively. The price of $12 is taken as representing the fair market value of a share of the stock as of the date of the gift $\frac{((3\times10)+(2\times15))}{5}$. If, instead, the mean sale prices per share on June 13 and June 20 were $15 and $10, respectively, price of $13 is taken as representing the fair market value $\frac{((3\times15)+(2\times10))}{5}$. If stocks or bonds are listed on more than one exchange, the records of the exchange where the stocks or bonds are principally dealt in should be employed. In valuing listed securities, the donor should be careful to consult accurate records to obtain values as of the date of the gift. If quotations of unlisted securities are obtained from brokers, or evidence as to their sale is obtained from officers of the issuing companies, copies of letters furnishing such quotations or evidence of sale should be attached to the return.

(c) *Based on bid and asked prices.*—If the provisions of paragraph (b) of this section are inapplicable because actual sales are not available during a reasonable period beginning before and ending after the date of the gift, the fair market value may be determined by taking the mean between the bona fide bid and asked prices on the date of the gift, or if none, by taking a weighted average of the means between the bona fide bid and asked prices on the nearest trading date before and the nearest trading date after the date of the gift, if both such nearest dates are within a reasonable period. The average is to be determined in the manner described in paragraph (b) of this section.

(d) *Where selling prices and bid and asked prices are not available for dates both before and after the date of gift.*—If the provisions of paragraphs (b) and (c) of this section are inapplicable because no actual sale prices or quoted bona fide bid and asked prices are available on a date within a reasonable period before the date of the gift, but such prices are available on a date within a reasonable period after the date of the gift, or vice versa, then the mean between the highest and lowest available sale prices or bid and asked prices may be taken as the value.

(e) *Where selling prices or bid and asked prices do not represent fair market value.*—In cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under paragraphs (b), (c), and (d) of this section does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be

considered in determining fair market value. Where sales at or near the date of the gift are few or of a sporadic nature, such sales alone may not indicate fair market value. In certain exceptional cases, the size of the block of securities made the subject of each separate gift in relation to the number of shares changing hands in sales may be relevant in determining whether selling prices reflect the fair market value of the block of stock to be valued. If the donor can show that the block of stock to be valued, with reference to each separate gift, is so large in relation to the actual sales on the existing market that it could not be liquidated in a reasonable time without depressing the market, the price at which the block could be sold as such outside the usual market, as through an underwriter, may be a more accurate indication of value than market quotations. Complete data in support of any allowance claimed due to the size of the block of stock being valued should be submitted with the return. On the other hand, if the block of stock to be valued represents a controlling interest, either actual or effective, in a going business, the price at which other lots change hands may have little relation to its true value.

(f) *Where selling prices or bid and asked prices are unavailable.*— If the provisions of paragraphs (b), (c), and (d) of this section are inapplicable because actual sale prices and bona fide bid and asked prices are lacking, then the fair market value is to be determined by taking the following factors into consideration:

(1) In the case of corporate or other bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors; and

(2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some of the "other relevant factors" referred to in subparagraphs (1) and (2) of this paragraph are: the good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers, or any technical experts as of or near the date of the gift.

§ 25.2512-3 Valuation of Interests in Businesses.—(a) Care should be taken to arrive at an accurate valuation of any interest in a business which the donor transfers without an adequate and full consideration in money or money's worth. The fair market value of any interest in a business, whether a partnership or a proprietorship, is the net amount which a willing purchaser, whether an individual or a corporation, would pay for the interest to a willing seller, neither

being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts. The net value is determined on the basis of all relevant factors including—

(1) A fair appraisal as of the date of the gift of all the assets of the business, tangible and intangible, including good will;

(2) The demonstrated earning capacity of the business; and

(3) The other factors set forth in paragraph (f) of § 25.2512–2 relating to the valuation of corporate stock, to the extent applicable.

Special attention should be given to determining an adequate value of the good will of the business. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of examinations of the business made by accountants, engineers, or any technical experts as of or near the date of the gift.

§ 25.2512–4 VALUATION OF NOTES.—The fair market value of notes, secured or unsecured, is presumed to be the amount of unpaid principal, plus accrued interest to the date of the gift, unless the donor establishes a lower value. Unless returned at face value, plus accrued interest, it must be shown by satisfactory evidence that the note is worth less than the unpaid amount (because of the interest rate, or date of maturity, or other cause), or that the note is uncollectible in part (by reason of the insolvency of the party or parties liable, or for other cause), and that the property, if any, pledged or mortgaged as security is insufficient to satisfy it.

§ 25.2512–5 VALUATION OF ANNUITIES, LIFE ESTATES, TERMS FOR YEARS, REMAINDERS AND REVERSIONS.—(a) *In general.*—(1) The fair market value of annuities, life estates, terms for years, remainders and reversions is their present value, determined under this section, except in the case of annuities and life insurance under contracts issued by companies regularly engaged in their sale. The valuation of such commercial annuity contracts and insurance policies is determined under § 25.2512–6. Where the donor transfers property in trust or otherwise and retains an interest therein, the value of the gift is the value of the property transferred less the value of the donor's retained interest. If the donor assigns or relinquishes an annuity, life estate, remainder or reversion which he holds by virtue of a transfer previously made by himself or another, the value of the gift is the value of the interest transferred.

(2) The present value of an annuity, life estate, remainder or reversion determined under this section which is dependent on the continuation or termination of the life of one person is computed by the use of Table I in paragraph (f) of this section. The present value of an annuity, term for years, remainder or reversion dependent on a term certain is computed by the use of Table II in paragraph (f). If the interest to be valued is dependent upon more than one life or there is a term certain concurrent with one or more lives, see paragraph (e) of this section. For purposes of the computations described in this section, the age of a person is to be taken as the age of that person at his nearest birthday.

(b) *Annuities.*—(1) *Payable annually at end of year.*—If an annuity is payable annually at the end of each year during the life of an individual (as for example if the first payment is due one year after the date of the gift), the amount payable annually is multiplied by the figure in column 2 of Table I opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. If the annuity is payable annually at the end of each year for a definite number of years, the amount payable annually is multiplied by the figure in column 2 of Table II opposite the number of years in column 1 representing the duration of the annuity. The application of this subparagraph may be illustrated by the following examples:

Example (1). The donor assigns an annuity of $10,000 a year payable annually during his life immediately after an annual payment has been made. The age of the donor on the date of assignment is 40 years and 8 months. By reference to Table I, it is found that the figure in column 2 opposite 41 years is 17.6853. The value of the gift is, therefore, $176,853 ($10,000 multiplied by 17.6853).

Example (2). The donor was entitled to receive an annuity of $10,000 a year payable annually at the end of annual periods throughout a term of 20 years; the donor, when 15 years have elapsed, makes a gift thereof to his son. By reference to Table II, it is found that the figure in column 2 opposite 5 years, the unexpired portion of the 20-year period is 4.5151. The present value of the annuity is, therefore, $45,151 ($10,000 multiplied by 4.5151).

(2) *Payable at the end of semiannual, quarterly, monthly, or weekly periods.*—If an annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods during the life of an individual (as for example if the first payment is due one month after the date of the gift), the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table I opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. The product so obtained is then multiplied by whichever of the following factors is appropriate:

1.0087 for semiannual payments,
1.0130 for quarterly payments,
1.0159 for monthly payments, or
1.0171 for weekly payments.

If the annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods for a definite number of years, the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table II opposite the number of years in column 1 representing the duration of the annuity. The product so obtained is then multiplied by whichever of the above factors is appropriate. The application of this subparagraph may be illustrated by the following example:

Example. The facts are the same as those contained in example (1) set forth in subparagraph (1) above, except that the annuity is payable semiannually. The aggregate annual amount, $10,000, is multiplied by the factor 17.6853, and the product multiplied by 1.0087. The value of the gift is, therefore, $178,391.62 ($10,000 x 17.6853 x 1.0087).

(3) *Payable at the beginning of annual, semiannual, quarterly, monthly, or weekly periods.*—(i) If the first payment of an annuity for the life of an individual is due at the beginning of the annual or other payment period rather than at the end (as for example if the first payment is to be made immediately after the date of the gift), the value of the annuity is the sum of (*a*) the first payment plus (*b*) the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in subparagraph (1) or (2) above. The application of this subdivision may be illustrated by the following example:

Example. The donee is made the beneficiary for life of an annuity of $50 a month from the income of a trust, subject to the right reserved by the donor to cause the annuity to be paid for his own benefit or for the benefit of another. On the day a payment is due, the donor relinquishes his reserved power. The donee is then 50 years of age. The value of the gift is $50 plus the product of $50 x 12 x 14.8486 (see Table I) x 1.0159, or $9,100.82.

(ii) If the first payment of an annuity for a definite number of years is due at the beginning of the annual or other payment period, the applicable factor is the product of the factor shown in Table II multiplied by whichever of the following factors is appropriate:

1.0350 for annual payments,
1.0262 for semiannual payments,
1.0218 for quarterly payments,
1.0189 for monthly payments, or
1.0177 for weekly payments.

The application of this subdivision may be illustrated by the following example:

Example. The donee is the beneficiary of an annuity of $50 a month, subject to a reserved right in the donor to cause the annuity or the cash value thereof to be paid for his own benefit or the benefit of another. On the day a payment is due, the donor relinquishes the power. There are 300 payments to be made covering a period of 25 years, including the payment due. The value of the gift is the product of $50 x 12 x 16.4815 (factor for 25 years, Table II) x 1.0189, or $10,075.80.

(c) *Life estates and terms for years.*—If the interest to be valued is the right of a person for his life, or for the life of another person, to receive the income of certain property or to use nonincome-producing property, the value of the interest is the value of the property multiplied by the figure in column 3 of Table I opposite the number of years nearest to the actual age of the measuring life. If the interest to be valued is the right to receive income of property or to use nonincome-producing property for a term of years, column 3 of Table II is used. The application of this paragraph may be illustrated by the following example:

Example. The donor, who during his life is entitled to receive the income from property worth $50,000, makes a gift of such interest. The donor is 31 years old on the date of the gift. The value of the gift is $35,534 ($50,000 x .71068).

(d) *Remainders or reversionary interests.*—If the interest to be valued is a remainder or reversionary interest subject to a life estate, the value of the interest should be obtained by multiplying the value of the property at the date of the gift by the figure in column 4 of Table I opposite the number of years nearest the age of the life tenant. If the remainder or reversion is to take effect at the end of a term of years, column 4 of Table II should be used. The application of this paragraph may be illustrated by the following example:

Example. The donor transfers by gift property worth $50,000 which he is entitled to receive upon the death of his brother, to whom the income for life has been bequeathed. The brother at the date of the gift is 31 years of age. By reference to Table I, it is found that the figure in column 4 opposite age 31 is 0.28932. The value of the gift is, therefore, $14,466. ($50,000 x 0.28932.)

(e) *Actuarial computations by the Internal Revenue Service.*—If the interest to be valued is dependent upon the continuation or termination of more than one life, or there is a term certain concurrent with one or more lives, or if the retained interest of the donor is conditioned upon survivorship, a special factor is necessary. The factor is to be computed upon the basis of the Makehamized mortality table appearing as Table 38 of United States Life Table and Actuarial Tables 1939–1941, published by the United States Department of Commerce, Bureau of the Census, and interest at the rate of 3½ percent a year, compounded annually. Many such factors may be found in, or readily computed with the use of the tables contained in, a pamphlet entitled "Actuarial Values for Estate and Gift Tax." This pamphlet may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington 25, D. C. However, if a special factor is required in the case of an actual gift, the Commissioner will furnish the factor to the donor upon request. The request must be accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the interest, and by copies of the relevant instruments.

(f) The following tables shall be used in the application of the provisions of this section:

TABLE I

Table, single life, 3½ percent, showing the present worth of an annuity, of a life interest, and of a remainder interest

1 Age	2 Annuity	3 Life estate	4 Remainder	1 Age	2 Annuity	3 Life estate	4 Remainder
0	23. 9685	. 83890	. 16110	5	24. 6392	. 86237	. 13763
1	24. 9035	. 87162	. 12838	6	24. 5326	. 85864	. 14139
2	24. 8920	. 87122	. 12877	7	24. 4188	. 85466	. 14534
3	24. 8246	. 86886	. 13114	8	24. 2982	. 85044	. 14956
4	24. 7378	. 86582	. 13418	9	24. 1713	. 84600	. 15400

TABLE I—Continued

1 Age	2 Annuity	3 Life estate	4 Remainder	1 Age	2 Annuity	3 Life estate	4 Remainder
10	24. 0387	. 84135	. 15865	58	12. 0546	. 42191	. 57809
11	23. 9008	. 83653	. 16347	59	11. 6960	. 40936	. 59064
12	23. 7600	. 83160	. 16840	60	11. 3369	. 39679	. 60321
13	23. 6161	. 82656	. 17344	61	10. 9776	. 38422	. 61578
14	23. 4693	. 82143	. 17857	62	10. 6186	. 37165	. 62835
15	23. 3194	. 81618	. 18382	63	10. 2604	. 35911	. 64089
16	23. 1665	. 81083	. 18917	64	9. 9036	. 34663	. 65337
17	23. 0103	. 80536	. 19464	65	9. 5486	. 33420	. 66580
18	22. 8511	. 79979	. 20021	66	9. 1960	. 32186	. 67814
19	22. 6870	. 79404	. 20596	67	8. 8464	. 30962	. 69038
20	22. 5179	. 78813	. 21187	68	8. 5001	. 29750	. 70250
21	22. 3438	. 78203	. 21797	69	8. 1578	. 28552	. 71448
22	22. 1646	. 77576	. 22424	70	7. 8200	. 27370	. 72630
23	21. 9801	. 76930	. 23070	71	7. 4871	. 26205	. 73795
24	21. 7902	. 76266	. 23734	72	7. 1597	. 25059	. 74941
25	21. 5950	. 75582	. 24418	73	6. 8382	. 23934	. 76066
26	21. 3942	. 74880	. 25120	74	6. 5231	. 22831	. 77169
27	21. 1878	. 74157	. 25843	75	6. 2148	. 21752	. 78248
28	20. 9759	. 73416	. 26584	76	5. 9137	. 20698	. 79302
29	20. 7581	. 72653	. 27347	77	5. 6201	. 19670	. 80330
30	20. 5345	. 71871	. 28129	78	5. 3345	. 18671	. 81329
31	20. 3052	. 71068	. 28932	79	5. 0572	. 17700	. 82300
32	20. 0699	. 70245	. 29755	80	4. 7884	. 16759	. 83241
33	19. 8288	. 69401	. 30599	81	4. 5283	. 15849	. 84151
34	19. 5816	. 68536	. 31464	82	4. 2771	. 14970	. 85030
35	19. 3285	. 67650	. 32350	83	4. 0351	. 14123	. 85877
36	19. 0695	. 66743	. 33257	84	3. 8023	. 13308	. 86692
37	18. 8044	. 65815	. 34185	85	3. 5789	. 12526	. 87474
38	18. 5334	. 64867	. 35133	86	3. 3648	. 11777	. 88223
39	18. 2566	. 63898	. 36102	87	3. 1601	. 11060	. 88940
40	17. 9738	. 62908	. 37092	88	2. 9648	. 10377	. 89623
41	17. 6853	. 61899	. 38101	89	2. 7788	. 09726	. 90274
42	17. 3911	. 60869	. 39131	90	2. 6019	. 09107	. 90893
43	17. 0913	. 59820	. 40180	91	2. 4342	. 08520	. 91480
44	16. 7860	. 58751	. 41249	92	2. 2754	. 07964	. 92036
45	16. 4754	. 57664	. 42336	93	2. 1254	. 07439	. 92561
46	16. 1596	. 56559	. 43441	94	1. 9839	. 06944	. 93056
47	15. 8388	. 55436	. 44564	95	1. 8507	. 06477	. 93523
48	15. 5133	. 54297	. 45703	96	1. 7256	. 06040	. 93960
49	15. 1831	. 53141	. 46859	97	1. 6082	. 05629	. 94371
50	14. 8486	. 51970	. 48030	98	1. 4982	. 05244	. 94756
51	14. 5101	. 50785	. 49215	99	1. 3949	. 04882	. 95118
52	14. 1678	. 49587	. 50413	100	1. 2973	. 04541	. 95459
53	13. 8221	. 48377	. 51623	101	1. 2033	. 04212	. 95788
54	13. 4734	. 47157	. 52843	102	1. 1078	. 03877	. 96123
55	13. 1218	. 45926	. 54074	103	. 9973	. 03491	. 96509
56	12. 7679	. 44688	. 55312	104	. 8313	. 02911	. 97089
57	12. 4120	. 43442	. 56558	105	. 4831	. 01691	. 98309

TABLE II

Table showing the present worth at 3½ percent of an annuity for a term certain, of an income interest for a term certain, and of a remainder interest postponed for a term certain

1 Number of years	2 Annuity	3 Term certain	4 Remainder	1 Number of years	2 Annuity	3 Term certain	4 Remainder
1	0. 9662	. 033816	. 966184	16	12. 0941	. 423294	. 576706
2	1. 8997	. 066489	. 933511	17	12. 6513	. 442796	. 557204
3	2. 8016	. 098057	. 901943	18	13. 1897	. 461639	. 538361
4	3. 6731	. 128558	. 871442	19	13. 7098	. 479844	. 520156
5	4. 5151	. 158027	. 841973	20	14. 2124	. 497434	. 502566
6	5. 3286	. 186499	. 813501	21	14. 6980	. 514429	. 485571
7	6. 1145	. 214009	. 785991	22	15. 1671	. 530849	. 469151
8	6. 8740	. 240588	. 759412	23	15. 6204	. 546714	. 453286
9	7. 6077	. 266269	. 733731	24	16. 0584	. 562043	. 437957
10	8. 3166	. 291081	. 708919	25	16. 4815	. 576853	. 423147
11	9. 0016	. 315054	. 684946	26	16. 8904	. 591162	. 408838
12	9. 6633	. 338217	. 661783	27	17. 2854	. 604988	. 395012
13	10. 3027	. 360596	. 639404	28	17. 6670	. 618346	. 381654
14	10. 9205	. 382218	. 617782	29	18. 0358	. 631252	. 368748
15	11. 5174	. 403109	. 596891	30	18. 3920	. 643722	. 356278

§ 25.2512-6 VALUATION OF CERTAIN LIFE INSURANCE AND ANNUITY CONTRACTS.—The value of a life insurance contract or of a contract for the payment of an annuity issued by a company regularly engaged in the selling of contracts of that character is established through the sale of the particular contract by the company, or through the sale by the company of comparable contracts. As valuation of an insurance policy through sale of comparable contracts is not readily ascertainable when the gift is of a contract which has been in force for some time and on which further premium payments are to be made, the value may be approximated by adding to the interpolated terminal reserve at the date of the gift the proportionate part of the gross premium last paid before the date of the gift which covers the period extending beyond that date. If, however, because of the unusual nature of the contract such approximation is not reasonably close to the full value, this method may not be used. The following examples, so far as relating to life insurance contracts, are of gifts of such contracts on which there are no accrued dividends or outstanding indebtedness.

Example (1). A donor purchases from a life insurance company for the benefit of another a life insurance contract or a contract for the payment of an annuity. The value of the gift is the cost of the contract.

Example (2). An annuitant purchased from a life insurance company a single payment annuity contract by the terms of which he was entitled to receive payments of $1,200 annually for the duration of

his life. Five years subsequent to such purchase, and when of the of 50 years, he gratuitously assigns the contract. The value of the gift is the amount which the company would charge for an annuity contract providing for the payment of $1,200 annually for the life of a person 50 years of age.

Example (3). A donor owning a life insurance policy on which no further payments are to be made to the company (e. g., a single premium policy or paid-up policy) makes a gift of the contract. The value of the gift is the amount which the company would charge for a single premium contract of the same specified amount on the life of a person of the age of the insured.

Example (4). A gift is made four months after the last premium due date of an ordinary life insurance policy issued nine years and four months prior to the gift thereof by the insured, who was 35 years of age at date of issue. The gross annual premium is $2,811. The computation follows:

Terminal reserve at end of tenth year	$14,601.00
Terminal reserve at end of ninth year	12,965.00
Increase	1,636.00
One-third of such increase (the gift having been made four months following the last preceding premium due date), is	545.33
Terminal reserve at end of ninth year	12,965.00
Interpolated terminal reserve at date of gift	13,510.33
Two-thirds of gross premium ($2,811)	1,874.00
Value of the gift	15,384.33

§ 25.2512–7 Effect of Excise Tax.—If jewelry, furs or other property, the purchase of which is subject to an excise tax, is purchased at retail by a taxpayer and made the subject of gifts within a reasonable time after purchase, the purchase price, including the excise tax, is considered to be the fair market value of the property on the date of the gift, in the absence of evidence that the market price of similar articles has increased or decreased in the meantime. Under other circumstances, the excise tax is taken into account in determining the fair market value of property to the extent, and only to the extent, that it affects the price at which the property would change hands between a willing buyer and a willing seller, as provided in § 25.2512–1.

§ 25.2512–8 Transfers for Insufficient Consideration.—Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a value in money or money's worth, as love and af-

fection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift. Similarly, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the spouse's property or estate, shall not be considered to any extent a consideration "in money or money's worth." See, however, section 2516 and the regulations thereunder with respect to certain transfers incident to a divorce.

§ 25.2513 STATUTORY PROVISIONS; GIFT BY HUSBAND OR WIFE TO THIRD PARTY; CONSIDERED AS MADE ONE-HALF BY EACH.

SEC. 2513. GIFT BY HUSBAND OR WIFE TO THIRD PARTY.

(a) CONSIDERED AS MADE ONE-HALF BY EACH.—

(1) IN GENERAL.—A gift made by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This paragraph shall not apply with respect to a gift by a spouse of an interest in property if he creates in his spouse a general power of appointment, as defined in section 2514 (c), over such interest. For purposes of this section, an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

(2) CONSENT OF BOTH SPOUSES.—Paragraph (1) shall apply only if both spouses have signified (under the regulations provided for in subsection (b)) their consent to the application of paragraph (1) in the case of all such gifts made during the calendar year by either while married to the other.

(b) MANNER AND TIME OF SIGNIFYING CONSENT.—

(1) MANNER.—A consent under this section shall be signified in such manner as is provided under regulations prescribed by the Secretary or his delegate.

(2) TIME.—Such consent may be so signified at any time after the close of the calendar year in which the gift was made, subject to the following limitations—

(A) The consent may not be signified after the 15th day of April following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse;

(B) The consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse in accordance with section 6212(a).

(c) REVOCATION OF CONSENT.—Revocation of a consent previously signified shall be made in such manner as is provided under regulations prescribed by the Secretary or his delegate, but the right to revoke a consent previously signified with respect to a calendar year—

(1) Shall not exist after the 15th day of April following the close of such year if the consent was signified on or before such 15th day; and

(2) Shall not exist if the consent was not signified until after such 15th day.

(d) JOINT AND SEVERAL LIABILITY FOR TAX.—If the consent required by subsection (a)(2) is signified with respect to a gift made in any calendar year, the liability with respect to the entire tax imposed by this chapter of each spouse for such year shall be joint and several.

§ 25.2513–1 GIFTS BY HUSBAND OR WIFE TO THIRD PARTY CONSIDERED AS MADE ONE-HALF BY EACH.—(a) A gift made by one spouse to a person other than his (or her) spouse may, for the purpose of the gift tax, be considered as made one-half by him and one-half by

his spouse, but only if at the time of the gift each spouse was a citizen or resident of the United States. For purposes of this section, an individual is to be considered as the spouse of another individual only if he was married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

(b) The provisions of this section will apply to gifts made during a particular calendar year only if both spouses signify their consent to treat all gifts made to third parties during that calendar year by both spouses while married to each other as having been made one-half by each spouse. As to the manner and time for signifying consent see § 25.2513–2. Such consent, if signified with respect to any calendar year, is effective with respect to all gifts made to third parties during such year except as follows:

(1) If the consenting spouses were not married to each other during a portion of the calendar year, the consent is not effective with respect to any gifts made during such portion of the calendar year. Where the consent is signified by an executor or administrator of a deceased spouse, the consent is not effective with respect to gifts made by the surviving spouse during the portion of the calendar year that his spouse was deceased.

(2) If either spouse was a nonresident not a citizen of the United States during any portion of the calendar year, the consent is not effective with respect to any gift made during that portion of the calendar year.

(3) The consent is not effective with respect to a gift by one spouse of a property interest over which he created in his spouse a general power of appointment (as defined in section 2514(c)).

(4) If one spouse transferred property in part to his spouse and in part to third parties, the consent is effective with respect to the interest transferred to third parties only insofar as such interest is ascertainable at the time of the gift and hence severable from the interest transferred to his spouse. See § 25.2512–5 for the principles to be applied in the valuation of annuities, life estates, terms for years, remainders and reversions.

(5) The consent applies alike to gifts made by one spouse alone and to gifts made partly by each spouse, provided such gifts were to third parties and do not fall within any of the exceptions set forth in subparagraphs (1) through (4) of this paragraph. The consent may not be applied only to a portion of the property interest constituting such gifts. For example, a wife may not treat gifts made by her spouse from his separate property to third parties as having been made one-half by her if her spouse does not consent to treat gifts made by her to third parties during the same calendar year as having been made one-half by him. If the consent is effectively signified on either the husband's return or the wife's return, all gifts made by the spouses to third parties (except as described in subparagraphs (1) through (4) of this paragraph), during the calendar year will be treated as having been made one-half by each spouse.

(c) If a husband and wife consent to have the gifts made to third party donees considered as made one-half by each spouse, and only one spouse makes gifts during the year, the other spouse is not required to file a gift tax return provided: (1) the total value of the

gifts made to each third party donee is not in excess of $6,000, and (2) no portion of the property transferred constitutes a gift of a future interest. If a transfer made by either spouse during the year to a third party represents a gift of a future interest in property and the spouses consent to have the gifts considered as made one-half by each, a gift tax return for such year must be filed by each spouse regardless of the value of the transfer. (See § 25.2503–3 for the definition of a future interest.)

(d) The following examples illustrate the application of this section relative to the requirements for the filing of a return, assuming that a consent was effectively signified:

(1) A husband made gifts valued at $7,000 during the year to a third party and his wife made no gifts. Each spouse is required to file a return.

(2) A husband made gifts valued at $5,000 to each of two third parties during the year and his wife made no gifts. Only the husband is required to file a return. (See § 25.6019–2.)

(3) A husband made gifts valued at $5,000 to a third party, and the wife made gifts valued at $2,000 to the same third party during the year. Each spouse is required to file a return.

(4) A husband made gifts valued at $5,000 to a third party and his wife made gifts valued at $3,000 to another third party during the year. Only the husband is required to file a return. (See § 25.6019–2.)

(5) A husband made gifts valued at $2,000 during the year to third parties which represented gifts of future interests in property (see § 25.2503–3), and his wife made no gifts during such calendar year. Each spouse is required to file a return.

§ 25.2513–2 Manner and Time of Signifying Consent.—(a) Consent to the application of the provisions of section 2513 with respect to a calendar year shall, in order to be effective, be signified by both spouses. If both spouses file gift tax returns within the time for signifying consent, it is sufficient if—

(1) the consent of the husband is signified on the wife's return, and the consent of the wife is signified on the husband's return;

(2) the consent of each spouse is signified on his own return; or

(3) the consent of both spouses is signified on one of the returns.

If only one spouse files a gift tax return within the time provided for signifying consent, the consent of both spouses shall be signified on that return. However, wherever possible, the notice of the consent is to be shown on both returns and it is preferred that the notice be executed in the manner described in subparagraphs (1) of this paragraph. The consent may be revoked only as provided in § 25.2513–3. If one spouse files more than one gift tax return for a calendar year on or before the 15th day of April following the close of the calendar year, the last return so filed will, for the purpose of determining whether a consent has been signified, be considered as the return.

(b) The consent may be signified at any time following the close of the calendar year, subject to the following limitations:

(1) The consent may not be signified after the 15th day of April following the close of the calendar year, unless before such 15th day

no return has been filed for the year by either spouse, in which case the consent may not be signified after a return for the year is filed by either spouse; and

(2) The consent may not be signified for a calendar year after a notice of deficiency in gift tax for that year has been sent to either spouse in accordance with the provisions of section 6212.

(c) The executor or administrator of a deceased spouse, or the gaurdian or committee of a legally incompetent spouse, as the case may be, may signify the consent.

(d) If the donor and spouse censent to the application of section 2513, the return or returns for the calendar year must set forth, to the extent provided thereon, information relative to the transfers made by each spouse.

§ 25.2513–3 Revocation of Consent.—If the consent to the application of the provisions of section 2513 for a calendar year was effectively signified on or before the 15th day of April following the close of the calendar year, either spouse may revoke the consent by filing in duplicate with the district director of internal revenue a signed statement of revocation, but only if the statement is filed on or before such 15th day of April. Therefore, a consent which was not effectively signified until after the 15th day of April following the close of the calendar year to which it applies may not be revoked.

§ 25.2513–4 Joint and Several Liability for Tax.—If consent to the application of the provisions of section 2513 is signified as provided in § 25.2513–2, and not revoked as provided in § 25.2513–3, the liability with respect to the entire gift tax of each spouse for such calendar year is joint and several. See paragraph (d) of § 25.2511–1.

§ 25.2514 Statutory Provisions; Powers of Appointment.

SEC. 2514. POWERS OF APPOINTMENT.

(a) Powers Created on or Before October 21, 1942.—An exercise of a general power of appointment created on or before October 21, 1942, shall be deemed a transfer of property by the individual possessing such power; but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof. If a general power of appointment created on or before October 21, 1942, has been partially released so that it is no longer a general power of appointment, the subsequent exercise of such power shall not be deemed to be the exercise of a general power of appointment if—

(1) Such partial release occurred before November 1, 1951, or

(2) The donee of such power was under a legal disability to release such power on October 21, 1942, and such partial release occurred not later than six months after the termination of such legal disability.

(b) Powers Created After October 21, 1942.—The exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power. A disclaimer or renunciation of such a power of appointment shall not be deemed a release of such power.

(c) Definition of General Power of Appointment.—For purposes of this section, the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power (hereafter in this subsection referred to as the "possessor"), his estate, his creditors, or the creditors of his estate; except that—

(1) A power to consume, invade, or appropriate property for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.

(2) A power of appointment created on or before October 21, 1942, which is exercisable by the possessor only in conjunction with another person shall not be deemed a general power of appointment.

(3) In the case of a power of appointment created after October 21, 1942, which is exercisable by the possessor only in conjunction with another person—

(A) If the power is not exercisable by the possessor except in conjunction with the creator of the power—such power shall not be deemed a general power of appointment;

(B) If the power is not exercisable by the possessor except in conjunction with a person having a substantial interest in the property subject to the power, which is adverse to exercise of the power in favor of the possessor—such power shall not be deemed a general power of appointment. For the purposes of this subparagraph a person who, after the death of the possessor, may be possessed of a power of appointment (with respect to the property subject to the possessor's power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the possessor's power;

(C) If (after the application of subparagraphs (A) and (B)) the power is a general power of apointment and is exercisable in favor of such other person—such power shall be deemed a general power of appointment only in respect of a fractional part of the property subject to such power, such part to be determined by dividing the value of such property by the number of such persons (including the possessor) in favor of whom such power is exercisable.

For purposes of subparagraphs (B) and (C), a power shall be deemed to be exercisable in favor of a person if it is exercisable in favor of such person, his estate, his creditors, or the creditors of his estate.

(d) CREATION OF ANOTHER POWER IN CERTAIN CASES.—If a power of appointment created after October 21, 1942, is exercised by creating another power of appointment which, under the applicable local law, can be validly exercised so as to postpone the vesting of any estate or interest in the property which was subject to the first power, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power, such exercise of the first power shall, to the extent of the property subject to the second power, be deemed a transfer of property by the individual possessing such power.

(e) LAPSE OF POWER.—The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts:

(1) $5,000, or

(2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.

(f) DATE OF CREATION OF POWER.—For purposes of this section a power of appointment created by a will executed on or before October 21, 1942, shall be considered a power created on or before such date if the person executing such will dies before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.

§ 25.2514–1 TRANSFERS UNDER POWER OF APPOINTMENT.—(a) *Introductory.*—(1) Section 2514 treats the exercise of a general power of appointment created on or before October 21, 1942, as a transfer of property for purposes of the gift tax. The section also treats as a transfer of property the exercise or complete release of a general

power of appointment created after October 21, 1942, and under certain circumstances the exercise of a power of appointment (not a general power of appointment) created after October 21, 1942, by the creation of another power of appointment. See paragraph (d) of § 25.2514–3. Under certain circumstances, also, the failure to exercise a power of appointment created after October 21, 1942, within a specified time, so that the power lapses, constitutes a transfer of property. Paragraphs (b) through (e) of this section contain definitions of certain terms used in §§ 25.2514–2 and 25.2514–3. See § 25.2514–2 for specific rules applicable to certain powers created on or before October 21, 1942. See § 25.2514–3 for specific rules applicable to powers created after October 21, 1942.

(b) *Definition of "power of appointment."*—(1) *In general.*—The term "power of appointment" includes all powers which are in substance and effect powers of appointment received by the donee of the power from another person, regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the principal of the trust, the power to consume or appropriate is a power of appointment. Similarly, a power given to a donee to affect the beneficial enjoyment of a trust property or its income by altering, amending or revoking the trust instrument or terminating the trust is a power of appointment. A power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. For example, if under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and A, another person, has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, A is considered as having a power of appointment. However, he would not be considered to have a power of appointment if he only had the power to appoint a successor, including himself, under limited conditions which did not exist at the time of exercise, release or lapse of the trustee's power, without an accompanying unrestricted power of removal. Similarly, a power to amend only the administrative provisions of a trust instrument, which cannot substantially affect the beneficial enjoyment of the trust property or income, is not a power of appointment. The mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment. Further, the right in a beneficiary of a trust to assent to a periodic accounting, thereby relieving the trustee from further accountability, is not a power of appointment if the right of assent does not consist of any power or right to enlarge or shift the beneficial interest of any beneficiary therein.

(2) *Relation to other sections.*—For purposes of §§ 25.2514–1 through 25.2514–3, the term "power of appointment" does not include powers reserved by a donor to himself. No provision of section 2514 or of §§ 25.2514–1 through 25.2514–3 is to be construed as in any way

limiting the application of any other section of the Internal Revenue Code or of these regulations. The power of the owner of a property interest already possessed by him to dispose of his interest, and nothing more, is not a power of appointment, and the interest is includible in the amount of his gifts to the extent it would be includible under section 2511 or other provisions of the Internal Revenue Code. For example, if a trust created by S provides for payment of the income to A for life with power in A to appoint the entire trust property by deed during her lifetime to a class consisting of her children, and a further power to dispose of the entire corpus by will to anyone, including her estate, and A exercises the inter vivos power in favor of her children, she has necessarily made a transfer of her income interest which constitutes a taxable gift under section 2511 (a), without regard to section 2514. This transfer also results in a relinquishment of her general power to appoint by will, which constitutes a transfer under section 2514 if the power was created after October 21, 1942.

(3) *Powers over a portion of property.*—If a power of appointment exists as to part of an entire group of assets or only over a limited interest in property, section 2514 applies only to such part or interest.

(c) *Definition of "general power of appointment."*—(1) *In general.*—The term "general power of appointment" as defined in section 2514(c) means any power of appointment exercisable in favor of the person possessing the power (referred to as the "possessor"), his estate, his creditors, or the creditors of his estate, except (i) joint powers, to the extent provided in §§ 25.2514–2 and 25.2514–3 and (ii) certain powers limited by an ascertainable standard, to the extent provided in subparagraph (2) of this paragraph. A power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the possessor or his estate, is included within the meaning of a power of appointment exercisable in favor of the possessor, his estate, his creditors, or the creditors of his estate. A power of appointment exercisable for the purpose of discharging a legal obligation of the possessor or for his pecuniary benefit is considered a power of appointment exercisable in favor of the possessor or his creditors. However, for purposes of §§ 25.2514–1 through 25.2514–3, a power of appointment not otherwise considered to be a general power of appointment is not treated as a general power of appointment merely by reason of the fact that an appointee may, in fact, be a creditor of the possessor or his estate. A power of appointment is not a general power if by its terms it is either—

(*a*) Exercisable only in favor of one or more designated persons or classes other than the possessor or his creditors, or the possessor's estate or the creditors of his estate, or

(b) Expressly not exercisable in favor of the possessor or his creditors, the possessor's estate or the creditors of his estate.

A beneficiary may have two powers under the same instrument, one of which is a general power of appointment and the other of which is not. For example, a beneficiary may have a general power to withdraw a limited portion of trust corpus during his life, and a further power exercisable during his lifetime to appoint the corpus among his children. The latter power is not a general power of appointment (but its exercise may cause a release of the former power; see example in paragraph (b)(2) of this section).

(2) *Powers limited by an ascertainable standard.*—A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor is, by reason of section 2514(c)(1), not a general power of appointment. A power is limited by such a standard if the extent of the possessor's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words " support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standards are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised."

(3) *Certain powers under wills of decedents dying between January 1 and April 2, 1948.*—Section 210 of the Technical Changes Act of 1953 provides that if a decedent died after December 31, 1947, but before April 3, 1948, certain property interests described therein may, if the decedent's surviving spouse so elects, be accorded special treatment in the determination of the marital deduction to be allowed the decedent's estate under the provisions of section 812(e) of the Internal Revenue Code of 1939. See paragraph (h) of § 81.47a of Regulations 105 (26 CFR (1939) 81.47a (h)). The section further provides that property affected by the election shall be considered property with respect to which the surviving spouse has a general power of appointment. Therefore, notwithstanding any other provision of law or of §§ 25.2514–1 through 25.2514–3, if the surviving spouse has made an election under section 210 of the Technical Changes Act of 1953, the property which was the subject of the election shall be considered as property with respect to which she has a general power of appointment created after October 21, 1942, exercisable by deed or will, to the extent it was treated as an interest passing to the surviving spouse and not passing to any other person for the purpose of the marital deduction in the prior decedent's estate.

(d) *Definition of "exercise."*—Whether a power of appointment is in fact exercised may depend upon local law. However, regardless of local law, a power of appointment is considered as exercised for purposes of section 2514 even though the exercise is in favor of the taker in default of appointment, and irrespective of whether the appointed interest and the interest in default of appointment are identical or whether the appointee renounces any right to take under the appointment. A power of appointment is also considered as exercised even though the disposition cannot take effect until the occurrence of an event after the exercise takes place, if the exercise is irrevocable

and, as of the time of the exercise, the condition was not impossible of occurrence. For example, if property is left in trust to A for life, with a power in A to appoint the remainder by an instrument filed with the trustee during his life, and A exercises his power by appointing the remainder to B in the event that B survives A, A is considered to have exercised his power if the exercise was irrevocable.

(e) *Time of creation of power.*—A power of appointment created by will is in general considered as created on the date of the testator's death. However, section 2514(f) provides that a power of appointment created by a will executed on or before October 21, 1942, is considered a power created on or before that date if the testator dies before July 1, 1949, without having republished the will, by codicil or otherwise, after October 21, 1942. Whether or not a power of appointment created by an inter vivos instrument executed on or before October 21, 1942, is considered a power created on or before that date depends upon the facts and circumstances of the particular case. For example, assume that A created a revocable trust before October 21, 1942, providing for payment of income to B for life with remainder as B shall appoint by will. If A dies after October 21, 1942, without having exercised his power of revocation, B's power of appointment is considered a power created after October 21, 1942. On the other hand, assume that C created an irrevocable inter vivos trust before October 21, 1942, naming T as trustee and providing for payment of income to D for life with remainder to E. Assume further that T was given the power to pay corpus to D and the power to appoint a successor trustee. If T resigns after October 21, 1942, and appoints D as successor trustee, D is considered to have a power of appointment created before October 21, 1942. As another example assume that F created an irrevocable inter vivos trust before October 21, 1942, providing for payment of income to G for life with remainder as G shall appoint by will, but in default of appointment income to H for life with remainder as H shall appoint by will. If G dies after October 21, 1942, without having exercised his power of appointment, H's power of appointment is considered a power created before October 21, 1942, even though it was only a contingent interest until G's death. If, in this last example, G had exercised his power of appointment by creating a similar power in I, I's power of appointment would be considered a power created after October 21, 1942. A power is not considered as created after October 21, 1942, merely because the power is not exercisable or the identity of its holders is not ascertained until after that date.

§ 25.2514–2 Powers of Appointment Created on or Before October 21, 1942.—(a) *In general.*—The exercise of a general power of appointment created on or before October 21, 1942, is deemed to be a transfer of property by the individual processing the power.

(b) *Joint powers created on or before October 21, 1942.*—Section 2514(c)(2) provides that a power created on or before October 21, 1942, which at the time of the exercise is not exercisable by the possessor except in conjunction with another person, is not deemed a general power of appointment.

(c) *Release or lapse.*—A failure to exercise a general power of appointment created on or before October 21, 1942, or a complete

release of such a power is not considered to be an exercise of a general power of appointment. The phrase "a complete release" means a release of all powers over all or a portion of the property subject to a power of appointment, as distinguished from the reduction of a power of appointment to a lesser power. Thus, if the possessor completely relinquished all powers over one-half of the property subject to a power of appointment, the power is completely released as to that one-half. If at or before the time a power of appointment is relinquished, the holder of the power exercises the power in such a manner or to such an extent that the relinquishment results in the reduction, enlargement, or shift in a beneficial interest in property, the relinquishment will be considered to be an exercise and not a release of the power. For example, assume that A created a trust in 1940 providing for payment of the income to B for life with the power in B to amend the trust, and for payment of the remainder to such persons as B shall appoint or, upon default of appointment, to C. If B amended the trust in 1948 by providing that upon his death the remainder was to be paid to D, and if he further amended the trust in 1955 by deleting his power to amend the trust, such relinquishment will be considered an exercise and not a release of a general power of appointment. On the other hand, if the 1948 amendment became ineffective before or at the time of the 1955 amendment, or if B in 1948 merely amended the trust by changing the purely ministerial powers of the trustee, his relinquishment of the power in 1955 will be considered as release of a power of appointment.

(d) *Partial release.*—If a general power of appointment created on or before October 21, 1942, is partially released so that it is not thereafter a general power of appointment, a subsequent exercise of the partially released power is not an exercise of a general power of appointment if the partial release occurs before whichever is the later of the following dates:

(1) November 1, 1951; or

(2) If the possessor was under a legal disability to release the power on October 21, 1942, the day after the expiration of 6 months following the termination of such legal disability.

However, if a general power created on or before October 21, 1942, is partially released on or after the later of those dates, a subsequent exercise of the power will constitute an exercise of a general power of appointment. The legal disability referred to in this paragraph is determined under local law and may include the disability of an insane person, a minor, or unborn child. The fact that the type of general power of appointment possessed by the holder actually was not generally releasable under the local law does not place the holder under a legal disability within the meaning of this paragraph. In general, however, it is assumed that all general powers of appointment are releasable, unless the local law on the subject is to the contrary, and it is presumed that the method employed to release the power is effective, unless it is not in accordance with the local law relating specifically to releases or, in the absence of such local law, is not in accordance with the local law relating to similar transactions.

(e) *Partial exercise.*—If a general power of appointment created on or before October 21, 1942, is exercised only as to a portion of the

property subject to the power, the exercise is considered to be a transfer only as to the value of that portion.

§ 25.2514–3 Powers of Appointment Created After October 21, 1942.—(a) *In general.*—The exercise, release, or lapse (except as provided in paragraph (c) of this section) of a general power of appointment created after October 21, 1942, is deemed to be a transfer of property by the individual possessing the power. The exercise of a power of appointment that is not a general power is considered to be a transfer if it is exercised to create a further power under certain circumstances (see paragraph (d) of this section). See paragraph (c) of § 25.2514–1 for the definition of various terms used in this section. See paragraph (b) of this section for the rules applicable to determine the extent to which joint powers created after October 21, 1942, are to be treated as general powers of appointment.

(b) *Joint powers created after October 21, 1942.*—The treatment of a power of appointment created after October 21, 1942, which is exercisable only in conjunction with another person is governed by section 2514(c)(3), which provides as follows:

(1) Such a power is not considered as a general power of appointment if it is not exercisable by the possessor except with the consent or joinder of the creator of the power.

(2) Such power is not considered as a general power of appointment if it is not exercisable by the possessor except with the consent or joinder of a person having a substantial interest in the property subject to the power which is adverse to the exercise of the power in favor of the possessor, his estate, his creditors, or the creditors of his estate. An interest adverse to the exercise of a power is considered as substantial if its value in relation to the total value of the property subject to the power is not insignificant. For this purpose, the interest is to be valued in accordance with the actuarial principles set forth in § 25.2512–5 or, if it is not susceptible to valuation under those provisions, in accordance with the general principles set forth in § 25.2512–1. A taker in default of appointment under a power has an interest which is adverse to an exercise of the power. A coholder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. Thus, for example, if X, Y, and Z held a power jointly, to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y. The application of this subparagraph may be further illustrated by the following examples in each of which it is assumed that the value of the interest in question is substantial:

Example (1). The taxpayer and R are trustees of a trust under which the income is to be paid to the taxpayer for life and then to M for life, and R is remainderman. The trustees have power to distrib-

ute corpus to the taxpayer. Since R's interest is substantially adverse to an exercise of the power in favor of the taxpayer, the latter does not have a general power of appointment. If M and the taxpayer were trustees, M's interest would likewise be adverse.

Example (2). The taxpayer and L are trustees of a trust under which the income is to be paid to L for life and then to M for life, and the taxpayer is remainderman. The trustees have power to distribute corpus to the taxpayer during L's life. Since L's interest is adverse to an exercise of the power in favor of the taxpayer, the taxpayer does not have a general power of appointment. If the taxpayer and M were trustees, M's interest would likewise be adverse.

Example (3). The taxpayer and L are trustees of a trust under which the income is to be paid to L for life. The trustees can designate whether corpus is to be distributed to the taxpayer or to A after L's death. L's interest is not adverse to an exercise of the power in favor of the taxpayer, and the taxpayer therefore has a general power of appointment.

(3) A power which is exercisable only in conjunction with another person, and which after application of the rules set forth in subparagraphs (1) and (2) of this paragraph, constitutes a general power of appointment, will be treated as though the holders of the power who are permissible appointees of the property were joint owners of property subject to the power. The possessor, under this rule, will be treated as possessed of a general power of appointment over an aliquot share of the property to be determined with reference to the number of joint holders, including the possessor, who (or whose estates or creditors) are permissible appointees. Thus, for example, if X, Y, and Z hold an unlimited power jointly to appoint among a group of persons, including themselves, but on the death of X the power does not pass to Y and Z jointly, then Y and Z are not considered to have interests adverse to the exercise of the power in favor of X. In this case, X is considered to possess a general power of appointment as to one-third of the property subject to the power.

(c) *Partial releases, lapses, and disclaimers of general powers created after October 21, 1942.*—(1) The general principles set forth in § 25.2511–2 for determining whether a donor of property (or of a property right or interest) has divested himself of all or any portion of his interest therein to the extent necessary to effect a completed gift are applicable in determining whether a partial release of a power of appointment constitutes a taxable gift. Thus, if a general power of appointment is partially released so that thereafter the donor may still appoint among a limited class of persons not including himself the partial release does not effect a complete gift, since the possessor of the power has retained the right to designate the ultimate beneficiaries of the property over which he holds the power and since it is only the termination of such control which completes a gift.

(2) If a general power of appointment created after October 21, 1942, was partially released prior to June 1, 1951, so that it no longer represented a general power of appointment, as defined in paragraph (c) of § 25.2514–1, the subsequent exercise, release, or lapse of the partially released power at any time thereafter will not constitute the exercise or release of a general power of appointment. For example,

assume that A created a trust in 1943 under which B possessed a general power of appointment. By an instrument executed in 1948 such general power of appointment was reduced in scope by B to an excepted power. The inter vivos exercise in 1955, or in any calendar year thereafter, of such excepted power is not considered an exercise or release of a general power of appointment for purposes of the gift tax.

(3) If a general power of appointment created after October 21, 1942, was partially released after May 31, 1951, the subsequent exercise, release or a lapse of the power at any time thereafter, will constitute the exercise or release of a general power of appointment for gift tax purposes.

(4) A release of a power of appointment need not be formal or express in character. For example, the failure to excercise a general power of appointment created after October 21, 1942, within a specified time so that the power lapses, constitutes a release of the power. In any case where the possessor of a general power of appointment is incapable of validly exercising or releasing a power, by reason of minority, or otherwise, and the power may not be validly exercised or released on his behalf, the failure to exercise or release the power is not a lapse of the power. If a trustee has in his capacity as trustee a power which is considered as a general power of appointment, his resignation or removal as trustee will cause a lapse of his power. However, section 2514(e) provides that a lapse during any calendar year is considered as a release so as to be subject to the gift tax only to the extent that the property which could have been appointed by exercise of the lapsed power of appointment exceeds the greater of (i) $5,000, or (ii) 5 percent of the aggregate value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied. For example, if an individual has a noncumulative right to withdraw $10,000 a year from the principal of a trust fund, the failure to exercise this right of withdrawal in a particular year will not constitute a gift if the fund at the end of the year equals or exceeds $200,000. If, however, at the end of the particular year the fund should be worth only $100,000, the failure to exercise the power will be considered a gift to the extent of $5,000, the excess of $10,000 over 5 percent of a fund of $100,000. Where the failure to exercise a power, such as a right of withdrawal, occurs in more than a single year, the value of the taxable transfer will be determined separately for each year.

(5) A disclaimer or renunciation of a general power of appointment is not considered to be a release of the power. The disclaimed or renunciation must be unequivocal and effective under local law. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. There can be no disclaimer or renunciation of a power after its acceptance. In any case where a power is purported to be disclaimed or renounced as to only a portion of the property subject to the power, the determination as to whether or not there has been a complete and unqualified refusal to accept the rights to which one is entitled will depend on all the facts and circumstances of the particular case, taking into account the recognition and effectiveness of such a disclaimer under local law. Such rights refer to the inci-

dents of the power and not to other interests of the possessor of the power in the property. If effective under local law, the power may be disclaimed or renounced without disclaiming or renouncing such other interests. In the absence of facts to the contrary, the failure to renounce or disclaim within a reasonable time after learning of its existence will be presumed to constitute an acceptance of the power.

(d) *Creation of another power in certain cases.*—Paragraph (d) of section 2514 provides that there is a transfer for purposes of the gift tax of the value of property (or of property rights or interests) with respect to which a power of appointment, which is not a general power of appointment, created after October 21, 1942, is exercised by creating another power of appointment which, under the terms of the instruments creating and exercising the first power and under applicable local law, can be validly exercised so as to (1) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of the creation of the first power, or (2) (if the applicable rule against perpetuities is stated in terms of suspension of ownership or of the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power. For the purpose of section 2514(d), the value of the property subject to the second power of appointment is considered to be its value unreduced by any precedent or subsequent interest which is not subject to the second power. Thus, if a donor has a power to appoint $100,000 among a group consisting of his children or grandchildren and during his lifetime exercises the power by making an outright appointment of $75,000 and by giving one appointee a power to appoint $25,000, no more than $25,000 will be considered a gift under section 2514(d). If, however, the donor appoints the income from the entire fund to a beneficiary for life with power in the beneficiary to appoint the remainder, the entire $100,000 will be considered a gift under section 2514(d), if the exercise of the second power can validly postpone the vesting of any estate or interest in the property or can suspend the absolute ownership or power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

(e) *Examples.*—The application of this section may be further illustrated by the following examples in each of which it is assumed, unless otherwise stated, that S has transferred property in trust after October 21, 1942, with the remainder payable to R at L's death, and that neither L nor R has any interest in or power over the enjoyment of the trust property except as is indicated separately in each example:

Example (1). The income is payable to L for life. L has the power to cause the income to be paid to R. The exercise of the right constitutes the making of a transfer of property under section 2511. L's power does not constitute a power of appointment since it is only a power to dispose of his income interest, a right otherwise possessed by him.

Example (2). The income is to be accumulated during L's life. L has the power to have the income distributed to himself. If L's power is limited by an ascertainable standard (relating to health,

etc.) as defined in paragraph (c) (2) of § 25.2514–1, the lapse of such power will not constitute a transfer of property for gift tax purposes. If L's power is not so limited, its lapse or release during L's lifetime may constitute a transfer of property for gift tax purposes. See especially paragraph (c) (4) of § 25.2514–3.

Example (3). The income is to be paid to L for life. L has a power, exercisable at any time, to cause the corpus to be distributed to himself. L has a general power of appointment over the remainder interest, the release of which constitutes a transfer for gift tax purposes of the remainder interest. If in this example L had a power to cause the corpus to be distributed only to X, L would have a power of appointment which is not a general power of appointment, the exercise or release of which would not constitute a transfer of property for purposes of the gift tax.

Example (4). The income is payable to L for life. R has the right to cause the corpus to be distributed to L at any time. R's power is not a power of appointment, but merely a right to dispose of his remainder interest, a right already possessed by him. In such a case, the exercise of the right constitutes the making of a transfer of property under section 2511 of the value, if any, of his remainder interest. See paragraph (e) of § 25.2511–1.

Example (5). The income is to be paid to L. R has the right to appoint the corpus to himself at any time. R's general power of appointment over the corpus includes a general power to dispose of L's income interest therein. The lapse or release of R's general power over the income interest during his life may constitute the making of a transfer of property. See especially paragraph (c) (4) of § 25.2514–3.

§ 25.2515 Statutory Provisions; Tenancies by the Entirety.

SEC. 2515. TENANCIES BY THE ENTIRETY.

(a) Creation.—The creation of a tenancy by the entirety in real property, either by one spouse alone or by both spouses, and additions to the value thereof in the form of improvements, reductions in the indebtedness thereon, or otherwise, shall not be deemed transfers of property for purposes of this chapter, regardless of the proportion of the consideration furnished by each spouse, unless the donor elects to have such creation of a tenancy by the entirety treated as a transfer, as provided in subsection (c).

(b) Termination.—In the case of the termination of a tenancy by the entirety, other than by reason of the death of a spouse, the creation of which, or additions to which, were not deemed to be transfers by reason of subsection (a), a spouse shall be deemed to have made a gift to the extent that the proportion of the total consideration furnished by such spouse multiplied by the proceeds for such termination (whether in form of cash, property, or interests in property) exceeds the value of such proceeds of termination received by such spouse.

(c) Exercise of Election.—The election provided by subsection (a) shall be exercised by including such creation of a tenancy by the entirety or additions made to the value thereof as a transfer by gift, to the extent such transfer constitutes a gift, determined without regard to this section, in the gift tax return of the donor for the calendar year in which such tenancy by the entirety was created or additions made to the value thereof, filed within the time prescribed by law, irrespective of whether or not the gift exceeds the exclusion provided by section 2503(b).

(d) Certain Joint Tenancies Included.—For purposes of this section, the term "tenancy by the entirety" includes a joint tenancy between husband and wife with right of survivorship.

§ 25.2515–1 TENANCIES BY THE ENTIRETY; IN GENERAL.—(a) *Nature of.*—An estate by the entirety in real property is essentially a joint tenancy between husband and wife with the right of survivorship. As used in this section and §§ 25.2515–2 through 25.2515–4, the term "tenancy by the entirety" includes a joint tenancy between husband and wife in real property with right of survivorship, or a tenancy which accords to the spouses rights equivalent thereto regardless of the term by which such a tenancy is described in local property law.

(b) *Gift upon creation of tenancy by the entirety; in general.*—During calendar years prior to 1955 the contribution made by a husband or wife in the creation of a tenancy by the entirety constituted a gift to the extent that the consideration furnished by either spouse exceeded the value of the rights retained by that spouse. The contribution made by either or both spouses in the creation of such a tenancy during the calendar year 1955, or any calendar year thereafter, is not deemed a gift by either spouse, regardless of the proportion of the total consideration furnished by either spouse, unless the donor spouse elects (see § 25.2515–2) under section 2515(c) to treat such transaction as a gift in the calendar year in which the transaction is effected. However, there is a gift upon the termination of such a tenancy, other than by the death of a spouse, if the proceeds received by one spouse on termination of the tenancy are larger than the proceeds allocable to the consideration furnished by that spouse to the tenancy. The creation of a tenancy by the entirety takes place if (1) a husband or his wife purchases property and causes the title thereto to be conveyed to themselves as tenants by the entirety, (2) both join in such a purchase, or (3) either or both cause to be created such a tenancy in property already owned by either or both of them. The rule prescribed herein with respect to the creation of a tenancy by the entirety applies also to contributions made in the making of additions to the value of such a tenancy (in the form of improvements, reductions in the indebtedness, or otherwise), regardless of the proportion of the consideration furnished by each spouse. See § 25.2516–1 for transfers made pursuant to a property settlement agreement incident to divorce.

(c) *Consideration.*—(1) *In general.*—(i) The consideration furnished by a person in the creation of a tenancy by the entirety or the making of additions to the value thereof is the amount contributed by him in connection therewith. The contribution may be made by either spouse or by a third party. It may be furnished in the form of money, other property, or an interest in property. If it is furnished in the form of other property or an interest in property, the amount of the contribution is the fair market value of the property or interest at the time it was transferred to the tenancy or was exchanged for the property which became the subject of the tenancy. For example, if a decedent devised real property to the spouses as tenants by the entirety and the fair market value of the property was $30,000 at the time of the decedent's death, the amount of the decedent's contribution to the creation of the tenancy was $30,000. As another example, assume that in 1950 the husband purchased real property for $25,000, taking it in his own name as sole owner, and that in 1956 when the

property had a fair market value of $40,000 he caused it to be transferred to himself and his wife as tenants by the entirety. Here, the amount of the husband's contribution to the creation of the tenancy was $40,000 (the fair market value of the property at the time it was transferred to the tenancy). Similarly, assume that in 1950 the husband purchased, as sole owner, corporate shares for $25,000 and in 1956, when the shares had a fair market value of $35,000, he exchanged them for real property which was transferred to the husband and his wife as tenants by the entirety. The amount of the husband's contribution to the creation of the tenancy was $35,000 (the fair market value of the shares at the time he exchanged them for the real property which became the subject of the tenancy).

(ii) Whether consideration derived from third-party sources is deemed to have been furnished by a third party or to have been furnished by the spouses will depend upon the terms under which the transfer is made. If a decedent devises real property to the spouses as tenants by the entirety, the decedent, and not the spouses, is the person who furnished the consideration for the creation of the tenancy. Likewise, if a decedent in his will directs his executor to discharge an indebtedness of the tenancy, the decedent, and not the spouses, is the person who furnished the consideration for the addition to the value of the tenancy. However, if the decedent bequeathed a general legacy to the husband and the wife and they used the legacy to discharge an indebtedness of the tenancy, the spouses, and not the decedent, are the persons who furnished the consideration for the addition to the value of the tenancy. The principles set forth in this subdivision with respect to transfers by decedents apply equally well to inter vivos transfers by third parties.

(iii) Where a tenancy is terminated in part (e. g., where a portion of the property subject to the tenancy is sold to a third party, or where the original property is disposed of and in its place there is substituted other property of lesser value acquired through reinvestment under circumstances which satisfy the requirements of paragraph (d)(2)(ii) of this section), the proportionate contribution of each person to the remaining tenancy is in general the same as his proportionate contribution to the original tenancy, and the character of his contribution remains the same. These proportions are applied to the cost of the remaining or substituted property. Thus, if the total contribution to the cost of the property was $20,000 and a fourth of the property was sold, the contribution to the remaining portion of the tenancy is normally $15,000. However, if it is shown that at the time of the contribution more or less than one-fourth thereof was attributable to the portion sold, the contribution is divided between the portion sold and the portion retained in the proper proportion. If the portion sold was acquired as a separate tract, it is treated as a separate tenancy. As another example of the application of this subdivision, assume that in 1950 X (a third party) gave to H and W (H's wife), as tenants by the entirety, real property then having a value of $15,000. In 1955, H spent $5,000 thereon in improvements and under section 2515(c) elected to treat his contribution as a gift. In 1956, W spent $10,000 in improving the property but did not elect to treat her contribution as a gift. Between 1957 and 1960 the prop-

erty appreciated in value by $30,000. In 1960, the property was sold for $60,000, and $45,000 of the proceeds of the sale were, under circumstances that satisfy the requirements of paragraph (d)(2)(ii) of this section, reinvested in other real property. Since X contributed one-half of the total consideration for the original property and the additions to its value, he is considered as having furnished $22,500 (one-half of $45,000) toward the creation of the remaining portion of the tenancy and the making of additions to the value thereof. Similarly, H is considered as having furnished $7,500 (one-sixth of $45,000) which was treated as a gift in the year furnished, and W is considered as having furnished $15,000 (one-third of $45,000) which was not treated as a gift in the year furnished.

(2) *Proportion of consideration attributable to appreciation.*— Any general appreciation (appreciation due to fluctuations in market value) in the value of the property occurring between two successive contribution dates which can readily be measured and which can be determined with reasonable certainty to be allocable to any particular contribution or contributions previously furnished is to be treated, for the purpose of the computations in §§ 25.2515–3 and 25.2515–4, as though it were additional consideration furnished by the person who furnished the prior consideration. Any general depreciation in value is treated in a comparable manner. For the purpose of the first sentence of this subparagraph, successive contribution dates are the two consecutive dates on which any contributions to the tenancy are made, not necessarily by the same party. Further, appreciation allocable to the prior consideration falls in the same class as the prior consideration to which it relates. The application of this subparagraph may be illustrated by the following examples:

Example (1). In 1940, H purchased real property for $15,000 which he caused to be transferred to himself and W (his wife) as tenants by the entirety. In 1956 when the fair market value of the property was $30,000, W made $5,000 improvements to the property. In 1957 the property was sold for $35,000. The general appreciation of $15,000 which occurred between the date of purchase and the date of W's improvements to the property constitutes an additional contribution by H, having the same characteristics as his original contribution of $15,000.

Example (2). In 1955 real property was purchased by H and W and conveyed to them as tenants by the entirety. The purchase price of the property was $15,000 of which H contributed $10,000 and W, $5,000. In 1960 when the fair market value of the property is $21,000, W makes improvements thereto of $5,000. The property then is sold for $26,000. The appreciation in value of $6,000 results in an additional contribution of $4,000 (10,000/15,000 x $6,000) by H, and an additional contribution by W of $2,000 (5,000/15,000 x $6,000). H's total contribution to the tenancy is $14,000 ($10,000+$4,000) and W's total contribution is $12,000 ($5,000+$2,000+$5,000).

Example (3). In 1956 real property was purchased by H and W and conveyed to them as tenants by the entirety. The purchase price of the property was $15,000, on which a down payment of $3,000 was made. The remaining $12,000 was to be paid in monthly installments over a period of 15 years. H furnished $2,000 of the down

payment and W, $1,000. H paid all the monthly installments. During the period 1956 to 1971 the property gradually appreciates in value to $24,000. Here, the appreciation is so gradual and the contributions so numerous that the amount allocable to any particular contribution cannot be ascertained with any reasonable certainty. Accordingly, in such a case the appreciation in value may be disregarded in determining the amount of consideration furnished in making the computations provided for in §§ 25.2515–3 and 25.2515–4.

(d) *Gift upon termination of tenancy by the entirety.*—(1) *In general.*—Upon the termination of the tenancy, whether created before, during, or subsequent to the calendar year 1955, a gift may result, depending upon the disposition made of the proceeds of the termination (whether the proceeds be in the form of cash, property, or interests in property). A gift may result notwithstanding the fact that the contribution of either spouse to the tenancy was treated as a gift. See § 25.2515–3 for the method of determining the amount of any gift which may result from the termination of the tenancy in those cases in which no portion of the consideration contributed was treated as a gift by the spouses in the year in which furnished. See § 25.2515–4 for the method of determining the amount of any gift which may result from the termination of the tenancy in those cases in which all or a portion of the consideration contributed was treated as constituting a gift by the spouses in the year in which furnished. See § 25.2515–2 for the procedure to be followed by a donor who elects under section 2515(c) to treat the creation of a tenancy by the entirety (or the making of additions to its value) as a transfer subject to the gift tax in the year in which the transfer is made, and for the method of determining the amount of the gift.

(2) *Termination.*—(i) *In general.*—Except as indicated in subdivision (ii) of this subparagraph, a termination of a tenancy is effected when all or a portion of the property so held by the spouses is sold, exchanged, or otherwise disposed of, by gift or in any other manner, or when the spouses through any form of conveyance or agreement become tenants in common of the property or otherwise alter the nature of their respective interests in the property formerly held by them as tenants by the entirety. In general, any increase in the indebtedness on a tenancy constitutes a termination of the tenancy to the extent of the increase in the indebtedness. However, such an increase will not constitute a termination of the tenancy to the extent that the increase is offset by additions to the tenancy within a reasonable time after such increase. Such additions (to the extent of the increase in the indebtedness) shall not be treated by the spouses as contributions within the meaning of paragraph (c) of this section.

(ii) *Exchange or reinvestment.*—A termination is not considered as effected to the extent that the property subject to the tenancy is exchanged for other real property, the title to which is held by the spouses in an identical tenancy. For this purpose, a tenancy is considered identical if the proportionate values of the spouses' respective rights (other than any change in the proportionate values resulting solely from the passing of time) are identical to those held in the property which was sold. In addition the sale, exchange, (other than an exchange described above), or other disposition of property

held as tenants by the entirety is not considered as a termination if all three of the following conditions are satisfied:

(*a*) There is no division of the proceeds of the sale, exchange or other disposition of the property held as tenants by the entirety;

(*b*) On or before the due date for the filing of a gift tax return for the calendar year in which the property held as tenants by the entirety was sold, exchanged, or otherwise disposed of, the spouses enter into a binding contract for the purchase of other real property; and

(*c*) After the sale, exchange, or other disposition of the former property and within a reasonable time after the date of the contract referred to in subdivision (*b*), such other real property actually is acquired by the spouses and held by them in an identical tenancy.

To the extent that all three of the conditions set forth in this subdivision are not met (whether by reason of the death of one of the spouses or for any other reason), the provisions of the preceding sentence shall not apply, and the sale, exchange or other disposition of the property will constitute a termination of the tenancy. As used in subdivision (*c*) the expression "a reasonable time" means the time which, under the particular facts in each case, is needed for those matters which are incident to the acquisition of the other property (i.e., perfecting of title, arranging for financing, construction, etc.). The fact that proceeds of a sale are deposited in the name of one tenant or of both tenants separately or jointly as a convenience does not constitute a division within the meaning of subdivision (*a*) if the other requirements of this subdivision are met. The proceeds of a sale, exchange, or other disposition of property held as tenants by the entirety will be deemed to have been used for the purchase of other real property if applied to the purchase or construction of improvements which themselves constitute real property and which are additions to other real property held by the spouses in a tenancy identical to that in which they held the property which was sold, exchanged, or otherwise disposed of.

(3) *Proceeds of termination.*—(i) The proceeds of termination may be received by a spouse in the form of money, property, or an interest in property. Where the proceeds are received in the form of property (other than money) or an interest in property, the value of the proceeds received by that spouse is the fair market value, on the date of termination of the tenancy by the entirety, of the property or interest received. Thus, if a tenancy by the entirety is terminated so that thereafter each spouse owns an undivided half interest in the property as tenant in common, the value of the proceeds of termination received by each spouse is one-half the value of the property at the time of the termination of the tenancy by the entirety. If under local law one spouse without the consent of the other, can bring about a severance of his or her interest in a tenancy by the entirety and does so by making a gift of his or her interest to a third party, that spouse is considered as having received proceeds of termination in the amount of the fair market value, at the time of the termination, of his severable interest determined in accordance with the rules prescribed in § 25.2512–5. He has in addition, made a gift to the third party of the

fair market value of the interest conveyed to the third party. In such a case, the other spouse also is considered as having received as proceeds of termination the fair market value, at the time of termination, of the interest which she thereafter holds in the property as tenant in common with the third party. However, since section 2515(b) contemplates that the spouses may divide the proceeds of termination in some proportion other than that represented by the values of their respective legal interests in the property, if both spouses join together in making a gift to a third party of property held by them as tenants by the entirety, the value of the proceeds of termination which will be treated as received by each is the amount which each reports (on his or her gift tax return filed for the calendar year in which the termination occurs) as the value of his or her gift to the third party. This amount is the amount which each reports without regard to whether the spouses elect under section 2513 to treat the gifts as made one-half by each. For example, assume that H and W (his wife) hold real property as tenants by the entirety; that in 1956, when the property has a fair market value of $60,000, they give it to their son; and that on their gift tax returns for the calendar year 1956, H reports himself as having made a gift to the son of $36,000 and W reports herself as having made a gift to the son of $24,000. Under these circumstances, H is considered as having received proceeds of termination valued at $36,000, and W is considered as having received proceeds of termination valued at $24,000.

(ii) Except as provided otherwise in subparagraph (2) (ii) of this paragraph (under which certain tenancies by the entirety are considered not to be terminated), where the proceeds of a sale, exchange, or other disposition of the property are not actually divided between the spouses but are held (whether in a bank account or otherwise) in their joint names or in the name of one spouse as custodian or trustee for their joint interests, each spouse is presumed, in the absence of a showing to the contrary, to have received, as of the date of termination, proceeds of termination equal in value to the value of his or her enforceable property rights in respect of the proceeds.

§ 25.2515–2 Tenancies by the Entirety; Transfers Treated as Gifts; Manner of Election and Valuation.—(a) The election to treat the creation of a tenancy by the entirety in real property, or additions made to its value, as constituting a gift in the year in which effected, shall be exercised by including the value of such gifts in the gift tax return of the donor for the calendar year in which the tenancy was created, or the additions in value were made to the property. See section 6019 and the regulations thereunder. The election may be exercised only in a return filed within the time prescribed by law, or before the expiration of any extension of time granted pursuant to law for the filing of the return. See section 6075 for the time for filing the gift tax return, and section 6081 for extensions of time for filing the return, together with the regulations thereunder. In order to make the election, a gift tax return must be filed for the calendar year in which the tenancy was created, or additions in value thereto made, even though the value of the gift involved does not exceed the amount of the exclusion provided by section 2503(b).

(b) If the donor spouse exercises the election as provided in paragraph (a) of this section, the amount of the gift at the creation of the tenancy is the amount of his contribution to the tenancy less the value of his retained interest in it, determined as follows:

(1) If under the law of the jurisdiction governing the rights of the spouses, either spouse, acting alone, can bring about a severance of his or her interest in the property, the value of the donor's retained interest is one-half the value of the property.

(2) If, under the law of the jurisdiction governing the rights of the spouses each is entitled to share in the income or other enjoyment of the property but neither, acting alone, may defeat the right of the survivor of them to the whole of the property, the amount of retained interest of the donor is determined by use of the appropriate actuarial factors for the spouses at their respective attained ages at the time the transaction is effected.

(c) Factors representing the respective interests of the spouses, under a tenancy by the entirety, at their attained ages at the time of the transaction may be found in, or readily computed with the use of the tables contained in, the actuarial pamphlet referred to in paragraph (e) of § 25.2512–5. State law may provide that the husband only is entitled to all of the income or other enjoyment of the real property held as tenants by the entirety, and the wife's interest consists only of the right of survivorship with no right of severance. In such a case, a special factor may be needed to determine the value of the interests of the respective spouses. See paragraph (e) of § 25.2512–5 for the procedure for obtaining special factors from the Commissioner in cases requiring their use.

(d) The application of this paragraph may be illustrated by the following example:

Example. A husband with his own funds acquires real property valued at $10,000 and has it conveyed to himself and his wife as tenants by the entirety. Under the law of the jurisdiction governing the rights of the parties, each spouse is entitled to share in the income from the property but neither spouse acting alone could bring about a severance of his or her interest. The husband elects to treat the transfer as a gift in the year in which effected. At the time of transfer, the ages of the husband and wife are 45 and 40, respectively, on their birthdays nearest to the date of transfer. The value of the gift to the wife is $5,502.90, computed as follows:

Value of property transferred	$10,000.00
Less $10,000 x .44971 (factor for value of donor's retained rights)	4,497.10
Value of gift	5,502.90

§ 25.2515–3 Termination of Tenancy by the Entirety; Cases in Which Entire Value of Gift Is Determined Under Section 2515(b).—(a) In any case in which—

(1) The creation of a tenancy by the entirety (including additions in value thereto) was not treated as a gift, and

(2) The entire consideration for the creation of the tenancy, and any additions in value thereto, was furnished solely by the spouses (see paragraph (c)(1)(ii) of § 25.2515–1),

the termination of the tenancy (other than by the death of a spouse) always results in the making of a gift by a spouse who receives a smaller share of the proceeds of the termination (whether received in cash, property or interests in property) than the share of the proceeds attributable to the total consideration furnished by him. See paragraph (c) of § 25.2515–1 for a discussion of what constitutes consideration and the value thereof. Thus, a gift is effected at the time of termination of the tenancy by the spouse receiving less than one-half of the proceeds of termination if such spouse (regardless of age) furnished one-half or more of the total consideration for the purchase and improvements, if any, of the property held in the tenancy. Also, if one spouse furnished the entire consideration, a gift is made by such spouse to the extent that the other spouse receives any portion of the proceeds of termination. See § 25.2515–4 for determination of the amount of the gift, if any, in cases in which the creation of the tenancy was treated as a gift or a portion of the consideration was furnished by a third person. See paragraph (d)(2) of § 25.2515–1 as to the acts which effect a termination of the tenancy.

(b) In computing the value of the gift under the circumstances described in paragraph (a) of this section, it is necessary to first determine the spouse's share of the proceeds attributable to the consideration furnished by him. This share is computed by multiplying the total value of the proceeds of the termination by a fraction, the numerator of which is the total consideration furnished by the donor spouse and the denominator of which is the total consideration furnished by both spouses. From this amount there is subtracted the value of the proceeds of termination received by the donor spouse. The amount remaining is the value of the gift. In arriving at the "total consideration furnished by the donor spouse" and the "total consideration furnished by both spouses", for purposes of the computation provided for in this paragraph, the consideration furnished (see paragraph (c) of § 25.2515–1) is not reduced by any amounts which otherwise would have been excludable under section 2503(b) in determining the amount of taxable gifts for the years in which the consideration was furnished. As an example assume that in 1955, real property was purchased for $30,000, the husband and wife each contributing $12,000 and the remaining $6,000 being obtained through a mortgage on the property. In each of the years 1956 and 1957, the husband paid $3,000 on the principal of the indebtedness, but did not disclose the value of these transfers on his gift tax returns for those years. The total consideration furnished by the husband is $18,000, the total consideration furnished by the wife is $12,000, and the total consideration furnished by both spouses is $30,000.

(c) The application of this section may be illustrated by the following examples:

Example (1). In 1956 the husband furnished $30,000 and his wife furnished $10,000 of the consideration for the purchase and subsequent improvement of real property held by them as tenants by the entirety. The husband did not elect to treat the consideration furnished as a gift. The property later is sold for $60,000, the husband receiving $35,000 and his wife receiving $25,000 of the proceeds of

the termination. The termination of the tenancy results in a gift of $10,000 by the husband to his wife, computed as follows:

$$\frac{\$30{,}000 \text{ (consideration furnished by husband)}}{\$40{,}000 \text{ (total consideration furnished by both spouses)}} \times \$60{,}000 \text{ (proceeds of termination)} = \$45{,}000$$

$45,000—$35,000 (proceeds received by husband=$10,000 gift by husband to wife

Example (2). In 1950 the husband purchased shares of X Company for $10,000. In 1955 when those shares had a fair market value of $30,000, he and his wife purchased real property from A and had it conveyed to them as tenants by the entirety. In payment for the real property, the husband transferred his shares of X Company to A and the wife paid A the sum of $10,000. They later sold the real property for $60,000, divided $24,000 (each taking $12,000) and reinvested the remaining $36,000 in other real property under circumstances that satisfied the conditions set forth in paragraph (d) (2) (ii) of § 25.2515–1. The tenancy was terminated only with respect to the $24,000 divided between them. This termination of the tenancy resulted in a gift of $6,000 by the husband to the wife, computed as follows:

$$\frac{\$30{,}000 \text{ (consideration furnished by husband)}}{\$40{,}000 \text{ (total consideration furnished by both spouses)}} \times \$24{,}000 \text{ (proceeds of termination)} = \$18{,}000$$

$18,000—$12,000 (proceeds received by husband) = $6,000 gift by husband to wife.

Since the tenancy was terminated only in part, with respect to the remaining portion of the tenancy each spouse is considered as having furnished that proportion of the total consideration for the remaining portion of the tenancy as the consideration furnished by him before the sale bears to the total consideration furnished by both spouses before the sale. See paragraph (c) of § 25.2515–1. The consideration furnished by the husband for the reduced tenancy is $27,000, computed as follows:

$$\frac{\$30{,}000 \text{ (consideration furnished by husband before sale)}}{\$40{,}000 \text{ (total consideration furnished by both spouses before sale)}} \times \$36{,}000 \text{ (consideration for reduced tenancy)} = \$27{,}000$$

The consideration furnished by the wife is $9,000, computed in a similar manner.

§ 25.2515–4 Termination of Tenancy by Entirety; Cases in Which None, or a Portion Only, of a Value of Gift Is Determined Under Section 2515(b).—(a) *In general.*—The rules provided in section 2515(b) (see § 25.2515–3) are not applied in determining whether a gift has been made at the termination of a tenancy to the extent that the consideration furnished for the creation of the tenancy was treated as a gift or if the consideration for

the creation of the tenancy was furnished by a third party. Consideration furnished for the creation of the tenancy was treated as a gift if it was furnished either (1) during calendar years prior to 1955, or (2) during the calendar year 1955 and subsequent years and the donor spouse exercised the election to treat the furnishing of consideration as a gift. See paragraph (b) of this section for the manner of computing the value of gifts resulting from the termination of the tenancy under these circumstances. See paragraph (c) of this section for the rules to be applied where part of the total consideration for the creation of the tenancy and additions to the value thereof was not treated as a gift and part either was treated as a gift or was furnished by a third party.

(b) *Value of gift when entire consideration is of the type described in paragraph (a) of this section.*—If the entire consideration for the creation of a tenancy by the entirety was treated as a gift or contributed by a third party, the determination of the amount, if any, of a gift made at the termination of the tenancy will be made by the application of the general principles set forth in § 25.2511–1. Under those principles, when a spouse surrenders a property interest in a tenancy, the creation of which was treated as a gift, and in return receives an amount (whether in the form of cash, property, or an interest in property) less than the value of the property interest surrendered, that spouse is deemed to have made a gift in an amount equal to the difference between the value, at the time of termination, of the property interest surrendered by such spouse and the amount received in exchange. Thus, if the husband's interest in such a tenancy at the time of termination is worth $44,971 and the wife's interest therein at the time is worth $55,029, the property is sold for $100,000, and each spouse receives $50,000 out of the proceeds of the sale, the wife has made a gift to the husband of $5,029. The principles applied in paragraph (c) of § 25.2515–2 for the method of determining the value of the respective interests of the spouses at the time of the creation of a tenancy by the entirety are equally applicable in determining the value of each spouse's interest in the tenancy at termination, except that the actuarial factors to be applied are those for the respective spouses at the ages attained at the date of termination.

(c) *Valuation of gift where both types of consideration are involved.*—If the consideration furnished consists in part of the type described in paragraph (a) of § 25.2515–3 (consideration furnished by the spouses after 1954, and not treated as a gift in the year furnished) and in part of the type described in paragraph (a) of this section (consideration furnished by the spouses and treated as a gift or furnished by a third party), the amount of the gift is determined as follows:

(1) By applying the principles set forth in paragraph (b) of § 25.2515–3 to that portion of the total proceeds of termination which the consideration described in paragraph (a) of § 25.2513–3 bears to the total consideration furnished;

(2) By applying the principles set forth in paragraph (b) of this section to the remaining portion of the total proceeds of termination; and

(3) By subtracting the proceeds of termination received by the donor from the total of the amounts which under the principles referred to in subparagraphs (1) and (2) of this paragraph are to be compared with the proceeds of termination received by a spouse in determining whether a gift was made by that spouse.

For example assume that consideration of $30,000 was furnished by the husband in 1954. Assume also that on February 1, 1955, the husband contributed $12,000 and the wife $8,000, the husband's contribution not being treated as a gift (see paragraph (b) of § 25.2515–1). Assume further that between 1957 and 1965 the property appreciated in value by $40,000 and was sold in 1965 for $90,000 (of which the husband received $40,000 and the wife $50,000). The principles set forth in paragraph (b) of § 25.2515–3 are applied to $36,000 (20,000/50,000 x $90,000) in arriving at the amount which is compared with the proceeds of termination received by a spouse. Applying the principles set forth in paragraph (b) of § 25.2515–3, this amount in the case of the husband is $21,600 (12,000/20,000 x $36,000). Similarly, the principles set forth in paragraph (b) of this section are applied to $54,000 ($90,000 – 36,000), the remaining portion of the proceeds of termination, in arriving at the amount which is compared with the proceeds of termination received by a spouse. If in this case either spouse, without the consent of the other spouse, can bring about a severance of his interest in the tenancy, the amount determined under paragraph (b) of this section in the case of the husband would be $27,000 (½ of $54,000). The total of the two amounts which are to be compared with the proceeds of termination received by the husband is $48,600 ($21,600 – 27,000). This sum of $48,600 is then compared with the $40,000 proceeds received by the husband, and the termination of the tenancy has resulted, for gift tax purposes, in a transfer of $8,600 by the husband to his wife in 1965. See paragraph (d) of this section for an additional example illustrating the application of this paragraph.

(d) The application of paragraph (c) of this section may further be illustrated by the following example:

Example. X died in 1948 and devised real property to Y and Z (Y's wife) as tenants by the entirety. Under the law of the jurisdiction, both spouses are entitled to share equally in the income from, or the enjoyment of, the property, but neither spouse, acting alone, may defeat the right of the survivor of them to the whole of the property. The fair market value of the property at the time of X's death was $100,000 and this amount is the consideration which X furnished toward the creation of the tenancy. In 1955, at which time the fair market value of the property was the same as at the time of X's death, improvements of $50,000 were made to the property, of which Y furnished $40,000 out of his own funds and Z furnished $10,000 out of her own funds. Y did not elect to treat his transfer to the tenancy as resulting in the making of a gift in 1955. In 1956 the property was sold for $300,000 and Y and Z each received $150,000 of the proceeds. At the time the property was sold Y and Z were 45 and 40 years of age, respectively, on their birthdays nearest the date of sale. The value of the gift made by Y to Z is $19,942, computed as follows:

Amount determined under principles set forth in § 25.2515–3:

$$\frac{\$50{,}000 \text{ (consideration not treated as gift in year furnished)}}{\$150{,}000 \text{ (total consideration furnished)}} \times \$300{,}000 \text{ (proceeds of termination)} =$$

$100,000 (proceeds of termination to which principles set forth in § 25.2515–3 apply)

$$\frac{\$40{,}000 \text{ (consideration furnished by H and not treated as gift)}}{\$50{,}000 \text{ (total consideration not treated as gift)}} \times \$100{,}000 = \$80{,}000$$

Amount determined under principles set forth in paragraph (b) of this section:

$300,000 (total proceeds of termination) —$100,000 (proceeds to which principles set forth in § 25.2515–3 apply) =

$200,000 (proceeds to which principles set forth in paragraph (b) apply)

.44971 (factor for Y's interest) × $200,000 = $89,942

Amount of gift

Amount determined under § 25.2515–3	$80,000
Amount determined under paragraph (b)	89,942
Total	169,942
Less: Proceeds received by Y	150,000
Amount of gift made by Y to Z	19,942

§ 25.2516 STATUTORY PROVISIONS; CERTAIN PROPERTY SETTLEMENTS.

SEC. 2516. CERTAIN PROPERTY SETTLEMENTS.

Where husband and wife enter into a written agreement relative to their marital and property rights and divorce occurs within 2 years thereafter (whether or not such agreement is approved by the divorce decree), any transfers of property or interests in property made pursuant to such agreement—

(1) To either spouse in settlement of his or her marital or property rights, or

(2) To provide a reasonable allowance for the support of issue of the marriage during minority,

shall be deemed to be transfers made for a full and adequate consideration in money or money's worth.

§ 25.2516–1 CERTAIN PROPERTY SETTLEMENTS.—(a) Section 2516 provides that transfers of property or interests in property made under the terms of a written agreement between spouses in settlement of their marital or property rights are deemed to be for an adequate and full consideration in money or money's worth and, therefore, exempt from the gift tax (whether or not such agreement is approved by a divorce decree), if the spouses obtain a final decree of divorce from each other within two years after entering into the agreement.

(b) See paragraph (b) of § 25.6019–3 for the circumstances under which information relating to property settlements must be disclosed on the transferor's gift tax return for the calendar year in which the agreement becomes effective.

§ 25.2516–2 TRANSFERS IN SETTLEMENT OF SUPPORT OBLIGATIONS.—Transfers to provide a reasonable allowance for the support of children (including legally adopted children) of a marriage during minority

are not subject to the gift tax if made pursuant to an agreement which satisfies the requirements of section 2516.

DEDUCTIONS

§ 25.2521 STATUTORY PROVISIONS; SPECIFIC EXEMPTION.

SEC. 2521. SPECIFIC EXEMPTION.

In computing taxable gifts for the calendar year, there shall be allowed a deduction in the case of a citizen or resident an exemption of $30,000, less the aggregate of the amounts claimed and allowed as specific exemption in the computation of gift taxes for the calendar year 1932 and all calendar years intervening between that calendar year and the calendar year for which the tax is being computed under the laws applicable to such years.

§ 25.2521–1 SPECIFIC EXEMPTION.—(a) In determining the amount of taxable gifts for the calendar year there may be deducted, if the donor was a resident or citizen of the United States at the time the gifts were made, a specific exemption of $30,000, less the sum of the amounts claimed and allowed as an exemption in prior calendar years. The exemption, at the option of the donor, may be taken in the full amount of $30,000 in a single calendar year, or be spread over a period of years in such amounts as the donor sees fit, but after the limit has been reached no further exemption is allowable. Except as otherwise provided in a tax convention between the United States and another country, a donor who was a nonresident not a citizen of the United States at the time the gift or gifts were made is not entitled to this exemption.

(b) No part of a donor's lifetime specific exemption of $30,000 may be deducted from the value of a gift attributable to his spouse where a husband and wife consent, under the provisions of section 2513, to have the gifts made during a calendar year considered as made one-half by each of them. The "gift-splitting" provisions of section 2513 do not authorize the filing of a joint gift tax return nor permit a donor to claim any of his spouse's specific exemption. For example, if a husband has no specific exemption remaining available, but his wife does, and the husband makes a gift to which his wife consents under the provisions of section 2513, the specific exemption remaining available may be claimed only on the return of the wife with respect to one half of the gift. The husband may not claim any specific exemption since he has none available.

(c) The amount by which the specific exemption claimed and allowed in gift tax returns for prior calendar years exceeds $30,000 is includible in determining the aggregate sum of the taxable gifts for preceding calendar years. See paragraph (b) of § 25.2504–1.

§ 25.2522(a) STATUTORY PROVISIONS; CHARITABLE AND SIMILAR GIFTS; CITIZENS OR RESIDENTS.

SEC. 2522. CHARITABLE AND SIMILAR GIFTS.

(a) CITIZENS OR RESIDENTS.—In computing taxable gifts for the calendar year, there shall be allowed as a deduction in the case of a citizen or resident the amount of all gifts made during such year to or for the use of—

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

(2) A corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and 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, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) A fraternal society, order, or association, operating under the lodge system, but only if such gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals;

(4) Posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual.

§ 25.2522(a)-1 CHARITABLE AND SIMILAR GIFTS; CITIZENS OR RESIDENTS.—(a) In determining the amount of taxable gifts for the calendar year there may be deducted, in the case of a donor who was a citizen or resident of the United States at the time the gifts were made, all gifts included in the "total amount of gifts" made by the donor during the taxable year (see section 2503 and the regulations thereunder) and made to or for the use of:

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

(2) Any corporation, trust, community chest, fund or foundation organized and operated exclusively for religious, charitable scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, if no part of the net earnings of the organization inures to the benefit of any private shareholder or individual, and no substantial part of its activities is carrying on propaganda, or otherwise attempting, to influence legislation.

(3) A fraternal society, order, or association, operating under the lodge system, provided the gifts are to be used by the society, order or association exclusively for one or more of the purposes set forth in subparagraph (2) of this paragraph.

(4) Any post or organization of war veterans or auxiliary unit or society thereof, if organized in the United States or any of its possessions, and if no part of its net earnings inures to the benefit of any private shareholder or individual.

The deduction is not limited to gifts for use within the United States, or to gifts to or for the use of domestic corporations, trusts, community chests, funds or foundations, or fraternal societies, orders or associations operating under the lodge system. For the deductions for charitable and similar gifts made by a nonresident who was not a citizen of the United States at the time the gifts were made, see § 25.2522(b)-1.

(b) The deduction under section 2522 is not allowed for a transfer to a corporation, trust, community chest, fund or foundation unless the organization or trust meets the following three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes.

(2) It must not by a substantial part of its activities attempt to influence legislation by propaganda or otherwise.

(3) Its net earnings must not inure in whole or in part to the benefit of private shareholders or individuals other than as legitimate objects of the exempt purposes.

For further limitations see § 25.2522(c)-1, relating to gifts to trusts and organizations which have engaged in a prohibited transaction described in section 681(b)(2) or section 503(c).

(c) In order to prove the right to the charitable, etc., deduction provided by section 2522 the donor must submit such data as may be requested by the district director. As to the extent the deductions provided by this section are allowable, see section 2524.

§ 25.2522(a)-2. TRANSFERS NOT EXCLUSIVELY FOR CHARITABLE, ETC., PURPOSES.—(a) *Remainders and similar interests.*—If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The present value of a remainder or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in § 25.2512-5. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor from column 4 of Table I or II of § 25.2512-5, whichever is applicable. If the interest involved is such that its value is to be determined by a special computation (see paragraph (e) of § 25.2512-5), a request for a specific factor accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments may be submitted by the donor to the Commissioner, who may, if conditions permit, supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph of § 25.2512-5.

(b) *Transfers subject to a condition or a power.*—If, as of the date of the gift, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest passes to or is vested in charity on the date of the gift and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable on the date of the gift, the deduction is allowable. If the donee or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so given by the donor, the deduction will be limited to that portion of the property or fund which is exempt from the exercise of

the power. The deduction is not allowed in the case of a transfer in trust conveying to charity a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust by the donor consist of stock in a corporation, the fiscal policies of which are controlled by the donor and his family, that the trustees and remaindermen are likewise members of the donor's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed. Similarly, if the trustees are not members of the donor's family but have no power to sell or otherwise dispose of closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction will be allowed.

§ 25.2522(b) STATUTORY PROVISIONS; CHARITABLE AND SIMILAR GIFTS; NONRESIDENTS.

SEC. 2522. CHARITABLE AND SIMILAR GIFTS. * * *

(b) NONRESIDENTS.—In the case of a nonresident not a citizen of the United States, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of—

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

(2) A domestic corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and 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, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) A trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation; but only if such gifts are to be used within the United States exclusively for such purposes;

(4) A fraternal society, order, or association, operating under the lodge system, but only if such gifts are to be used within the United States exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals;

(5) Posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual.

§ 25.2522(b)-1 CHARITABLE AND SIMILAR GIFTS; NONRESIDENTS NOT CITIZENS.—(a) The deduction for charitable and similar gifts, in the case of a nonresident who was not a citizen of the United States at the time he made the gifts is governed by the same rules as those applying to gifts by citizens or residents, subject, however, to the following exceptions:

(1) If the gifts are made to or for the use of a corporation, the corporation must be one created or organized under the laws of the United States or of any State or Territory thereof.

(2) If the gifts are made to or for the use of a trust, community chest, fund or foundation, or a fraternal society, order or association

operating under the lodge system, the gifts must be for use within the United States exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals.

§ 25.2522(c) STATUTORY PROVISIONS; CHARITABLE AND SIMILAR GIFTS; DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.

SEC. 2522. CHARITABLE AND SIMILAR GIFTS. * * *

(c) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—For disallowance of certain charitable, etc., deductions otherwise allowable under this section, see sections 504 and 681.

§ 25.2522(c)-1 DISALLOWANCE OF CHARITABLE, ETC., DEDUCTIONS BECAUSE OF PROHIBITED TRANSACTIONS.—(a) Sections 503(e) and 681(b)(5) provide that no deduction which would otherwise be allowable under section 2522 for a gift for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, is allowed if—

(1) The gift is made in trust and, for income tax purposes for the taxable year of the trust in which the gift is made, the deduction otherwise allowable to the trust under section 642(c) is limited by section 681(b)(1) by reason of the trust having engaged in a prohibited transaction described in section 681(b)(2); or

(2) The gift is made to any corporation, community chest, fund or foundation which, for its taxable year in which the gift is made, is not exempt from income tax under section 501(a) by reason of having engaged in a prohibited transaction described in section 503(c).

(b) For purposes of section 503(e) and section 681(b)(5), the term "gift" includes any gift, contribution, or transfer without adequate consideration.

(c) Regulations relating to the income tax contain the rules for the determination of the taxable year of the trust for which the deduction under section 642(c) is limited by section 681(b), and for the determination of the taxable year of the organization for which an exemption is denied under section 503(a). Generally, such taxable year is a taxable year subsequent to the taxable year during which the trust or organization has been notified by the Internal Revenue Service that it has engaged in a prohibited transaction. However, if the trust or organization during or prior to the taxable year entered into the prohibited transaction for the purpose of diverting its corpus or income from the charitable or other purposes by reason of which it is entitled to a deduction or exemption, and the transaction involves a substantial part of such income or corpus, then the deduction of the trust under section 642(c) for such taxable year is limited by section 681(b), or the exemption of the organization for such taxable year is denied under section 503(a), whether or not the organization has previously received notification by the Internal Revenue Service that it has engaged in a prohibited transaction. In certain cases, the limitation of section 503 or 681 may be removed or the exemption may be reinstated for certain subsequent taxable years under the rules set forth in the income tax regulations under sections 503 and 681.

(d) In cases in which prior notification by the Internal Revenue Service is not required in order to limit the deduction of the trust under section 681(b), or to deny exemption of the organization under

section 503, the deduction otherwise allowable under § 25.2522(a)-1 is not disallowed with respect to gifts made during the same taxable year of the trust or organization in which a prohibited transaction occurred, or in a prior taxable year, unless the donor or a member of his family was a party to the prohibited transaction. For purposes of the preceding sentence, the members of the donor's family include only his brothers and sisters (whether by whole or half blood), spouse, ancestors, and lineal descendants.

§ 25.2522(d) STATUTORY PROVISIONS; CHARITABLE AND SIMILAR GIFTS; OTHER CROSS REFERENCES.

SEC. 2522. CHARITABLE AND SIMILAR GIFTS. * * *

(d) OTHER CROSS REFERENCES.

(1) For exemption of gifts to or for benefit of Library of Congress, see section 5 of the Act of March 3, 1925, as amended (56 Stat. 765; 2 U. S. C. 161).

(2) For construction of gifts for benefit of Library of Post Office Department as gifts to or for the use of the United States, see section 2 of the Act of August 8, 1946 (60 Stat. 924; 5 U. S. C. 393).

(3) For exemption of gifts for benefit of Office of Naval Records and Library, Navy Department, see section 2 of the Act of March 4, 1937 (50 Stat. 25; 5 U. S. C. 419b).

(4) For exemption of gifts to or for benefit of National Park Service, see section 5 of the Act of July 10, 1935 (49 Stat. 478; 16 U. S. C. 19c).

(5) For construction of gifts accepted by the Secretary of State under the Foreign Service Act of 1946 as gifts to or for the use of the United States, see section 1021(e) of that Act (60 Stat. 1032; 22 U. S. C. 809).

(6) For construction of gifts or bequests of money accepted by the Attorney General for credit to "Commissary Funds, Federal Prisons" as gifts or bequests to or for the use of the United States, see section 2 of the Act of May 15, 1952, 66 Stat. 73, as amended by the Act of July 9, 1952, 66 Stat. 479 (31 U. S. C. 725s–4).

(7) For payment of tax on gifts of United States obligations to the United States, see section 24 of the Second Liberty Bond Act, as amended (59 Stat. 48, § 4; 31 U. S. C. 757e).

(8) For construction of gifts for benefit of or use in connection with Naval Academy as gifts to or for the use of the United States, see section 3 of the Act of March 31, 1944 (58 Stat. 135; 34 U. S. C. 1115b).

(9) For exemption of gifts for benefit of Naval Academy Museum, see section 4 of the Act of March 26, 1938 (52 Stat. 119; 34 U. S. C. 1119).

(10) For exemption of gifts received by National Archives Trust Fund Board, see section 7 of the National Archives Trust Fund Board Act (55 Stat. 582; 44 U. S. C. 300gg).

§ 25.2523(a) STATUTORY PROVISIONS; GIFT TO SPOUSE; IN GENERAL.

SEC. 2523. GIFT TO SPOUSE.

(a) IN GENERAL.—Where a donor who is a citizen or resident transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to one-half of its value.

§ 25.2523(a)-1 GIFT TO SPOUSE; IN GENERAL.—(a) *In general.*—In determining the amount of taxable gifts for the calendar year 1955 or any calendar year thereafter, in the case of a donor who was a citizen or resident of the United States at the time the gift was made, there may be deducted an amount equal to one-half the value of any

property interest (except as otherwise provided in paragraph (b) of this section) transferred by gift to a donee who at the time of the gift was the donor's spouse. This deduction is referred to as the "marital deduction." No marital deduction is authorized with respect to a gift if the donor, at the time of the gift, was a nonresident not a citizen of the United States. However, if the donor was a citizen or resident of the United States at the time the gift was made, he is not deprived of the right to the marital deduction by reason of the fact that his spouse was a nonresident not a citizen. For convenience the donor's spouse is generally referred to in the feminine gender, but if the donor is a woman the reference is to her husband. The donor must submit such proof as is necessary to establish the right to the marital deduction, including any evidence requested by the district director.

(b) "*Deductible interests*" *and* "*nondeductible interests.*"—The property interests transferred by a donor to his spouse fall within two general categories: (1) those with respect to which the marital deduction is authorized, and (2) those with respect to which the deduction is not authorized. These categories are referred to in this section and §§ 25.2523(b)–1 through 25.2523(f)–1 as "deductible interests" and "nondeductible interests," respectively (see subdivision (ii) of this paragraph). Subject to the limitations set forth in §§ 25.2523(f)–1 (relating to gifts of community property) and 25.2524–1 (relating to cases in which the total value of the gifts made to the donee spouse in any one year is less than $6,000), the marital deduction is equal to one-half of the aggregate value of the "deductible interests." A property interest transferred by a donor to his spouse is a "deductible interest" if it does not fall within one of the two following classes of "nondeductible interests":

(i) A property interest transferred by a donor to his spouse which is a "terminable interest", as defined in § 25.2523(b)–1, is a "nondeductible interest" to the extent specified in that section.

(ii) Any property interest transferred by a donor to his spouse is a "nondeductible interest" to the extent that it is not included in the total amount of gifts made during the calendar year. See §§ 25.2515–1 (relating to tenancies by the entirety) and 25.2516–1 (relating to property settlements, followed by divorce) for some, but not necessarily all, of the situations in which property is transferred by a donor to his spouse and not included in the total amount of gifts made during the calendar year. If the total gifts made by a donor to his spouse during a calendar year have a value of $6,000 or more the amount of the marital deduction is determined without regard to the amount of the exclusion, if any, allowable. For example, assume that in 1955 a donor made a cash gift of $10,000 to his wife. No other gifts were made by the donor in 1955. The amount of the marital deduction is one-half of $10,000, or $5,000; the amount of the exclusion is $3,000; and the total amount of included gifts is $2,000. See § 25.2524–1 with respect to the amount of the marital deduction allowable where the total gifts made in a calendar year by a donor to his spouse have a value of less than $6,000.

(c) *Valuation.*—If the income from property is made payable to the donor or another individual for life, or for a term of years, with

remainder absolutely to the donor's spouse or to her estate, the marital deduction is equal to one-half the present value of the remainder. The present value of the remainder (that is, its value as of the date of gift) is to be determined in accordance with the rules stated in § 25.2512–5. For example, if the donor's spouse is to receive $50,000 upon the death of a person 31 years of age, the present value of the remainder is $14,466. See the example in paragraph (d) of § 25.2512–5. If the remainder is such that its value is to be determined by a special computation (see § 25.2512–5), a request for a specific factor, accompanied by a statement of the dates of birth of each person, the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments may be submitted by the donor to the Commissioner who, if conditions permit, may supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value, made in accordance with the principles set forth in § 25.2512–5.

§ 25.2523(b) STATUTORY PROVISIONS; GIFT TO SPOUSE; LIFE ESTATE OR OTHER TERMINABLE INTEREST.

SEC. 2523. GIFT TO SPOUSE. * * *

(b) LIFE ESTATE OR OTHER TERMINABLE INTEREST.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

(1) If the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor (or his heirs or assigns) or such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse; or

(2) If the donor immediately after the transfer to the donee spouse has a power to appoint an interest in such property which he can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For purposes of this paragraph, the donor shall be considered as having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or on the failure of an event or contingency to occur.

An exercise or release at any time by the donor, either alone or in conjunction with any person, of a power to appoint an interest in property, even though not otherwise a transfer, shall, for purposes of paragraph (1), be considered as a transfer by him. Except as provided in subsection (e), where at the time of the transfer it is impossible to ascertain the particular person or persons who may receive from the donor an interest in property so transferred by him, such interest shall, for purposes of paragraph (1), be considered as transferred to a person other than the donee spouse.

§ 25.2523(b)–1 LIFE ESTATE OR OTHER TERMINABLE INTEREST.—(a) *In general.*—(1) The provisions of section 2523(b) generally prevent the allowance of the marital deduction with respect to certain property interests (referred to generally as "terminable interests," defined in subparagraph (3) of this paragraph), transferred to the

donee spouse under the circumstances described in subparagraph (2) of this paragraph, unless the transfer comes with one of the exceptions set forth in § 25.2523(d)–1, relating to certain joint interests, or § 25.2523(e)–1, relating to certain life estates with powers of appointment.

(2) If a donor transfers a terminable interest in property to the donee spouse, the marital deduction is disallowed with respect to the transfer if the donor spouse also—

(i) Transferred an interest in the same property to another donee (see paragraph (b) of this section), or

(ii) Retained an interest in the same property in himself (see paragraph (c) of this section), or

(iii) Retained a power to appoint an interest in the same property (see paragraph (d) of this section).

Notwithstanding the preceding sentence, the marital deduction is disallowed under these circumstances only if the other donee, the donor, or the possible appointee, may, by reason of the transfer or retention, possess or enjoy any part of the property after the termination or failure of the interest therein transferred to the donee spouse.

(3) For purposes of this section, a distinction is to be drawn between "property," as such term is used in section 2523, and an "interest in property." The "property" referred to is the underlying property in which various interests exist; each such interest is not, for this purpose, to be considered as "property." A "terminable interest" in property is an interest which will terminate or fail on the lapse of time or on the occurrence or failure to occur of some contingency. Life estates, terms for years, annuities, patents, and copyrights are therefore terminable interests. However, a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity or term for years, is not a terminable interest.

(b) *Interest in property which another donee may possess or enjoy.*—(1) Section 2523(b) provides that no marital deduction shall be allowed with respect to the transfer to the donee spouse of a "terminable interest" in property, in case—

(i) The donor transferred (for less than adequate and full consideration in money or money's worth) an interest in the same property to any person other than the donee spouse (or the estate of such spouse), and

(ii) By reason of such transfer, such person (or his heirs or assigns) may possess or enjoy any part of such property after the termination or failure of the interest therein transferred to the donee spouse.

(2) In determining whether the donor transferred an interest in property to any person other than the donee spouse, it is immaterial whether the transfer to the person other than the donee spouse was made at the same time as the transfer to such spouse, or at any earlier time.

(3) Except as provided in § 25.2523(e)–1, if at the time of the transfer it is impossible to ascertain the particular person or persons who may receive a property interest transferred by the donor, such interest is considered as transferred to a person other than the donee spouse for the purpose of section 2523(b). This rule is particularly

applicable in the case of the transfer of a property interest by the donor subject to a reserved power. See § 25.2511–2. Under this rule, any property interest over which the donor reserved a power to revest the beneficial title in himself, or over which the donor reserved the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves, is for the purpose of section 2523(b), considered as transferred to a "person other than the donee spouse." The following examples illustrate the application of the provisions of this subparagraph:

(i) If a donor transferred property in trust naming his wife as the irrevocable income beneficiary for 10 years, and providing that, upon the expiration of that term, the corpus should be distributed among his wife and children in such proportions as the trustee should determine, the right to the corpus, for the purpose of the marital deduction, is considered as transferred to a "person other than the donee spouse."

(ii) If, in the above example, the donor had provided that, upon the expiration of the 10-year term, the corpus was to be paid to his wife, but also reserved the power to revest such corpus in himself, the right to corpus, for the purpose of the marital deduction, is considered as transferred to a "person other than the donee spouse."

(4) The term "person other than the donee spouse" includes the possible unascertained takers of a property interest, as, for example, the members of a class to be ascertained in the future. As another example, assume that the donor created a power of appointment over a property interest, which does not come within the purview of § 25.2523(e)–1. In such a case, the term "person other than the donee spouse" refers to the possible appointees and takers in default (other than the spouse) of such property interest.

(5) An exercise or release at any time by the donor (either alone or in conjunction with any person) of a power to appoint an interest in property, even though not otherwise a transfer by him is considered as a transfer by him in determining, for the purpose of section 2523(b), whether he transferred an interest in such property to a person other than the donee spouse.

(6) The following examples illustrate the application of this paragraph. In each example it is assumed that the property interest which the donor transferred to a person other than the donee spouse was not transferred for an adequate and full consideration in money or money's worth:

(i) H (the donor) transferred real property to W (his wife) for life, with remainder to A and his heirs. No marital deduction may be taken with respect to the interest transferred to W, since it will terminate upon her death and A (or his heirs or assigns) will thereafter possess or enjoy the property.

(ii) H transferred property for the benefit of W and A. The income was payable to W for life and upon her death the principal was to be distributed to A or his issue. However, if A should die without issue, leaving W surviving, the principal was then to be distributed to W. No marital deduction may be taken with respect to the interest transferred to W, since it will terminate in the event of her death if A or his issue survive, and A or his issue will thereafter possess or enjoy the property.

(iii) H purchased for $100,000 a life annuity for W. If the annuity payments made during the life of W should be less than $100,000, further payments were to be made to A. No marital deduction may be taken with respect to the interest transferred to W, since A may possess or enjoy a part of the property following the termination of W's interest. If, however, the contract provided for no continuation of payments, and provided for no refund upon the death of W, or provided that any refund was to go to the estate of W, then a marital deduction may be taken with respect to the gift.

(iv) H transferred property to A for life with remainder to W provided W survives A, but if W predeceases A, the property is to pass to B and his heirs. No marital deduction may be taken with respect to the interest transferred to W.

(v) H transferred real property to A, reserving the right to the rentals of the property for a term of 20 years. H later transferred the right to the remaining rentals to W. No marital deduction may be taken with respect to the interest since it will terminate upon the expiration of the balance of the 20-year term and A will thereafter possess or enjoy the property.

(vi) H transferred a patent to W and A as tenants in common. In this case, the interest of W will terminate upon the expiration of the term of the patent, but possession and enjoyment of the property by A must necessarily cease at the same time. Therefore, since A's possession or enjoyment cannot outlast the termination of W's interest, the provisions of section 2523(b) do not disallow the marital deduction with respect to the interest.

(c) *Interest in property which the donor may possess or enjoy.*— (1) Section 2523(b) provides that no marital deduction is allowed with respect to the transfer to the donee spouse of a "terminable interest" in property, if—

(i) The donor retained in himself an interest in the same property, and

(ii) By reason of such retention, the donor (or his heirs or assigns) may possess or enjoy any part of the property after the termination or failure of the interest transferred to the donee spouse. However, as to a transfer to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, see § 25.2523(d)–1.

(2) In general, the principles illustrated by the examples under paragraph (b) of this section are applicable in determing whether the marital deduction may be taken with respect to a property interest transferred to the donee spouse subject to the retention by the donor of an interest in the same property. The application of this paragraph may be further illustrated by the following example:

Example. The donor purchased three annuity contracts for the benefit of his wife and himself. The first contract provided for payments to the wife for life, with refund to the donor in case the aggregate payments made to the wife were less than the cost of the contract. The second contract provided for payments to the donor for life, and then to the wife for life if she survived the donor. The third contract provided for payments to the donor and his wife for their joint lives and then to the survivor of them for life. No marital deduction may be taken with respect to the gifts resulting from the

purchases of the contracts since, in the case of each contract, the donor may possess or enjoy a part of the property after the termination or failure of the interest transferred to the wife.

(d) *Interest in property over which the donor retained a power to appoint.*—(1) Section 2523(b) provides that no marital deduction is allowed with respect to the transfer to the donee spouse of a "terminable interest" in property if—

(i) The donor had, immediately after the transfer, a power to appoint an interest in the same property, and

(ii) The donor's power was exercisable (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of the property after the termination or failure of the interest transferred to the donee spouse.

(2) For the purposes of section 2523(b), the donor is to be considered as having, immediately after the transfer to the donee spouse, such a power to appoint even though the power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur. It is immaterial whether the power retained by the donor was a taxable power of appointment under section 2514.

(3) The principles illustrated by the examples under paragraph (b) of this section are generally applicable in determining whether the marital deduction may be taken with respect to a property interest transferred to the donee spouse subject to retention by the donor of a power to appoint an interest in the same property. The application of this paragraph may be further illustrated by the following example:

Example. The donor, having a power of appointment over certain property, appointed a life estate to his spouse. No marital deduction may be taken with respect to such transfer, since if the retained power to appoint the remainder interest is exercised, the appointee thereunder may possess or enjoy the property after the termination or failure of the interest taken by the donee spouse.

§ 25.2523(c) STATUTORY PROVISIONS; GIFT TO SPOUSE; INTEREST IN UNIDENTIFIED ASSETS.

SEC. 2523. GIFT TO SPOUSE. * * *

(c) INTEREST IN UNIDENTIFIED ASSETS.—Where the assets out of which, or the proceeds of which, the interest transferred to the donee spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets were transferred from the donor to such spouse, then the value of the interest transferred to such spouse shall, for purposes of subsection (a), be reduced by the aggregate value of such particular assets.

§ 25.2523(c)–1 INTEREST IN UNIDENTIFIED ASSETS.—(a) Section 2523(c) provides that if an interest passing to a donee spouse may be satisfied out of a group of assets (or their proceeds) which include a particular asset that would be a nondeductible interest if it passed from the donor to his spouse, the value of the interest passing to the spouse is reduced, for the purpose of the marital deduction, by the value of the particular asset.

(b) In order for this section to apply, two circumstances must coexist, as follows:

(1) The property interest transferred to the donee spouse must be payable out of a group of assets. An example of a property interest payable out of a group of assets is a right to a share of the corpus of a trust upon its termination.

(2) The group of assets out of which the property interest is payable must include one or more particular assets which, if transferred by the donor to the donee spouse, would not qualify for the marital deduction. Therefore, section 2523(c) is not applicable merely because a group of assets includes a terminable interest, but would only be applicable if the terminable interest were nondeductible under the provisions of § 25.2523(b)–1.

(c) If the circumstances in the preceding paragraph are both present, the marital deduction with respect to such property interest may not exceed one-half of the excess, if any, of its value over the aggregate value of the particular asset or assets which, if transferred to the donee spouse, would not qualify for the marital deduction. The application of this section may be illustrated by the following example:

Example. H was absolute owner of a rental property and on July 1, 1950, transferred it to A by gift, reserving the income for a period of 20 years. On July 1, 1955, he created a trust to last for a period of 10 years. H was to receive the income from the trust and at the termination of the trust the trustee is to turn over to H's wife, W, property having a value of $100,000. The trustee has absolute discretion in deciding which properties in the corpus he shall turn over to W in satisfaction of the gift to her. The trustee received two items of property from H. Item (1) consisted of shares of corporate stock. Item (2) consisted of the right to receive the income from the rental property during the unexpired portion of the 20-year term. Assume that at the termination of the trust on July 1, 1965, the value of the right to the rental income for the then unexpired term of 5 years (item (2)) will be $30,000. Since item (2) is a nondeductible interest and the trustee can turn it over to W in partial satisfaction of her gift, only $70,000 of the $100,000 receivable by her on July 1, 1965, will be considered as property with respect to which a marital deduction is allowable. The present value on July 1, 1955, of the right to receive $70,000 at the end of 10 years is $49,624.33 (70,000×.708919, as found in Table II of § 25.2512–5). The value of the property qualifying for the marital deduction, therefore, is $49,624.33 and a marital deduction is allowed for one-half of that amount, or $24,812.17.

§ 25.2523(d) Statutory Provisions; Gift to Spouse; Joint Interest.

SEC. 2523. GIFT TO SPOUSE. * * *

(d) Joint Interest.—If the interest is transferred to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, shall not be considered for purposes of subsection (b) as an interest retained by the donor in himself.

§ 25.2523(d)–1 Joint Interests.—Section 2523(d) provides that if a property interest is transferred to the donee spouse as sole joint

tenant with the donor or as a tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, is not for the purposes of section 2523(b), to be considered as an interest retained by the donor in himself. Under this provision, the fact that the donor may, as surviving tenant, possess or enjoy the property after the termination of the interest transferred to the donee spouse does not preclude the allowance of the marital deduction with respect to the latter interest. Thus, if the donor purchased real property in the name of himself and wife as tenants by the entirety, or as joint tenants with right of survivorship and, pursuant to the provisions of section 2515(c), elected to treat such transaction as a completed gift in the calendar year effected, a marital deduction equal to one-half the value of the interest of the donee spouse in such property may be taken. See paragraph (c) of § 25.2523(b)-1, and section 2524.

§ 25.2523(e) STATUTORY PROVISIONS; GIFT TO SPOUSE; LIFE ESTATE WITH POWER OF APPOINTMENT IN DONEE SPOUSE.

SEC. 2523. GIFT TO SPOUSE. * * *

(e) LIFE ESTATE WITH POWER OF APPOINTMENT IN DONEE SPOUSE.—Where the donor transfers an interest in property, if by such transfer his spouse is entitled for life to all of the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the donee spouse to appoint the entire interest, or such specific portion (exercisable in favor of such donee spouse, or of the estate of such donee spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of such interest, or such portion, to any person other than the donee spouse—

(1) The interest, or such portion, so transferred shall, for purposes of subsection (a) be considered as transferred to the donee spouse, and

(2) No part of the interest, or such portion, so transferred shall for purposes of subsection (b)(1), be considered as retained in the donor or transferred to any person other than the donee spouse.

This subsection shall apply only if, by such transfer, such power in the donee spouse to appoint the interest, or such portion, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

§ 25.2523(e)-1 MARITAL DEDUCTION; LIFE ESTATE WITH POWER OF APPOINTMENT IN DONEE SPOUSE.—(a) *In general.*—Section 2523(e) provides that if an interest in property is transferred by a donor to his spouse (whether or not in trust) and the spouse is entitled for life to all the income from the entire interest or all the income from a specific portion of the entire interest, with a power in her to appoint the entire interest or the specific portion, the interest transferred to her is a deductible interest, to the extent that it satisfies all five of the conditions set forth below (see paragraph (b) of this section if one or more of the conditions is satisfied as to only a portion of the interest):

(1) The donee spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest.

(2) The income payable to the donee spouse must be payable annually or at more frequent intervals.

(3) The donee spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate.

(4) The power in the donee spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the donee spouse.

(b) *Specific portions; deductible amount.*—If either the right to income or the power of appointment given to the donee spouse pertains only to a specific portion of a property interest, the portion of the interest which qualifies as a deductible interest is limited to the extent that the rights in the donee spouse meet all of the five conditions described in paragraph (a) of this section. While the rights over the income and the power must coexist as to the same interest in property, it is not necessary that the rights over the income or the power as to such interest be in the same proportion. However, if the rights over income meeting the required conditions set forth in paragraph (a) (1) and (2) of this section extend over a smaller share of the property interest than the share with respect to which the power of appointment requirements set forth in paragraph (a) (3) through (5) of this section are satisfied, the deductible interest is limited to the smaller share, Conversely, if a power of appointment meeting all the requirements extends to a smaller portion of the property interest than the portion over which the income rights pertain, the deductible interest cannot exceed the value of the portion to which such power of appointment applies. Thus, if the donor gives to the donee spouse the right to receive annually all of the income from a particular property interest and a power of appointment meeting the specifications prescribed in paragraph (a) (3) through (5) of this section as to only one-half of the property interest, then only one-half of the property interest is treated as a deductible interest. Correspondingly, if the income interest of the spouse satisfying the requirements extends to only one-fourth of the property interest and a testamentary power of appointment satisfying the requirements extends to all of the property interest, then only one-fourth of the interest in the spouse qualifies as a deductible interest. Further, if the donee spouse has no right to income from a specific portion of a property interest but a testamentary power of appointment which meets the necessary conditions over the entire interest, then none of the interest qualifies for the deduction. In addition, if, from the time of the transfer, the donee spouse has a power of appointment meeting all of the required conditions over three-fourths of the entire property interest and the prescribed income rights over the entire interest, but with a power in another person to appoint one-half of the entire interest, the value of the interest in the donee spouse over only one-half of the property interest will qualify as a deductible interest.

(c) *Definition of "specific portion".*—A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the donee spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the donee spouse reflects its proportionate share

of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to one-half or a specified percentage of the property, or the equivalent, the interest is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest. Even though the rights in the donee spouse may not be expressed in terms of a definite fraction or percentage, a deduction may be allowable if it is shown that the effect of local law is to give the spouse rights which are identical to those she would have acquired if the size of the share had been expressed in terms of a definite fraction or percentage. The following examples illustrate the application of this and the preceding paragraphs of this section:

Example (1). The donor transferred to a trustee 500 identical shares of X Company stock. He provided that during the lifetime of the donee spouse the trustee should pay her annually one-half of the trust income or $6,000, whichever is the larger. The spouse was also given a general power of appointment, exercisable by her last will over the sum of $160,000 or over three-fourths of the trust corpus, whichever should be of larger value. Since there is no certainty that the trust income will not vary from year to year, for purposes of paragraphs (a) and (b) of this section, an annual payment of a specified sum, such as the $6,000 provided for in this case, is not considered as representing the income from a definite fraction or a specific portion of the entire interest if that were the extent of the spouse's interest. However, since the spouse is to receive annually at least one-half of the trust income, she will, for purposes of paragraphs (a) and (b) of this section, be considered as receiving all of the income from one-half of the entire interest in the stock. Inasmuch as there is no certainty that the value of the stock will be the same on the date of the donee spouse's death as it was on the date of the transfer to the trustee, for purposes of paragraphs (a) and (b) of this section, a specified sum, such as the $160,000 provided for in this case, is not considered to be a definite fraction of the entire interest. However, since the donee spouse has a general power of appointment over at least three-fourths of the trust corpus, she is considered as having a general power of appointment over three fourths of the entire interest in the stock.

Example (2). The donor transferred to a trustee an office building and 250 identical shares of Y Company stock. He provided that during the lifetime of the donee spouse the trustee should pay her annually three-fourths of the trust income. The spouse was given a general power of appointment, exercisable by will, over the office building and 100 shares of the stock. By the terms of the trust instrument the donee spouse is given all the income from a definite fraction of the entire interest in the office building and in the stock. She also has a general power of appointment over the entire interest in the office building. However, since the amount of property represented by a single share of stock would be altered if the corporation split its stock, issued stock dividends, made a distribution of capital, etc., a power to

appoint 100 shares at the time of the donee spouse's death is not the same necessarily as a power to appoint 100/250 of the entire interest which the 250 shares represented on the date of the gift. If it is shown in this case that the effect of local law is to give the spouse a general power to appoint not only the 100 shares designated by the donor but also 100/250 of any shares or amounts which are distributed by the corporation and included in the corpus, the requirements of this paragraph will be satisfied and the donee spouse will be considered as having a general power to appoint 100/250 of the entire interest in the 250 shares.

(d) *Definition of "entire interest".*—Since a marital deduction is allowed for each qualifying separate interest in property transferred by the donor to the donee spouse, for purposes of paragraphs (a) and (b) of this section, each property interest with respect to which the donee spouse received some rights is considered separately in determining whether her rights extend to the entire interest or to a specific portion of the entire interest. A property interest which consists of several identical units of property (such as a block of 250 shares of stock, whether the ownership is evidenced by one or several certificates) is considered one property interest, unless certain of the units are to be segregated and accorded different treatment, in which case each segregated group of items is considered a separate property interest. The bequest of a specified sum of money constitutes the bequest of a separate property interest if immediately following the transfer and thenceforth it, and the investments made with it, must be so segregated or accounted for as to permit its identification as a separate item of property. The application of this paragraph may be illustrated by the following examples:

Example (1). The donor transferred to a trustee three adjoining farms, Blackacre, Whiteacre, and Greenacre. The trust instrument provided that during the lifetime of the donee spouse the trustee should pay her all of the income from the trust. Upon her death, all of Blackacre, a one-half interest in Whiteacre, and a one-third interest in Greenacre were to be distributed to the person or persons appointed by her in her will. The donee spouse is considered as being entitled to all of the income from the entire interest in Blackacre, all of the income from the entire interest in Whiteacre, and all of the income from the entire interest in Greenacre. She also is considered as having a power of appointment over the entire interest in Blackacre, over one-half of the entire interest in Whiteacre, and over one-third of the entire interest in Greenacre.

Example (2). The donor transferred $250,000 to C, as trustee. C is to invest the money and pay all of the income from the investments to W, the donor's spouse, annually. W was given a general power, exercisable by will, to appoint one-half of the corpus of the trust. Here, immediately following establishment of the trust, the $250,000 will be sufficiently segregated to permit its identification as a separate item, and the $250,000 will constitute an entire property interest. Therefore, W has a right to income and a power of appointment such that one-half of the entire interest is a deductible interest.

Example (3). The donor transferred 100 shares of Z Corporation stock to D, as trustee. W, the donor's spouse, is to receive all of the

income of the trust annually and is given a general power, exercisable by will, to appoint out of the trust corpus the sum of $25,000. In this case the $25,000 is not, immediately following establishment of the trust, sufficiently segregated to permit its identification as a separate item of property in which the donee spouse has the entire interest. Therefore, the $25,000 does not constitute the entire interest in a property for the purpose of paragraphs (a) and (b) of this section.

(e) *Application of local law.*—In determining whether or not the conditions set forth in paragraph (a) (1) through (5) of this section are satisfied by the instrument of transfer, regard is to be had to the applicable provisions of the law of the jurisdiction under which the interest passes and, if the transfer is in trust, the applicable provisions of the law governing the administration of the trust. For example, silence of a trust instrument as to the frequency of payment will not be regarded as a failure to satisfy the condition set forth in paragraph (a) (2) of this section that income must be payable to the donee spouse annually or more requently unless the applicable law permits payment to be made less frequently than annually. The principles outlined in this paragraph and paragraphs (f) and (g) of this section which are applied in determining whether transfers in trust meet such conditions are equally applicable in ascertaining whether, in the case of interests not in trust, the donee spouse has the equivalent in rights over income and over the property.

(f) *Right to income.*—If an interest is transferred in trust, the donee spouse is "entitled for life to all of the income from the entire interest or a specific portion of the entire interest," for the purpose of the condition set forth in paragraph (a) (1) of this section, if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the donor's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the donee spouse during her life such an income or that the spouse should have such use of the trust property as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life of the entire interest or a specific portion of the entire interest will be sufficient to qualify the trust unless the terms of the trust and the surrounding circumstances considered as a whole evidence an intention to deprive the spouse of the requisite degree of enjoyment. In determining whether a trust evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for the administration of the trust.

(2) If the over-all effect of a trust is to give to the donee spouse such enforceable rights as will preserve to her the requisite degree of enjoyment, it is immaterial whether that result is effected by rules specifically stated in the trust instrument, or, in their absence, by the rules for the management of the trust property and the allocation of receipts and expenditures supplied by the State law. For example, a provision in the trust instrument for amortization of bond premium by ap-

propriate periodic charges to interest will not disqualify the interest transferred in trust even though there is no State law specifically authorizing amortization or there is a State law denying amortization which is applicable only in the absence of such a provision in the trust instrument.

(3) In the case of a trust, the rules to be applied by the trustee in allocation of receipts and expenses between income and corpus must be considered in relation to the nature and expected productivity of the assets transferred in trust, the nature and frenquency of occurrence of the expected receipts, and any provisions as to change in the form of investments. If it is evident from the nature of the trust assets and the rules provided for management of the trust that the allocation to income of such receipts as rents, ordinary cash dividends and interest will give to the spouse the substantial enjoyment during life required by the statute, provisions that such receipts as stock dividends and proceeds from the conversion of trust assets shall be treated as corpus will not disqualify the interest transferred in trust. Similarly, provision for a depletion charge against income in the case of trust assets which are subject to depletion will not disqualify the interest transferred in trust, unless the effect is to deprive the spouse of the requisite benefiical enjoyment. The same principle is applicable in the case of depreciation, trustees' commissions, and other charges.

(4) Provisions granting administrative powers to the trustees will not have the effect of disqualifying an interest transferred in trust unless the grant of powers evidences the intention to deprive the donee spouse of the beneficial enjoyment required by the statute. Such an intention will not be considered to exist if the entire terms of the instrument are such that the local courts will impose reasonable limitations upon the exercise of the powers. Among the powers which if subject to reasonable limitations will not disqualify the interest transferred in trust are the power to determine the allocation or apportionment of receipts and disbursements between income and corpus, the power to apply the income or corpus for the benefit of the spouse, and the power to retain the assets transferred to the trust. For example, a power to retain trust assets which consist substantially of unproductive property will not disqualify the interest if the applicable rules for the administration of the trust require, or permit the spouse to require, that the trustee either make the property productive or convert it within a reasonable time. Nor will such a power disqualify the interest if the applicable rules for administration of the trust require the trustee to use the degree of judgment and care in the exercise of the power which a prudent man would use if he were owner of the trust assets. Further, a power to retain a residence for the spouse or other property for the personal use of the spouse will not qualify the interest transferred in trust.

(5) An interest transferred in trust will not satisfy the condition set forth in paragraph (a)(1) of this section that the donee spouse be entitled to all the income if the primary purpose of the trust is to safeguard property without providing the spouse with the required beneficial enjoyment. Such trusts include not only trusts which expressly provide for the accumulation of the income but also trusts which indirectly accomplish a similar purpose. For example, assume

that the corpus of a trust consists substantially of property which is not likely to be income producing during the life of the donee spouse and that the spouse cannot compel the trustee to convert or otherwise deal with the property as described in subparagraph (4) of this paragraph. An interest transferred to such a trust will not qualify unless the applicable rules for the administration require, or permit the spouse to require, that the trustee provide the required beneficial enjoyment, such as by payments to the spouse out of other assets of the trust.

(6) If a trust may be terminated during the life of the donee spouse, under her exercise of a power of appointment or by distribution of the corpus to her, the interest transferred in trust satisfies the condition set forth in paragraph (a)(1) of this section (that the spouse be entitled to all the income) if she (i) is entitled to the income until the trust terminates, or (ii) has the right, exercisable in all events, to have the corpus distributed to her at any time during her life.

(7) An interest transferred in trust fails to satisfy the condition set forth in paragraph (a)(1) of this section, that the spouse be entitled to all the income, to the extent that the income is required to be accumulated in whole or in part or may be accumulated in the discretion of any person other than the donee spouse; to the extent that the consent of any person other than the donee spouse is required as a condition precedent to distribution of the income; or to the extent that any person other than the donee spouse has the power to alter the terms of the trust so as to deprive her of her right to the income. An interest transferred in trust will not fail to satisfy the condition that the spouse be entitled to all the income merely because its terms provide that the right of the donee spouse to the income shall not be subject to assignment, alienation, pledge, attachment or claims of creditors.

(8) In the case of an interest transferred in trust, the terms "entitled for life" and "payable annually or at more frequent intervals", as used in the conditions set forth in paragraph (a) (1) and (2) of this section, require that under the terms of the trust the income referred to must be currently (at least annually; see paragraph (e) of this section) distributable to the spouse or that she must have such command over the income that it is virtually hers. Thus, the conditions in paragraph (a) (1) and (2) of this section are satisfied in this respect if, under the terms of the trust instrument, the donee spouse has the right exercisable annually (or more frequently) to require distribution to herself of the trust income, and otherwise the trust income is to be accumulated and added to corpus. Similarly, as respects the income for the period between the last distribution date and the date of the spouse's death, it is sufficient if that income is subject to the spouse's power to appoint. Thus, if the trust instrument provides that income accrued or undistributed on the date of the spouse's death is to be disposed of as if it had been received after her death, and if the spouse has a power of appointment over the trust corpus, the power necessarily extends to the undistributed income.

(g) *Power of appointment in donee spouse.*—(1) The conditions set forth in paragraph (a) (3) and (4) of this section, that is, that the donee spouse must have a power of appointment exercisable in

favor of herself or her estate and exercisable alone and in all events, are not met unless the power of the donee spouse to appoint the entire interest or a specific portion of it falls within one of the following categories:

(i) A power so to appoint fully exercisable in her own favor at any time during her life (as, for example, an unlimited power to invade); or

(ii) A power so to appoint exercisable in favor of her estate. Such a power, if exercisable during life, must be fully exercisable at any time during life, or, if exercisable by will, must be fully exercisable irrespective of the time of her death; or

(iii) A combination of the powers described under subdivision (i) and (ii) of this subparagraph. For example, the donee spouse may, until she attains the age of 50 years, have a power to appoint to herself and thereafter have a power to appoint to her estate. However, the condition that the spouse's power must be exercisable in all events is not satisfied unless irrespective of when the donee spouse may die the entire interest or a specific portion of it will at the time of her death be subject to one power or the other.

(2) The power of the donee spouse must be a power to appoint the entire interest or a specific portion of it as unqualified owner (and free of the trust if a trust is involved, or free of the joint tenancy if a joint tenancy is involved) or to appoint the entire interest or a specific portion of it as a part of her estate (and free of the trust if a trust is involved), that is, in effect, to dispose of it to whomsoever she pleases. Thus, if the donor transferred property to a son and the donee spouse as joint tenants with right of survivorship and under local law the donee spouse has a power of severance exercisable without consent of the other joint tenant, and by exercising this power could acquire a one-half interest in the property as a tenant in common, her power of severance will satisfy the condition set forth in paragraph (a) (3) of this section that she have a power of appointment in favor of herself or her estate. However, if the donee spouse entered into a binding agreement with the donor to exercise the power only in favor of their issue, that condition is not met. An interest transferred in trust will not be regarded as failing to satisfy the condition merely because takers in default of the donee spouse's exercise of the power are designated by the donor. The donor may provide that, in default of exercise of the power, the trust shall continue for an additional period.

(3) A power is not considered to be a power exercisable by a donee spouse alone and in all events as required by paragraph (a) (4) of this section if the exercise of the power in the donee spouse to appoint the entire interest or a specific portion of it to herself or to her estate requires the joiner or consent of any other person. The power is not "exercisable in all events", if it can be terminated during the life of the donee spouse by any event other than her complete exercise or release of it. Further, a power is not "exercisable in all events" if it may be exercised for a limited purpose only. For example, a power which is not exercisable in the event of the spouse's remarriage is not exercisable in all events. Likewise, if there are any restrictions, either by the terms of the instrument or under applicable

local law, on the exercise of a power to consume property (whether or not held in trust) for the benefit of the spouse, the power is not exercisable in all events. Thus, if a power of invasion is exercisable only for the spouse's support, or only for her limited use, the power is not exercisable in all events. In order for a power of invasion to be exercisable in all events, the donee spouse must have the unrestricted power exercisable at any time during her life to use all or any part of the property subject to the power, and to dispose of it in any manner, including the power to dispose of it by gift (whether or not she has power to dispose of it by will).

(4) If the power is in existence at all times following the transfer of the interest, limitations of a formal nature will not disqualify the interest. Examples of formal limitations on a power exercisable during life are requirements that an exercise must be in a particular form, that it must be filed with a trustee during the spouse's life, that reasonable notice must be given, or that reasonable intervals must elapse between successive partial exercises. Examples of formal limitations on a power exercisable by will are that it must be exercised by a will executed by the donee spouse after the making of the gift or that exercise must be by specific reference to the power.

(5) If the donee spouse has the requisite power to appoint to herself or her estate, it is immaterial that she also has one or more lesser powers. Thus, if she has a testamentary power to appoint to her estate, she may also have a limited power of withdrawal or of appointment during her life. Similarly, if she has an unlimited power of withdrawal, she may have a limited testamentary power.

(h) *Existence of a power in another.*—Paragraph (a)(5) of this section provides that a transfer described in paragraph (a) is nondeductible to the extent that the donor created a power in the trustee or in any other person to appoint a part of the interest to any person other than the donee spouse. However, only powers in other persons which are in opposition to that of the donee spouse will cause a portion of the interest to fail to satisfy the condition set forth in paragraph (a)(5) of this section. Thus, a power in a trustee to distribute corpus to or for the benefit of the donee spouse will not disqualify the trust. Similarly, a power to distribute corpus to the spouse for the support of minor children will not disqualify the trust if she is legally obligated to support such children. The application of this paragraph may be illustrated by the following examples:

Example (1). Assume that a donor created a trust, designating his spouse as income beneficiary for life with an unrestricted power in the spouse to appoint the corpus during her life. The donor further provided that in the event the donee spouse should die without having exercised the power, the trust should continue for the life of his son with a power in the son to appoint the corpus. Since the power in the son could become exercisable only after the death of the donee spouse, the interest is not regarded as failing to satisfy the condition set forth in paragraph (a)(5) of this section.

Example (2). Assume that the donor created a trust, designating his spouse as income beneficiary for life and as donee of a power to appoint by will the entire corpus. The donor further provided that the trustee could distribute 30 percent of the corpus to the donor's son

when he reached the age of 35 years. Since the trustee has a power to appoint 30 percent of the entire interest for the benefit of a person other than the donee spouse, only 70 percent of the interest placed in trust satisfied the condition set forth in paragraph (a)(5) of this section. If, in this case, the donee spouse had a power, exercisable by her will, to appoint only one-half of the corpus as it was constituted at the time of her death, it should be noted that only 35 percent of the interest placed in the trust would satisfy the condition set forth in paragraph (a)(3) of this section.

§ 25.2523(f) STATUTORY PROVISIONS; COMMUNITY PROPERTY.

SEC. 2523. GIFT TO SPOUSE. * * *

(f) COMMUNITY PROPERTY.—

(1) A deduction otherwise allowable under this section shall be allowed only to the extent that the transfer can be shown to represent a gift of property which is not, at the time of the gift, held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country.

(2) For purposes of paragraph (1), community property (except property which is considered as community property solely by reason of paragraph (3)) shall not be considered as "held as community property" if the entire value of such property (and not merely one-half thereof) is treated as the amount of the gift.

(3) If during the calendar year 1942 or in succeeding calendar years, property held as such community property (unless considered by reason of paragraph (2) as not so held) was by the donor and the donee spouse converted, by one transaction or a series of transactions, into separate property of the donor and such spouse (including any form of coownership by them), the separate property so acquired by the donor and any property acquired at any time by the donor in exchange therefor (by one exchange or a series of exchanges) shall, for purposes of paragraph (1), be considered as "held as community property."

(4) Where the value (at the time of such conversion) of the separate property so acquired by the donor exceeded the value (at such time) of the separate property so acquired by such spouse, paragraph (3) shall apply only with respect to the same portion of such separate property of the donor as the portion which the value (as of such time) of such separate property so acquired by such spouse is of the value (as of such time) of the separate property so acquired by the donor.

§ 25.2523(f)–1 MARITAL DEDUCTION IN CASES INVOLVING COMMUNITY PROPERTY.—(a) *In general.*—The marital deduction is allowable with respect to any transfer by a donor to his spouse only to the extent that the transfer can be shown to represent a gift of property which was not, at the time of the gift, held as "community property", as defined in paragraph (b) of this section. The burden of establishing the extent to which a transfer represents a gift of property not so held rests upon the donor.

(b) *Definition of "community property."*—(1) For the purpose of paragraph (a) of this section, the term "community property" is considered to include—

(i) Any property held by the donor and his spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, except property in which the donee spouse had at the time of the gift merely an expectant interest. The donee spouse is regarded as having, at any particular time, merely an expectant interest in property held at that time by the donor

and herself as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, if, in case such property were transferred by gift into the separate property of the donee spouse, the entire value of such property (and not merely one-half of it), would be treated as the amount of the gift.

(ii) Separate property acquired by the donor as a result of a "conversion", after December 31, 1941, of property held by him and the donee spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country (except such property in which the donee spouse had at the time of the "conversion" merely an expectant interest), into their separate property, subject to the limitation with respect to value contained in subparagraph (5) of this paragraph.

(iii) Property acquired by the donor in exchange (by one exchange or a series of exchanges) for separate property resulting from such "conversion."

(2) The characteristics of property which acquired a noncommunity instead of a community status by reason of an agreement (whether antenuptial or postnuptial) are such that section 2523(f) classifies the property as community property of the donor and his spouse in the computation of the marital deduction. In distinguishing property which thus acquired a noncommunity status from property which acquired such a status solely by operation of the community property law, section 2523(f) refers to the former category of property as "separate property" acquired as a result of a "conversion" of "property held as such community property." As used in section 2523(f) the phrase "property held as such community property" is used to denote the body of property comprehended within the community property system; the expression "separate property" includes any noncommunity property, whether held in joint tenancy, tenancy by the entirety, tenancy in common, or otherwise; and the term "conversion" includes any transaction or agreement which transforms property from a community status into a noncommunity status.

(3) The separate property which section 2523(f) classifies as community property is not limited to that which was in existence at the time of the conversion. The following are illustrative of the scope of section 2523(f):

(i) A partition of community property between husband and wife, whereby a portion of the property became the separate property of each, is a conversion of community property.

(ii) A transfer of community property into some other form of coownership, such as a joint tenancy, is a conversion of the property.

(iii) An agreement (whether made before or after marriage) that future earnings and gains which would otherwise be community property shall be shared by the spouses as separate property effects a conversion of such earnings and gains.

(iv) A change in the form of ownership of property which causes future rentals, which would otherwise have been acquired as community property, to be acquired as separate property effects a conversion of the rentals.

(4) The rules of section 2523(f) are applicable, however, only if the conversion took place after December 31, 1941, and only to the extent stated in this section.

(5) If the value of the separate property acquired by the donor as a result of a conversion did not exceed the value of the separate property thus acquired by the donee spouse, the entire separate property thus acquired by the donor is to be considered, for the purposes of this section, as held by him and the donee spouse as community property. If the value (at the time of conversion) of the separate property so acquired by the donor exceeded the value (at that time) of the separate property so acquired by the donee spouse, only a part of the separate property so acquired by the donor (and only the same fractional part of property acquired by him in exchange for such separate property) is to be considered, for purposes of this section, as held by him and the donee spouse as community property. The part of such separate property (or property acquired in exchange for it) which is considered as so held is the same proportion of it which the value (at the time of the conversion) of the separate property so acquired by the donee spouse is of the value (at that time) of the separate property so acquired by the donor. The following example illustrates the application of the provisions of this paragraph:

Example. During 1942 the donor and his spouse partitioned certain real property held by them under community property laws. The real property then had a value of $224,000. A portion of the property, then having a value of $160,000, was converted into the donor's separate property, and the remaining portion, then having a value of $64,000, was converted into his spouse's separate property. In 1955 the donor made a gift to his spouse of the property acquired by him as a result of the partition, which property then had a value of $200,000. The portion of the property transferred by gift which is considered as community property is

$$\frac{\$64{,}000 \quad \text{(value of property acquired by donee spouse)}}{\$160{,}000 \quad \text{(value of property acquired by donor spouse)}} \times \$200{,}000 = \$80{,}000$$

The marital deduction with respect to the gift is, therefore, limited to one-half of $120,000 (the difference between $200,000, the value of the gift, and $80,000, the portion of the gift considered to have been of "community property"). The marital deduction with respect to the gift is, therefore, $60,000.

§ 25.2524 Statutory Provisions; Extent of Deductions.

SEC. 2524. EXTENT OF DEDUCTIONS.

The deductions provided in sections 2522 and 2523 shall be allowed only to the extent that the gifts therein specified are included in the amount of gifts against which such deductions are applied.

§ 25.2524–1 Extent of Deductions.—Under the provisions of section 2524, the charitable deduction provided for in section 2522 and the marital deduction provided for in section 2523 are allowable only to the extent that the gifts with respect to which those deductions are authorized are included in the "total amount of gifts" made during

the calendar year, computed as provided in section 2503 and § 25.2503–1 (i. e., the total gifts less exclusions). The following example illustrates the application of the provisions of this section:

Example. The only gifts made by a donor to his spouse during the calendar year were a gift of $3,000 in May and a gift of $2,000 in August. The first $3,000 of such gifts is excluded under the provisions of section 2503 in determining the "total amount of gifts" made during the calendar year. The marital deduction of $2,500 (one-half of $3,000 plus one-half of $2,000) otherwise allowable is limited by section 2524 to $2,000.

PROCEDURE AND ADMINISTRATION

§ 25.6001 STATUTORY PROVISIONS; NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS AND SPECIAL RETURNS.

SEC. 6001. NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS.

Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary or his delegate may from time to time prescribe. Whenever in the judgment of the Secretary or his delegate it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary or his delegate deems sufficient to show whether or not such person is liable for tax under this title.

§ 25.6001–1 RECORDS REQUIRED TO BE KEPT.—(a) *In general.*—Every person subject to taxation under chapter 12 of the Internal Revenue Code of 1954 shall for the purpose of determining the total amount of his gifts, keep such permanent books of account or records as are necessary to establish the amount of his total gifts (limited as provided by section 2503(b)), together with the deductions allowable in determining the amount of his taxable gifts, and the other information required to be shown in a gift tax return. All documents and vouchers used in preparing the gift tax return (see § 25.6019–1) shall be retained by the donor so as to be available for inspection whenever required.

(b) *Supplemental data.*—In order that the district director may determine the correct tax the donor shall furnish such supplemental data as may be deemed necessary by the district director. It is, therefore, the duty of the donor to furnish, upon request, copies of all documents relating to his gift or gifts, appraisal lists of any items included in the total amount of gifts, copies of balance sheets or other financial statements obtainable by him relating to the value of stock constituting the gift, and any oher information obtainable by him that may be necessary in the determination of the tax. See section 2512 and the regulations issued thereunder. For every policy of life insurance listed on the return, the donor must procure a statement from the insurance company on Form 938 and file it with the district director who receives the return. If specifically requested by the district director, the insurance company shall file this statement direct with the district director.

§ 25.6011 STATUTORY PROVISIONS; GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

SEC. 6011. GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

(a) GENERAL RULE.—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

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(c) INCOME, ESTATE, AND GIFT TAXES.—For requirement that returns of income, estate, and gift taxes be made whether or not there is tax liability, see section 6012 to 6019, inclusive.

§ 25.6011–1 GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.—(a) *General rule.*—Every person made liable for any tax imposed by chapter 12 of the Code shall make such returns or statements as are required by the regulations in this part. The return or statement shall include therein the information required by the applicable regulations or forms.

(b) *Use of prescribed forms.*—Copies of the forms prescribed by paragraph (b) of § 25.6001–1 and § 25.6019–1 may be obtained from district directors. The fact that a person required to file a form has not been furnished with copies of a form will not excuse him from the making of a gift tax return, or from the furnishing of the evidence for which the forms are to be used. Application for a form should be made to the district director in ample time to enable the person whose duty it is to file the form to have the form prepared, verified, and filed with the district director on or before the date prescribed for the filing thereof.

§ 25.6019 STATUTORY PROVISIONS; GIFT TAX RETURNS.

SEC. 6019. GIFT TAX RETURNS.

(a) IN GENERAL.—Any individual who in any calendar year makes any transfers by gift (except those which under section 2503(b) are not to be included in the total amount of gifts for such year) shall make a return with respect to the gift tax imposed by subtitle B.

(b) TENANCY BY THE ENTIRETY.—For provisions relating to requirement of return in the case of election as to the treatment of gift by creation of tenancy by the entirety, see section 2515(c).

§ 25.6019–1 PERSONS REQUIRED TO FILE RETURNS.—(a) *In general.*—Any individual citizen or resident of the United States who within the calendar year 1955, or within any calendar year thereafter, makes a transfer or transfers by gift to any one donee of a value or total value in excess of $3,000 (or regardless of value in the case of a gift of a future interest in property) must file a gift tax return on Form 709 for that year. A nonresident not a citizen of the United States who made such a gift must also file a return on Form 709 if under § 25.2511–3 the transfer is subject to the gift tax. The return is required even though because of the deductions authorized by sections 2521 (specific exemption), 2522 (charitable, etc., deduction), and 2523 (marital deduction) no tax may be payable. Individuals only are required to file returns and not trusts, estates, part-

nerships or corporations. Duplicate copies of the return are not required to be filed. See §§ 25.6075–1 and 25.6091–1 for the time and place for filing the gift tax return. For delinquency penalty for failure to file return, see section 6651 and § 301.6651–1 of this chapter (Regulations on Procedure and Administration). For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207.

(b) *Deceased donor.*—If the donor dies before filing his return, the executor of his will or the administrator of his estate shall file the return. If the donor becomes legally incompetent before filing his return, his guardian or committee shall file the return.

(c) *Ratification of return.*—The return shall not be made by an agent unless by reason of illness, absence, or nonresidence, the person liable for the return is unable to make it within the time prescribed. Mere convenience is not sufficient reason for authorizing an agent to make the return. If by reason of illness, absence or nonresidence, a return is made by an agent, the return must be ratified by the donor or other person liable for its filing within a reasonable time after such person becomes able to do so. If the return filed by the agent is not so ratified, it will not be considered the return required by the statute. Supplemental data may be submitted at the time of ratification. The ratification may be in the form of a statement, executed under the penalties of perjury and filed with the district director, showing specifically that the return made by the agent has been carefully examined and that the person signing ratifies the return as the donor's. If a return is signed by an agent, a statement fully explaining the inability of the donor must accompany the return.

§ 25.6019–2 Returns Required in Case of Consent Under Section 2513.—Except as otherwise provided in this section, the provisions of § 25.6019–1 are applicable with respect to the filing of a gift tax return or returns in the case of a husband and wife who consent (see § 25.2513–1) to the application of section 2513. In such a case, if both of the consenting spouses are (without regard to the provisions of section 2513) required under the provisions of § 25.6019–1 to file returns, returns must be filed by both spouses. If only one of the consenting spouses is (without regard to the provisions of section 2513) required under § 25.6019–1 to file a return, a return must be filed by that spouse. In the latter case, if after giving effect to the provisions of section 2513 the other spouse is considered to have made any gift (regardless of value) of a future interest in property or any gift or gifts to any one-third party donee exceeding $3,000 in value, then a return must also be filed by such other spouse. Thus, if during any calendar year the husband made a gift of $5,000 to a son (the gift not being a future interest in property) and the wife made no gifts, only the husband is required to file a return for such year. However, if the wife had made a gift of $2,000 to the same son, or if the gift made by the husband had amounted to $7,000, each spouse would be required to file a return if the consent is signified as provided in section 2513.

§ 25.6019–3 Contents of Return.—(a) *In general.*—The return shall set forth: (1) each gift made during the calendar year which under sections 2511 through 2515 is to be included in computing

taxable gifts; (2) the deductions claimed and allowable under sections 2521 through 2524; and (3) the taxable gifts made for each of the preceding calendar years (see § 25.2504–1). In addition the return shall set forth the fair market value of all gifts not made in money, including gifts resulting from sales and exchanges of property made for less than full and adequate consideration in money or money's worth, giving, as of the date of the sale or exchange, both the fair market value of the property sold or exchanged and the fair market value of the consideration received by the donor. If a donor contends that his retained power over property renders the gift incomplete (see § 25.2511–2) and hence not subject to tax as of the calendar year of the initial transfer, the transaction should be disclosed in the return for the calendar year of the initial transfer and evidence showing all relevant facts, including a copy of the instrument of transfer, shall be submitted with the return. The instructions printed on the return should be carefully followed. A certified or verified copy of each document required by the instructions printed on the return form shall be filed with the return. Any additional documents the donor may desire to submit may be submitted with the return.

(b) *Disclosure of transfers coming within provisions of section 2516.*—Section 2516 provides that certain transfers of property pursuant to written property settlements between husband and wife are deemed to be transfers for full and adequate consideration in money or money's worth if divorce occurs within two years. In any case where a husband and wife enter into a written agreement of the type contemplated by section 2516, and the final decree of divorce is not granted on or before the due date for the filing of a gift tax return for the calendar year in which the agreement became effective (see § 25.6075–1), the transfer shall be disclosed by the transferor upon a gift tax return filed for the calendar year in which the agreement became effective and a copy of the agreement shall be attached to the return. In addition, a certified copy of the final divorce decree shall be furnished the district director not later than 60 days after the divorce is granted. Pending receipt of evidence that the final decree of divorce has been granted (but in no event for a period of more than two years from the effective date of the agreement), the transfer will tentatively be treated as made for a full and adequate consideration in money or money's worth.

§ 25.6019–4 Description of Property Listed on Return.—The properties comprising the gifts made during the calendar year shall be listed on the return and shall be described in such a manner that they may be readily identified. Thus, there should be given for each parcel of real estate a legal description, its area, a short statement of the character of any improvements, and, if located in a city, the name of the street and number. Description of bonds shall include the number transferred, principal amount, name of obligor, date of maturity, rate of interest, date or dates on which interest is payable, series number where there is more than one issue, and the principal exchange upon which listed, or the principal business office of the obligor, if unlisted. Description of stocks shall include number of

shares, whether common or preferred, and, if preferred, what issue thereof, par value, quotation at which returned, exact name of corporation, and, if the stock is unlisted, the location of the principal business office, the State in which incorporated and the date of incorporation, or if the stock is listed, the principal exchange upon which sold. Description of notes shall include name of maker, date on which given, date of maturity, amount of principal, amount of principal unpaid, rate of interest and whether simple or compound, and date to which interest has been paid. If the gift of property includes accrued income thereon to the date of the gift, the amount of such accrued income shall be separately set forth. Description of the seller's interest in land contracts transferred shall include name of buyer, date of contract, description of property, sale price, initial payment, amounts of installment payments, unpaid balance of principal, interest rate and date prior to gift to which interest has been paid. Description of life insurance policies shall show the name of the insurer and the number of the policy. In describing an annuity, the name and address of the issuing company shall be given, or, if payable out of a trust or other fund, such a description as will fully identify the trust or fund. If the annuity is payable for a term of years, the duration of the term and the date on which it began shall be given, and if payable for the life of any person, the date of birth of that person shall be stated. Judgments shall be described by giving the title of the cause and the name of the court in which rendered, date of judgment, name and address of judgment debtor, amount of judgment, rate of interest to which subject, and by stating whether any payments have been made thereon, and, if so, when and in what amounts.

§ 25.6075 STATUTORY PROVISIONS; TIME FOR FILING GIFT TAX RETURNS.

SEC. 6075. TIME FOR FILING ESTATE AND GIFT TAX RETURNS.

* * * * * * *

(b) GIFT TAX RETURNS.—Returns made under section 6019 (relating to gift taxes) shall be filed on or before the 15th day of April following the close of the calendar year.

§ 25.6075–1 RETURNS; TIME FOR FILING GIFT TAX RETURNS.—The gift tax return required by section 6019 must be filed on or before the due date. The due date is the date on or before which the return is required to be filed in accordance with the provisions of section 6075(b) or the last day of the period covered by an extension of time granted by the district director as provided in § 25.6081–1. Unless an extension of time has been granted, the due date is the 15th day of April following the close of the calendar year in which gifts were made. When the due date falls on Saturday, Sunday, or a legal holiday, the due date for filing the return is the next succeeding day which is not Saturday, Sunday, or a legal holiday. For definition of a legal holiday, see section 7503 and § 301.7503–1 of this chapter (Regulations on Procedure and Administration). As to additions to the tax for failure to file the return within the prescribed time, see section 6651 and § 301.6651–1 of this chapter (Regulations on Procedure and Administration).

§ 25.6081 STATUTORY PROVISIONS; EXTENSION OF TIME FOR FILING RETURNS.

SEC. 6081. EXTENSION OF TIME FOR FILING RETURNS.

(a) GENERAL RULE.—The Secretary or his delegate may grant a reasonable extension of time for filing any return, declaration, statement, or other document required by this title or by regulations. Except in the case of taxpayers who are abroad, no such extension shall be for more than 6 months.

* * * * * * *

(c) POSTPONEMENT BY REASON OF WAR.—For time for performing certain acts postponed by reason of war, see section 7508.

§ 25.6081–1 EXTENSION OF TIME FOR FILING RETURNS.—It is important that the donor file on or before the due date a return as nearly complete and final as it is possible for him to prepare. However, the district director is authorized to grant a reasonable extension of time for filing returns. Applications for extensions of time for filing gift tax returns shall be addressed to the district director for the district in which the donor files his returns and must contain a full recital of the causes for delay. Except in the case of donors who are abroad, no extension for filing gift tax returns may be granted for more than 6 months. An extension of time for filing a return does not operate to extend the time for payment of the tax or any part thereof, unless so specified in the extension. For extensions of time for payment of tax, see § 25.6161–1. No extension of time for filing a return may be granted unless the application is received by the district director before the expiration of the time within which the return must otherwise be filed. The application should, when possible, be made sufficiently early to permit the district director to consider the matter and reply before what otherwise would be the due date of the return.

§ 25.6091 STATUTORY PROVISIONS; PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

SEC. 6091. PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

(a) GENERAL RULE.—When not otherwise provided 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 ths 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.

* * * * * * *

§ 25.6091–1 PLACE FOR FILING RETURNS AND OTHER DOCUMENTS.—If the donor is a resident of the United States, the gift tax return required by section 6019 shall be filed with the district director for the district in which the legal residence or principal place of business of the donor is located. If the donor is a nonresident (whether or not a citizen), and his principal place of business is located in an internal revenue district, the gift tax return shall be filed with the district director for the internal revenue district in which the donor's principal

place of business is located. If the donor is a nonresident (whether or not a citizen), and he does not have a principal place of business which is located in an internal revenue district, the gift tax return shall be filed with the Director of International Operations, Internal Revenue Service, Washington 25, D. C., or with such other official as the Commissioner may designate.

§ 25.6151 STATUTORY PROVISIONS; TIME AND PLACE FOR PAYING TAX SHOWN ON RETURNS.

SEC. 6151. TIME AND PLACE FOR PAYING TAX SHOWN ON RETURNS.

(a) GENERAL RULE.—Except as otherwise provided in this section, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary or his delegate, pay such tax to the principal internal revenue officer for the internal revenue district in which the return is required to be filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

* * * * * * *

(c) DATE FIXED FOR PAYMENT OF TAX.—In any case in which a tax is required to be paid on or before a certain date, or within a certain period, any reference in this title to the date fixed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax).

§ 25.6151–1 TIME AND PLACE FOR PAYING TAX SHOWN ON RETURN.—The tax shown on the gift tax return is to be paid by the donor at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return), unless the time for paying the tax is extended in accordance with the provisions of section 6161. However, for provisions relating to certain cases in which the time for paying the gift tax is postponed by reason of an individual serving in, or in support of, the Armed Forces of the United States in a combat zone, see section 7508. For provisions relating to the time and place for filing the return, see §§ 25.6075–1 and 25.6091–1.

§ 25.6161 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.

* * * * * * *

(b) AMOUNT DETERMINED AS DEFICIENCY.—Under regulations prescribed by the Secretary or his delegate, the Secretary or his delegate may extend, to the extent provided below, the time for payment of the amount determined as a deficiency:

(1) In the case of a tax imposed by chapter 1 or 12, for a period not to exceed 18 months from the date fixed for payment of the deficiency, and, in exceptional cases, for a further period not to exceed 12 months;

* * * * * * *

An extension under this subsection may be granted only where it is shown to the satisfaction of the Secretary or his delegate that the payment of a deficiency upon the date fixed for the payment thereof will result in undue hardship to the taxpayer in the case of a tax imposed by chapter 1, to the estate in the case of a tax imposed by chapter 11, or to the donor in the case of a tax imposed by chapter 12. No extension shall be granted if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

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§ 25.6161–1 EXTENSION OF TIME FOR PAYING TAX OR DEFICIENCY.—(a) *In general.*—(1) *Tax shown on return.*—A reasonable extension of time to pay the amount of tax shown on the return may be granted by the district director at the request of the donor. The period of such extension shall not be in excess of six months from the date fixed for the payment of the tax, except that if the taxpayer is abroad the period of extension may be in excess of six months.

(2) *Deficiency.*—The time for payment of any amount determined as a deficiency in respect of tax imposed by chapter 12 of the Code, or for payment of any part thereof may be extended by the district director at the request of the donor for a period not to exceed 18 months from the date fixed for the payment of the deficiency, as shown on the notice and demand from the district director, and, in exceptional cases, for a further period not in excess of 12 months. No extension of time for the payment of a deficiency shall be granted if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(3) *Extension of time for filing distinguished.*—The granting of an extension of time for filing a return does not operate to extend the time for the payment of the tax or any part thereof, unless so specified in the extension.

(b) *Undue hardship required for extension.*—An extension of the time for payment shall be granted only upon a satisfactory showing that payment on the due date of the amount with respect to which the extension is desired will result in an undue hardship. The extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, loss due to the sale of property at a sacrifice price, will result to the donor from making payment on the due date of the amount with respect to which the extension is desired. If a market exists, the sale of the property at the current market price is not ordinarily considered as resulting in an undue hardship.

(c) *Application for extension.*—An application for an extension of the time for payment of the tax shown on the return, or for the payment of any amount determined as a deficiency, shall be in writing and shall be accompanied by evidence showing the undue hardship that would result to the donor if the extension were refused. The application shall also be accompanied by a statement of the assets and liabilities of the donor and an itemized statement showing all receipts and disbursements for each of the three months immediately preceding the due date of the amount to which the application relates. The application, with supporting documents, must be filed with the district director on or before the date prescribed for payment of the

amount with respect to which the extension is desired. The application will be examined by the district director, and within 30 days, if possible, will be denied, granted, or tentatively granted subject to certain conditions of which the donor will be notified. If an additional extension is desired, the request therefor must be made to the district director on or before the expiration of the period for which the prior extension is granted.

(d) *Payment pursuant to extension.*—If an extension of time for payment is granted, the amount the time for payment of which is so extended shall be paid on or before the expiration of the period of the extension without the necessity of notice and demand from the district director. The granting of an extension of the time for payment of the tax or deficiency does not relieve the donor from liability for the payment of interest thereon during the period of the extension. See section 6601 and § 301.6601–1 of this chapter (Regulations on Procedure and Administration).

§ 25.6165 STATUTORY PROVISIONS; BONDS WHERE TIME TO PAY TAX OR DEFICIENCY HAS BEEN EXTENDED.

SEC. 6165. BONDS WHERE TIME TO PAY TAX OR DEFICIENCY HAS BEEN EXTENDED.

In the event the Secretary or his delegate grants any extension of time within which to pay any tax or any deficiency therein, the Secretary or his delegate may require the taxpayer to furnish a bond in such amount (not exceeding double the amount with respect to which the extension is granted) conditioned upon the payment of the amount extended in accordance with the terms of such extension.

§ 25.6165–1 BONDS WHERE TIME TO PAY TAX OR DEFICIENCY HAS BEEN EXTENDED.—For general provisions relating to bonds when extensions of time to pay the gift tax are granted, see the regulations under sections 6165 and 7101 contained in part 301 of this chapter (Regulations on Procedure and Administration).

§ 25.6321 STATUTORY PROVISIONS; LIEN FOR TAXES.

SEC. 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.

§ 25.6321–1 LIEN FOR TAXES.—For regulations concerning the lien for taxes, see § 301.6321–1 of this chapter (Regulations on Procedure and Administration).

§ 25.6322 STATUTORY PROVISIONS; PERIOD OF LIEN.

SEC. 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.

§ 25.6323 STATUTORY PROVISIONS; VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) INVALIDITY OF LIEN WITHOUT NOTICE.—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be

valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) UNDER STATE OR TERRITORIAL LAWS.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) WITH CLERK OF DISTRICT COURT.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) WITH CLERK OF DISTRICT COURT FOR DISTRICT OF COLUMBIA.—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) FORM OF NOTICE.—If the notice filed pursuant to subsection (a) (1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a) (2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) EXCEPTION IN CASE OF SECURITIES.—

(1) EXCEPTION.—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the exisence of such lien.

(2) DEFINITION OF SECURITY.—As used in this subsection, the term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(d) DISCLOSURE OF AMOUNT OF OUTSTANDING LIEN.—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

§ 25.6323–1 VALIDITY AGAINST MORTGAGES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.—For regulations concerning the validity of liens against mortgagees, pledges, purchasers, and judgment creditors, see § 301.6323–1 of this chapter (Regulations on Procedure and Administration).

§ 25.6324 STATUTORY PROVISIONS; SPECIAL LIENS FOR ESTATE AND GIFT TAXES.

SEC. 6324. SPECIAL LIENS FOR ESTATE AND GIFT TAXES.

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(b) LIEN FOR GIFT TAX.—Except as otherwise provided in subsection (c) (relating to transfers of securities), the gift tax imposed by chapter 12 shall be a lien upon all gifts made during the calendar year, for 10 years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth shall be divested of

the lien herein imposed and the lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth.

(c) EXCEPTION IN CASE OF SECURITIES.—The lien imposed by subsection (a) or (b) shall not be valid with respect to a security, as defined in section 6323(c)(2), as against any mortgagee, pledgee, or purchaser of any such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

§ 25.6324–1 SPECIAL LIEN FOR GIFT TAX.—For regulations concerning the special lien for the gift tax, see § 301.6324–1 of this chapter (Regulations on Procedure and Administration).

§ 25.6601 STATUTORY PROVISIONS; INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) GENERAL RULE.—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

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§ 25.6601–1 INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.—For regulations concerning interest on underpayment, nonpayment, or extensions of time for payment, of tax, see § 301.6601–1 of this chapter (Regulations on Procedure and Administration).

§ 25.7101 STATUTORY PROVISIONS; FORM OF BONDS.

SEC. 7101. FORM OF BONDS.

Whenever, pursuant to the provisions of this title (other than sections 7485 and 6803(a)(1)), or rules or regulations prescribed under authority of this title, a person is required to furnish a bond or security—

(1) GENERAL RULE.—Such bond or security shall be in such form and with such surety or sureties as may be prescribed by regulations issued by the Secretary or his delegate.

(2) UNITED STATES BONDS AND NOTES IN LIEU OF SURETY BONDS.—The person required to furnish such bond or security may, in lieu thereof, deposit bonds or notes of the United States as provided in 6 U. S. C. 15.

§ 25.7101–1 FORM OF BONDS.—For general provisions relating to bonds, see the regulations under sections 6165 and 7101 contained in part 301 of this chapter (Regulations on Procedure and Administration).

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved November 10, 1958.

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

(Filed by the Division of the Federal Register on November 14, 1958, 8:45 a. m., and published in the issue of the Federal Register for November 15, 1958, 23 F. R. 8904.)

SUBCHAPTER B.—TRANSFERS

SECTION 2511.—TRANSFERS IN GENERAL

A transfer by a donor to a trust, subject to revocation. See Rev. Rul. 58-395, page 398.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

26 CFR 31.3121(a)(7)-1: Payments for service not in the course of an employer's trade or business or for domestic service. (Also Section 3401; 31.3401 (a) (3)-1.) Rev. Rul. 58-580

> Service performed by an individual in and about the private home of his employer in the care and maintenance of a house bus for family use and in driving such bus to and from the home of the employer on pleasure trips constitute "domestic service" for purposes of the Federal Insurance Contributions Act and the Collection of Income Tax at Source on Wages.
>
> Liability is incurred for the taxes imposed under the Federal Insurance Contributions Act for each quarter in which the individual is paid cash remuneration of $50 or more for such service. No liability is incurred by the employer for the withholding of income tax on wages paid to the individual for such service, by virtue of section 3401(a)(3) of the Internal Revenue Code of 1954.

Advice has been requested whether services performed by an individual in caring for and driving a house bus for family use constitute "domestic service" for purposes of the Federal Insurance Contributions Act and the Collection of Income Tax at Source on Wages (chapters 21 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The owner of a bus had it converted to a house bus or "land cruiser" with complete living accommodations, for use by his family in taking pleasure trips. The bus was licensed for private use rather than for commercial purposes and was usually garaged on the home premises of the owner. An individual was hired to care for and drive the bus. His primary duties consisted of caring for and driving the bus to and from the home of the owner. When not on the road, his duties were essentially those of a caretaker and housekeeper for the bus. He performed no other services for the owner during such periods. While on the road, he served as driver and housekeeper and made emergency repairs when necessary. Approximately one-sixth of his time was devoted to driving the bus to and from the home of the

owner. The driver was paid a straight salary and was hired on a full-time basis in order to have his services available when needed. He was not required to keep regular hours when not on the road, but was subject to call at all times.

Section 3121(a)(7)(B) of the Federal Insurance Contributions Act excepts from the term "wages" cash remuneration paid by an employer in any calendar quarter to an employee for domestic service in a private home of the employer, if the cash remuneration paid in such quarter by an employer to the employee for such service is less than $50. Under section 3401(a)(3) of the 1954 Code, relating to the withholding of income tax, the term "wages" does not include remuneration paid for domestic service in a private home.

Section 31.3121(a)(7)-1 of the Employment Tax Regulations provides that the term "domestic service" includes services of a household nature performed by an employee in or about a private home of the person by whom he is employed. In general, services of a household nature in or about a private home include, among others, services performed by housekeepers, handymen and chauffeurs of automobiles for family use. The foregoing definition of "domestic service" is equally applicable for purposes of the Collection of Income Tax at Source on Wages.

The information presented discloses that the bus was used for pleasure rather than for commercial purposes and that the duties of the driver included the care of the bus as well as driving it to and from the private home of his employer. The fact that the greater part of his services was spent in or about the home of the employer indicates that such services were similar to those performed by a chauffeur. Only a minor part of his services were such as are not commonly expected of a chauffeur.

Accordingly, it is held that the driver's services constitute "domestice service" within the meaning of section 3121(a)(7) of the Federal Insurance Contributions Act and section 3401(a)(3) of the Internal Revenue Code of 1954. Therefore, liability for the employer and employee taxes imposed under the Federal Insurance Contributions Act was incurred for each calendar quarter during which cash remunerations paid to the employee by the employer for such services amounted to $50 or more, but no liability was incurred by the employer for the withholding of income tax with respect to any remuneration paid to the employee by virtue of the exception provided in section 3401(a)(3), *supra*.

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26 CFR 31.3121(b)(8)-1: Services performed by a minister of a church or a member of a religious order. Rev. Rul. 58-550

Theological seminaries (including schools of theology or divinity) which are operated as departments or activities of universities which are neither religious organizations nor integral agencies of such organizations under the authority of a religious body constituting a church or church denomination, are not theological seminaries of the type contemplated in Revenue Ruling 55-242, C. B. 1955-1, 489. Accordingly, services of ordained ministers as teachers and administrators on the faculty of such seminaries whose duties involve no ecclesiastical function, and who have not been assigned to their

positions by their ecclesiastical superiors, are not performed in the exercise of their ministry and consequently are not excepted from employment for Federal employment tax purposes.
Revenue Ruling 55–242, C. B. 1955–1, 489, clarified.

Advice has been requested whether services performed by ordained ministers as teachers and administrators on the faculties of divinity schools or schools of theology are services performed in the exercise of their ministry and excepted from employment as contemplated by Rev. Rul. 55–242, C. B. 1955–1, 489, under the circumstances described below.

In the instant case, the *M* divinity school is a department of the *M* university which is a charitable and educational institution of learning exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954. The university is completely nonsectarian and nondenominational. It is not in any way under the control, sponsorship, or authority of any religious or denominational group, body or church.

The divinity school, a component part of the university, is a nondenominational school of religion offering courses to college graduates leading to the degrees of Bachelor of Divinity, Master of Theology, and Doctor of Theology, primarily for the purpose of preparing students for the work of the ministry. The course of studies is a broad one and is designed to fulfill the fundamental scholastic requirements for the ordination of ministers of most denominations, but students of the divinity school who receive degrees do not thereby gain the right to pursue the ministry. They must apply to and receive the approval of the appropriate authorities of the various denominations with which they wish to be affiliated, and must meet any additional requirements those authorities may impose. Some graduates of the divinity school do not become ministers at all.

There is considerable interchange of teaching facilities between the various departments of the university, and many members of the faculty of the divinity school conduct courses, give lectures or otherwise assist in the conduct of courses in other departments of the university. Similarly, many general faculty members who are not primarily divinity school personnel conduct courses, give lectures or otherwise assist in the divinity school curriculum.

Section 3121(b)(8)(A) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) excepts from "employment" services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order. The exception applies to the services which are ordinarily the duties of such ministers or members of religious orders. The duties of ministers include the ministration of sacerdotal functions and the conduct of religious worship and the control, conduct, and maintenance of religious organizations (including the religious boards, societies, and other integral agencies of such organizations), under the authority of a religious body constituting a church or church denomination.

Section 31.3121(b)(8)–1(b)(2) of the Employment Tax Regulations provides, in part, that any religious organization is deemed to be under the authority of a religious body constituting a church or

church denomination if it is organized and dedicated to carrying out the tenets and principles of a faith in accordance with either the requirements or sanctions governing the creation of institutions of the faith. The term "religious organization" has the same meaning and application as is given to the term for income tax purposes.

Revenue Ruling 55–242, C. B. 1955–1, 489, holds that ordained ministers serving on the faculties of theological seminaries as teachers and administrators are performing services in the exercise of their ministry and that such services are excepted from "employment" under section 3121(b)(8)(A) of the Federal Insurance Contributions Act, *supra*.

The theological seminary referred to in Revenue Ruling 55–242, *supra*, qualifies as a nonprofit, charitable, religious, and educational institution of learning exempt from Federal income tax under section 101(6) of the Internal Revenue Code of 1939 (now section 501(c)(3) of the 1954 Code). Although the Revenue Ruling does not explicitly so state, it is the position of the Internal Revenue Service that such theological seminary is deemed to be under the authority of a religious body constituting a church or church denomination since, in connection with its stated purpose of training and educating individuals for the ministry, it is organized and dedicated to carrying out, extending, or advancing the tenets and principles of a particular faith (church or church denomination) in accordance with either the requirements or sanctions governing the creation of institutions of such faith. Under these circumstances the services performed by the ministers on the faculty of such theological seminary are clearly in the control, conduct, and maintenance of a religious organization under the authority of a religious body constituting a church or church denomination as contemplated within the limits and scope of section 31.3121(b)(8)–1(b)(2) of the Employment Tax Regulations.

In view of the foregoing, it is concluded that the *M* divinity school, which is a department or activity of *M* university and not a religious organization or entity separate and apart therefrom, is not a theological seminary within the meaning and concept of Revenue Ruling 55–242, *supra*. It is further concluded that, for Federal employment tax purposes, *M* university is not an integral agency of any religious organization under the authority of a religious body constituting a church or church denomination. In this connection, see also Rev. Rul. 55–243, C. B. 1955–1, 490, relating to services performed by ordained ministers on the faculty of a college which is not under the authority of a religious body constituting a church or church denomination.

Accordingly, services of ordained ministers on the faculty of the *M* divinity school, whose specific duties involve no ecclesiastical function such as the conduct of religious worship or the ministration of sacerdotal functions, and who have not been assigned or designated to their positions by their ecclesiastical superiors, are not performed in the exercise of their ministry and consequently are not excepted from "employment" under the provisions of section 3121(b)(8)(A) of the Federal Insurance Contributions Act of 1954, nor is the remuneration paid to such ministers excluded from "wages" by virtue of the provisions of section 3401(a)(9) of the Internal Revenue Code of 1954, relating to the Collection of Income Tax at Source on Wages

(chapter 24, subtitle C of the Code.) The ministers may not, with respect to the services in question, obtain social security coverage as self-employed individuals pursuant to section 1402(e) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

In the event the university (which as stated above is exempt from Federal income tax under section 501(c)(3) of the Code) waives its corresponding exemption from the taxes imposed under the Federal Insurance Contributions Act, *supra*, the wages of such minister-employees should, where appropriate, be included on the Employer's Quarterly Federal Tax Return, Form 941, filed by the university.

Revenue Ruling 55–242, C. B. 1955–1, 489, clarified.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 3306(i)–1, 31.3401(a)–1.) Rev. Rul. 58–504

An independent senior accountant, not licensed as a certified public accountant, is in charge of the major part of the clientele of an accounting firm but his work is subject to the review of the owner of the firm. The owner, a certified public accountant, signs all reports and tax returns prepared on behalf of the firm. The accountant does not hold himself out to the public as an independent contractor but works exclusively and on a continuing basis for the firm. *Held*, the accountant is an employee of the firm for Federal employment tax purposes, including the withholding of income tax at the source on wages.

Advice has been requested whether an accountant performing services for an accounting firm, under the circumstances described below, is an employee of the firm for Federal employment tax purposes.

A taxpayer, a certified public accountant, established an accounting firm and engaged in the independent practice of public accountancy. He personally performed all the services connected with his practice with the exception of detailed work which was performed by a junior accountant, as an employee. As a result of a severe illness, the taxpayer was later required to reduce his office work. He met this situation by making the employee a senior accountant and turned over to him the major part of his clientele. Under an oral agreement, the services for his clientele were to be handled independently by the senior accountant, but subject to the review of the owner of the firm. The accountant is not a certified public accountant and cannot hold himself out to the public for this type of work. He is required to perform the services under the name of the firm and for the firm's clients; and the firm determines the fees to be charged. The senior accountant is compensated on a commission basis and is allowed a drawing account. In the event his account is overdrawn, a debit balance is carried on the records until sufficient additional fees are earned by him. He does not perform services for other accounting firms and engages no helpers. The firm furnishes him with office space and equipment. Secretarial services are furnished by the firm but the accountant contributes a certain percentage of his fees toward the cost of such services. His work is done in the office of the firm, in his home, and in the offices of clients. However, he must report to the firm in person or by telephone and must give account fre-

quently as to his whereabouts and the work being done. Services are performed at a time convenient to him, with no regular hours. He does not perform a daily, weekly, or monthly routine, and is not restricted to any specific territory. Where travel is involved, he is furnished with funds to cover such expenses. All work which requires the approval of a certified public accountant is reviewed and signed by the owner. The accountant is not given detailed instructions on how to perform his services, since he is well trained and proficient in his work. His services may be terminated at any time by the firm. The senior accountant may terminate the relationship at any time he chooses.

Under section 3121 (d) (2) of the Federal Insurance Contributions Act [chapter 21, subtitle C, Internal Revenue Code of 1954], the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Whether an individual is an employee under the usual common law rules depends upon the particular facts in each case. The guides for determining, under such rules, whether an employer-employee relationship exists are found in section 31.3121 (d)–1 (c) of the Employment Tax Regulations.

Based on the facts in the instant case, it is concluded that the worker herein involved is not an independent contractor. He is performing personal services on a continuing basis under the firm's name and for the firm's clients. He has no clientele of his own. Although he is trained and qualified to perform the work without detailed supervision and does perform his services with some freedom of action, the owner of the firm retains a general over-all control with respect to the accounting services. Accordingly, it is held that the senior accountant is an employee of the firm for purposes of the taxes imposed under the Federal Insurance Contributions Act. Compare S. S. T. 208, C. B. 1937–2, 395.

This conclusion also applies for purposes of the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, 1954 Code).

(Also Sections 1401, 3306, 3401; 1.1401–1, 31.3306(i)–1, 31.3401(a)–1.) Rev. Rul. 58–505

The *M* company is engaged in the mutual insurance business. Certain officers, who perform administrative duties as such for the company, also sell insurance policies for the company aside from and independent of their duties as officers. The company has no right to control or direct the individual in the selling activities either as to result or as to details and means by which that result is accomplished. *Held*, the individuals are, in effect, serving the company in two different and distinct capacities, that is, as officers and as insurance agents. They are employees for Federal employment tax purposes with respect to duties performed by them as officers of the company, but are not employees for such purposes with respect to their selling activities.

Advice has been requested as to the status, for Federal employment tax purposes, of officers of an insurance company with respect to services performed by them in selling insurance for the company.

The *M* company is engaged in the sale of insurance policies. The president and the secretary of the company receive salaries for certain administrative services they perform as officers of the company. Separate and apart from such duties, the two officers also sell insurance policies under the company's standard agents' contracts. They are paid for such sales in exactly the same manner as the company pays its regular agents, that is, by a certain commission on each policy sold. The officers are not required, as a part of their official duties, to write insurance for the company. The salary paid to such officers is not related in any way to their services in writing applications for insurance policies. The company does not have the right to discharge them as employees insofar as their selling activities are concerned, but their services in this respect may be terminated by themselves or the company upon giving 30 days' notice by either party. The company has no right to control or direct them in their selling activities either as to the result to be accomplished or as to the details and means by which that result is accomplished.

Under the regulations applicable to the Federal employment taxes, an officer of a corporation is, in that capacity, an employee thereof unless he performs no services or performs minor services and he does not receive or is not entitled to receive remuneration, directly or indirectly. Therefore, the officers, as such, here involved are employees of the company for the purposes of the Federal employment taxes under the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, Subtitle C, Internal Revenue Code of 1954).

As to their sales services, such services, standing alone, are not performed under a degree of direction and control sufficient to constitute the individuals as employees for such activities under the usual common law rules for Federal employment tax purposes.

The question to be resolved is whether their services in the two capacities (as officers and as sales agents) are interrelated. If their services are found to be interrelated, then it could not be said that they were acting in two separate and distinct activities. Interrelated services which, as a whole, contain the elements establishing the existence of a common law relationship of employer and employee would result in a conclusion that, with respect to *all* services performed by the individuals, they are employees for Federal employment tax purposes. If, however, the services in the two capacities are separate and distinct, that is, if there is no interrelation either as to duties or remuneration in the two capacities, then the status of each type of service must be considered separately.

In the instant case, based on the facts presented, it is concluded that the services performed by the president and the secretary of the company as officers and as salesmen are not interrelated and that they are, therefore, performing services in two separate and unrelated capacities. Accordingly, they are not employees of the company with respect to the services which they perform for it in selling insurance and the remunerattion they receive for such services is not wages for purposes of the Federal employment taxes. Compare Rev. Rul. 58-360, page 423.

The Federal Insurance Contributions Act (but not the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages) contains a special statutory provision (section 3121 (d) (3) (B)) which includes in the definition of "employee" a full-time life insurance agent who is not an employee under the usual common law rules applicable in determining the employer-employee relationship.

Under the sales agent contracts between the company and the two officers, it was not the intention of the company that they should be "full-time life insurance agents." Furthermore, as a matter of fact they do not perform services as such. Therefore, as to the sales activities of the officers, they are not statutory employees under section 3121 (d) (3) (B) of the Federal Insurance Contributions Act. Income received from such activities constitutes income from a trade or business. Such income, therefore, is subject to the tax imposed on self-employment income by section 1401 of the Code. See Rev. Rul. 54–309, C. B. 1954–2, 261.

(Also Sections 1402, 3306, 3401; 1.1402(a)–1; 31.3306(i)–1; 31.3401(c)–1.) Rev. Rul. 58–568

A farm operator is engaged in raising chicks to broiler size under a broiler production agreement with a feed company. The farm operator furnishes the brooder houses and equipment, manages and controls the broiler raising operations, and performs all services required to raise and care for the chicks. The feed company furnishes the chicks, chicken feed, and funds to cover certain expenses incurred in connection with the operations and also pays the farm operator an agreed-upon amount each week during the growing periods covered by the agreement. The weekly payments to the farm operator are for the use of the broiler houses and equipment and for the care of the chicks. The feed company can sell the poultry at its discretion and can terminate the agreement at any time the farm operator fails to exercise sound management practices. Net profits are divided equally between the parties. Held, the farm operator is not an employee of the feed company for Federal employment tax purposes.

The farm operator has the status of a self-employed person and the income he derives from raising chicks to broiler size should be included in computing his net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954 for taxable years ending after 1954.

Advice has been requested relative to the status, for Federal employment tax purposes, of a farm operator who raises chicks to broiler size for a feed company under the circumstances described below.

A farm operator is primarily engaged in general farming operations. In addition, he raises broilers on his farm pursuant to the terms of a broiler production agreement entered into with a feed company. Under the agreement, the farm operator furnishes two brooder houses equipped with the necessary brooders, feeders, waterers, etc., which have a value of approximately $3,500.00. The feed company furnishes the chicks and chicken feed and provides the farm operator with a specified amount each growing period to pay for, or apply against, the cost of the heat and lights used during that period. The feed company also pays the farm operator an agreed-upon amount each week for the use of the brooder houses and equipment and for

the care of the chicks. If the cost of the utilities necessary for the broiler raising operations exceeds the amount provided by the feed company for that purpose, the excess is paid by the farm operator from his own funds.

The farm operator manages and controls the broiler raising operations. He performs all services necessary to raise and care for the chicks and the feed company does not supervise him in the performance of his services or require him to devote any particular amount of time to the broiler raising operations. A representative of the feed company visits the farm from time to time to observe the operations, to note the mortality rate of the chicks, etc. The feed company reserves the right to determine when the broilers are to be sold and to terminate the agreement at any time the farm operator fails to exercise sound management practices.

The agreement covers either four or five growing periods of approximately eight weeks each, the fifth period to be at the option and agreement of both parties. The expenses incurred by the feed company, including the cost of the chicks and chicken feed, the amounts provided for the cost of utilities, and the weekly payments made to the farm operator, are deducted from the amounts received from the sale of the broilers. The balance is divided equally between the feed company and the farm operator.

Under section 3121(d)(2) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Whether an individual is an employee under the usual common law rules depends upon the particular facts in each case. The guides for determining whether, under such rules, an employer-employee relationship exists are found in section 31.3121(d)-1(c) of the Employment Tax Regulations.

The facts in the instant case indicate that the feed company's sole interest is in the results accomplished by the farm operator and that the company does not exercise or retain the right to exercise such control over the farm operator in the performance of his services as is necessary under the usual common law rules to establish the relationship of employer and employee. Accordingly, liability for the taxes imposed under the Federal Insurance Contributions Act is not incurred by the feed company with respect to the amounts paid to the farm operator pursuant to the terms of the broiler production agreement.

This conclusion is also applicable for purposes of the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

It is held further that the broiler raising operations are not excluded from the term "trade or business" under the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, of the Code), for taxable years ending after December 31, 1954. Accordingly, the farm operator has the status of a self-employed person and the income he derives from the raising of chicks to broiler size should be included in computing his net earnings from self-employment for taxable years ending after 1954.

26 CFR 31.3121(g)-1: Agricultural labor. (Also Section 3306; 31.3306(k)-1.) Rev. Rul. 58-581

A company owns and operates a farm on which it has raised a large number of nut-bearing trees. After harvesting, the nuts are delivered to the company's plant, where they undergo a number of processing operations which include husking, curing and drying, weighing, size grading, cracking, quality grading, dehydrating, cooking, salting, and packing in high vacuum containers. *Held*, none of the services performed for the company in these processing operations of the nuts constitutes "agricultural labor" for purposes of the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

The Internal Revenue Service has been requested to determine whether services performed by employees of a company in connection with the processing of nuts under the circumstances described below constitute "agricultural labor" as defined in section 3121(g) of the Federal Insurance Contributions Act and section 3306(k) of the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954).

A company owns and operates a farm on which it has raised a large number of nut-bearing trees. After harvesting, the nuts are delivered to the company's plant, which is located within the farm boundaries, where they undergo a number of processing operations preparatory for marketing. The processing operations include husking, curing and drying, weighing, size grading, cracking, quality grading, dehydrating, cooking, salting, and packing in high vacuum containers.

With certain exceptions not here material, under paragraph (4) of section 3121(g) of the Federal Insurance Contributions Act, services performed by an employee in the handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, of any agricultural or horticultural commodity constitute "agricultural labor" if (1) the services are performed in the employ of the operator of a farm; (2) the services are performed with respect to the commodity in its unmanufactured state; and (3) the operator produced more than one-half of the commodity with respect to which the services are performed during a pay period. Section 31.3121(g)-1(e)(4) of the Employment Tax Regulations, relating to requirement (2) above, provides, in part, that processing services which change the commodity from its raw or natural state do not constitute agricultural labor. Furthermore, the provisions of paragraph (4), section 3121(g) of the Federal Contributions Act, are not applicable with respect to services performed "in connection with commercial canning."

The term "agricultural labor" is defined in paragraph (4) of section 3306(k) of the Federal Unemployment Tax Act to include the same kinds, or types, of services as are specified in paragraph (4), section 3121(g), *supra*. However, with certain exceptions not here material, these services will constitute "agricultural labor" within the meaning of this paragraph only if performed "as an incident to ordinary farming operations" and, as in section 3121(g), if they are not performed in connection with commercial canning. Section

31.3306(k)-1(e)(1) of the Employment Tax Regulations relating to paragraph (4) of section 3306(k), provides, in part, that generally services are performed "as an incident to ordinary farming operations" if they are services of the character ordinarily performed by the employees of a farmer or of a farmers' cooperative organization or group as a prerequisite to the marketing, in its unmanufactured state, of any agricultural or horticultural commodity produced by such farmer or by the members of such farmers' organization or group.

From the foregoing it is evident that processing services which change nuts from their raw or natural state or relate to commercial canning do not constitute "agricultural labor" as defined in the abovementioned Acts. The processing operations described herein constitute a method by which the nuts are changed from their raw or natural state. Furthermore, these plant processing services are considered to be performed "in connection with commercial canning." Accordingly, it is held that services performed by employees of the instant company in the processing of nuts under the circumstances stated do not constitute "agricultural labor" within the meaning of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. Such conclusion is also applicable for purposes of the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, Internal Revenue Code of 1954). See also the similar holding in Revenue Ruling 57-608. C. B.) 1957 2,638, pertaining to the processing of tobacco.

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26 CFR 31.3121(i)-1: Computation to nearest dollar of cash remuneration for domestic service.

Amount of wages of a member of the uniformed services to be shown on Form W-2, Withholding Tax Statement. See Rev. Rul. 58-532, page 879.

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26 CFR 31.3121(k)-1; Waiver of exemption from taxes. Rev. Rul. 58-514

Procedures to be followed, pending the amendment of regulations under the Federal Insurance Contributions Act, in applying the provisions of sections 3121(b)(8)(B) and 3121(k)(1) of the Federal Insurance Contributions Act, as amended by section 405 of the Social Security Amendments of 1958, and the provisions of section 403 of the Social Security Amendments of 1954, as amended by section 401 of the Social Security Amendents of 1956 and by Public Law 85-785, which provide for the social security coverage of individuals employed by certain exempt organizations.

SECTION 1. BACKGROUND.

.01 The Social Security Amendments of 1958, P. L. 85-840, approved August 28, 1958, C. B. 1958-3, 85, amended sections 3121(b)(8)(B) and 3121(k)(1) of the Federal Insurance Contributions Act (Chapter 21, subtitle C, Internal Revenue Code of 1954), relating to services performed in the employ of organizations described in section 501(c)(3) of the Internal Revenue Code, which are

exempt from income tax under section 501(a) of the Code. Section 3121(k)(1) previously was amended by the Social Security Amendments of 1956, as explained in Rev. Rul. 57–11, C. B. 1957–1,344.

.02 Public Law 85–785, approved August 27, 1958, C. B. 1958–3, 83, amended section 403(a) of the Social Security Amendments of 1954, which also had been amended by the Social Security Amendments of 1956, as explained in Rev. Rul. 57–11, *supra.*

SEC. 2. PURPOSE.

The purpose of this Revenue Ruling is to set forth the present provisions of sections 3121(b)(8)(B) and 3121(k)(1) of the Federal Insurance Contributions Act, and section 403 of the Social Security Amendment of 1954, and to explain the effect of the amendments referred to above.

SEC. 3. SCOPE.

The provisions of this Revenue Ruling are interim in nature and are subject to modification by regulations to follow. However, any such modification shall not render invalid any act performed pursuant to, and in accordance with, the provisions of this Revenue Ruling.

SEC. 4. SECTIONS 3121(b)(8)(B) AND 3121(k)(1) OF THE FEDERAL INSURANCE CONTRIBUTIONS ACT.

.01 Section 3121(b)(8) of the Federal Insurance Contributions Act, as amended by section 405(b) of the Social Security Amendments of 1958, provides an exception form the term "employment" and reads in part, as follows:

> (B) 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), but this subparagraph shall not apply to service performed during the period for which a certificate, filed pursuant to subsection (k) (or the corresponding subsection of prior law), is in effect if such service is performed by an employee—
>
> (i) whose signature appears on the list filed by such organization under subsection (k) (or the corresponding subsection of prior law),
>
> (ii) who became an employee of such organization after the calendar quarter in which the certificate (other than a certificate referred to in clause (iii)) was filed, or
>
> (iii) who, after the calendar quarter in which the certificate was filed with respect to a group described in section 3121(k)(1)(E), became a member of such group.
>
> except that this subparagraph shall apply with respect to service performed by an employee as a member of a group described in section 3121(k)(1)(E) with respect to which no certificate is in effect;

.02 Section 3121(k) of the Federal Insurance Contributions Act, as amended by section 405(a) of the Social Security Amendments of 1958, provides, in part, as follows:

> (k) EXEMPTION OF RELIGIOUS, CHARITABLE, AND CERTAIN OTHER ORGANIZATIONS.—
>
> (1) WAIVER OF EXEMPTION BY ORGANIZATION.—
>
> (A) An organization described in section 501(c)(3) which is exempt from income tax under section 501(a) may file a certificate (in such form and manner, and with such official, as may be prescribed by regulations made under this chapter) certifying that it desires to have the insurance system established by title II of the Social Security Act extended to service performed by its employees and that at least two-thirds of its employees concur in the filing of the certificate. Such certificate may be filed only if it is accompanied by a list containing the signature, address, and social

security account number (if any) of each employee who concurs in the filing of the certificate. Such list may be amended at any time prior to the expiration of the twenty-fourth month following the calendar quarter in which the certificate is filed by filing with the prescribed official a supplemental list or lists containing the signature, address, and social security account number (if any) of each additional employee who concurs in the filing of the certificate. The list and any supplemental list shall be filed in such form and manner as may be prescribed by regulations made under this chapter.

(B) The certificate shall be in effect (for purposes of subsection (b)(8)(B) and for purposes of section 210(a)(8)(B) of the Social Security Act) for the period beginning with whichever of the following may be designated by the organization:

(i) the first day of the calendar quarter in which the certifiicate is filed,

(ii) the first day of the calendar quarter succeeding such quarter, or

(iii) the first day of any calendar quarter preceding the calendar quarter in which the certificate is filed, except that, in the case of a certificate filed prior to January 1, 1960, such date may not be earlier than January 1, 1956, and in the case of a certificate filed after 1959, such date may not be earlier than the first day of the fourth calendar quarter preceding the quarter in which such certificate is filed.

(C) In the case of service performed by an employee whose name appears on a supplemental list filed after the first month following the calendar quarter in which the certificate is filed, the certificate shall be in effect (for purposes of subsection (b)(8)(B) and for purposes of section 210(a)(8)(B) of the Social Security Act) only with respect to service performed by such individual for the period beginning with the first day of the calendar quarter in which such supplemental list is filed.

(D) The period for which a certificate filed pursuant to this subsection or the corresponding subsection of prior law is effective may be terminated by the organization, effective at the end of a calendar quarter, upon giving 2 years' advance notice in writing, but only if, at the time of the receipt of such notice, the certificate has been in effect for a period of not less than 8 years. The notice of termination may be revoked by the organization by giving, prior to the close of the calendar quarter specified in the notice of termination, a written notice of such revocation. Notice of termination or revocation thereof shall be filed in such form and manner, and with such official, as may be prescribed by regulations made under this chapter.

(E) If an organization described in subparagraph (A) employs both individuals who are in positions covered by a pension, annuity, retirement, or similar fund or system established by a State or by a political subdivision thereof and individuals who are not in such positions, the organization shall divide its employees into two separate groups. One group shall consist of all employees who are in positions covered by such a fund or system and (i) are members of such fund or system, or (ii) are not members of such fund or system but are eligible to become members thereof; and the other group shall consist of all remaining employees. 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 one of the groups if at least two-thirds of the employees in such group concur in the filing of the certificate. The organization may also file such a certificate with respect to the employees in the other group if at least two-thirds of the employees in such other group concur in the filing of such certificate.

(F) An organization which filed a certificate under this subsection after 1955 but prior to the enactment of this subparagraph may file a request at any time before 1960 to have such certificate effective, with respect to the service of individuals who concurred in the filing of such certificate (initially or through the filing of a supplemental list) prior to enactment of this subparagraph and who concur in the filing of such new request, for the period beginning 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. Such request shall be filed with such official and in such form and manner as may be prescribed by regulations made under this chapter. If a request is filed pursuant to this subparagraph—

(i) for purposes of computing interest and for purposes of section 6651 (relating to addition to tax for failure to file tax return), the due date for the return and payment of the tax for any calender 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

(ii) the statutory period for the assessment of such tax shall not expire before the expiration of 3 years from such due date.

(G) If a certificate filed pursuant to this paragraph is effective for one or more calendar quarters prior to the quarter in which the certificate is filed, then—

(i) for purposes of computing interest and for purposes of section 6651 (relating to addition to tax for failure to file 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

(ii) the statutory period for the assessment of such tax shall not expire before the expiration of 3 years from such due date.

SEC. 5. WAIVER CERTIFICATES.

The procedures and rules stated in paragraphs (a) and (b) of section 31.3121(k)(1) of the Employment Tax Regulations, C. B. 1956-2, at page 675, are applicable in describing the organizations which may file waiver certificates and the employees who may concur in such filing, and are applicable to the execution and filing of the certificates. However, in applying such regulations, the amended law and the provisions of this Revenue Ruling should be kept in mind.

SEC. 6. EFFECTIVE DATE OF WAIVER CERTIFICATE FILED AFTER AUGUST 28, 1958.

.01 A waiver certificate filed by an organization after August 28, 1958, will become effective on whichever of the following dates the organization may designate, and such date must be specified in the waiver certificate:

(1) The first day of the calendar quarter in which the waiver certificate is filed with the District Director,

(2) The first day of the following calendar quarter, or

(3) The first day of any calendar quarter beginning after 1955 and before the quarter in which the certificate is filed, provided, however, that a waiver certificate filed after 1959 may not be made effective for a calendar quarter earlier than the fourth calender quarter preceding the calendar quarter in which the certificate is filed. For example, a certificate filed in December 1959 may be made effective as early as January 1, 1956; but a certificate filed in January 1960 may not be made effective for a calendar quarter prior to the quarter beginning January 1, 1959.

.02 It is important that employees who are eligible to concur in the filing of a waiver certificate be informed of its proposed effective date before or at the time they are given the opportunity to sign the list of concurring employees.

SEC. 7. EMPLOYEES WHO SIGN SUPPLEMENTAL LISTS.

.01 *If waiver certificate is filed after August 28, 1958.*—If an employee does not sign the original list (Form SS-15a) accompanying

a waiver certificate which is filed after August 28, 1958, a supplemental list (Form SS–15a Supplement) signed by such employee may be filed with the District Director at any time prior to the expiration of the twenty-fourth month following the calendar quarter in which the certificate is filed. If the supplemental list is filed on or before the last day of the first month following the quarter in which the certificate is filed, the certificate will be effective, in the case of any employee whose signature appears on the supplemental list, with respect to services performed on and after the effective date specified in the certificate. However, if the supplemental list is filed after such first month (but within the twenty-four month period) the certificate will be effective with respect to services performed by the employee during the period beginning with the first day of the quarter in which the supplemental list is filed.

.02 *If waiver certificate was filed before August 29, 1958.*—The Social Security Amendments of 1958 make no change in the law and the rules governing the filing of a supplemental list (Form SS–15a Supplement) of employees who concur in the filing of a waiver certificate which was filed before August 29, 1958. Accordingly, if an employee did not sign the original list (Form SS–15a) accompanying a waiver certificate which was filed before August 29, 1958, a supplemental list signed by such employee may be filed before January 1, 1959, or at any time thereafter which is not later than the expiration of the twenty-fourth month following the first calendar quarter for which the certificate originally was in effect. If the supplemental list is filed after the first month following such first calendar quarter, the certificate will be effective, in the case of any employee whose signature appears on the supplemental list, with respect to services performed on or after the first day of the calendar quarter following the quarter in which the supplemental list is filed. If the supplemental list is filed on or before the last day of the first month following the first calendar quarter for which the certificate originally was in effect, the certificate will be effective, in the case of any employee whose signature appears on the supplemental list, with respect to services performed on or after the first day of the first calendar quarter for which the certificate originally was in effect.

SEC. 8. RETROACTIVE COVERAGE FOR EMPLOYEES OF ORGANIZATION WHICH FILED WAIVER CERTIFICATE BEFORE AUGUST 29, 1958.

.01 Retroactive coverage may be obtained for certain employees or former employees of an organization which filed a waiver certificate after 1955 but before August 29, 1958. The coverage may be obtained if the organization files a request with the District Director at any time before 1960. The period of retroactivity may begin with the first day of any calendar quarter after 1955 and prior to the calendar quarter for which the certificate is effective.

.02 The retroactive coverage will be applicable only to those individuals who concurred in the filing of the organization's waiver certificate (initially or through the filing of a supplemental list before August 29, 1958) and who also concur in the filing of the request for retroactive coverage. Such individuals will have retroactive coverage for the period beginning on the date specified in the request, which date shall not be earlier than January 1, 1956, and ending at

the close of the calendar quarter immediately preceding the quarter in which the individual's original coverage was effective.

.03 A new form, Form SS–15b, will be provided for use by the organization in filing the request and by the individuals who concur in the request.

.04 Only one request on Form SS–15b may be filed by an organization.

SEC. 9. INDIVIDUALS EMPLOYED AFTER WAIVER CERTIFICATE IS FILED.

If an individual is in the employ of an organization in the same quarter in which the certificate is filed, and does not sign the original list of concurring employees on Form SS–15a, such employee can be covered only through the filing of a supplemental list as described in section 7. However, an individual who is hired or reemployed by an organization after the calendar quarter in which the organization filed a waiver certificate is immediately covered, and it is not necessary for such employee to sign a supplemental list. See section 10, below, as to the rule applicable to employees of an organization having employees in positions covered by a retirement system of a State or of a political subdivision thereof.

SEC. 10. WAIVER CERTIFICATES FILED AFTER AUGUST 28, 1958, BY ORGANIZATIONS HAVING EMPLOYEES COVERED BY RETIREMENT SYSTEM OF STATE OR POLITICAL SUBDIVISION THEREOF.

A new rule applies to the filing of a waiver certificate after August 28, 1958, by an organization which employs both individuals who are in positions covered by a pension, annuity, retirement, or similar fund or system established by a State or by a political subdivision thereof and individuals who are not in such positions. For the purpose of filing a waiver certificate or certificates such an organization shall divide its employees into two separate groups. One group shall consist of all employees who are in positions covered by such a fund or system and (i) are members of such fund or system, or (ii) are not members of such fund or system but are eligible to become members thereof. The other group shall consist of all remaining employees. The two groups of employees may not be combined for the purpose of filing a waiver certificate. If it is desired to obtain coverage for either group of employees a waiver certificate may be filed with respect to the employees in such group provided that two-thirds of the employees in such group concur in the filing of the certificate. If it is desired to obtain social security coverage for both groups of employees two waiver certificates must be filed by the employing organization. In general, the rules governing coverage under waiver certificates are to be applied in the same manner as if each group were deemed to have a different employer. If a certificate is filed for the coverage of one group of employees, and the other group is not covered, an employee who becomes a member of the noncovered group will not be covered by the certificate filed with respect to the covered group. If a certificate is filed with respect to a group, and an employee becomes a member of that group in the same quarter in which the certificate was filed and does not sign the original list of concurring employees on Form SS–15a, such employee (even though he may have been covered under a certificate filed with respect to the other group) can be covered only through the filing of a supplemental

list as described in section 7.01. However, if an employee becomes a member of a covered group after the calendar quarter in which the certificate was filed for such group, such employee will be covered by the certificate without the necessity of signing a supplemental list.

SEC. 11. DUE DATE OF RETURNS AND TAX PAYMENTS FOR QUARTERS COVERED RETROACTIVELY.

.01 If a waiver certificate filed after August 28, 1959, is effective, as provided in section 6.01(3), above, for one or more calendar quarters prior to the quarter in which the certificate is filed, then the due date for the return and payment of the employer tax and employee tax for any such prior calendar quarter resulting from the filing of such certificate is the last day of the calendar month following the calendar quarter in which the certificate is filed.

.02 If a request is filed for retroactive coverage for one or more calendar quarters, as provided in section 8, above, the due date for the return and payment of the employer tax and employee tax for any calendar quarter resulting from the filing of such request is the last day of the calendar month following the calendar quarter in which the request is filed.

SEC. 12. SECTION 403 OF THE SOCIAL SECURITY AMENDMENTS OF 1954.

.01 Section 403 of the Social Security Amendments of 1954, as amended by section 401 of the Social Security Amendments of 1956 and by Public Law 85–785, approved August 27, 1958, provides as follows:

> SEC. 403. (a) IN ANY CASE IN WHICH—
>
> (1) an individual has been employed, at any time subsequent to 1950 and prior to the enactment of the Social Security Amendments of 1956, by an organization which is described in section 501(c)(3) of the Internal Revenue Code of 1954 and which is exempt from income tax under section 501(a) of such Code but which did not have in effect, during the entire period in which the individual was so employed, a valid waiver certificate under section 1426(l)(1) of the Internal Revenue Code of 1939 or section 3121(k)(1) of the Internal Revenue Codde of 1954;
>
> (2) the service performed by such individual as an employee of such organization during the period subsequent to 1950 and prior to 1957 would have constituted employment (as defined in section 210 of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939 or section 3121(b) of the Internal Revenue Code of 1954, as the case may be, at the time such service was performed) if such organization had filed prior to the performance of such service such a certificate accompanied by a list of the signatures of employees who concurred in the filing of such certificate and such individual's signature had appeared on such list;
>
> (3) the taxes imposed by sections 1400 and 1410 of the Internal Revenue Code of 1939 or sections 3101 and 3111 of the Internal Revenue Code of 1954, as the case may be, have been paid with respect to any part of the remuneration paid to such individual by such organization for such service performed during the period in which such organization did not have a valid waiver certificate in effect;
>
> (4) part of such taxes have been paid prior to the enactment of the Social Security Amendments of 1956;
>
> (5) so much of such taxes as have been paid prior to the enactment of the Social Security Amendments of 1956 have been paid by such organization in good faith and without knowledge that a waiver certificate was necessary or upon the assumption that a valid waiver certificate had been filed by it under section 142(l)(1) of the Internal Revenue Code of 1939 or section 3121(k)(1) of the Internal Revenue Code of 1954, as the case may be; and
>
> (6) no refund of such taxes has been obtained,

the amount of such remuneration with respect to which such taxes have been paid shall, upon the request of such individual (filed in such form and manner, and with such official, as may be prescribed by regulations under chapter 21 of the Internal Revenue Code of 1954), be deemed to constitute remuneration for employment as defined in section 210 of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939 or section 3121(b) of the Internal Revenue Code of 1954, as the case may be.

(b) In any case in which—

(1) an individual has been employed, at any time subsequent to 1950 and prior to the enactment of the Social Security Amendments of 1956, by an organization which has filed a valid waiver certificate under section 1426(l)(1) of the Internal Revenue Code of 1939 or section 3121(k)(1) of the Internal Revenue Code of 1954:

(2) the service performed by such individual during the time he was so employed would have constituted employment (as defined in section 210 of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939 or section 3121(b) of the Internal Revenue Code of 1954, as the case may be, at the time such service was performed) if such individual's signature had appeared on the list of signatures of employees who concurred in the filing of such certificate;

(3) the taxes imposed by sections 1400 and 1410 of the Internal Revenue Code of 1939 or sections 3101 and 3111 of the Internal Revenue Code of 1954, as the case may be, have been paid prior to the enactment of the Social Security Amendments of 1956 with respect to any part of the remuneration paid to such individual by such organization for such service; and

(4) no refund of such taxes has been obtained,

the amount of such remuneration with respect to which such taxes have been paid shall, upon the request of such individual (filed on or before January 1, 1959, and in such form and manner, and with such official, as may be prescribed by regulations made under chapter 21 of the Internal Revenue Code of 1954), be deemed to constitute remuneration for employment as defined in section 210 of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939 or section 3121(b) of the Internal Revenue Code of 1954, as the case may be, and such individual shall be deemed to have concurred in the filing of the waiver certificate filed by such organization under section 1426(l)(1) of the Internal Revenue Code of 1939 or section 3121(k)(1) of the Internal Revenue Code of 1954.

.02 The date of enactment of the Social Security Amendments of 1956, referred to above, was August 1, 1956.

SEC. 13. RULES AND PROCEDURES FOR FILING REQUESTS UNDER SECTION 403 OF SOCIAL SECURITY AMENDMENTS OF 1954, AS AMENDED.

.01 *In general.*—The procedures and rules stated in section 408.216 (c) and (d) of Regulations 128, as added by Treasury Decision 6176, C. B. 1956–1, 661, are applicable to the execution and filing of requests under section 403 of the Social Security Amendments of 1954, as amended, to the effect of the requests, and to the optional tax payments under section 403(a). However, in applying these provisions, the amendments described in subsections .02 and .03, below, should be kept in mind.

.02 *Amendments made to subsection (a) of Section 403 of the Social Security Amendments of 1954.*—Pursuant to section 403(a) of the Social Security Amendments of 1954, as amended, an individual who, as an employee, performed services during all or a portion of the period after December 31, 1950, and prior to August 1, 1956, for an organization which did not have a valid waiver certificate on Form SS–15 in effect during the entire period in which such individual was so employed may, under certain circumstances, request that the remuneration received by him for services performed after 1950 and before 1957 be deemed to constitute remuneration for employment for

purposes of the taxes imposed under the Federal Insurance Contributions Act and for purposes of title II of the Social Security Act. The taxes imposed by the Federal Insurance Contributions Act must have been paid before August 1, 1956, with respect to some part of the remuneration paid to such individual by the employing organization for services performed by him during the period (beginning after 1950 and ending before 1957) in which the organization did not have a valid waiver certificate in effect. So much of such taxes as were paid before August 1, 1956, must have been paid by the employing organization in good faith and without knowledge that a waiver certificate was necessary or upon the assumptions that a valid waiver certificate had been filed.

.03 *Amendment made to subsection (b) of Section 403 of the Social Security Amendments of 1954.*—Section 403 (b) of the Social Security Amendments of 1954 was amended by section 401 of the Social Security Amendments of 1956 to provide that an individual who, as an employee, performed services during all or a portion of the period after December 31, 1950, and prior to August 1, 1956, for an organization which filed a valid waiver certificate, but who failed to sign the list of concurring employees, may request on or before January 1, 1959, that the remuneration received by him for such services be deemed to constitute remuneration for employment for purposes of the taxes imposed by the Federal Insurance Contributions Act and for purposes of title II of the Social Security Act. Section 403(b) was not further amended by the Social Security Amendments of 1958.

SEC. 14. FOR FURTHER INFORMATION.

For forms, and for information about requests, waiver certificates, tax returns, and tax payments, communicate with your District Director of Internal Revenue.

SECTION 3122.—FEDERAL SERVICE

Status of fees received by Federal court reporters from the sale of official transcripts of court proceedings. See Rev. Rul. 58–360, page 423.

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3306.—DEFINITIONS

26 CFR 31.3306(c)(6)-1: Services in employ of United States or instrumentality thereof. (Also Section 61; 1.61–2.) — Rev. Rul. 58–527

A cafeteria association organized and operated pursuant to Navy Civilian Personnel Instruction 65 for the purpose of providing in-plant feeding services for the civilian employees of a naval shore establishment is an instrumentality wholly-owned by the United States within the meaning of section 3306(c)(6) of the Federal Unemployment Tax Act. Services performed in its employ are excepted from "employment" under such section.

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Advice has been requested whether services performed for a cafeteria association established for the purpose of providing in-plant feeding services for all civilian employees of a naval shore establishment are excepted from "employment" as services performed in the employ of a wholly-owned instrumentality of the United States by reason of section 3306(c)(6) of the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954).

The establishment and operation of cafeterias and other eating facilities at naval establishments are governed by Instruction 65 of the Navy Civilian Personnel instructions relating to employee services. The instructions provide that employee services are an integral part of the Industrial Relations or Civilian Personnel Programs of the Navy Department. Under the authority of such instructions, the association in the instant case is operated through the medium of a food service board, the members of which are appointed by the commanding officer of the naval shore establishment concerned. The board is responsible for determining operating policies and procedures subject to approval by the commanding officer. The cafeteria is operated in Government buildings with equipment furnished by the Government. Title to all property used remains in the Government. No part of the cafeteria association's income inures to the benefit of any private individual. Any profits from the association's operations are used to provide adequate operating reserves, to improve food services and facilities, and to provide such welfare and recreational facilities as will benefit the employees of the association. In the event of dissolution, all equipment, surplus funds, and other assets would be disposed of as directed by the Secretary of the Navy.

Section 3306(c)(6) of the Federal Unemployment Tax Act provides in part that the term "employment" means any service, of whatever nature, performed by an employee for the person employing him except services performed in the employ of the United States Government or of an instrumentality of the United States which is wholly-owned by the United States or exempt from the tax imposed by section 3301 of the Act by virtue of any other provision of law.

Since the Government has proprietary control of the property and operations of the cafeteria association and no individual has any enforceable financial interest or right in any property furnished or acquired, it is held that the cafeteria association is an instrumentality wholly-owned by the United States within the meaning of section 3306(c)(6) of the Federal Unemployment Tax Act. Accordingly, services performed in its employ are excepted from employment and the tax imposed by the Act is not applicable with respect to the remuneration for such services.

This conclusion is supported by the decision of the Court of Appeals for the District of Columbia in the case of *Bernard P. Nimro* v. *Glen B. Davis*, 204 Fed. (2d), 734. Such remunerations are, however, includible in determining the gross income of the recipients for Federal income tax purposes.

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26 CFR 31.3306(i)-1: Who are employees.

Accountants who perform services exclusively for a public accounting firm. See Rev. Rul. 58-504, page 727.

Services performed by officers in the sale of insurance for their company. See Rev. Rul. 58–505, page 728.

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26 CFR 3306(i)–1: Who are employees.

Services performed by a farmer under a broiler production agreement with the operator of a feed store. See Rev. Rul. 58–568, page 730.

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26 CFR 31.3306(k)–1: Agricultural labor.

For application with respect to the processing of nuts, see Rev. Rul. 58–581, page 732.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

26 CFR 31.3401(a)–1: Wages.

Application to payments made to officers or former officers of the uniformed services under the Act of September 2, 1957, for pay earned during the period from July 1, 1932, through June 30, 1934. See Rev. Rul. 58–443, page 411.

Remuneration paid to accountants who perform services exclusively for a public accounting firm. See Rev. Rul. 58–504, page 727.

Fees received by officers from the sale of insurance policies for their company. See Rev. Rul. 58–505, page 728.

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26 CFR 31.3401 (a) (3)–1: Remuneration for domestic service.

Remuneration for domestic services performed in the operation and care of a house bus or land cruiser used for pleasure trips. See Rev. Rul. 58–580, page 723.

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26 CFR 31.3401(c)–1: Employee.

Services performed by a farmer under a broiler production agreement with the operator of a feed store. See Rev. Rul. 58–568, page 730.

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26 CFR 31.3401(d)–1: Employer.

The scope of the term "employer." See Rev. Rul. 58–599, page 45.

SECTION 3402.—INCOME TAX COLLECTED AT SOURCE

26 CFR 31.3402(a)-1: Requirement of withholding.

Status for income-tax withholding purposes of income from services donated to charity. See Rev. Rul. 58–495, page 27.

Territorial cost-of-living allowance as part of basic compensation of Federal employees after conversion of their positions under section 202(7) of the Classification Act of 1949, as amended. See Rev. Rul. 58–503, page 390.

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26 CFR 31.3402(d)-1: Failure to withhold. Rev. Rul. 58–577
(Also Section 6601; 301.6601-1.)

Interest is assessable against an employer who fails to deduct and withhold tax from the wages of an employee even though the employee subsequently files an income tax return and satisfies his income tax liability.

Advice has been requested with respect to the assessment of interest against an employer who fails to deduct and withhold tax from the wages of an employee as required under section 3402 of the Internal Revenue Code of 1954 where such employee subsequently files an income tax return and satisfies his income tax liability.

In the instant case, the employer engaged an individual whom he considered to be an independent contractor and not an employee. Consequently, he did not deduct and withhold any tax from the earnings of such individual and did not report in his quarterly returns on Form 941, Employer's Quarterly Federal Tax Return, any amounts as being withheld from such individual. It was subsequently determined that the individual was an employee whereupon the employer filed the necessary supplemental returns and was assessed for the tax which should have been withheld, plus interest. In the meantime the employee had timely filed an income tax return for the calendar year and satisfied his income tax liability. In view of such fact, the tax assessed against the employer with respect to his supplemental returns was abated in accordance with the provisions of section 3402(d) of the Code. No penalties were assessed due to reasonable cause. The employer contends that he is not liable for the payment of the interest assessed since the employee has paid his income tax in full.

Section 3402 of the Code provides, in part, as follows:

(d) TAX PAID BY RECIPIENT.—If the employer, in violation of the provisions of this chapter, fails to deduct and withhold the tax under this chapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect to such failure to deduct and withhold.

Every employer required to deduct and withhold the tax under section 3402 of the Code from the wages of an employee is liable for the payment of such tax whether or not it is collected from the employee by the employer. However, such tax is not collectible from the employer, by reason of the provision of section 3402(d) of the Code, after the related income tax liability of the employee has been paid. The

fact that the employee has satisfied his liability by reporting his annual income and paying the tax due thereon does not operate to relieve the employer from liability for penalties or additions to the tax applicable in respect to his failure to deduct and withhold. Therefore, if the employer fails to withhold, delinquent or supplemental returns, as the case may be, should be filed and the employer should report thereon the tax that should have been withheld. Where the provisions of section 3402(d) apply, as in the instant case, interest, and where appropriate, penalties, will be assessed against the employer for the periods beginning with the due date or dates for payment of the tax which the employer was required, but failed to withhold, until the following April 15, or any prior date upon which the employee satisfied his individual income tax liability.

In the instant case, the employer is liable for the interest assessed with respect to the supplemental returns filed by him on which he reported the tax which he was required to withhold. Since the provisions of section 3402(d) of the Code are applicable, interest should be assessed in accordance with the provisions of section 6601 of the Code and the regulations applicable thereunder (section 301.6601–1 of the Regulations on Procedure and Administration) from the respective periods prescribed for the payment of the tax by the employer, which he was required to withhold, until the date of payment by the employee or the following April 15, whichever is earlier.

SUBTITLE D.—MISCELLANEOUS EXCISE TAXES

CHAPTER 31.—RETAILERS EXCISE TAXES

SUBCHAPTER A.—JEWELRY AND RELATED ITEMS

SECTION 4001.—IMPOSITION OF TAX

(Also Sections 4011, 4021, 4031.) Rev. Rul. 58–408

The tax on jewelry and related items imposed by section 4001 of the Internal Revenue Code of 1954 applies to the net amount charged a customer for an item after the deduction of a discount granted by a so-called "gift certificate" mailed to all customers.

Advice has been requested concerning the applicability of the retailers excise tax where jewelry is sold at retail under the conditions described below.

A retail jeweler mails so-called "gift certificates" to all of his customers of record. The "certificates" state that they will be honored in the amount of x dollars toward the purchase of any item of jewelry whose listed price is x or more dollars but that they are not negotiable for cash. A recipient of a "certificate" makes a purchase and receives a credit of x dollars toward the listed price, thus paying x dollars less than the listed price for the item of jewelry.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon jewelry and related items based upon the price for which sold at retail.

Section 320.5 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the retailer's sales price is the basis for the tax and that, in general, this should be the retailer's actual price at the point of distribution or sale.

It is held that, under the circumstances described above, the customer, in effect, is being given a discount of x dollars from the listed price of the item. The actual selling price thus becomes the listed price minus x dollars discount. Since the tax on jewelry and related items is based on the actual selling price, it follows that the tax should be based upon the net amount charged the customer for the item.

Rev. Rul. 58–437

Where any article of silver-plated flatware is partially plated with a deposit of gold which is one one-hundred-thousandth of an inch or more in thickness, it is subject to the retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954, as an article ornamented, mounted, or fitted with a precious metal or imitation thereof.

Advice has been requested whether the retailers excise tax applies to the sale of an article of silver-plated flatware which is also partially plated with a deposit of gold greater than one one-hundred-thousandth of an inch in thickness.

A retailer sells silver-plated flatware. In addition, he sells some articles of silver-plated flatware which are partially gold-plated. The thickness of the gold-plating is considerably greater than one one-hundred-thousandth of an inch. For example, a silver-plated teaspoon with an overall surface of about eight square inches, has about one square inch of the handle gold-plated.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of certain articles, including "articles made of, or ornamented, mounted, or fitted with precious metals or imitations thereof" and "gold, gold-plated, silver, or sterling flatware or hollow ware, and silver-plated hollow ware."

Section 320.33(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "precious metals" to include platinum, gold, silver, and other metals of similar or greater value and the term "imitations thereof" to include platings and alloys of such metals. Section 320.35(a) of the regulations provides that the terms "flatware and hollow ware" include all articles commonly or commercially known and sold as such in the trade, and that any gold, gold-plated, silver, silver-plated, or sterling article which is not so known is subject to the tax as an article made of, ornamented, mounted or fitted with precious metals or imitations thereof. Section 320.35(b) of the regulations provides that no tax attaches to the sale at retail of any article commonly or commercially known or sold in the trade as "silver-plated flatware."

S. T. 935, C. B. 1948–2, 192, provides that articles, other than articles commonly or commercially known as jewelry, merely coated with a deposit of precious metal which is less than one one-hundred-thousandth of an inch in thickness are not considered to be ornamented with a precious metal or imitation thereof within the meaning of the law. Thus, an article, other than jewelry, having a deposit of a pre-

cious metal or alloy which is one one-hundred-thousandth of an inch or greater in thickness is considered to be an article ornamented with a precious metal or imitation thereof.

When an article of silver-plated flatware, such as a teaspoon is partially plated with a deposit of gold having a thickness of one one-hundred-thousandth of an inch or more, such article then becomes an article which is ornamented, mounted, or fitted with a precious metal or imitation thereof within the meaning of section 4001 of the Code. Accordingly, it is held that retail sales of such articles are subject to the tax imposed by that section.

Rev. Rul. 58–551

The retailers excise tax on jewelry and related items applies to sales of clasps or slides for so-called "western type" lariat or string neckties regardless of the material from which made; however, the tax does not apply to sales of the neckties themselves unless they are ornamented with precious metals or imitations thereof or with precious or semiprecious stones.

Advice has been requested whether the retailers excise tax on jewelry and related items applies to sales of so-called "western type" lariat or string neckties with clasps or slides.

These "western type" lariat or string neckties are made in various styles, usually consisting of leather, plastic, or cord braid, fitted with metal or plastic tips. They are adjusted by means of clasps or slides fashioned from polished steer horn, deer antler, wood, metal, or plastic.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon jewelry and related items sold at retail. The items subject to the tax include all articles commonly or commercially known as jewelry, whether real or imitation. Under the provisions of section 320.31 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, this category of items includes (1) articles designed to be worn on the person or apparel for the purpose of adornment and which in accordance with custom or ordinary usage are worn so as to be displayed, regardless of the substance of which made, and (2) articles to be carried in the hand, or hung on the arm, or carired or worn on the person, if made of, or ornamented, mounted, or fitted with pearls, precious or semiprecious stones, or imitations thereof.

Since clasps or slides for neckwear are designed to be worn for the purpose of adornment, it is held that the retailers excise tax imposed by section 4001 of the Code applies to sales at retail of clasps or slides for so-called "western type" lariat or string neckties, regardless of the material from which made. On the other hand, the neckties themselves are not considered to be subject to the tax unless the tips are so made that the ties must be regarded as ornamented with precious metals or imitations thereof or with precious or semiprecious stones. If a necktie which is ornamented in such a manner as to become taxable is sold in combination with a clasp or slide, the retailers excise tax applies to the entire price for which the combination is sold.

However, if a necktie which is not ornamented in such a manner that it becomes taxable is sold in combination with a clasp or slide, the retailers excise tax applies only to that portion of the selling price

of the combination which is allocable to the taxable clasp, or slide. If the clasp and the necktie have separate retail selling prices, the taxable portion of the combination may be determined by applying to the retail selling price of the combination the ratio which the separate retail selling price of the clasp bears to the sum of the retail selling prices of both the taxable clasp and the nontaxable necktie. If, however, either of these articles is not sold separately at retail and does not have an established retail sales price, the taxable portion of the combination may be determined by a comparison of the cost of the clasp with the sum of the costs of both the clasp and the necktie. The comparison of costs is to be made at the time of assembly. If the retailer does not have information regarding such comparison, he may obtain it from the person who assembles the clasp with the necktie.

(Also Sections 4011, 4021, 4031.) Rev. Rul. 58-608

The retailers excise tax on jewelry and related items, imposed by section 4001 of the Internal Revenue Code of 1954, applies to transactions involving merchandise obtained by fraudulent use of charge plates or through the use of fictitious names, addresses, and forged credentials.

Advice has been requested as to the applicability of the retailers excise tax to transactions involving merchandise obtained by means of fraudulent credit purchases.

A retailer sells jewelry and related items which are subject to the retailers excise tax. In some instances individuals obtain merchandise fraudulently by using charge plates which are stolen or found, while in other instances they obtain such merchandise through the use of fictitious names, addresses and forged credentials. The retailer contends that these transactions do not constitute bona fide credit sales and that the taxable items so acquired by the fraudulent purchaser should be excluded from the retailers excise tax.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon articles of jewelry and related items sold at retail. A similar tax is imposed upon furs by section 4011, upon toilet preparations by section 4021, and upon luggage, handbags, etc., by section 4031.

Section 320.1(f) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, defines the term "sale" to mean an agreement whereby the seller transfers the property (that is, the title or the substantial incidents of ownership) in goods to the buyer for a consideration called the price, which may consist of money, services, or other things.

For purposes of the retailers excise taxes, a sale takes place either on passage of title or transfer of the substantial incidents of ownership. The indicia of ownership are considered to be transferred when the "buyer" receives the goods and takes possession thereof. In the instant case, when the fraudulent purchaser takes possession of the merchandise, all the formal aspects of a sale have taken place and such transactions constitute sales at retail on which the retailer is liable for tax.

Accordingly, it is held that the fraudulent transactions referred to above are subject to the retailers excise tax imposed by section 4001

of the Code. A similar conclusion would apply to sales, under the same circumstances, of articles subject to the taxes imposed by section 4011, section 4021, or section 4031.

Rev. Rul. 58–619

Where an article subject to the retailers excise tax on jewelry and related items, imposed by section 4001 of the Internal Revenue Code of 1954, is exchanged for another article at a retail store other than the store from which the article was originally purchased, no refund of the retailers excise tax is allowable.

Advice has been requested whether credit or refund of the retailers excise tax paid by a retailer on the sale of a taxable article may be allowed to another retailer who accepts that article in exchange for some other article.

In the instant case, a retailer accepts certain articles, such as sterling flatware, in exchange for, or as partial payment for, other articles, regardless of whether the first articles were purchased from him. Sometimes, a bride or other person, who has received flatware as a gift, exchanges a duplicate article for some other article in the same pattern.

Section 4001 of the Internal Revenue Code of 1954 imposes upon certain articles sold at retail a tax which is based upon the price for which the articles are sold. Sterling flatware is included among the articles upon which the tax is imposed.

Section 6416(b)(1) of the Code, relating to special cases in which retailers or manufacturers excise tax payments may be considered overpayments, provides that when the price of an article, on which a tax was based, is readjusted by reason of the return or repossession of the article, a credit or refund of the tax may be allowed in the amount of the part of the tax proportionate to the part of the price repaid or credited to the purchaser.

Section 320.74(c) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that where an article is sold and, before use, the sale is rescinded by a return of the article to the retailer and the purchaser receives credit for the full amount of the purchase price, including tax, in an exchange of the article for another article, with appropriate adjustment for the difference, if any, in the values of both articles, the tax applies to the second article, if taxable. If tax was paid by the retailer with respect to the first article, the amount thereof may be applied as a credit upon a subsequent return or may be made the subject of a claim for refund.

Revenue Ruling 58–348, I. R. B. 1958–28, 28, holds that where an article purchased as a gift is returned to the retailer who sold the article by the purchaser's donee because of a duplication or for other valid reasons, the return of the article prior to use and a refund or credit to the donee of the entire tax-included selling price entitles the retailer to a credit or refund of the tax paid with respect to the article returned. However, where the donee is allowed a credit in an exchange of the article for another taxable article, tax will attach to the full price of the second article, including the allowance made with respect to the returned article.

The law, the regulations, and the Revenue Ruling referred to above relate only to the return of taxable articles to the retailer who had

sold those articles and had paid tax thereon. There is no provision of law or regulations under which a credit or refund of the retailers excise tax may properly be allowed to a retailer other than the one who paid the tax to the Government. It may not be said that a sale of taxable articles by one retailer is rescinded by the acceptance of those articles by another retailer in an exchange transaction.

Accordingly, it is held that where one retailer sells a taxable article which later is accepted by another retailer in exchange for some other taxable article, the second retailer is liable for the retailers excise tax based upon the full price for which he sells the second article without any reduction for the credit which he allows for the first article. There is no basis for a credit or refund of the tax paid by the first retailer. Furthermore, the second retailer is liable for the retailers excise tax based upon the price for which he subsequently sells the article accepted in exchange.

Circumstances under which credit or refund of retailers excise tax is allowable to a retailer with respect to taxable articles returned to him by a person other than the purchaser. See Rev. Rul. 58–348, page 888.

Applicability of the retailers excise tax to a charge for gift wrapping an article at the customer's request. See Rev. Rul. 58–552, page 758.

Retail sales of jewelry and related items to an agency of the United States. See Rev. Rul. 58–592, page 900.

SUBCHAPTER B.—FURS

SECTION 4011.—IMPOSITION OF TAX

Circumstances under which credit or refund of retailers excise tax is allowable to a retailer with respect to taxable articles returned to him by a person other than the purchaser. See Rev. Rul. 58–348, page 888.

Sales of furs at a discount through the medium of a gift certificate. See Rev. Rul. 58–408, page 745.

Applicability of the retailers excise tax to a charge for gift wrapping an article at the customer's request. See Rev. Rul. 58–552, page 758.

Retail sales of furs to an agency of the United States. See Rev. Rul. 58–592, page 900.

Transactions involving merchandise obtained by fraudulent use of charge plates. See Rev. Rul. 58–608, page 748.

SUBCHAPTER C.—TOILET PREPARATIONS

SECTION 4021.—IMPOSITION OF TAX

Rev. Rul. 58-409

Fabric pads saturated with toilet preparations are toilet articles or similar substances used or intended to be used or applied for toilet purposes, the sales of which are subject to the retailers excise tax on toilet preparations, imposed by section 4021 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the retailers excise tax on toilet preparations, imposed by section 4021 of the Internal Revenue Code of 1954, to sales of fabric pads saturated with toilet preparations, such as cleansing lotion, deodorant solution, face creams, mascara remover, nail polish remover, and similar preparations.

Section 4021 of the Code provides:

> There is hereby imposed upon the following articles sold at retail a tax equivalent to ten percent of the price for which so sold—
>
> Perfume
> Essences
> Extracts
> Toilet waters
> Cosmetics
> Petroleum jellies
> Hair oils
> Pomades
> Hair dressings
> Hair restoratives
> Hair dyes
> Aromatic cachous
> Toilet powders
>
> Any other similar substance, article, or preparation, by whatsoever name known or distinguished; any of the above which are used or applied or intended to be used or applied for toilet purposes.

Section 320.50(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, provides that the tax applies to the sale by the retailer of the articles enumerated in the statute and similar articles commonly or commercially known as toilet articles, which are used or applied or intended to be used or applied for toilet purposes. Any article advertised or held out for toilet purposes, or for any purpose for which the articles enumerated in the law are customarily used, will be subject to the tax regardless of the name by which it may be known or distinguished. The tax attaches to the sale by the retailer of any preparation which is used or applied or intended to be used or applied for toilet purposes or used in connection with the bath or care of the body, or applied to the clothing as a perfume or to the body as a toilet article. Section 320.50(b) enumerates examples of the type of article taxable under the section, including deodorants for personal use and face creams and lotions.

Therefore, it is held that fabric pads saturated with toilet preparations, such as cleansing lotion, deodorant solution, face creams, mascara remover, nail polish remover, and similar preparations, are toilet articles or similar substances used or intended to be used or applied for toilet purposes within the meaning of section 4021 of the Code. Ac-

cordingly, sales at retail of fabric pads saturated with toilet preparations are subject to the retailers excise tax.

Because the position of the Internal Revenue Service as to the applicability of the tax to fabric pads staurated with toilet preparations has not been consistent with that expressed above, and by virtue of the authority of section 7805(b) of the Code, the conclusion of this Revenue Ruling will be applied only to sales made on or after January 1, 1959.

Circumstances under which credit or refund of retailers excise tax is allowable to a retailer with respect to taxable articles returned to him by a person other than the purchaser. See Rev. Rul. 58–348, page 888.

Sales of toilet preparations at a discount through the medium of a gift certificate. See Rev. Rul. 58–408, page 745.

Applicability of the retailers excise tax to a charge for gift wrapping an article at the customer's request. See Rev. Rul. 58–552, page 758.

Retail sales of toilet preparations to an agency of the United States. See Rev. Rul. 58–592, page 900.

Transactions involving merchandise obtained by fraudulent use of charge plates. See Rev. Rul. 58–608, page 748.

SUBCHAPTER D.—LUGGAGE, HANDBAGS, ETC.

SECTION 4031.—IMPOSITION OF TAX

Rev. Rul. 58–375

The retailers excise tax on luggage, handbags, etc., applies to the sale at retail of a leather bag which comes within the meaning of the term "brief cases made of leather or imitation leather," even though the bag is sold for use in carrying books and other school supplies.

Advice has been requested concerning the applicability of the retailers excise tax on luggage, handbags, etc., to the sale of a bag made of leather, which is sold for the purpose of carrying books and other school supplies. The bag is equipped with a handle, has two straps for closure purposes, but does not have any partitions, pockets, or zippers.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of various articles, including brief cases made of leather or imitation leather.

Section 320.60 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that the term

"brief cases made of leather or imitation leather" includes all receptacles commonly or commercially known and sold as such, which are made of leather or imitation leather, regardless of size or the purpose for which purchased. This term also includes so-called "ring binders," "portfolios," "envelopes," etc., which are made of leather or imitation leather, regardless of size, provided such articles are capable of being closed on all four sides by means of a zipper, lock, snap fastener, or some other such device.

Accordingly, so-called "schoolbags," which are made of leather or of any material which has been processed or treated in any manner to simulate or imitate leather and which can be closed on all four sides by means of a zipper, lock, snap fastener, or some other similar device so as to serve as a brief case, are subject to the retailers excise tax when sold at retail. The statute contains no provisions which would exempt from tax the sale of such bags to students for educational purposes. Therefore, it is held that the bag described above falls within the meaning of the term "brief cases made of leather or imitation leather," and is subject to the retailers excise tax on luggage, handbags, etc.

Rev. Rul. 58–410

Occasionally, luggage carried by passengers of an airline company is damaged in transit. The airline company reimburses the passengers for the value of such articles and, from time to time, the damaged luggage is sold by the airline company. *Held*, such occasional sales by the airline company for the purpose of disposing of damaged luggage are not sales at retail within the meaning of section 4031 of the Internal Revenue Code of 1954 and are not subject to the retailers excise tax imposed by that section.

Rev. Rul. 58–537

The retailers excise tax on luggage, handbags, etc., imposed by section 4031 of the Internal Revenue Code of 1954 does not apply to sales of a so-called "truck driver's log book holder" designed to accommodate a truck drivers log book and accessories, or to a so-called "automobile papers case" which resembles an envelope.

Advice has been requested whether sales of the items described below are subject to the retailers excise tax on luggage, handbags, etc.

(1) A so-called "truck driver's log book holder" is made from calf finish vinyl and measures 14 inches by nine inches when open and nine inches by six inches when closed with button down snaps. It has a built-in loop to accommodate a pencil, two slits for a six inch plastic rule, two slits for the back of a driver's log book, and one side-opening pocket for receipts, notes, bills, etc.

(2) Another so-called "truck driver's log book holder" is made of pliable vinylite and measures ten and one-half inches by ten inches when open and ten inches by six and one-quarter inches when closed by a four and one-quarter inch flap. It has two open pockets for carrying a log book and other important papers.

(3) A so-called "automobile papers case" is made of pliable vinylite and measures nine and one-half inches by nine and one-half inches

when open and nine and one-half by four and three-quarters when closed with a full length pocket opening along the fold.

(4) Another so-called "automobile papers case" measures four by nine and one-half inches in size and resembles an ordinary envelope except that the flap is the full four by nine and one-half inches. It is made from stout highly embossed paper with one full-length compartment opening along the fold.

(5) A so-called "insurance folder" made of leather or imitation leather which measures eleven and one-quarter by five and one-half inches in size when folded. It closes by means of snap fasteners and is equipped with plastic pockets designed for holding and storing insurance policies and other papers.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon luggage, handbags, etc., including wallets, billfolds, card, pass, and key cases sold at retail, including in each case fittings or accessories therefor sold on or in connection with the sale thereof.

Articles such as those described above are not suitable for use as wallets, billfolds, card or pass cases. Accordingly, it is held that such items are not subject to the retailers excise tax imposed by section 4031 of the Code.

Circumstances under which credit or refund of retailers excise tax is allowable to a retailer with respect to taxable articles returned to him by a person other than the purchaser. See Rev. Rul. 58-348, page 888.

Sales of luggage, handbags, etc., at a discount through the medium of a gift certificate. See Rev. Rul. 58-408, page 745.

Applicability of the retailers excise tax to a charge for gift wrapping an article at the customer's request. See Rev. Rul. 58-552, page 758.

Retail sales of luggage, handbags, etc., to an agency of the United States. See Rev. Rul. 58-592, page 900.

Transactions involving merchandise obtained by fraudulent use of charge plates. See Rev. Rul. 58-608, page 748.

SUBCHAPTER E.—SPECIAL FUELS

SECTION 4041.—IMPOSITION OF TAX

(Also Section 4082.) Rev. Rul. 58-398

A special tractor fuel, which is produced by a registered gasoline producer by blending "housebrand" gasoline and "No. 1" fuel oil, is a special motor fuel which is subject to the retailers excise tax imposed by section 4041(b) of the Internal Revenue Code of 1954.

However, under the provisions of section 4041(d) of the Code, the tax does not apply to the sale of the fuel for use, or to the use of the fuel, on a farm for farming purposes.

Pursuant to the provisions of section 4082(c) of the Code, the manufacturers excise tax does not apply to gasoline used by the producer in the production of the special motor fuel. Where the gasoline and fuel oil are held by a common carrier pipeline, but are the property of the producer, it is immaterial where the blending operation takes place.

Advice has been requested (1) whether the retailers excise tax applies to the sale or use of a product which is produced by blending gasoline and fuel oil; (2) whether the manufacturers excise tax applies to the use of gasoline by the producer in the production of the fuel; and (3) whether the applicability of these excise taxes would be affected by the fact that the gasoline and fuel oil are held by a common carrier pipeline at the time of the blending operation.

A registered producer of gasoline blends and sells as a special tractor fuel a product made by blending "housebrand" gasoline and "No. 1" fuel oil. The gasoline and fuel oil, although held by a common carrier pipeline, are the property of the blender. The blended product has 90 percent or more evaporated at 392 degrees Fahrenheit and 95 percent or more evaporated at 464 degrees Fahrenheit.

Section 4041(b) of the Internal Revenue Code of 1954 imposes a tax on any liquid (other than gasoline, kerosene, gas oil, or fuel oil) sold for use or used as special motor fuel. The tax attaches when the fuel is sold by any person to the owner, lessee, or other operator of a motor vehicle, motorboat, or airplane, which is not diesel powered, for use as a fuel for the propulsion of such motor vehicle, motorboat, or airplane, or when the fuel is used by any person for such purposes if the fuel was obtained otherwise than by a taxable sale. Section 4041(d) of the Code provides that no tax shall be imposed under subsection (b) on the sale of any liquid sold for use on a farm for farming purposes, or on the use of any liquid used on a farm for farming purposes.

Pursuant to the provisions of section 4082(c) of the Code, no tax applies to gasoline used by a producer in the production of the special motor fuels referred to in section 4041(b) of the Code.

Under the provisions of the Internal Revenue Code of 1939, the manufacturers excise tax on gasoline was imposed by section 3412. Section 3412(c)(2) of the 1939 Code, prior to amendment by the Excise Tax Reduction Act of 1954, 68 Stat. 37, C. B. 1954–1, 343, read as follows:

The term gasoline means (A) all products commonly or commercially known and sold as gasoline (including casinghead and natural gasoline), benzol, benzene, or naphtha, regardless of their classifications or uses; and (B) any other liquid of a kind prepared, advertised, offered for sale or sold for use as, or used as, a fuel for the propulsion of motor vehicles, motorboats, or airplanes; except that it does not include any of the foregoing (other than products commonly or commercially known or sold as gasoline) sold for use otherwise than as a fuel for the propulsion of motor vehicles, motorboats, or airplanes, and otherwise than in the manufacture or production of such fuel and does not include kerosene, gas oil, or fuel oil.

Section 314.30(b)(2) of Regulations 44, applicable to this provision of the 1939 Code, provides that the term "gasoline" includes benzol,

benzene, naphtha, or any other liquid of a kind prepared, advertised, offered for sale, or sold for use as, or used as, a fuel for the propulsion of motor vehicles, motor boats, or airplanes, 10 percent of which has been recovered when the thermometer reads 347 degrees Fahrenheit (175 degrees Centigrade) *or* 95 per cent of which has been recovered when the thermometer reads 464 degrees Fahrenheit (240 degrees Centrigrade) 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. Section 314.30(c) of the regulations provides that the term "gasoline" does not include products commonly or commercially known or sold as kerosene, gas oil, or fuel oil, which means any product so designated (1) 10 per cent of which has not been recovered when the thermometer reads 347 degrees Fahrenheit and (2) 95 per cent of which has not been recovered when the thermometer reads 464 degrees Fahrenheit, when subjected to distillation in accordance with the above mentioned method of test.

The Excise Tax Reduction Act of 1954 changed the method of taxation of liquid fuels coming within the distillation range provided in section 314.30(b)(2) of the regulations by eliminating the tax on the manufacturer's sale and imposing it either upon the retailer's sale or upon the consumer's use. The provisions of section 3412(c)(2) of the 1939 Code regarding these fuels were eliminated so that the section as amended by the Excise Tax Reduction Act of 1954 provides that the term "gasoline" means all products commonly or commercially known or sold as gasoline (including casinghead and natural gasoline). Thus, the provisions of section 314.30(b)(2) of the regulations were no longer applicable in defining the term "gasoline" for purposes of section 3412(c)(2) of the 1939 Code. At the same time, the Excise Tax Reduction Act revised section 2450 of the 1939 Code, which imposed a retailers excise tax on diesel fuel, to include a new subsection, (b), imposing a retailers excise tax on these fuels which are designated therein as Special Motor Fuels. Section 2450(b) of the 1939 Code is now section 4041(b) of the 1954 Code.

Pending the issuance of regulations on the provisions of section 4041(b) of the 1954 Code, the Internal Revenue Service considers that the distillation ranges contained in sections 314.30(b)(2) and 314.30(c) of Regulations 44 still provide an acceptable guide for classification of products as special motor fuels, or as kerosene, gas oil, or fuel oil.

Since, in the instant case, the blended product sold as a special tractor fuel meets the distillation test for special motor fuel rather than for kerosene, gas oil, or fuel oil, it is held that the product is subject to the retailers excise tax imposed by section 4041(b) of the Code when sold for use, or used, as fuel for the propulsion of motor vehicles, motorboats, or airplanes. However, under the provisions of section 4041(d) of the Code, the tax does not apply to the sale of the product where it is sold for use on a farm for farming purposes, or to the use of the product where it is used on a farm for farming purposes.

In accordance with the provisions of section 4082(c) of the Code, the producer incurs no liability for the manufacturers excise tax on gasoline used in the production of the special tractor fuel.

Inasmuch as the registered producer holds title to the gasoline and fuel oil used in producing the special tractor fuel, it is immaterial where the blending operation takes place. See S. T. 734, C. B. XIII–1381 (1934).

Rev. Rul. 58–399

Where a purchaser of special motor fuel is unable to determine, at the time of purchase, what portion of the liquid delivered into his bulk storage tanks will be used as a fuel for the propulsion of motor vehicles, motorboats, or airplanes, the vendor may sell the fuel on a tax-free basis but the vendee will become liable for tax on whatever quantity of the liquid he uses as a fuel in motor vehicles, motorboats, or airplanes. On the other hand, if the purchaser furnishes a statement, prior to or at the time of the vendor's sale, indicating that the liquid is for use as a fuel in motor vehicles, motorboats, or airplanes, the vendor is liable for tax on the entire quantity of fuel sold but is entitled to a credit or refund of the tax paid on any liquid subsequently used otherwise than as a fuel in motor vehicles, motorboats, or airplanes.

Advice has been requested concerning the applicability of the excise tax on special motor fuels when sold for use, or used, as a fuel under the conditions described below.

A vendor of special motor fuel proposes to sell his product to a vendee who is unable to determine, prior to or at the time of the sale, how and in what quantities the fuel is to be used. The special motor fuel is to be delivered into bulk storage tanks located on the premises of the purchaser. Later, this liquid is to be withdrawn from the storage tanks for use as a fuel in the propulsion of registered highway motor vehicles and in internal combustion engines which are not "motor vehicles, motorboats, or airplanes" of the type referred to in section 4041(b) of the Internal Revenue Code of 1954.

Section 4041(b) of the Code imposes a tax upon certain special motor fuels 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. That section further provides that unless there was a taxable sale of the liquid, the tax will apply to such liquid used by any person as a fuel for the propulsion of a motor vehicle, motorboat, or airplane.

Regulations 119, made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, pertains to diesel fuel. However, the provisions of these regulations are followed, insofar as applicable, in administering the tax on special motor fuels. Therefore, where reference is made in the regulations to "diesel-powered highway vehicle" the words "motor vehicle, motorboat, or airplane" may be substituted. Section 324.21(b) of those regulations states that, for purposes of the tax, the sale of a taxable liquid to an owner, lessee, or other operator of a diesel-powered highway vehicle shall be considered a taxable sale of such liquid where the liquid is delivered by the vendor into the fuel supply tank of the vehicle, or, where not so delivered, the vendee indicates in writing to the vendor 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 as a fuel in a diesel-powered highway vehicle. If such a written statement is not furnished by the vendee, he shall be liable for the tax on that quantity of the liquid

which is used by him as fuel in a diesel-powered highway vehicle. Section 324.44 of the regulations provides that where a vendor who has paid tax upon the sale of a taxable liquid for use as a fuel in a diesel-powered highway vehicle establishes that his vendee used such liquid otherwise than as a fuel in a diesel-powered highway vehicle, he may take a credit for such tax paid by him against the tax shown to be due on any subsequent return or he may file a claim for refund in accordance with the Code and regulations.

It is held that where a purchaser of special motor fuel is unable to determine, at the time of purchase, what portion of the liquid delivered into his bulk storage tanks will be used as a fuel for the propulsion of motor vehicles, motorboats, or airplanes, the vendor may sell the fuel on a tax-free basis, but the vendee will become liable for tax on whatever quantity of the liquid he uses as a fuel in motor vehicles, motorboats, or airplanes. On the other hand, if the purchaser furnishes a statement, prior to or at the time of the vendor's sale, indicating that the liquid is for use as a fuel in motor vehicles, motorboats, or airplanes, the vendor is liable for the tax on the entire quantity of fuel sold but is entitled to a credit or refund of the tax paid on any liquid subsequently used otherwise than as a fuel in motor vehicles, motorboats, or airplanes.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO RETAILERS TAX

SECTION 4051.—DEFINITION OF PRICE

(Also Sections 4001, 4011, 4021, 4031.) Rev. Rul. 58-552

Whether a charge for gift wrapping an article, at the customer's request, is to be included in the selling price of the article for purposes of computing the retailers excise tax depends upon whether the charge is shown on the invoice, price tag, or records of the retailer as a separate or distinct item.

Advice has been requested whether a charge made by a retail store for gift wrapping an article is to be included in the selling price of the article for purposes of computing the retailers excise tax.

Some retail department stores provide gift wrapping and/or gift boxes to their customers without charge. However, due to the rising costs of labor and material, other stores make charges for such services. Some of these stores have gift boxes available in every department. In this case, the customer can, if he wishes, pay an additional amount for having the article gift wrapped at the time of purchase. In other stores, the customer purchases an article at the regular price in on department and then takes the merchandise to a special desk where he pays a charge for having the article gift wrapped. In both of the above illustrations, the customer can purchase an article at the regular price without having the article gift wrapped.

Sections 4001, 4011, 4021, and 4031 of the Internal Revenue Code of 1954 impose upon certain articles sold at retail a tax based upon the price for which sold. Section 4051 of the Code provides that, in de-

termining the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment.

Section 320.5 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that, in general, the sale price, which is the basis of the tax, should be the retailer's actual price at the point of distribution or sale. In determining the sale price, for tax purposes, there shall be included any charge incident to placing the article in condition packed ready for shipment. Section 320.6 of the regulations provides that any charges for coverings, containers, etc., incident to placing an article in condition packed ready for shipment shall be included as a part of the sale price for the purpose of computing the tax. Therefore, the amount paid for the article and its covering or container is the basis for computing the tax even though a separate charge for such covering or container is billed on the invoice.

The determination of the tax base where an article is gift wrapped by a retailer depends upon the nature of the transaction. If the retailer sells a gift wrapped article for a stated price, the tax applies to that price. On the other hand, if the article is sold for a stated price without gift wrapping but in condition packed ready for delivery to the customer and at the customer's request the retailer performs a gift wrapping service, the gift wrapping service charge is not included in the tax base, provided such charge is shown separately on the invoice, price tag, or records of the retailer. If the invoice, price tag, or records of the retailer do not show as separate amounts the selling price of the article and the charge for the gift wrapping service, it is presumed that the total amount shown constitutes the retailer's actual price which is subject to tax.

It is held that, since, in both of the illustrations in the instant case, the customers may purchase the articles for a stated price without gift wrapping, any additional charge for gift wrapping an article may be excluded from the tax, provided such amount is shown separately on the invoice, price tag, or records of the retailer.

SECTION 4055.—STATE AND LOCAL GOVERNMENT EXEMPTION

Whether an intercollegiate athletic association comes within the scope of the exemption from certain Federal excise taxes provided with respect to transactions with States and local governmental units. See Rev. Rul. 58–492, page 814.

SECTION 4056.—EXEMPTION FOR EXPORTS

Simplified Export Exemption Certificate for use by retailers to establish exemption with respect to sales of articles to citizens and/or residents of Mexico in United States counties contiguous to the Mexican border. See Rev. Proc. 58–10, page 1120.

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER A.—AUTOMOTIVE AND RELATED ITEMS

PART I.—MOTOR VEHICLES

SECTION 4061.—IMPOSITION OF TAX

Rev. Rul. 58-343

A drag link assembly, which is especially designed for use as a component part of the steering mechanism on a motor grader equipped with front wheels which may be tilted, is not an automobile part or accessory within the meaning of section 4061(b) of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of the drag link assembly described below.

A company is principally engaged in the manufacture and sale of automobile parts and accessories. It manufactures a drag link assembly for use on a motor grader equipped with front wheels which can be tilted approximately 25 degrees to the right or left of a vertical position. The drag link assembly serves as the connecting linkage between the arm at the end of the steering column and the spindle arm so that controlled turning of the front wheels may be accomplished whether such wheels are in an upright or tilted position. The drag link assembly has a particular angle of bend and is of the length required to function properly only on a motor grader with leaning front wheels.

Section 4061(a) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of certain motor vehicle articles. Paragraph (1) enumerates chassis and bodies for automobile trucks, automobile buses, and truck and bus trailers and semitrailers, as well as tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer. Paragraph (2) enumerates chassis and bodies for other automobiles and certain trailers and semitrailers suitable for use in connection with passenger automobiles.

Section 4061(b) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories, with certain exceptions not here material, for any of the articles enumerated in section 4061(a).

It is held that, since the drag link assembly is primarily designed and adapted for use on a nontaxable motor grader, it is not an automobile part or accessory within the meaning of section 4061(b) of the Code. Accordingly, sales of such drag link assemblies are not subject to the manufacturers excise tax.

Rev. Rul. 58-361

Transmissions which are primarily designed and adapted for off-highway vehicles which perform heavy duty operations are not automotive parts or accessories for vehicles taxable under section 4061(a) of the Internal Revenue Code of 1954 and are not subject

to the manufacturers excise tax imposed by section 4061(b) of the Code. Furthermore, sales of replacement parts which are usable only on these nontaxable transmissions are not subject to the tax.

Advice has been requested concerning the applicability of the manufacturers excise tax on automotive parts or accessories to the sale of certain transmissions and of replacement parts for such articles.

The transmissions are designed for and used exclusively in trucks and prime movers engaged in off-highway earth moving and mining operations. The size and input torque capacity of these transmissions preclude their use in over-the-highway vehicles.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer of parts or accessories, with certain exceptions not here material, for any of the motor vehicle articles enumerated in section 4061(a) of the Code.

Since the transmissions described above are primarily designed and adapted for use on off-highway vehicles, it is held that they are not automotive parts or accessories for vehicles taxable under section 4061(a) of the Code. Accordingly, sales of these transmissions are not subject to the tax imposed by section 4061(b) of the Code.

It is further held that replacement parts which are primarily designed and adapted for use only on these nontaxable transmissions are not subject to the tax. However, if parts for transmissions primarily designed or adapted for use in taxable vehicles are sold as replacement parts for these nontaxable transmissions, the tax imposed by section 4061(b) of the Code attaches to the sale of such parts for repair or replacement purposes.

Rev. Rul. 58–385

An engine "pre-heater" which is designed to be installed on an automobile, truck, or bus in order to facilitate engine starting in cold weather is an automobile part or accessory within the purview of section 4061(b) of the Internal Revenue Code of 1954 and, therefore, the sale of such "pre-heater" by the manufacturer thereof is subject to the manufacturers excise tax on automobile parts or accessories.

Advice has been requested whether the sales of automotive engine "pre-heaters' by the manufacturer thereof are subject to the manufacturers excise tax on automobile parts or accessories.

A company manufactures and sells automotive engine "pre-heaters." These "pre-heaters" are designed to be easily mounted on the engine fire wall or inside fender face of any truck, automobile, or bus, and serve the function of keeping the fluid inside the engine radiator and block warm, thus assuring easy engine starting in cold weather. While a vehicle upon which the "pre-heater" is mounted is at rest, the "pre-heater," which operates on a thermo-syphon principle, is plugged into any standard electrical outlet. The "pre-heater" will then heat the fluid in the engine radiator and block to normal engine temperature and by means of a thermostat maintain the fluid at that temperature. The presence of a "pre-heater" on a vehicle does not interfere with circulation in the cooling system during normal operation of the vehicle.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax upon the sales by the manufacturer, producer, or importer of parts or accessories (other than tires or inner tubes and other than automobile radio or television sets) for any of the automotive articles enumerated in section 4061(a) of the Code. Automobile, automobile truck, and automobile bus chassis are among the articles enumerated in section 4061(a) of the Code..

Section 316.55(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, describes the term "parts or accessories" for the automotive articles enumerated in section 4061(a) of the Code as including (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (2) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

It is held that the engine "pre-heaters," described in the instant case, are parts or accessories within the purview of section 4061(b) of the Code; therefore, the sales of such "pre-heaters" by the manufacturer thereof are subject to the manufacturers excise tax on automobile parts or accessories.

Rev. Rul. 58–424

The sale by the manufacturer of a certain diesel type dump truck chassis, which is 96 inches in overall width and is equipped for operation over the highway, is subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954 even though the chassis will be used exclusively in an underground mine. There is no provision in the statute under which a refund may be allowed for the reason that the chassis is never used on the highway.

Advice has been requested whether the manufacturers excise tax applies to the sale by the manufacturer of a diesel type dump truck chassis for use exclusively in an underground mine or whether a subsequent refund of the tax may be allowed because the chassis is never used on the highway.

A manufacturer sells a diesel type dump truck chassis to a purchaser who places a body thereon and uses the vehicle exclusively in an underground mine. The chassis is 96 inches in overall width and it is equiped with the necessary lights, brakes, bumper, horn, etc., for operation over the highway.

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 bodies, automobile bus chassis and bodies, truck and bus trailer and semitrailer chassis and bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

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. In the instant case, it is held that the above-described truck chassis is primarily designed

and adapted for the transportation of property over the highway. See Rev. Rul. 57–440, C. B. 1957–2, 721. Accordingly, the sale of the chassis by the manufacturer thereof is subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Code even though the truck will never be operated over the highway but will be used exclusively in an underground mine. There is no provision in the statute under which a subsequent refund of the tax may be allowed for the reason that the chassis is never used on the highway.

Rev. Rul. 58–444

Under the provisions of section 4061 (b) and section 4062 of the Internal Revenue Code of 1954, a tax is imposed upon the sales of automobile storage batteries by the manufacturer, producer, or importer thereof. *Held*, where an automobile storage battery is restored to useful condition by the replacement of one or more cells in such battery with one or more cells from another battery, or where a battery is produced by the replacement of worn plates or by a complete assembly of useful parts, such as containers, separators, and plates salvaged from junk batteries, such operations constitute manufacturing (rebuilding). Therefore, a person who restores batteries in such a manner for sale is regarded as a manufacturer within the meaning of the Code and is liable for the manufacturers excise tax on his sales of the batteries, regardless of the identity of the original batteries from which any of these parts were salvaged and regardless of whether any new parts are incorporated therein. *Held further*, the mere replacement of separators or casings in a battery does not constitute manufacturing, and the sale of batteries so reconditioned, assembled, and recharged is not subject to the tax.

Rev. Rul. 58–487

A self-propelled "mobile home" vehicle which provides living and sleeping accomodations is a taxable vehicle within the meaning of section 4061 (a) of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on motor vehicles to sales of a self-propelled "mobile home" vehicle.

A manufacturer produces and sells a conventional four-wheeled automobile chassis and a specially designed body which provides living and sleeping accomodations consisting of a permanently installed bed, kitchen facilities, dining area, wardrobe closet, and lavatory facilities. The living and sleeping area is separated from the seat for the driver and passengers and is designed with windows and a separate door similar to those in a house trailer.

Section 4061(a)(2) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of automobile chassis and bodies other than those taxable under section 4601(a)(1) and chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles. Section 4653(a) of the Code provides that the tax imposed under 4061(a)(2) shall not apply in the case of house trailers.

Since the vehicle described above is not a house trailer of the type which is exempt by section 4063(a), the sale of the vehicle by the manufacturer is subject to the manufacturers excise tax imposed by section 4061(a) of the Code. Furthermore, the equipment, such as the bed, etc., provided with the vehicle is subject to the tax, when sold on or in connection with the sale of the taxable vehicle.

Rev. Rul. 58–488

Although certain described three-wheel motor vehicles have some characteristics of motorcycles, the vehicles are considered to be automobiles within the meaning of section 4061(a)(2) of the Internal Revenue Code of 1954. Accordingly, sales of the vehicles by the importer thereof are subject to the manufacturers excise tax imposed by that section.

Advice has been requested whether the manufacturers excise tax applies to the sale by the importer of the two motor vehicles described below. The basis for the request is that the vehicles should be considered as motorcycles which are not subject to the manufacturers excise tax.

The first vehicle has two front wheels and one rear wheel. It has a single-cylinder, air-cooled, two stroke engine which develops nine horsepower. It is driven by a roller chain drive, steered by handle bars, and is accelerated by rotating a handle bar grip. The vehicle has a "kick" starter, four speeds, three-wheel mechanical brakes, luggage compartment, two headlamps and one tail lamp. It weighs 385 pounds and attains a maximum speed of 50 miles per hour. Two persons may ride in the vehicle in tandem. The body of the vehicle consists of a lower portion of light sheet metal "wrap-around," which provides almost shoulder-high protection for the driver and any passenger, and an upper portion of clear plastic which forms a hood over the occupants. The plastic hood is hinged on one side of the vehicle in such a manner that the hood and a portion of the metal side panel are raised to permit entrance and exit.

The second vehicle has one front and two rear wheels. It has a single-cylinder, three-speed, two-stroke engine with electric starter, and develops 5.2 horsepower. It likewise has three-wheel mechanical brakes, is driven by chain drive, and attains a maximum speed of 50 miles per hour. The vehicle has one headlamp and one tail lamp, and directional lights and it weighs 210 pounds. The streamlined body, which has no front fenders, encloses the chassis and has an open cockpit for the driver.

Section 4061(a)(2) of the Internal Revenue Code of 1954 imposes a tax on automobile chassis and bodies other than those taxable under paragraph (1), and on chassis and bodies, for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles.

Although the above-described vehicles have some characteristics of motorcycles, since they have automobile-type bodies which enclose and protect the driver and any passengers and are primarily designed for the transportation of persons on the highway, it is held that they are automobiles within the meaning of section 4061(a)(2) of the Code. Accordingly, sales of the vehicles by the importer thereof are subject to the manufacturers excise tax imposed by that section.

Rev. Rul. 58–489

Battery cable terminals which are designed and adapted for use on various sizes and types of storage batteries are not automotive parts or accessories within the meaning of section 4061(b) of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on automotive parts or accessories to the sale of certain battery cable terminals.

The terminals are of solderless two-piece slip-yoke construction. Such construction provides a secure connection for either positive or negative post on different sizes or types of storage batteries. The yoke end of the terminal may be fastened over battery cables of different sizes. Thus, the terminals are designed for use in connection with a wide variety of batteries other than those used in taxable motor vehicles.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories, with certain exceptions not here material, for any of the motor vehicle articles enumerated in section 4061(a) of the Code.

Since the battery cable terminals described above are not primarily designed or adapted for use in connection with taxable motor vehicles, it is held that they are not automotive parts or accessories within the meaning of section 4061(b) of the Code. Accordingly, sales of the terminals by the manufacturer are not subject to the tax imposed by that section of the Code.

Rev. Rul. 58–506

A company manufactures so-called "all-purpose rollers." The self-propelled machines have front and rear rollers and are used to compress and smooth beds for and surfaces of streets, highways, etc. The machines are equipped with an off-set drive which permits close tolerance work near curbs and buildings. *Held*, since all-purpose rollers are primarily designed and adapted for use in the construction and maintenance of streets and highways, rather than for the transportation of persons or property on the highway, they are not subject to the manufacturers excise tax imposed by section 4061 of the Internal Revenue Code of 1954.

Rev. Rul. 58–507

Where a dealer makes seat covers for a customer, using the leather trim of the customer's old seat covers together with new material, the charge made is not subject to the manufacturers excise tax. Additionally, where a customer's automobile seats are burned, only the springs being left, the recovering of the seats with cotton padding and new upholstery material does not constitute the sale of a taxable seat cover.

The Internal Revenue Service has been requested to determine whether the transactions described below are considered to be taxable sales of automobile seat covers.

Section 4061(b) of the Internal Revenue Code of 1954 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). Automobile seat covers are automobile accessories within the meaning of section 4061(b). See S. T. 944, C. B. 1952–2, 255, as clarified by Rev. Rul. 54–330, C. B. 1954–2, 409. Moreover, *covers* made of plastic, terry cloth, corduroy, or other similar materials, which are held out as being suitable for use as automobile seat covers, furniture covers, bath mats, table covers, playpen covers, etc., but which by reason of their size, shape, and design are more suitable for use as automobile seat covers than for any other use, are subject to the manufacturers excise tax as automobile parts or accessories. See Revenue Ruling 56–349, C. B. 1956–2, 793.

The particular transactions in question and the conclusions regarding the taxability thereof are set forth in the succeeding paragraphs.

SITUATION No. 1.—A customer has partially worn-out seat covers on his car. The leather trim at the top of the seat covers, which in the instant case extends down approximately nine inches, is in good condition. A dealer uses the leather trim, together with new material, to make another set of seat covers for the customer.

Conclusion. The dealer incurs no manufacturers excise tax liability on the charge made, since the customer's own material formed a large part of the seat covers.

SITUATION No. 2.—A dealer purchases bolts of cloth which were produced for use in a certain kind of automobile. Some of the bolts are upholstery material; the rest are slip cover material. The dealer uses the upholstery material to renew the upholstery of automobile seats or to replace parts of the automobile seat upholstery which have been damaged, such as by cigarette burns. The slip cover material is used to produce complete seat covers where the customer prefers to cover a worn or burned seat, rather than to have the seat renewed or a part of it replaced.

Conclusion. Where bolts of upholstery material are used in the manner stated, the dealer incurs no manufacturers excise tax liability, since the dealer's operations are in the nature of "repairs" rather than the manufacture and sale of seat covers. On the other hand, where the bolts of slip cover material are used to produce detachable seat covers, the sale or use of such covers by the dealer is subject to the tax imposed by section 4061 (b) of the code.

SITUATION No. 3.—A customer's automobile seats were burned, only the spring being left. The seats are covered with cotton padding and new upholstery material.

Conclusion. No manufacturers excise tax liability is incurred with respect to charges for this operation, since the dealer's operations are in the nature of "repairing" the existing seat rather than "manufacturing and selling" an automobile seat or seat cover.

Rev. Rul. 58–528

A company manufactures "patches" which are intended for use in repairing convertible automobile tops. However, they can also be used for mending tents, tarpaulins, awnings, canvas furniture, and similar articles. *Held*, since these "patches" are susceptible of general use, they are not considered automobile parts or accessories within the meaning of section 4061(b) of the Internal Revenue Code of

1954. Accordingly, the manufacturers excise tax imposed by that section of the Code does not apply to the sale of such articles by the manufacturer, producer, or importer thereof.

Rev. Rul. 58–569

A hydraulic tower and related articles which are designed to be mounted upon a "street light tower truck" are not automobile parts or accessories for purposes of the manufacturers excise tax on automobile parts or accessories. However, a transmission power take-off which is used to operate the tower is considered to be an automobile part or accessory for purposes of the tax. Furthermore, the sale by the manufacturer of a specially designed truck body to be used in conjunction with the tower is subject to the manufacturers excise tax on motor vehicles.

Advice has been requested whether the manufacturers excise tax on motor vehicles applies in the situation described below.

A corporation purchases a standard motor truck chassis with a cab. The chassis is then turned over to a company which manufactures and mounts thereon a specially designed body and other special purpose equipment. The completed vehicle is known to the industry as a "street light tower truck." The vehicle and equipment are used for maintenance and replacement of street lights and other incidental overhead line work where an access tower is required. The following are the items manufactured and mounted on the chassis by the company:

Item 1. A specially designed body with a sliding hatch cover, rear door, and shelves.

Item 2. A 30-gallon galvanized reservoir to carry a water supply for lamp washing and two tubs for washing lamps.

Item 3. A heavy duty hydraulic tower.

Item 4. A rotary platform mounted upon the hydraulic tower.

Item 5. A stationary ladder for access to the hydraulic tower.

Item 6. A hydraulic pump for operation of the tower.

Item 7. A power take-off from the truck transmission for the operation of the hydraulic pump.

Item 8. Controls for the operation of the hydraulic tower.

When the vehicle is completed, it is returned to the corporation, and the company makes a charge for the sale and installation of the articles enumerated above.

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 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 or inner tubes and other than automobile radio and television receiving sets) for the articles enumerated in section 4061(a) of the Code.

It is held that the body described in item 1 above is a taxable body and that the sale of the body by the manufacturer is subject to the manufacturers excise tax on motor vehicles imposed by section 4061(a) of the Code. The power take-off described in item 7 is an automobile

part or accessory within the purview of section 4061(b) of the Code; therefore, the sale of the power take-off by the manufacturer thereof is subject to the manufacturers excise tax on automobile parts or accessories.

The articles enumerated in items 2, 3, 4, 5, 6, and 8, are not automobile parts or accessories of the type contemplated by section 4061(b) of the Code. These articles may be sold tax free in connection with the sale of the body by the manufacturer if they are billed separately on the invoice to the customer or if the sale prices of the articles can be determined from the manufacturer's records.

(Also Section 4218.) Rev. Rul. 58–582

A so-called "truck body kit," consisting of a front end section, two sides, and a top section, constitutes a truck body as contemplated by section 4061(a)(1) of the Internal Revenue Code of 1954. Therefore, the manufacturer's sales thereof are subject to the excise tax imposed by that section. Customers purchasing such a kit and performing such operations as the addition of a floor, doors, lining, etc., are liable for the tax on their sale or use of the completed body, subject to the credit or refund provisions applicable to the use of any tax paid articles in the further manufacturing process.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of so-called "truck body kits" in the situations described below.

(1) A manufacturer produces and sells a truck body kit which includes, as a minimum, a front end section, two sides, and a top section. The manufacturer also produces parts required to complete a truck body, such as floors, doors, gates, linings, etc. Generally, the kits are sold to distributors; however, in some instances they are sold at the factory and installed on the customer's chassis by the kit manufacturer.

(2) A distributor combines a truck body kit purchased from the kit manufacturer with parts or accessories of his own manufacture or with parts or accessories purchased from sources other than the kit manufacturer. The distributor installs the complete truck body on a customer's chassis.

(3) A truck fleet operator purchases a truck body kit and either produces or purchases separately the necessary parts or accessories to complete a truck body. The fleet operator assembles a complete body and installs it on a chassis for use in his business.

Section 406(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 (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof). Section 4218(a) of the Code provides, with certain exceptions not here applicable, that if any person manufactures, produces, or imports an article and uses it, otherwise than as material in the manufacture or production of, or as a component part of, another taxable article man-

ufactured by him, he shall be liable for the tax in the same manner as if such article was sold by him, and 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.

Section 316.4 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "manufacturer" includes a person who produces a taxable article by combining two or more articles. This section further provides that a manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, is liable for the tax, and not the person who buys and assembles a taxable article from such component parts.

It is held that a truck body kit consisting of front end section, two sides, and a top section is an article which has reached such a stage of manufacture as to constitute a truck body as contemplated by section 4061(a)(1) of the Code. Therefore, under the circumstances described in (1) above, the manufacturer is liable for tax under that section of the Code on his sale of the truck body kit. Where the kits are sold to a distributor at wholesale, the tax base is the actual wholesale price, subject to the adjustments under section 4216(a) of the Code. The tax also applies to any parts or accessories, such as floors, doors, etc., sold by the manufacturer on or in connection with the sale of the kit. Where a kit manufacturer who sells primarily at wholesale assembles the components of a kit and installs the assembled body on a customer's chassis for his use rather than for resale, the transaction is considered to be a sale at retail and tax is based, under section 4216(b)(1) of the Code, on the manufacturers highest established wholesale price for such kits, plus any charges for parts or accessories and for assembling the complete body. No tax, however, applies to a charge for installing the complete body on the customer's chassis.

It is further held that, under the circumstances described in (2) above, the distributor is liable for the tax on his sale of the complete truck body, whether assembled or in a knockdown condition, including any charge for assembling the complete body. If the body kits or the parts or accessories were purchased taxpaid, the distributor may claim a credit or refund of such tax. A distributor is not liable for tax, however, on his sale of a complete truck body assembled by him where he purchases a body kit and the parts or accessories therefor from one manufacturer under such circumstances that the manufacturer has sold a complete body in knockdown condition.

Under the circumstances described in (3) above, the fleet operator is liable for tax on his use of the completed body. As set forth in Revenue Ruling 54–490, C. B. 1954–2, 416, the tax imposed by 4061(a)(1) of the Code applies to the customer's cost of producing the completed body, plus ten percent of such cost.

The mere addition, by a purchaser of a body kit, of parts or accessories which are insubstantial with respect to the body as completed (such as mudflaps, running lights, emblems, or similar articles) does not characterize such a purchaser as a truck body manufacturer.

The Internal Revenue Service has previously held that a purchaser of a truck body kit incurs no tax liability on his resale or use of the assembled body even though he performs such operations as the ad-

dition of a floor, doors, lining, etc., in connection with such body. That position has received publicity in the industry involved and has been relied upon as a basis for not paying the tax under such circumstances. Therefore, under the authority of section 7805(b) of the Code, this ruling, to the extent that it holds taxable the sale or use of a complete truck body by a person who purchases a taxable truck body kit and performs thereon some act of further manufacture, will not be applied to sales or use prior to January 1, 1959.

Rev. Rul. 58–584

A sleeping unit which is designed for mounting on the top of an automobile is an automobile accessory within the meaning of section 4061(b) of the Internal Revenue Code of 1954. Accordingly, the sale of such article by the manufacturer is subject to the manufacturers excise tax imposed by that section.

Advice has been requested whether the manufacturers excise tax applies to the sale by the manufacturer of a sleeping unit which is designed for mounting on the top of an automobile.

The sleeping unit is constructed of aluminum, is fully enclosed, and is of sufficient size to provide sleeping room for two adults. It is designed for mounting on the top of any automobile by means of rubber grip-type suction cups and adjustable side hook straps. It is equipped with two air mattresses, a mounting rack, and sliding screen doors. When travelling, the unit may be used to carry sports equipment and baggage.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (with certain exceptions not here material) for any of the articles enumerated in section 4061(a).

Since the above-described article is designed for mounting on the top of an automobile, it is held that the article is an automobile accessory within the meaning of section 4061(b) of the Code. Accordingly, the sale by the manufacturer of such article is subject to the manufacturers excise tax imposed by that section.

Rev. Rul. 58–585

Coil springs which are primarily designed and adapted to give additional support to, and to increase the load capacity of, the springs on taxable motor vehicles are automobile parts or accessories whether or not they are permanently attached to such motor vehicles. Therefore, the sales of such coil springs are subject to the manufacturers excise tax imposed by section 4061(b) of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on parts or accessories for motor vehicles to sales of certain "helper" or "overload" coil springs.

A manufacturer sells two types of coil springs which are designed to give additional support to, and to increase the load capacity of, springs used on passenger automobiles and light trucks. One type is designed and adapted for use as a permanent attachment on passenger automobiles and light trucks to brace-up their sagging springs. The other type is designed and adapted for use on passenger auto-

mobiles, is not permanently attached to the vehicles, and can not be used to replace the regular automobile springs because it is too rigid. This type of coil spring is used to increase the load capacity of the springs on passenger automobiles when the automobiles are towing trailers or carrying heavy loads. Both types of coil springs are helical shaped, made of extra heavy duty wire, and are designed to fit into a saddle which is attached to the vehicles by means of a U-clamp.

Section 4061(a) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of certain motor vehicle articles. Paragraph (1) enumerates chassis and bodies for automobile trucks, automobile buses, and truck and bus trailers and semitrailers, as well as tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer. Paragraph (2) enumerates chassis and bodies for other automobiles and certain trailers and semitrailers suitable for use in connection with passenger automobiles.

Section 4061(b) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories, with certain exceptions not here material, for any of the articles enumerated in section 4061(a). Section 316.55 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "parts or accessories" for automobile truck or other automobile chassis or body includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (2) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

It is immaterial whether the coil springs, in the instant case, may or may not be permanently attached to passenger automobiles or light trucks. Since they are primarily designed and adapted for use on taxable motor vehicles, it is held that these coil springs are parts or accessories for articles taxable under section 4061(a) of the Code. Therefore, they are subject to the manufacturers excise tax imposed by section 4061(b) of the Code when sold by the manufacturer.

Rev. Rul. 58–609

Hydraulic bolster hoists which are primarily designed for use with farm wagons are not subject to the manufacturers excise tax imposed by section 4061(b) of the Internal Revenue Code of 1954 when sold by the manufacturer, producer, or importer.

Advice has been requested concerning the applicability of the manufacturers excise tax on automobile parts or accessories to sales of hydraulic bolster hoists which are used with farm wagons.

A company manufactures hydraulic bolster hoists which are specifically designed for use with farm wagons. These hoists may be mounted on any standard four-wheel farm wagon and are adjustable to fit any size wagon box or body. The hoists are equipped with a cylinder which can be operated from either a one-way or two-way hydraulic system. These hoists are used to lift the front end of a

farm wagon box or body for dumping purposes. While it is possible to use these hoists on taxable motor vehicles, they are primarily designed for the farm equipment mentioned above.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories, with certain exceptions not here material, for any of the articles enumerated in subsection 4061(a) of the Code.

In determining whether an article is a part or accessory within the meaning of section 4061(b) of the Code, consideration must be given to whether that article is primarily designed for use with the motor vehicles enumerated in section 4061(a) of the Code, as well as whether the primary use of the article is with those vehicles. Farm wagons are not within the class of motor vehicles enumerated in section 4061(a). See Rev. Rul. 54–506, C. B. 1954–2, 408.

Since these hydraulic bolster hoists are not primarily designed for use with taxable motor vehicles and are not primarily used with such vehicles, it is held that they are not subject to the manufacturers excise tax imposed by section 4061(b) of the Code when sold by the manufacturer.

Rev. Rul. 58–620

The manufacturers excise tax consequences of restoring unserviceable automobile parts to useful condition depend upon whether the identity of ownership of the article is retained by the restorer's customer, whether the identity of the article as such is retained, and whether any machining, rewinding, etc., is performed.

Revenue Rulings 54–329, C. B. 1954–2, 405; 56–189, C. B. 1956–1, 503; 57–572, C. B. 1957–2, 722; and 57–604, C. B. 1957–2, 724, modified.

Advice has been requested concerning the manufacturers excise tax consequences of restoring automobile generators to serviceable condition.

An automotive shop operator receives quantities of unserviceable automobile generators from various customers. The customers understand that they will, in turn, receive from the operator a like quantity of similar generators which have been restored to serviceable condition. When the unserviceable generators are received by the operator, they are dismantled and cleaned, and, where necessary, the armatures are rewound. The components of the generators are segregated, *i. e.*, the housings are collected at one point, the armatures at another, the armature frames at still another, etc. As orders are received, the necessary components are withdrawn from the several points and assembled into complete serviceable generators. Since the various components have been commingled so that their identification with any particular generator is lost, it is not known whether a restored generator is assembled from components which came from the same unserviceable generator.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax upon 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 sold by the manufacturer, producer, or importer. The tax is not limited to new parts but applies also to rebuilt or manufactured parts. The regulations applicable to the tax embody this concept by defining a

manufacturer as a person who produces a taxable article from scrap, salvage, or junk materials, as well as from new or raw material (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

In any transaction involving the restoration of a used taxable article there are two identities which are crucial to the tax consequences flowing from that transaction. The two identities are identity of ownership of the article and identity of the article itself as such. The essentials of the position of the Internal Revenue Service in this respect can be expressed in four situations:

(1) If the identity of the article is retained and the identity of ownership of the article is retained (*i. e.*, ownership remains in the customer), the operation performed in restoring the unserviceable unit to serviceable condition is a repair operation, regardless of whether any machining or rewinding, etc., is done on the restored unit. In such a situation, no tax is incurred by the operator on the operation as such. For guidance in determining whether identity of ownership of the article is retained in the customer, see Revenue Ruling 57–593, C. B. 1957–2, 723.

(2) If the identity of the article is retained but identity of ownership of the article is not retained (*i. e.*, ownership passes to the operator) and no machining or rewinding, etc., is done in the restoration of the unit, the operation is considered a reconditioning operation. In this situation, no tax is incurred by the operator on the sale of the reconditioned unit.

(3) If the identity of the article is retained but identity of ownership of the article is not retained, and machining or rewinding, etc., is done in restoring the unit to serviceable condition, the operation is considered a rebuilding operation. The operator is liable for tax on his sale of the rebuilt unit.

(4) If the identity of the article is not retained (*i. e.*, the components of the unserviceable article are segregated and commingled with other similar components at various points or in various bins), then it necessarily follows that identity of ownership of the article also is not retained. Therefore, when the components are withdrawn from the various points or bins and assembled into a serviceable unit, the operation is a manufacturing operation within the meaning of that term as set forth in section 316.4(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, regardless of whether any machining or rewinding, etc., is performed in the restoration. The sale of serviceable units so restored is subject to tax.

Since the identity of the articles is not retained under the circumstances in the instant case, it is held that the manufacturers excise tax applies to the operator's sales of the restored generators, without regard to whether machining or rewinding, etc., is performed.

Revenue Ruling 54–329, C. B. 1954–2, 405; Revenue Ruling 56–189, C. B. 1956–1, 503; Revenue Ruling 57–572, C. B. 1957–2, 722; and Revenue Ruling 57–604, C. B. 1957–2, 724, are modified. Under the authority of section 7805(b) of the Code, this Revenue Ruling will not be applied to sales made prior to July 1, 1959, of restored articles assembled from commingled components where no machining

or rewinding operations, etc., are performed in the restoration process, as in situation (4) described above.

Applicability of the exemption from manufacturers excise tax to sales of automobiles by the manufacturer thereof to a county for resale to the county sheriff and his deputies for their official use. See Rev. Rul. 58–413, page 813.

Applicability of the manufacturers excise tax to automobiles sold to a State under an agreement that within a limited time the automobiles would be traded back to the dealer. See Rev. Rul. 58–572, page 815.

PART II.—TIRES AND TUBES

SECTION 4071.—IMPOSITION OF TAX

(Also Section 4225.) Rev. Rul. 58–400

The manufacturers excise tax on tread rubber imposed by section 4071(a)(4) of the Internal Revenue Code of 1954 applies to sales to a retreader who uses the tread rubber for retreading tires and then exports the retreaded tires to foreign countries or ships them to possessions of the United States, including Puerto Rico.

Advice has been requested relative to obtaining a refund or credit of the manufacturers excise tax paid on tread rubber used in retreading tires exported to foreign countries or shipped to possessions of the United States, including Puerto Rico.

A company manufactures tread rubber which it sells to a tire retreader for use in retreading tires. The retreader exports these retreaded tires to foreign countries or ships them to possessions of the United States, including Puerto Rico. The manufacturer desires a refund of the manufacturers excise tax which it paid on its sales of tread rubber to the retreader.

Section 4071(a)(4) of the Internal Revenue Code of 1954 imposes a tax on tread rubber sold by the manufacturer, producer, or importer. Under the provisions of section 4225 of the Code, no tax is imposed on tread rubber when sold by the manufacturer for export or for shipment to a possession of the United States, and in due course so exported or shipped.

Section 316.1(e) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "possession of the United States" includes Puerto Rico. Section 316.25(a) of the regulations provides that to exempt from tax a sale for export it is necessary (1) that the article be identified as having been sold by the manufacturer for export and (2) that the article be exported in due course. Section 316.26(b) of the regulations provides that in any case where the manufacturer is not the exporter, such manufacturer must have in his possession a statement from the person to whom he sold the article that the article was in fact exported in due course prior to use or further manufacture.

While section 4073(c) of the Code provides that the tax does not apply to tread rubber sold by the manufacturer to any person for use by such person otherwise than in recapping or retreading of tires of the type used on highway vehicles, there is no provision in the Code or regulations which exempts a manufacturer's sale of tread rubber for use by his vendee as material in the manufacture or production of a nontaxable article. There is no tax on the sale of retreaded tires as such.

The sale of tread rubber to a retreader for use in retreading tires which the retreader exports or ships to a possession of the United States is a sale of tread rubber for further manufacture and not a sale of tread rubber for export or for shipment to a possession of the United States.

The export exemption provided by section 4225 of the Code is not applicable to sales of tread rubber for use in retreading tires which are then exported, since the rubber was not exported prior to use or further manufacture as required by the regulations. Accordingly, it is held that no refund or credit may be obtained of the manufacturers excise tax paid by the manufacturer of the tread rubber on his sales of the tread rubber used in retreading tires which were then exported or shipped to a possession of the United States, including Puerto Rico.

Rev. Rul. 58–438

The customer who furnishes scrap rubber to a person for processing into usable tread rubber, where he retains title to the scrap and, after processing, receives back the same rubber as material in usable tread rubber, is considered to be the manufacturer of the tread rubber. He is liable for the manufacturers excise tax imposed by section 4071 of the Internal Revenue Code of 1954 on his sale or use of all such tread rubber returned to him, and his liability is not affected by the fact that the processor may have added some new material to the scrap rubber which the customer furnished.

Advice has been requested concerning who is the manufacturer, for purposes of the manufacturers excise tax on tread rubber, where scrap rubber which is furnished by a customer is processed into usable tread rubber and returned to the customer for sale or use.

A manufacturer of tread rubber also processes scrap rubber, furnished by his customers, into usable tread rubber. The manufacturer accepts the scrap with the understanding that the customer retains title thereto. The scrap rubber is milled into slab form, and the slabs are then extruded into the form of tread rubber in die sizes ordered by the customer. In certain instances, the processor adds new material to the scrap.

Section 4071(a)(4) of the Internal Revenue Code of 1954 imposes a tax on tread rubber sold by the manufacturer, producer, or importer. Tread rubber produced by processing salvage rubber materials is subject to the tax imposed by that section. See Rev. Rul. 57–219, C. B. 1957–1, 370. Section 4073(c) of the Code provides that the tax imposed by section 4071 on sales of tread rubber shall not apply to tread rubber sold by the manufacturer, producer, or importer to any person for use by such person otherwise than in the recapping or retreading of tires of the type used on highway vehicels.

Section 316.4 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term

"manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles. That section also provides that where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer. Generally, in such cases, the proportion of the materials furnished by the person for whom the taxable article is manufactured is not considered in determining who is the manufacturer.

Accordingly, where the customer furnishes scrap rubber, to which he retains title, to be processed and returned to him in the form of usable tread rubber, it is held that the customer is the "manufacturer," as that term is used in the statute, and the person who performs the actual processing is the manufacturing agent. The customer, therefore, is liable for the manufacturers excise tax imposed by section 4071 of the Code on his sale or use of the tread rubber for the recapping or retreading of tires of the type used on highway vehicles. His liability for the tax is not affected by the fact that the processor may have added some new material to the scrap rubber which the customer furnished.

Rev. Rul. 58–583

The Internal Revenue Service sets forth a list of the categories of tires that are subject to the manufacturers excise tax, indicating whether they are taxable at eight cents a pound under section 4071(a)(1) of the Internal Revenue Code of 1954 or at five cents a pound under section 4071(a)(2).

The Internal Revenue Service has been asked to publish a list of the categories of tires that are subject to the manufacturers excise tax, indicating whether they are taxable at eight cents a pound under section 4071(a)(1) of the Internal Revenue Code of 1954 or at five cents a pound under section 4071(a)(2).

Section 4071(a) of the Code provides, in part, as follows:

IMPOSITION AND RATE OF TAX.—There is hereby imposed upon the following articles, if wholly or in part of rubber, sold by the manufacturer, producer, or importer, a tax at the following rates;

(1) Tires of the type used on highway vehicles, 8 cents a pound.
(2) Other tires, 5 cents a pound.

Section 4072 of the Code provides:

(a) RUBBER.—For purposes of this chapter, the term "rubber" includes synthetic and subsitute rubber.

* * * * * * *

(c) TIRES OF THE TYPE USED ON HIGHWAY VEHICLES.—For purposes of this part, the term "tires of the type used on highway vehicles" means tires of the type used on—

(1) motor vehicles which are highway vehicles, or
(2) vehicles of the type used in connection with motor vehicles which are highway vehicles.

Section 4073 of the Code provides:

(a) TIRES OF CERTAIN SIZES.—The tax imposed by section 4071 shall not apply to tires which are not more than 20 inches in diameter and not more than 1¾

inches in cross-section, if such tires are of all-rubber construction (whether hollow center or solid) without fabric or metal reinforcement.

(b) TIRES WITH INTERNAL WIRE FASTENING.—The tax imposed by section 4071 shall not apply to tires of extruded tiring with an internal wire fastening agent.

It will be noted that the statute imposes a tax upon two categories of tires, namely: (1) tires of the type used on highway vehicles, which are taxable at eight cents a pound; and (2) other tires which are taxable at five cents a pound (except those exempt under section 4073).

There is listed below a summary of the various categories of tires presently being manufactured that are subject to the manufacturers excise tax. The different categories are broken down between those taxable at eight cents a pound and those taxable at five cents a pound.

Tires taxable at eight cents a pound

Passenger Car and Bus
Truck, on-highway type
Mobile Home Trailer
Motorcycle
Racing Car (except those referred to in Rev. Rul. 57-95, C. B. 1957-1, 365)

Tires taxable at five cents a pound

Truck, off-highway type
Mining and Industrial Handling Casings
Farm Tractor and Implement
Airplane
Helicopter
Tractor Grader
Rice and Canefield
Industrial Pneumatic, including Straight Sides
Solid-Industrial, Truck and Tractor
Semi-Solid-Industrial Tractor
Hollow Center or Semi-Pneumatic Blown Valveless-Juvenile, Industrial

The above classifications are not considered to be all-inclusive. In any case where the classification of a particular type of tire is in doubt, a ruling thereon should be requested from the Service. Furthermore, it is noted that changes in the type of tires manufactured or substantial changes in the usage of the tires now manufactured, may require subsequent modification of this list.

PART III.—PETROLEUM PRODUCTS

Subpart A.—Gasoline

SECTION 4082.—DEFINITIONS

Rev. Rul. 58-457

A dealer, who has registered as a "producer" because he sells gasoline exclusively to other producers of gasoline, will not forfeit such "producer" status, provided by section 4082 of the Internal Revenue Code of 1954, by his use of a small portion of the gasoline in his business motor vehicles.

Advice has been requested whether a dealer, who has registered as a "producer" because he sells gasoline exclusively to producers of gasoline, forfeits his "producer" status by his use in his business motor vehicles of a small portion of the gasoline which he purchases free of tax.

Section 4081 of the Internal Revenue Code of 1954 imposes a tax on gasoline sold by the producer or importer thereof, or by any producer of gasoline. Section 4082(a) of the Code defines the term "producer" to include a refiner, compounder, or blender, and a dealer selling gasoline exclusively to producers of gasoline, as well as a producer. Section 4082(c) provides that if a producer or importer uses (otherwise than in the production of gasoline or of special motor fuels referred to in section 4041(b)) gasoline sold to him free of tax, or produced or imported by him, such use shall be considered a sale. Section 4083 of the Code provides that the tax imposed by section 4081 shall not apply in the case of sales of gasoline to a producer of gasoline.

In the instant case, all *actual* sales of gasoline by the dealer are to producers exclusively. Use by the dealer of a portion of the gasoline in the conduct of his business, while characterized in section 4082(c) as a sale for purposes of subjecting such use to the tax, is nevertheless not a sale in point of fact that would cause his registration under section 4101 of the Code to be cancelled.

Accordingly, it is held that this dealer is a "dealer selling gasoline exclusively to producers of gasoline" within the meaning of section 4082(a) and as such continues to qualify as a producer under that section of the Code, even though he uses, in his business motor vehicles, a portion of the gasoline which he purchases free of tax.

Gasoline used by a producer in the production of a special tractor fuel. See Rev. Rul. 58–398, page 754.

Subpart B.—Lubricating Oil

SECTION 4091.—IMPOSITION OF TAX

Rev. Rul. 58–439

The manufacturers excise tax imposed by section 4091 of the Internal Revenue Code of 1954 does not apply to the sale of oil by the manufacturer thereof direct to purchasers for use as a power transmission medium in hydraulic-type machinery, where it serves no lubricating purpose.

Advice has been requested whether the manufacturers excise tax applies to the sale of oil by the manufacturer thereof for use as a power transmission medium in hydraulic-type machinery, such as boosters, hoists, jacks, lifts, drawing benches, presses, converters, shock absorbers, knee action units, power brakes, and power steering devices.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax on lubricating oils sold by the manufacturer or producer. Section 314.40 of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "lubricating

oils" includes all oils, regardless of their origin, which are sold as lubricating oil and all oils which are suitable for use as lubricants. Section 314.43 of the regulations provides that no tax attaches where oil is sold by the manufacturer direct to a purchaser who uses it for nonlubricating purposes, provided the manufacturer has definite knowledge, prior to or at the time of sale, that the product is purchased for such purposes, and he obtains from the purchaser and retains in his possession a properly executed exemption certificate in the form prescribed by the regulations. No sale of oil may be made tax free by the manufacturer to a dealer for resale for nonlubricating uses even though it is known at the time of sale that the oil will be so resold. However, where any dealer resells tax-paid oil for nonlubricating uses, the manufacturer who paid the tax on his sale of the oil may secure a refund or credit in accordance with the provisions of section 314.64 of the regulations.

It is held that lubricating oil used as a power transmission medium in hydraulic-type machinery, such as boosters, hoists, jacks, lifts, drawing benches, presses, converters, shock absorbers, knee action units, power brakes, and power steering devices, where the oil serves no lubricating purpose, is considered as used for nonlubricating purposes. Therefore, the manufacturers excise tax does not apply to the sale of oil by the manufacturer thereof direct to purchasers for such use, provided the sale is supported by properly executed certificates of nonlubricating use.

Rev. Rul. 58–440

The sale of oil by the manufacturer thereof for use on metals in broaching, blanking, drilling, milling, and turning operations, and in the die cutting of threads is subject to the manufacturers excise tax on cutting oils imposed by section 4091 of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax applies to the sale of oil by the manufacturer thereof for use in broaching, blanking, drilling, milling, and turning operations, and in the die cutting of threads.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax on cutting oils and other lubricating oils sold by the manufacturer or producer. Section 4092(b) of the Code provides that the term "cutting oils" means oils sold for use in cutting and machining operation (including forging, drawing, rolling, shearing, punching, and stamping) on metals.

It is held that oils used on metals in broaching, blanking, drilling, milling, and turning operations, as well as in the die cutting of threads, are used for lubricating purposes in machining operations. Accordingly, the sale of oil by the manufacturer thereof for such use is subject to the manufacturers excise tax on cutting oils imposed by section 4091 of the Code.

Rev. Rul. 58–467

Lubricating oil used in processing rolled sheet steel on a Wein Trap Line does not perform a lubricating function. Accordingly, the manufacturers excise tax imposed by section 4091 of the Internal

Revenue Code of 1954 does not attach to the sale of lubricating oil by the manufacturer thereof direct to a purchaser for such use provided the sale is supported by the required certificate of nonlubricating use.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of lubricating oil by the manufacturer thereof for use in processing steel on a Wein Trap Line in the manner described below.

Rolled sheet steel, to be made into stampings, is drawn by the rolls of a Wein Trap Line through lubricating oil which is in a tank on the Wein Trap Line. The function of the oil is to flush or cleanse contaminants from the surface of the steel and also to prevent the formation of rust until the steel is used in the stamping operation. Following the flushing and washing operation the steel is drawn into another series of rolls, where it is straightened preparatory to being cut into the desired lengths at the end of the machine. The lubricating oil not remaining on the surface of the steel drains back into the oil tank through which the sheet steel has passed. After the steel has been cut into desired lengths, it is stored until processed by another piece of equipment that performs a drawing operation.

The Internal Revenue Service has been informed that the operation of the Wein Trap Line does not involve a "rolling" operation, the purpose of which is to bring the metal to the desired shape and form and to improve its quality by favorably affecting the structure and properties of the metal. Instead, in the instant case the previously "rolled" sheet steel is drawn between rolls merely to straighten the metal, and this operation is in no way assisted by the presence of the oil on the steel.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer or producer of cutting oils and other lubricating oils. Section 4092(b) of the Code defines the term "cutting oils" to mean oils sold for use in cutting and machining operation (including forging, drawing, rolling, sheering, punching, and stamping) on metals. Section 314.43(a) of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that no tax attaches where oil is sold by the manufacturer direct to a purchaser who uses it for nonlubricating purposes, provided the manufacturer has definite knowledge, prior to or at the time of sale, that the product is purchased for such purposes, and he obtains from such purchaser a certificate of nonlubricating use in the form prescribed by that section. No sale of oil may be made tax free by the manufacturer to a dealer for resale for nonlubricating uses even though it is known at the time of sale that the oil will be so resold. However, where any dealer resells tax-paid oil for nonlubricating uses, the manufacturer who paid the tax on his sale of the oil may secure a refund or credit in accordance with the provisions of section 314.64 of the regulations.

Therefore, it is held that lubricating oil used solely as a cleaning and rust preventive material on a Wein Trap Line as described above is not considered to perform a lubricating function. Accordingly, the manufacturers excise tax does not attach to the sale of the oil by the manufacturer thereof direct to a purchaser for such use, provided the sale is supported by the required certificate of nonlubricating use.

(Also Section 4092.)
(Also Part II, Section 3413.)

Rev. Rul. 58–476

The manufacturers excise tax on lubricating oil does not apply to the sale of oil by the manufacturer thereof direct to a purchaser for use in hot forging and piercing operations provided the sale is supported by a certificate of nonlubricating use.

Advice has been requested whether the position of the Internal Revenue Service, that sales of oil for use in hot forging and piercing operations are not subject to manufacturers excise tax, was affected by the provisions of section 304 of the Excise Tax Reduction Act of 1954, C. B. 1954–1, 343, which amended section 3413 of the Internal Revenue Code of 1939 (now section 4091 of the Internal Revenue Code of 1954).

The Service has consistently held that oils used in cold forging operations are used for lubricating purposes, and that the sale thereof is subject to tax. However, prior to the amendment of section 3413 of the 1939 Code by the Excise Tax Reduction Act of 1954, the Service held that the sale of oil for use in hot forging and piercing operations was not subject to tax. This determination, which was made in 1933, was based on the premise that because of the extreme heat to which oils used in hot forging and piercing operations were subjected, the oils were dissipated before performing any lubricating function.

Section 4091 of the 1954 Code (formerly section 3413 of the 1939 Code) imposes a tax on cutting oils and other lubricating oils sold by the manufacturer or producer. Section 4092(b) of the 1954 Code provides that the term "cutting oils" means oils sold for use in cutting and machining operations (including forging, drawing, rolling, shearing, punching, and stamping) on metals.

Pursuant to the provisions of section 314.43 of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, no tax attaches where oil is sold by the manufacturer direct to a purchaser who uses it for nonlubricating purposes provided the manufacturer has definite knowledge, prior to or at the time of sale, that the product is purchased for such purposes, and he obtains from such purchaser a certificate of nonlubricating use in the form prescribed by that section. No sale of oil may be made tax free by the manufacturer to a dealer for resale for nonlubricating uses even though it is known at the time of sale that the oil will be so resold. However, where any dealer resells tax-paid oil for nonlubricating uses, the manufacturer who paid the tax on his sale of the oil may secure a refund or credit in accordance with the provisions of section 314.64 of the regulations.

In the legislative history of the Excise Tax Reduction Act of 1954, there is no indication of Congressional intent to enlarge the scope of the law to tax that which theretofore had not been taxed. Rather, the history indicates that Congress intended only to provide a lower rate of tax for cutting oils and, at the same time, furnish statutory examples of cutting and machining operations.

Accordingly, it is held that the manufacturers excise tax on lubricating oil does not apply to the sale of oil by the manufacturer thereof direct to a purchaser for use in hot forging and piercing operations provided the sale is supported by a certificate of nonlubri-

cating use. It is further held, however, that the sale of oil by the manufacturer thereof for use in cold forging operations is subject to the excise tax on cutting oils.

(Also Section 4220.) Rev. Rul. 58–477

Lubricating oil sold by the manufacturer thereof to an automobile manufacturer for use in automatic transmissions of new automobiles for the purpose of serving as the power transmission medium is exempt from the manufacturers excise tax imposed by section 4091 of the Internal Revenue Code of 1954. No relief from the tax is available, however, on sales of lubricating oil for the purpose of replacing or replenishing the fluid in automatic transmissions.

Advice has been requested whether the manufacturers excise tax on lubricating oil applies to sales by the manufacturer thereof to automobile manufacturers for use as a hydraulic power transmission medium in new automobiles. Advice has further been requested concerning the applicability of this tax to sales of lubricating oil to dealers or consumers for use in replacing or replenishing such fluid in the automatic transmissions of used automobiles.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax on lubricating oils sold by the manufacturer or producer thereof. Section 314.40 of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2,47, provides that the term "lubricating oils" includes all oils, regardless of their origin, which are sold as lubricating oil and all oils which are suitable for use as a lubricant. Section 314.43(a) of the regulations provides that no tax attaches where oil is sold by the manufacturer direct to a purchaser who uses it for nonlubricating purposes.

Section 4220 of the Code provides, in part, that no manufacturers excise tax shall be imposed with respect to the sale of any article for use by the vendee as material in the manufacture or production of, or as a component part of, any other article subject to manufacturers excise tax.

Since the lubricating oil used in automatic transmissions of automobiles serves to lubricate the transmissions in addition to serving as a power transmission medium, it is not used for a nonlubricating purpose and the provision of the regulations regarding nonlubricating use is not applicable.

It is held that lubricating oil placed in automatic transmissions by the manufacturer of new automobiles for the purpose of serving as a hydraulic medium and lubricant, and which is contained in the automatic transmissions at the time the automobiles are sold by the manufacturer, is used as material in the manufacture of, or as a component part of, the new automobiles within the meaning of section 4220 of the Code. Accordingly, sales of lubricating oil by the manufacturers to automobile manufacturers for such use are exempt from the manufacturers excise tax provided they are supported by exemption certificates in the form prescribed by section 314.21 of the regulations. Where the automobile manufacturer places lubricating oil in the automatic transmissions of his cars, he is using the lubricating oil as a component material in the manufacture of the vehicles and may obtain a credit or refund, in the amount of tax paid on such lubricating oil, under the provisions of section 6416(b)(3)(A) of the Code.

It is further held that lubricating oil used for replacing or replenishing the fluid in automatic transmissions of used automobiles for the purpose of serving as a power transmission medium and as a lubricant is used for lubricating purposes. Accordingly, the tax applies to sales of lubricating oil by the manufacturer for such use in used automobiles, even if the manufacturer sells direct to consumers.

SECTION 4092.—DEFINITIONS

Applicability of the manufacturers excise tax on lubricating oils to the sale of oils for use in hot or cold forging operations and piercing operations. See Rev. Rul. 58–476, page 781.

SUBCHAPTER B.—HOUSEHOLD TYPE EQUIPMENT, ETC.

PART 1.—REFRIGERATION EQUIPMENT

SECTION 4111.—IMPOSITION OF TAX

Rev. Rul. 58–570

A refrigerated "milk dispenser," which is designed for use in the home, is subject to the manufacturers excise tax on household type refrigerators imposed by section 4111 of the Internal Revenue Code of 1954. However, a companion supporting cabinet is not considered a part or accessory for purposes of that section.

Advice has been requested whether the "home milk dispenser" described below is subject to the manufacturers excise tax on refrigeration equipment imposed by section 4111 of the Internal Revenue Code of 1954.

A manufacturer produces and sells a self-refrigerated article, which is designed for refrigerating, storing and dispensing milk in the home. The upper portion of the article provides refrigerated storage space for two removable three-gallon metal milk containers. Each container may be connected by a rubber tube to a dispensing outlet on the outside of the article. Below the milk storage space, there is additional refrigerated space for the storage of other products, such as butter, eggs, cream, and cottage cheese. The total refrigerated storage space is 2.955 cubic feet, the portion for the storage of milk occupying 2.22 cubic feet of this volume. The refrigeration unit, which is operated by plugging into any standard electrical outlet, is self-regulating, keeping the contents at a constant temperature.

The "dispenser" may be placed on a counter or table. However, the manufacturer also produces and sells a companion cabinet on which the "dispenser" may be conveniently placed. This cabinet contains no refrigerated space but contains shelves for storage of kitchen utensils.

Section 4111 of the Code provides, in part:

There is hereby imposed upon the sale of the following articles (including in each case parts or accessories therefor sold on or in connection with the sale thereof) by the manufacturer, producer, or importer a tax equivalent to the specified percent of the price for which so sold:

ARTICLES TAXABLE AT 5 PERCENT—
Household type refrigerators (for single or multiple cabinet installations) having, or being primarily designed for use with, a mechanical refrigerating unit operated by electricity, gas, kerosene, or gasoline.

Section 316.70(c)(2) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "household type refrigerator" includes refrigerators for single or multiple cabinet installations, which (i) are designed for domestic use, (ii) are arranged to provide refrigerated storage space for the preservation of food products or low temperature space for making ice cubes and frozen desserts, (iii) have a net storage space not exceeding 14 cubic feet, and (iv) have, or are primarily designed for use with, a mechanical refrigerator unit operated by electricity, gas, kerosene, or gasoline.

Since the above-described "home milk dispenser" (1) is designed for domestic use, (2) is arranged to provide refrigerated storage space for the preservation of food products, including milk, butter, eggs, etc., (3) has a net storage space not exceeding 14 cubic feet, and (4) is primarily designed for use with a mechanical refrigerating unit operated by electricity, it is held to be a household type refrigerator which is subject to the manufacturers excise tax imposed by section 4111 of the Code. On the other hand, the nonrefrigerated supporting cabinet is not considered to be a part or accessory for the taxable "dispenser." Therefore, no manufacturers excise tax applies to the manufacturer's sale of the cabinet, regardles of whether it is sold separately or with the "dispenser."

PART II.—ELECTRIC, GAS, AND OIL APPLIANCES

SECTION 4121.—IMPOSITION OF TAX

Rev. Rul. 58–344

Electric hot plates that are specially designed for use as china firing and enameling kilns, and that do not function for cooking purposes, are not cooking appliances of the household type. Therefore, sales of such articles are not subject to the manufacturers excise tax imposed by section 4121 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax imposed under section 4121 of the Internal Revenue Code of 1954 to the sale of an electric hot plate designed for use as a china firing and enameling kiln.

An electric hot plate, or kiln, is manufactured with a special wattage heating coil and a special insulating disc in order that it may be used by hobby shops, toy stores, schools, hospitals, camps, institutions, etc., for firing china and enameling trinkets. The kiln operates at a temperature of approximately 1500 degrees Fahrenheit and will not function for cooking purposes.

Section 4121(a) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain household-type ar-

ticles, including electric, gas, or oil appliances of the type used for cooking, warming, or keeping warm food or beverages for consumption on the premises.

It is held that electric hot plates of the type described above, which are specially designed and manufactured for use as china firing and enameling kilns and which do not function for cooking purposes, are not electric cooking appliances of the household type. Therefore, sales of such articles are not subject to the manufacturers excise tax imposed by section 4121 of the Code.

Rev. Rul. 58–362

The manufacturers excise tax on electric, gas, and oil appliances, imposed by section 4121(a) of the Internal Revenue Code of 1954, is applicable to the blower and housing assembly portion of a ventilation system designed to exhaust hot air rising from residential type, built-in ovens. However, the tax is not applicable to the duct and switch assembly or the hood and filter assembly of such ventilation system.

Advice has been requested whether the manufacturers excise tax on electric, gas, and oil appliances applies to the sale by a manufacturer of a ventilation system designed to exhaust hot air rising from residential type, built-in ovens. The ventilation system, which is normally mounted in the cabinet over the built-in oven, consists of a blower and housing assembly, a duct and switch assembly, and a hood and filter assembly.

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of various 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). Included therein are "electric exhaust blowers."

It is held that the tax imposed under section 4121(a) of the Code is applicable to the blower and housing assembly portion of the ventilation system described above. However, the tax is not applicable to the duct and switch assembly or the hood and filter assembly since such articles, while being accessories of the exhaust system, are not considered accessories of the electric exhaust blower within the meaning of section 4121(a) of the Code. For the purpose of computing the tax due, a selling price may be assigned to the taxable portion of the ventilation system which bears the same ratio to the selling price of the complete system as the cost of the taxable portion bears to the cost of the complete system. For example, if the cost of the blower and housing assembly is one-third of the cost of the entire system, tax will attach to one-third of the sale price of such ventilation system.

Rev. Rul. 58–386

The manufacturers excise tax on electric direct motor-driven fans and air circulators, imposed by section 4121(b) of the Internal Revenue Code of 1954, does not apply to louvers, shutters, etc., which are accessories of an exhaust system. However, the tax does apply to accessories and integral parts of the basic fan unit.

Advice has been requested concerning the applicability of the manufacturers excise tax to the sale of certain parts and accessories sold on or in connection with electric direct motor-driven attic fans.

M company manufactures and sells electric direct motor-driven attic fans in combination with several articles, including wall frames or boxes upon which the fans are mounted, louvers, shutters, ducts, and roof ventilator hoods and bases. *M* also sells, at the option of the purchaser, switches or guards or grills, which are designed to be used at the time of final installation of the exhaust system. In addition, *M* sells with the system other grills or guards and electric starters or switches which are integral parts of the basic fan unit.

Section 4121(b) of the Internal Revenue Code of 1954 imposes a tax upon the manufacturer, producer, or importer of electric direct motor-driven fans and air circulators not of the industrial type (including in each case parts or accessories sold on or in connection with the sale thereof).

Section 316.110(b)(1) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, sets forth a list of the direct motor-driven fans and air circulators which are of the nonindustrial type, including exhaust or intake ventilating fans of the household type for use in window or attic. Subsection (b)(3) provides that the tax applies to any parts or accessories sold on or in connection with, or with the sale of, any taxable direct motor-driven fan or air circulator or any household type appliance.

The tax on parts and accessories imposed by section 4121(b) of the Code does not apply to articles which are considered as accessories of the exhaust system as a whole, but only to those articles which are accessories or integral parts of the basic fan unit. Accordingly, it is held that no tax applies to louvers, shutters, ducts, and roof ventilator hoods and bases sold in combination with such fans, because they are not considered as accessories of the basic fan unit, but as accessories of the exhaust system. Likewise, switches and grills or guards which are designed to be used at the time of final installation of the system are not considered as accessories of the fan unit and, therefore, are not subject to the tax. However, wall boxes or frames, in which taxable fans or air circulators are mounted or assembled, and grills or guards and electric starters or switches which are integral parts of the basic fan unit, are considered parts or accessories for the fan or air circulator, and are to be included in determining the tax base when sold on or in connection with the sale thereof.

Rev. Rul. 58–411

A fan or blower unit primarily designed and adapted by the manufacturer for use in conjunction with a furnace of other nontaxable space heater is not subject to manufacturers excise tax on fans and air circulators imposed by section 4121(b) of the Internal Revenue Code of 1954. However, an electric direct motor-driven air circulator, not of the industrial type, which is primarily designed and adapted to be operated as an independent unit is subject to the tax.

Advice has been requested concerning the applicability of the manufacturers excise tax imposed by section 4121(b) of the Internal Revenue Code of 1954 to the sale of an electric direct motor-driven blower unit under the circumstances described below.

A company manufactures an oil burning, circulating, space heater. It also manufactures an electric direct motor-driven blower unit which is designed to be used in conjunction with the space heater. The blower unit is designed with two rotating blowers mounted on each end of an electric motor shaft. The blowers are enclosed in a metal case with air intake through two circular openings on the sides and an air outlet through an adjustable, directional vent on the face of the unit. The blower unit is entirely separate from the heater and is not attached in any way. It may be placed under the heater, thereby drawing cold air from the floor and forcing it around the hot wall of the combustion chamber and out of the top of the heater cabinet. This increases the efficiency of the heater by forcing the circulation of heated air throughout the rooms. Since the blower is a separate unit, it can be used with other types of space heaters, ranges, and furnaces to circulate heat or it can be used as an exhaust blower to draw out odors or stale air from the kitchen or other rooms. It may also be used to circulate fresh air.

Section 4121(b) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of electric direct motor-driven fans and air circulators not of the industrial type (including in each case parts or accessories therefor sold on or in connection with the sale thereof).

Oil burning, circulating, space heaters are not subject to the manufacturers excise tax. If an electric direct motor-driven air circulator, not of the industrial type, is primarily designed and adapted to be operated as an independent unit, it is subject to the manufacturers excise tax imposed by section 4121(b) of the Code. However, if it is primarily designed and adapted to be operated in conjunction with a nontaxable article such as a space heater, it is not subject to the tax.

In the instant case, it is held that, since the blower unit is primarily designed and adapted to be operated in conjunction with a nontaxable space heater, such blower unit is not subject to the manufacturers excise tax on fans and air circulators imposed by section 4121(b) of the Code.

Rev. Rul. 58–458

The manufacturers excise tax on electric, gas, or oil appliances of the household type, imposed by section 4121 of the Internal Revenue Code of 1954, does not apply to the sale of an electric "charcoal ignitor."

Advice has been requested whether the manufacturers excise tax on electric, gas, or oil appliances applies to the manufacturer's sale of a certain "charcoal ignitor" described below.

A company manufactures an article which consists of a rod with a metal loop on one end and with a handle and an electric cord on the other end. When the cord is inserted into a regular 110-volt outlet, heat is created in the loop end of the rod. When the heated rod is inserted into a pile of charcoal, it ignites the charcoal. The rod is intended for use with charcoal braziers which are ordinarily used for outdoor cooking.

Section 4121 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles of the household type (including in each case

parts or accessories therefor sold on or in connection with the sale thereof). Among the articles enumerated are electric, gas, or oil appliances of the type used for cooking, warming, or keeping warm food or beverages for consumption on the premises.

It is held that the charcoal ignitor described above is neither an article of the type enumerated in section 4121 of the Code nor an accessory therefor. Accordingly, the manufacturers excise tax does not apply to the manufacturer's sales of this article.

Rev. Rul. 58-490

A 24-cup coffee urn, primarily designed and sold for domestic use, is classified as a household type appliance and is subject to the manufacturers excise tax imposed by section 4121 of the Internal Revenue Code of 1954. However, 50-cup and 72-cup coffee urns which are not designed and sold primarily for household use, are considered not to be of the household type and are not subject to the tax.

Advice has been requested concerning the applicability of the manufacturers excise tax to the sales of coffee urns.

A manufacturer produces three basic coffee urns differing only in size. The smallest size or "buffet" size is a 24-cup automatic percolator advertised as being ideal for parties, family gatherings, luncheons, or buffets. The manufacturer states that the majority of sales of this model, which makes from 12 cups to 24 cups of coffee, will be made to consumers who will purchase it as a party urn. The medium size or "party" size model, a 50-cup percolator, is described as making from 20 cups to 50 cups of coffee and is ideal for bridge parties, recreation room get togethers, or club and church socials. The "king" size or the largest urn is a 72-cup automatic percolator which makes from 24 cups to 72 cups of coffee for lodge or club meetings, business groups, coffee shops, or institutions.

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of household-type electric, gas, or oil appliances of the type used for cooking, warming, or keeping warm, food or beverages for consumption on the premises.

Section 316.110(b)(2) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, states that the term "household type" is general in application so that any article falling within the category of electric, gas, or oil appliances of the type used for cooking, warming, or keeping warm food or beverages for consumption on the premises is considered of the "household type" and subject to tax if it has an actual practical commercial fitness for household use or if it is specifically designed and constructed for use in the household.

Accordingly, it is held that the 24-cup coffee urn has the capacity and is primarily designed so as to be suitable for use for domestic purposes as a household type article and is subject to the manufacturers excise tax on electric, gas, and oil appliances imposed by section 4121 of the Code. However, the 50-cup and the 72-cup coffee urns are considered to be primarily designed and sold by the manufacturer for other than household use and are not subject to the tax.

Rev. Rul. 58–491

An electric floor polisher and waxer, advertised and distributed almost exclusively for commercial use and weighing over thirty pounds, is not subject to the manufacturers excise tax imposed on electric appliances of the household type by section 4121(a) of the Internal Revenue Code of 1954.

Advice has been requested whether the electric floor polisher and waxer described below is an appliance of the household type.

A company manufactures a floor polisher and waxer weighing over thirty pounds, with a sixteen-inch brush spread and a one-half horsepower motor. It is a twin-brush model without wheels and can be operated with one hand. It is sold as a light "commercial" model for use in commercial establishments and large homes. It is distributed almost exclusively for nonhousehold use and is advertised almost exclusively in commercial publications rather than consumer publications. It can be operated on either AC or DC current and is sold to distributors at the same discount rate as other models which are sold as "household" polishers.

Section 4121(a) 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 electric floor polishers and waxers. Section 316.110(b)(2) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that an article is considered to be of the household type "if it has an actual practical commercial fitness for household use or if it is specifically designed and constructed for use in the household."

Electric floor polishers and waxers which are intended for commercial use, advertised in commercial publications rather than consumer publications, and distributed and used almost exclusively as nonhousehold polishers are not "specifically designed and constructed for use in the household." Furthermore, a polisher which is advertised and distributed in his manner and which weighs more than thirty pounds has no "actual practical commercial fitness for household use." Accordingly, it is held that the polisher described above is not an article of the household type within the meaning of section 316.110(b)(2) of Regulations 46. Therefore, it is not subject to the manufacturers excise tax imposed by section 4121(a) of the Code.

Rev. Rul. 58–508

Even though they contain small fans as necessary components, certain "portable air purifiers," which are designed primarily for use as air filters and purifiers rather than for obtaining the cooling effect of circulated air, are not subject to the manufacturers excise tax imposed by section 4121(b) of the Internal Revenue Code of 1954 when sold by the manufacturer.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of the "air purifiers" described below.

A manufacturer produces and sells so-called "portable air purifiers," which are designed for household use for removing from the air impurities such as smoke, smog, pollen, odors, and particles of

dust. The purifier is said to provide relief to hay fever and asthma suffers. Each purifier contains a small built-in two-speed electric direct motor-driven fan which passes the air through two specially designed filters. First, a chemically-treated aluminum, body-loading, mechanical filter removes all of the large dust particles. Then, the air passes through a throw-away activated carbon filter which removes the smoke, smog, pollen, and odors. The mechanical filter may be removed, washed, and replaced in the unit after having been sprayed with a special type of adhesive. The carbon filter may be replaced when it becomes saturated.

Section 4121(b) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of electric direct motor driven fans and air circulators not of the industrial type (including in each case parts or accessories therefor sold on or in connection with the sale thereof).

Although the portable air purifiers, in the instant case, contain fans for circulating the air, the complete units are not air circulators but are designed primarily for use as air filters and purifiers. The built-in fans are merely parts of the units included primarily for efficient air filtering action rather than for the cooling effect of circulated air.

Therefore, it is held that the manufacturers excise tax imposed by section 4121(b) of the Code does not apply to the manufacturer's sale of these portable air purifiers.

Rev. Rul. 58-519

Revenue Ruling 58-115, C. B. 1958-1, 409, published on March 24, 1958, concerning the applicability of the manufacturers excise tax on electric water heaters of the household type, imposed by section 4121(a) of the Internal Revenue Code of 1954, will not be applied to the so-called "quick recovery" type electric water heaters sold prior to April 1, 1958.

In Revenue Ruling 54-386, C. B. 1954-2, 414, the Internal Revenue Service held that an electric water heater with heating elements aggregating wattages not exceeding 7500 (7½ KW) is a heater of the household type and the sale thereof by the manufacturer is subject to the manufacturers excise tax unless the heater by reason of other features of design and construction is primarily adapted for purposes other than household use.

Revenue Ruling 54-386 was subsequently amplified by Revenue Ruling 58-115, C. B. 1958-1, 409, published on March 24, 1958. The latter Revenue Ruling applies to the so-called "quick recovery" type electric water heaters. A quick recovery type electric water heater is designed with an upper and a lower heating element, neither of which has a wattage exceeding 7500 but whose aggregate wattage, if they were energized simultaneously, would exceed 7500. These heaters are equipped with an interlocking control so that only one element operates at a time. Revenue Ruling 58-115 holds that a quick recovery type electric water heater which is equipped with an interlocking control, or is so designed by the manufacturer that such a control may be readily installed, for operation on one element not

exceeding 7500 watts, is an electric water heater of the household type and is therefore, subject to tax when sold by the manufacturer.

While this conclusion is consistent with the position intended to be set forth in Revenue Ruling 54–386, it is recognized that the language used in Revenue Ruling 54–386 is susceptible of a different interpretation when applied to the quick recovery type electric water heater described above. For this reason and under the provisions of section 7805(b) of the Internal Revenue Code of 1954, the conclusion set forth in Revenue Ruling 58–115 will not be applied to the quick recovery type electric water heaters sold before April 1, 1958.

(Also Section 4218.) Rev. Rul. 58–538

The manufacturers excise tax applies to the *use* of a gas kitchen range in the manufacture of a nontaxable combination gas kitchen heater-range.

The Internal Revenue Service has been asked whether the manufacturers excise tax on certain household type electric, gas, and oil appliances is applicable to a combination gas kitchen heater-range.

The combination consists of four conventional gas burners on the cooking surface, a griddle area, an oven and broiler in the right-hand section, and a built-in gas room heater in the left-hand section. The room heater section of the combination has no connection whatsoever with the cooking functions of the range.

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of household type electric, gas, and oil appliances of the type used for cooking, warming, or keeping warm food or beverages for consumption on the premises, including parts or accessories therefor sold on or in connection with the sale thereof.

Under the provisions of section 4218 of the Code, insofar as they are applicable to this situation, if a person manufactures an article subject to the manufacturers excise tax and uses it in the manufacture of a nontaxable article, the manufacturer incurs liability for the tax on his *use* of the taxable article in the same manner as if it were sold by him. The tax, in such cases, is to be computed on the price at which such or similar articles are sold, in the ordinary course of trade, by the manufacturer, producer, or importer thereof, as determined by the Secretary of the Treasury or his delegate.

In the instant case, the manufacturers excise tax imposed by section 4121 of the Code is not applicable to the sale of the kitchen heater-range, because that combination article is not considered to be an appliance of the type covered by that section. However, it is held that the manufacturer is liable for tax, under the provisions of section 4218 of the Code, on his *use* of the gas cooking range in the manufacture of the nontaxable combination gas heater-range.

Furthermore, to determine the constructive sale price of the range, for purposes of computing the tax, the combination is considered as composed of (1) taxable cooking parts such as oven, broiler, griddle, and surface cooking units, (2) heating parts in the built-in gas room heater, and (3) those parts such as cabinet and base which serve a dual

function in connection with the range and heater and are, therefore, called common parts. Accordingly, the ratio which the cost of the cooking parts bears to the sum of costs of the cooking and heating parts is applied to the manufacturer's lowest established wholesale price for the combination gas heater-range. This method indirectly allocates in the same ratio a part of the cost of the common parts to the range.

For example, assume that the cooking parts cost $9x$ dollars, the heating parts $6x$ dollars, and the common parts $3x$ dollars. On this basis 60 percent (9/15ths) of the total cost of the combination represents the cost of the cooking range. The constructive sale price of such range, upon which the tax should be computed, is determined by applying 60 percent to the lowest established wholesale price for the gas heater-range combination.

(Also Section 4218.) Rev. Rul. 58–543

The manufacturers excise tax applies to the *use* of an electric or gas range in the manufacture of a nontaxable appliance which combines an electric or gas range with a coal or wood kitchen heater-range.

Advice has been requested concerning the applicability of the manufacturers excise tax on electric, gas, and oil appliances to an appliance which combines an electric or gas range with a coal, wood, or oil kitchen heater which may be used for surface cooking.

The appliance is manufactured in one model which contains four electric top burners and an electric oven and broiler, all on the right-hand side. The left-hand side contains a coal, wood, or oil heating unit which is equipped with lids so that it may be used for surface cooking as well as heating. The appliance is manufactured in another model which is designed for the use of gas in the right-hand top burners and the oven and broiler. Otherwise, this model is identical to the electric model.

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of household-type electric, gas, and oil appliances of the type used for cooking, warming, or keeping warm food or beverages for consumption on the premises, including parts and accessories therefor sold on or in connection with the sale thereof.

Under the provisions of section 4218 of the Code, insofar as it applies to electric, gas, and oil appliances, if a person manufactures an article subject to the manufacturers excise tax and uses it in the manufacture of a nontaxable article, the manufacturer incurs liability for the tax on his *use* of the taxable article in the same manner as if it were sold by him. The tax, in such case, is to be computed on the price at which such or similar articles are sold, in the ordinary course of trade, by the manufacturers, producers, or importers thereof, as determined by the Secretary of the Treasury or his delegate.

In the case under consideration, the manufacturers excise tax imposed by section 4121(a) of the Code is not applicable to the sale of the combination electric or gas and coal or wood kitchen range, because that combination article is not considered to be an appliance of the

type covered by that section. However, it is held that the manufacturer is liable for tax, under the provisions of section 4218 of the Code, on his *use* of the electric or the gas cooking range in the manufacture of the nontaxable combination electric or gas and coal or wood kitchen range.

Moreover, to determine the constructive sale price of the electric or the gas range, for the purpose of computing the tax, the combination is considered as composed of (A) gas or electric cooking parts; (B) wood or coal burning heating-cooking parts; and (C) parts, such as cabinet and base, which serve a dual function in connection with both (A) and (B) and are, therefore, called common parts. Hence, the ratio which the cost of the gas or electric cooking parts bears to the sum of the costs of such parts and the wood or coal burning heating-cooking parts is applied to the manufacturer's lowest established wholesale price for the combination gas or electric and wood or coal range. This method indirectly allocates in the same ratio a part of the cost of the common parts to the taxable electric or gas cooking section.

For example, assume that the gas or the electric cooking parts cost $75x$ dollars, the wood or coal burning heating-cooking parts $50x$ dollars, and the common parts $25x$ dollars. On this basis 60 percent (75/125) of the total cost of the combination electric or gas and coal or wood range represents the cost of the electric or gas cooking portion. The constructive sale price of such portion, upon which the tax should be computed, is determined by applying 60 percent to the lowest established wholesale price for the combination electric or gas and coal or wood range.

Of course, if the combination range is designed to be equipped for oil, rather than coal or wood, in addition to gas or electricity, the entire range is an electric or gas and oil cooking appliance of the household type which is taxable under section 4121(a) of the Code. Under such circumstances, the tax applies to the price for which such range is sold by the manufacturer, producer, or importer at wholesale, subject to the additions and exclusions provided in section 4216(a) of the Code, relating to containers, packing, and transportation charges.

Rev. Rul. 58–571

The manufacturers excise tax on electric, gas, and oil appliances, imposed by section 4121(a) of the Internal Revenue Code of 1954, applies to sales by the manufacturer, producer, or importer of a power head and a rotary mower unit as part of tiller-mower combinations. However, the tax does not apply to lawn mower attachments which are not equipped with motors or engines but are dependent upon garden tractors for their propulsion and operation.

Advice has been requested concerning the applicability of the manufacturers excise tax on household-type electric, gas, and oil appliances to sales of tiller-lawn mower combinations and certain lawn mower attachments which are used on garden tractors.

X company manufactures tiller-mower combinations and various attachments for them. The tiller-mower combination is used to till soil, to open planting furrows, to cultivate gardens, and to mow grass. It consists of a power head complete with engine and handles, a four-

wheel mower unit with a cutting width of 21 inches, and a tiller unit. The power heads, the mower units, and the tiller units are packaged separately and each item is sold in whatever quantities may be desired by *X* company's customers. The power heads are constructed with gasoline engines of two and one-half, two and three-quarters, or three horsepower. However, the power heads are not equipped with wheels, but depend on the mower unit or the tiller unit for support. The combination is operated by mounting the power head on either the mower unit or the tiller unit with a "plug-in" hitch which makes it possible to convert from one function to the other. A variety of attachments are manufactured which fit the base of the tiller unit in place of the tiller blades. The tiller base and blades are not sold separately.

Y corporation manufactures a variety of garden tractors. These tractors are equipped with engines which range from one and six-tenths to six horsepower. The tractors are equipped with either two or four wheels. Various attachments, including lawn mower attachments, are manufactured by *Y* corporation to be used with the garden tractors. The lawn mower attachments are not equipped with motors or engines but are dependent upon the tractor for their propulsion and operation.

Section 4121(a) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated household-type electric, gas, and oil appliances, including power lawn mowers. The tax applies to any parts or accessories therefor sold on or in connection with the sale of such articles.

Section 316.4(c) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that a manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, is liable for the tax, and not the person who buys and assembles a taxable article from such component parts.

Revenue Ruling 116, C. B. 1953–1, 465, holds that a power lawn mower of the "household type" is one with a cutting width of less than 24 inches, unless the mower by reason of its design and construction is primarily adapted for another purpose, such as mowing golf greens.

For purposes of the manufacturers excise tax, the term "power lawn mower" includes all machines for cutting the grass of a lawn in which the cutting power is derived, either directly or indirectly, from a motor or other power unit. However, a distinction is made between the power head under consideration and a garden tractor. A garden tractor has its own wheels or support and is a complete article in itself, ready for operation with various attachments, including a lawn mower attachment. In comparison, the power head is not a complete article in itself, since it does not have wheels and must be mounted on the mower unit or the tiller unit in order to be operative. Furthermore, neither the mower unit nor the tiller unit is an attachment as such for another article, but they, as well as the power head, are integral parts of the tiller-mower combination.

Accordingly, it is held that sales by *X* company of power heads and rotary mower units as part of tiller-mower combinations are considered to be sales of household-type power lawn mowers in a knockdown condition and that portion of the sale price allocable thereto is subject to the manufacturers excise tax imposed by section 4121(a) of the Code.

However, since the lawn mower attachments sold by Y corporation are designed to be used with garden tractors and are not equipped with motors or engines but derive their cutting and propelling power from garden tractors, these attachments are not considered to be "power lawn mowers" within the meaning of section 4121(a) of the Code and are not subject to the tax imposed by that section.

If the power head and the mower unit are sold by X company without the tiller unit and its accessories, the tax applies to the entire sale price. On the other hand, if the power head, the mower unit, and the tiller unit are sold together by the manufacturer, the tax applies only to that portion of the sale price of the tiller-mower combination which is allocable to the power head and the mower unit. This tax base is determined by applying to the sale price of the tiller-mower combination (sum of the sale prices of the tiller unit, the mower unit, and the power head) the ratio which the established separate sale price of the mower unit bears to the sum of the established separate sale price of the mower and the tiller unit. This method of calculation indirectly allocates in the same ratio the sale price of the power head, a common part, to the mower unit and the tiller unit.

For example, assume that the price of the mower unit is $40x$ dollars, the price of the tiller unit is $60x$ dollars, and the price of the power head is $120x$ dollars. The total sale price of the combination is $220x$ dollars. The price ratio for the power lawn mower is two-fifths (40/100) or 40 percent. Accordingly, the tax base is 40 percent of $220x$ dollars, or $88x$ dollars. Should a manufacturer sell in the same transaction 75 power heads, 75 tiller units, 50 mower units, and 170 miscellaneous tiller unit attachments, he is considered to have sold 50 tiller-mower combinations and is liable for tax on 40 percent of the selling price of 50 tiller-mower combinations.

The sale price of the tiller unit attachments is omitted from the taxable sale price of the tiller-mower combination for the purpose of determining the tax base, since the attachments are not considered to be parts or accessories for a power lawn mower.

PART III.—ELECTRIC LIGHT BULBS

SECTION 4131.—IMPOSITION OF TAX

Rev. Rul. 58-539

Projection lamps which are primarily designed for use in electric motion and still picture projectors of the household type are considered to be electric light bulbs and are taxable as such under section 4131 of the Internal Revenue Code of 1954.

Advice has been requested relative to the application of the manufacturers excise tax on electric light bulbs to projection lamps which are primarily designed for use in electric motion or still picture projectors of the household type.

These projection lamps are imported and sold to manufacturers for use in manufacturing taxable electric motion and still picture projectors of the household type. These projection lamps are also sold by

the importer to various retailers, who resell to customers for use as repair and replacement lamps.

Section 4131 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of electric light bulbs and tubes. Section 316.180 of Regulations 46, made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, defines an electric light bulb or tube as being any device designed for the diffusion of artificial light for illuminative or decorative purposes through the use of electricity. Under the provisions of section 4220 of the Code and the applicable regulations, no manufacturers excise tax is imposed upon the sale of electric light bulbs for use by the vendee as material in the manufacture or production of, or as a component part of, any article which is subject to the manufacturers excise tax.

It is held that the projection lamps described above are electric light bulbs within the meaning of section 4131 of the Code. Therefore, the tax imposed by that section applies to the importer's sales of the projection lamps to retailers who resell such lamps for repair or replacement purposes. However, these lamps may be sold tax-free, under an exemption certificate as prescribed by the regulations, for use by the purchaser in the manufacture of taxable motion or still picture projectors of the household type.

SUBCHAPTER C.—ENTERTAINMENT EQUIPMENT

PART I.—RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS, ETC.

SECTION 4141.—IMPOSITION OF TAX

Rev. Rul. 58–345

The sales, by the manufacturer, of phonographs which use transistors instead of tubes are subject to the manufacturers excise tax on phonographs imposed by section 4141 of the Internal Revenue Code of 1954.

Advice has been requested whether the sales by the manufacturer of phonographs which use transistors instead of tubes are subject to the manufacturers excise tax imposed by section 4141 of the Internal Revenue Code of 1954.

A manufacturer produces and sells small phonographs which use transistors instead of tubes for power amplification. These phonographs, which are suitable for playing phonograph records, are contained in leatherette covered cabinets which resemble small suitcases.

Section 4141 of the Code imposes a tax upon the sales by the manufacturer, producer, or importer of 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, and phonograph records. This section further provides that except in the case of radio and television components and phonograph records, the tax imposed by this section shall apply only to articles of the entertainment type.

Revenue Ruling 56–217, C. B. 1956–1, 509, holds that transistors are not considered to be radio or television tubes of the types contemplated by section 4142 of the Code; therefore, such sales of those articles are not subject to the manufacturers excise tax. However, this conclusion is not considered to affect the taxability of phonographs which use transistors as components. Whether the sale of a phonograph is subject to tax depends on the suitability of such phonograph for use in the playing of phonograph records. The determination of taxability is not dependent upon size, type of power used, or the type of components used, except as these factors may be determinative of whether or not the phonograph is of the entertainment type.

Accordingly, it is held that, since the phonographs in the instant case are suitable for use in playing phonograph records, the sale of such phonographs by the manufacturer thereof is subject to the manufacturers excise tax imposed by section 4141 of the Code.

Rev. Rul. 58–387

The manufacturers excise tax on radio and television receiving sets imposed by section 4141 of the Internal Revenue Code of 1954 does not apply to sales by the manufacturer of speaker cabinets designed to house speakers alone.

Advice has been requested whether the manufacturers excise tax on radio and television receiving sets and related articles applies to sales by the manufacturer of speaker cabinets which are designed to house speakers of the type considered radio and television components for the purposes of section 4141 of the Internal Revenue Code of 1954.

Section 4141 of the Code provides:

There is hereby imposed on 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.

Except in the case of radio and television components and phonograph records, the tax imposed by this section shall apply only to articles of the entertainment type.

Section 4142 of the Code provides that the term "radio and television components" means chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the "built-in" type, and phonograph mechanisms, 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. Section 316.61(b) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the word "cabinets" as including containers suitable for housing radio receiving sets, automobile radio receiving sets, television receiving sets, automobile television receiving sets, phonographs, and combinations of the foregoing.

The term "cabinets" as used in the Code and regulations contemplates only cabinets for radio and television receiving sets, phonographs, or combinations of any of the foregoing. The term does not include cabinets for radio or television components as such.

Accordingly, it is held that sales by the manufacturer of cabinets designed to house speakers only are not subject to the manufacturers excise tax on radio receiving sets, television receiving sets, etc., imposed by section 4141 of the Code.

Rev. Rul. 58–468

The manufacturers excise tax on sales of radio and television receiving sets, imposed by section 4141 of the Internal Revenue Code of 1954, does not apply to sales by the manufacturer of a device which fits on an individual's ear and enables him to enjoy private listening from any apparatus which normally uses a speaker for its output.

Advice has been requested whether the manufacturers excise tax on radio and television receiving sets applies to sales by the manufacturer of a device which fits on an individual's ear and allows him to hear sound signals from any apparatus that normally uses a speaker for its output.

A company manufactures a small device which consists of one pickup coil, two transistors, three resistors, one speaker, two condensers, two batteries, one etched board, one case, one knob, and miscellaneous springs and screws. This device is so designed that it will conveniently fit on an individual's ear and enable him to enjoy private listening from any apparatus, such as a radio or television receiving set, which normally uses a speaker for its output. The radio or television set to be utilized must be modified slightly by adding a switch which will allow the user to disconnect the speaker, whereupon the sound will be transmitted through the device on the individual's ear, thus enabling him to hear the output of the radio or television set at a sound level audible only to him. By use of this device, many persons may enjoy private listening from a single receiving set.

Section 4141 of the Internal Revenue Code of 1954 provides:

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.

Except in the case of radio and television components and phonograph records, the tax imposed by this section shall apply only to articles of the entertainment type.

Section 4142 of the Code defines the term "radio and television components" as meaning chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the "built-in" type, and phonograph

mechanisms, 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. Section 316.61(d) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "speakers" as including 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 a part of radio receiving sets, automobile radio receiving sets, television receiving sets, automobile television receiving sets, phonographs, and any combinations thereof.

It is held that the device described above is neither a radio receiving set nor a radio and television component within the meaning of section 4141 of the Code. Therefore, the manufacturers excise tax imposed by that section does not apply to sales of this device by the manufacturer thereof. However, since the device may be considered a part or accessory for a radio or television receiving set, a phonograph, or combinations of such taxable articles, if a manufacturer of the latter articles sells the device on or in connection with a taxable article of his manufacture, the manufacturers excise tax would apply to the total sales price of the complete set.

SECTION 4142.—DEFINITION OF RADIO AND TELEVISION COMPONENT

(Also Section 4220.) Rev. Rul. 58–445

The exemption from manufacturers excise tax provided by section 4220 of the Internal Revenue Code of 1954 applies to sales of certain automatic record changers purchased by a manufacturer for incorporation into phonographs of his own manufacture. On the other hand, such exemption is not applicable where the record changer manufacturer sells the record changers to dealers for resale as such to consumers.

Advice has been requested whether the exemption from manufacturers excise tax provided by section 4220 of the Internal Revenue Code of 1954, insofar as radio and television components are concerned, applies to sales of certain automatic record changers under the circumstances described below.

A company manufactures automatic record changers, each of which includes, among other components, a motor, a turntable, and a pick-up arm. Some of the changers are sold to phonograph manufacturers who incorporate them into phonographs of their own manufacture. Other changers are sold directly to dealers who resell them as components to consumers. The consumers connect the changers to other components to form complete radio-television-phonograph systems.

Section 4141 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain articles, including radio and television components. Section 4142 of the Code defines the term "radio and television components" to include phonograph mechanisms which are suitable for use on or in connection with, or as component parts of any of the articles enumerated in section 4141 of the Code, whether or not primarily adapted for such use. The

automatic record changers in the instant case are taxable phonograph mechanisms within the meaning of Revenue Ruling 55–624, C. B. 1955–2, 456, which holds that a combination which includes a motor, a turntable, and a pick-up arm is a phonograph mechanism as contemplated by section 4142 of the Code.

Section 4220(2) of the Code provides that no manufacturers excise tax shall be imposed with respect to the sale of radio and television components (A) for use by the vendee as material in the manufacture or production of, or as a component part of, any article, or (B) for resale by the vendee for such use by his vendee, if such article is in due course so resold.

Under the provisions of section 4220(2), the automatic record changers described above may be sold tax free to the phonograph manufacturers for use by them as material in the manufacture of phonographs or any other article. However, it is held that such record changers may not be sold tax free, under section 4220(2), to dealers for resale as such to consumers for their use as components in radio-television-phonograph systems.

Rev. Rul. 58–590

A telescopic "rabbit ear" antenna designed to be mounted on the rear of a television set by means of a right angle bracket is not a "built in" antenna for purposes of the manufacturers excise tax on radio and television components. Accordingly, separate sales of such an antenna are not subject to the manufacturers excise tax imposed by section 4141 of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax applies to a telescopic "rabbit ear" type of indoor television antenna which is mounted on an insulated base. This base is to be attached to the back of the television set by means of a right angle mounting bracket.

Section 4141 of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of certain articles, including radio and television components. Section 4142 of the Code defines the term "radio and television components" to include chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the "built in" type, and phonograph mechanisms, which are suitable for use on or in connection with, or as component parts of any of the articles enumerated in section 4141 of the Code, whether or not primarily adapted for such use.

The term "built in" antennae includes all antennae of the type suitable for being installed or contained in radio and television receiving sets. The ordinary "rabbit ear" type of indoor antenna is not adapted or suitable for installation in a television receiving set. Accordingly, it is held that separate sales of the antenna described above are not subject to the manufacturers excise tax imposed by section 4141 of the Code. However, such antenna is considered to be a part or accessory for a television receiving set and, if a set manufacturer sells the antenna on or in connection with a taxable television receiving set, the manufacturers excise tax on television receiving sets would apply to the total sale price of the set and the antenna.

PART II.—MUSICAL INSTRUMENTS

SECTION 4151.—IMPOSITION OF TAX

Rev. Rul. 58–509

Guitars and ukuleles made of polystyrene plastic which are not suitable for use in the rendition of musical compositions or for the teaching of music are not subject to the manufacturers excise tax on musical instruments imposed by section 4151 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on musical instruments, imposed by section 4151 of the Internal Revenue Code of 1954, to sales by the manufacturer of certain plastic guitars and ukuleles, manufactured and sold primarily as musical toys through the toy trade.

A company manufactures and sells guitars and ukuleles which are made of polystyrene, a type of plastic. To a certain degree polystyrene has a rubber consistency; it "gives" under pressure; under tension it stretches; and under heat it melts. The pitch of a string of a guitar or ukelele is determined by its tension. The slightest variation on the tension causes the pitch to vary. It has been found that the heat of a person's hand on the neck of a polystyrene instrument is sufficient to distort the neck, varying the tension of the strings to such an extent that it puts the instrument out of tune. If the temperature rises to 100 degrees or above, the whole polystyrene instrument will be distorted under the tension of the strings.

Section 4151 of the Code imposes a tax upon the sale of musical instruments by the manufacturers, producer, or importer.

In determining whether a particular article is a musical instrument, consideration is given to the primary purpose for which the article is designed and the quality of the construction of the article, that is, whether it is a type of instrument used in the rendition of musical compositions, whether in solo presentation or in connection with other musical instruments, or for the teaching of music.

Applying these tests, it is held that the guitars and ukuleles described above are not musical instruments within the meaning of section 4151 of the Code and the manufacturer incurs no excise tax liability on his sales thereof.

Rev. Rul. 58–529

The extensive restyling of old pianos constitutes a rebuilding operation which characterizes the rebuilder as a "manufacturer." Accordingly, the manufacturers excise tax on musical instruments, imposed by section 4151 of the Internal Revenue Code of 1954, applies to the sale of the rebuilt pianos by the rebuilder.

The Internal Revenue Service has been asked whether the manufacturers excise tax on musical instruments applies to sales of upright pianos which have been restyled in the manner described below.

A company manufactures new pianos. Also, old upright pianos are bought for the purpose of restyling them for resale. The restyling is

accomplished by remodeling or refinishing the cabinets, replacing any defective parts, and, in some cases, covering the cabinets with leatherette, inserting mirrors over the keyboards and performing other types of restyling to produce a marketable instrument. These restyled pianos are advertised and sold by the company as rebuilt pianos.

Section 4151 of the Internal Revenue Code of 1954 imposes a tax on the price for which musical instruments, including pianos, are sold by the manufacturer, producer, or importer. Section 316.4 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article or (2) by combining or assembling two or more articles.

The restyling of pianos described above is considered to constitute a rebuilding operation the result of which is the production of an article which is different from the old pianos purchased by the company. Therefore, the rebuilder is a "manufacturer" as that term is defined in the regulations. Accordingly, it is held that the manufacturers excise tax applies to sales of the rebuilt pianos by the rebuilder.

Rev. Rul. 58–540

The manufacturers excise tax on musical instruments, imposed by section 4151 of the Internal Revenue Code of 1954, applies to sales of inexpensive castanets of moulded plastic displayed and sold as musical instruments.

Advice has been requested whether sales of certain plastic castanets are subject to the manufacturers excise tax on musical instruments.

A manufacturer sells moulded plastic castanets of his manufacture to distributors of musical instruments. The distributors resell the castanets to music and department stores where they are displayed for sale in the music department together with competitively priced castanets of a so-called "professional" type. These castanets are advertised in the manufacturers catalog as Spanish castanets made of ebony black highly durable composition moulded to the proper shape and formed under hundreds of tons of pressure.

It is contended that these castanets are a commercial product designed mainly for children; that they are easy to handle and very low in price; and that the only tone is basically a regular noise when they are clapped together. It is further contended that castanets which are considered real instruments of music are made of grenadilla wood, ebony, and other selected woods; that they are made in sizes ranging from four centimeters in diameter to seven centimeters; that they are made in two different tones—high tone and low tone; and that they sell at a higher price than the castanets in question. For these reasons, it is contended that the castanets in question are not musical instruments.

Section 4151 of the Internal Revenue Code of 1954 imposes a tax upon the sale of musical instruments by the manufacturer, producer, or importer.

Section 316.63(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "musical instruments" includes pianos and organs of all types, trombones, saxophones, violins, drums, xylophones, chimes, cymbals, etc., and all string, wind, reed, or percussion instruments used in producing music, or in reproducing it, except radios and phonographs, for which see section 316.61.

Revenue Ruling 54–331, C. B. 1954–2, 410, holds that maracas, bongos, castanets, and claves are considered musical instruments.

In determining whether a particular article is a musical instrument, consideration is given to the primary purpose for which the article is designed and the quality of the construction of the article, that is, whether it is a type of instrument used in the rendition of musical compositions, whether in solo presentation or in connection with other musical instruments, or for the teaching of music.

It is held that the plastic castanets referred to above, which are described, displayed, and advertised as musical instruments, which are sold by dealers in musical instruments, and which are constructed of durable material, are considered to be musical instruments within the meaning of section 4151 of the Code rather than commercial toys designed mainly for children. Accordingly, sales of these castanets by the manufacturer are subject to the excise tax imposed on sales of musical instruments by that section of the Code.

SUBCHAPTER D.—RECREATIONAL EQUIPMENT

PART I.—SPORTING GOODS

SECTION 4161.—IMPOSITION OF TAX

Rev. Rul. 58–401

The sale of skin diving equipment by the manufacturer thereof is not subject to the manufacturers excise tax on sporting goods imposed by section 4161 of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on sporting goods applies to the manufacturer's sales of skin diving equipment.

A company manufactures and sells the following equipment which is used in skin diving: underwater sleds, tow lines for the sleds, tow line reels, float markers, communication systems, and underwater metal detectors.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sales by the manufacturer, producer, or importer of various enumerated sporting goods, and parts or accessories of such articles sold on or in connection therewith, or with the sale thereof.

The manufacturers excise tax imposed upon the sales of sporting goods is not a general tax upon the sales of all sporting goods, but it is a tax imposed upon the sales of the specific articles enumerated in section 4161 of the Code and parts or accessories of such articles sold on or in connection therewith, or with the sale thereof.

Accordingly, it is held that, since underwater diving equipment is not enumerated in section 4161 of the Code, the sales of the skin diving equipment described in the instant case are not subject to the manufacturers excise tax on sporting goods.

Rev. Rul. 58–425

The manufacturers excise tax on sporting goods does not apply to sales of full length bamboo cane poles which are merely straightened, scraped, and varnished, but does apply to sales of bamboo cane poles which are scraped, varnished, cut into sections, and fitted with ferrules or other means whereby they may be joined together.

Advice has been requested whether the manufacturers excise tax on sporting goods applies to the sales of two types of articles described below.

In the first situation, a company sells bamboo cane poles which it has straightened, scraped, and varnished. No other work has been performed on these poles. In the second situation, the company scrapes, varnishes, and cuts into sections bamboo cane poles, and then attaches ferrules to the ends of the sections.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain sporting goods, including fishing rods, creels, reels and artificial lures, baits and flies.

Section 316.4 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that the term "maufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material as well as from new or raw material, (1) by processing, manipulating, or changing the form of the article, or (2) by combining or assembling two or more articles.

A pole constitutes a fishing rod as contemplated by section 4161 of the Code where it is designed by the manufacturer for fishing purposes and is suitable for such purposes. In this respect, no distinction is made between the terms "pole" and "rod". Cane poles whether in their natural state or straightened, scraped, and varnished are not regarded as being either manufactured or designed for fishing purposes. However, where cane poles are cut into sections and fitted with ferrules or other means whereby they may be joined together, they are considered to be manufactured and designed for fishing purposes.

Accordingly, it is held that the manufacturers excise tax does not apply to sales of the poles in the first situation described above, since they are not materially changed in design from their natural state. On the other hand, the jointed cane poles in the second situation described above are considered to have been materially changed in design from their natural state and are suitable for fishing purposes. Therefore, they are considered to be fishing rods and the company's sales of such rods are subject to the manufacturers excise tax imposed by section 4161 of the Code.

Rev. Rul. 58-606

The manufacturers excise tax on sporting goods does not apply to the sale by the manufacturer, producer, or importer of articles of fishing equipment which are not enumerated in section 4161 of the Internal Revenue Code of 1954 in any case where they are sold separately. Neither will the tax apply where such articles are sold together with taxable articles unless they are types of articles which when sold on or in connection with the sale of taxable articles may be regarded as constituting "parts or accessories of" the taxable articles.

The Internal Revenue Service has received numerous inquiries regarding the applicability of the manufacturers excise tax on sporting goods to sales by manufacturers, producers, or importers of various items of fishing equipment which are not specifically named in section 4161 of the Internal Revenue Code of 1954.

Some of the articles which the Service has been asked to classify for purposes of the manufacturers excise tax on sporting goods are bait boxes, casting nets, fish hook extractors, fishing tackle boxes, fish tank aerators, gaff hooks, landing nets, lure retrievers, retrieving lines and sinkers for nets, scent oil for bait, and wire minnow traps.

Section 4161 of the Code 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 "fishing rods, creels, reels and artificial lures, baits and flies."

The manufacturers excise tax on sporting goods does not apply to the sale by the manufacturer, producer, or importer of articles of fishing equipment which are not enumerated in section 4161 of the Code in any case where they are sold separately. Neither will the tax apply where such articles are sold together with taxable articles unless they are types of articles which, when sold on or in connection with the sale of taxable articles, may be regarded as constituting "parts or accessories of" the taxable articles by reason of their augmenting or adding to the utility of the taxable articles as such.

Accordingly, since bait boxes, casting nets, fish hook extractors, fishing tackle boxes, fish tank aerators, gaff hooks, landing nets, lure retrievers, retrieving lines and sinkers for nets, scent oil for bait, and wire minnow traps are not named as taxable articles in section 4161 of the Code and are not considered to be "parts or accessories of" any taxable articles when sold with such articles, they are not subject to the manufacturers excise tax when sold either separately or with taxable articles by the manufacturer, producer, or importer.

PART II.—PHOTOGRAPHIC EQUIPMENT

SECTION 4171.—IMPOSITION OF TAX

Rev. Rul. 58-520

A photographic print copier is not subject to the manufacturers excise tax on certain photographic equipment imposed by section 4171 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on certain photographic equipment to sales of photographic print copiers.

A company manufactures and sells a photographic print copier. The copier is an auxiliary device for copying photographic prints. It is used with a certain camera to make a copy of a picture taken by that camera. It consists of a housing which provides a chamber for glare-free even illumination by tungsten filament lamps and a flat support, on the inside rear of the housing, to hold the picture to be copied. It also is equipped with a copy lens, a timer, and a locating support which extends out from the front of the copier. The print copier does not, in itself, contain any mechanism for producing copies of photographic prints. It provides only the light and lens mechanism under which such copy picture is taken by the camera. All materials required for developing and printing of the resultant copy print are a part of the camera film. To obtain a copy of a picture which has been placed in the copier, the camera is placed on the print copier locating support, with the camera lens facing into the copy lens of the copier. Then the camera takes a picture of the print to be copied.

Section 4171 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain articles of photographic equipment (including in each case parts or assessories of such articles sold on or in connection therewith, or with the sale thereof). Enumerated as taxable articles are cameras, camera lenses, unexposed photographic film in rolls, and electric motion or still picture projectors of the household type.

It is held that the above-described print copiers do not come within the scope of any of the articles of photographic equipment enumerated in section 4171 of the Code; neither are the print copiers parts or accessories for any taxable articles of photographic equipment. Accordingly, sales of these articles by the manufacturer are not subject to the manufacturers excise tax imposed by that section, whether sold separately or in connection with the sale of taxable articles of photographic equipment.

PART III.—FIREARMS

SECTION 4181.—IMPOSITION OF TAX

Rev. Rul. 58-586

Where a person installs a telescopic sight on a complete new or used firearm, or cleans and blues a complete used firearm and replaces its sight and stock, his sales of such firearms are not subject to the manufacturers excise tax on firearms imposed by section 4181 of the Internal Revenue Code of 1954. However, where a person installs a sight and stock on a new or used barrel and action, which he owns or has sold to his customer, he is considered to have furnished material and manufactured a taxable firearm, the sale of which is subject to the tax.

Advice has been requested concerning the liability for the manufacturers excise tax upon sales of firearms by *A*, an individual, in the situations described below.

Situation (1). *A* purchases a complete new or used firearm, installs a telescopic sight thereon, and sells the firearm.

Situation (2). *A* acquires title to a complete used firearm. He cleans and blues the firearm, replaces the sight and stock, and then sells the improved firearm.

Situation (3). *A* assembles a firearm for a customer. The customer furnishes the barrel and action and *A* furnishes all other components. The firearm is for the customer's personal use and not for sale by the customer.

Situation (4). *A* purchases a new or used barrel and action, installs a sight and stock thereon, and then sells the complete firearm.

Situation (5). *A* acquires title to a barrel and action and sells it to a customer. Then he furnishes and installs a sight and stock for the customer.

Section 4181 of the Internal Revenue Code of 1954 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 316.4(a) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "manufacturer" to include a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

Among the factors to be considered in determining whether a person incurs liability for the manufacturers excise tax, in situations such as those described above, are (1) whether that person has performed a process which is regarded as manufacturing and (2) whether that person owns the materials used in producing the article so that he controls the sale of the article.

In view of the foregoing, it is held that *A* does not incur liability for the manufacturers excise tax in situations (1) and (2), since he has not performed an act of further manufacture. Moreover, in situation (3) *A* does not incur liability for the tax because there has been no sale of a firearm to the customer. On the other hand, it is held that *A* incurs liability for the tax in situations (4) and (5), since he is considered to have sold a taxable firearm for which he furnished material upon which he performed an act of manufacture.

SUBCHAPTER E.—OTHER ITEMS

PART I.—BUSINESS MACHINES

SECTION 4191.—IMPOSITION OF TAX

Rev. Rul. 58–364

Machines which print or perforate numbers and other identifying information on photographic film negatives are numbering machines within the meaning of section 4191 of the Internal Revenue Code of 1954. However, a device which prints numbers on such negatives only when installed in other equipment is not a taxable numbering machine.

Advice has been requested whether the manufacturers excise tax on business machines applies to sales of certain machines which print or perforate identifying information on photographic film negatives. The three machines, which are described below, are used in film production and processing operations.

(1) The first machine consists of a base plate and framework with guides, rollers, printing platen, and a type drum built therein. The type drum has a resetable 4-digit automatically advancing counter and an assortment of disc inserts mounted on a common shaft. A rachet arrangement permits rapid composing and aligning of the desired information by rotating the type discs into position by means of a pick. An ink pad rests against the line of type comprising the title. The pad swings out of the way when the operating handle is depressed and returns to the original position upon completion of the operation. There are holes in the base of the machine for fastening it on a table. The information printed on the film negatives consists of various classification data and includes numbering. The numbering disc can be set to number consecutively, to duplicate, or to repeat.

(2) The second machine is used in both the production and processing of film. The machine perforates an identifying number on each roll of film produced. The numbers are not advanced mechanically, but are reset by hand when a change in identification is necessary. In the film processing operation, the machine perforates an identifying number and letters on each roll of a customer's film and an identical marking on a ticket on which is entered the customer's name and address. An automatic number-advancing mechanism may be inserted in the machine when it is to be used for the processing operations.

(3) The third machine is a specially constructed numbering device. It is designed so that it may be incorporated in the roll paper head mechanism of a photographic printer. It stamps numerical identification on photofinishing order envelopes and on the prints being processed by the photographic printer. The machine can be set to number consecutively, to repeat the same number, or to print duplicate numbers. It cannot function until it is incorporated in the equipment with which it is designed to be used.

Section 4191 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of various business machines, including numbering machines.

It is held that the machines described in (1) and (2) above are taxable numbering machines within the meaning of section 4191 of the Code. Accordingly, sales by the manufacturer, producer, or importer of these machines are subject to the tax imposed by that section.

On the other hand, it is held that the device described in (3) above is not a taxable numbering machine within the meaning of section 4191 of the Code, since it is an incomplete machine which cannot function until it is incorporated in other equipment. Accordingly, the manufacturer, producer, or importer incurs no manufacturers excise tax liability on his sales of this device.

Rev. Rul. 58-388

Section 4191 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain

enumerated business machines (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof). Vending machines, as such, are not included in that enumeration of articles. *Held*, machines which are designed to vend trading stamps or credit stamps do not come within the scope of any of the articles enumerated in section 4191 of the Code. Accordingly, the manufacturers excise tax imposed by that section is not applicable to sales of such vending machines.

PART II.—PENS AND MECHANICAL PENCILS AND LIGHTERS

SECTION 4201.—IMPOSITION OF TAX

(Also Sections 4220, 6416.) Rev. Rul. 58-365

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 sales of ball point pens each of which is complete except for a pocket clip and/or a cap. The later attaching of a clip and/or cap is an act of further manufacture.

Advice has been requested (1) concerning the applicability of the manufacturers excise tax to sales of unclipped and uncapped ball point pens and (2) whether the subsequent attaching of a clip and/or a cap is considered to be an act of further manufacture.

M corporation manufactures and sells to *N* company ball point pens each of which is complete except for a pocket clip and a cap. *N* attaches a clip and a cap to each pen and resells the completed pens to distributors.

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.

Section 4220(1)(A) of the Code provides that no manufacturers excise tax shall be imposed with respect to the sale by the manufacturer of any article (other than an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4141, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171) for use by the vendee as material in the manufacture or production of, or as a component part of, an article which is subject to the manufacturers excise tax.

Under the provisions of section 6416(b)(3)(A) of the Code, if a manufacturer purchases ball point pens, on which the manufacturers excise tax has been paid, and uses them in the manufacture or production of, or as a component part of another article on which the manufacturers excise tax has been paid or which has been sold free of tax by virtue of section 4220 or 4224, relating to tax-free sales, the tax paid by the original manufacturer may be credited or refunded to the purchasing manufacturer.

It is held that the manufacturers excise tax imposed by section 4201 of the Code attaches to the sale of ball point pens by the manufacturer, producer, or importer thereof even though they are not equipped with pocket clips and/or caps. It is further held that the attaching of a cap and/or a pocket clip constitutes an act of further manufacture;

therefore, the person who performs such an operation is liable for the tax when he sells or uses the finished article.

Since *N* company which attaches the pocket clips and/or caps to the ball point pens, is liable for tax on its sales as a manufacturer, it follows that, under the provisions of section 4220 of the Code and the applicable regulations, *N* may purchase unclipped and/or uncapped ball point pens from *M* free of tax. Or, in accordance with section 6416(b)(3)(A) of the Code, *N* may purchase the unclipped and/or uncapped ball point pens on a tax-paid basis and then take a credit against its tax liability, or claim a refund, in an amount equal to the tax paid by *M* on *M*'s sale of the unclipped and/or uncapped ball point pens to *N*.

Rev. Rul. 58–376

The manufacturers excise tax on mechanical pencils, fountain pens, and ball point pens, imposed by section 4201 of the Internal Revenue Code of 1954, does not apply to sales of ball point pen barrels by *X* corporation or sales of ball point pen cartridges by *Y* corporation to a United States Government agency; however, where the agency purchases both barrels and cartridges from either *X* or *Y*, that corporation will be liable for the manufacturers excise tax on such sales, whether the components are assembled into a completed pen or whether they are in a knockdown condition.

Advice has been requested concerning the application of the manufacturers excise tax to sales of complete ball point pens and components thereof to an agency of the United States Government under the circumstances set forth below.

An agency of the United States Government purchases from the *X* manufacturing corporation plastic ball point pen barrels with screw caps and detachable sleeves. The caps and sleeves are made of nickel-plated steel. The agency purchases from the *Y* manufacturing corporation cartridges for ball point pens. The agency also purchases nickel-plated steel chains for attachment to such pens. At various times the agency purchases from the same manufacturer both the barrels, with caps and sleeves, and the cartridges.

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. No tax is imposed by this section upon parts or accessories sold on or in connection with the sale of these articles.

Section 4001 of the Code imposes a tax upon, among other things, articles made of, or ornamented, mounted, or fitted with precious metals or imitations thereof sold at retail. Since nickel is not a precious metal or imitation thereof, the retailers excise tax is not applicable to sales of these pens or chains.

The combining or assembling of a barrel and a cartridge to produce a complete ball point pen is a manufacturing operation, and any person who performs such an operation is a manufacturer of the ball point pens, irrespective of whether he actually produced either or both of the components.

In view of the foregoing, it is held that, where the agency purchases the barrels from *X* and the cartridges from *Y*, the manufacturers excise tax imposed by section 4201 of the Code does not apply to the sales of the components by either *X* or *Y*. On the other hand, if the

agency purchases both barrels and cartridges from either of those manufacturers, that manufacturer will be liable for the manufacturers excise tax on the sale, regardless of whether the components are sold in an assembled or unassembled condition.

In the event a complete ball point pen is purchased with a steel chain attached, no tax will be applicable to that portion of the price charged for the complete pen which is allocable to the nontaxable chain. See S. T. 943, C. B. 1952–1, 221, for method of computing the tax on the sale of a taxable article with a nontaxable article. Furthermore, where unequal numbers of the barrels and the cartridges are purchased from one manufacturer, no tax will apply to the extra, or unmatched, components.

Rev. Rul. 58–412

When the person for whom a ball point pen is manufactured furnishes and retains title to some of the materials used in the manufacture of the pen, he is considered the manufacturer, although he does not actually produce the completed pen. Accordingly, his subsequent sale of the pen is subject to the manufacturers excise tax imposed by section 4201 of the Internal Revenue Code of 1954.

Advice has been requested concerning the application of the manufacturers excise tax on pens and mechanical pencils and lighters where ball point pens are manufactured under the circumstances described below.

Under a special arrangement, *M* corporation produces complete ball point pens for *N* company. *N* supplies plastic tubing and plugs which *M* uses along with cartridges of its own manufacture for the assembly of complete ball point pens. Throughout the entire operation, *N* retains title to the plastic tubing and plugs used in the manufacture of the pens.

Section 4201 of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer of mechanical pencils, fountain pens, and ball point pens. Section 316.4(b) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

Accordingly, where *M* produces a complete ball point pen under the circumstances described above, it is held that *M* is merely the manufacturing agent and *N* is the manufacturer. Therefore, *N* is liable for the manufacturers excise tax on its sales of such pens.

Rev. Rul. 58–426

The manufacturers excise tax on mechanical lighters, imposed by section 4201 of the Internal Revenue Code of 1954, is applicable to an importer's sale of cigarette lighters with advertising imprinted thereon; however, if there is a separate agreement with a customer that the lighters be imprinted to his specifications and a separate reasonable price is agreed upon for such imprinting, the amount charged therefor is not subject to the tax, provided such amount is shown on the invoice rendered the customer or on the importer's records as a separate item.

The Internal Revenue Service has been asked whether the manufacturers excise tax on mechanical lighters applies to an importer's sale of lighters which have advertising material imprinted thereon.

A company imports and sells mechanical cigarette lighters which have advertising material imprinted thereon. These lighters are sold to customers in the United States for a stated price which includes a charge for imprinting the advertising material. The lighters are not made of, or ornamented, mounted, or fitted with precious metals or imitations thereof, or ornamented, mounted or fitted with pearls, precious or semi-precious stones or imitations thereof. Consequently, they are not subject to the retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954.

Section 4201 of the Code imposes a tax upon the price for which mechanical lighters for cigarettes, cigars, and pipes are sold by the manufacturer, producer, or importer.

It is held that the manufacturers excise tax on mechanical lighters, imposed by section 4201 of the Code, applies to the price for which the lighters are sold by the importer thereof. However, if there is a separate agreement with a customer that the lighters be imprinted in a manner designated by him and a separate price is agreed upon for such imprinting, the amount charged therefor is not considered to be a part of the selling price of the lighters, provided that amount is shown on the invoice rendered the customer or on the importer's records as a separate item and, also, that such amount represents a reasonable charge for such imprinting.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4218.—USE BY MANUFACTURER OR IMPORTER CONSIDERED SALE

Applicability of the manufacturers excise tax to the use of a gas kitchen range in the manufacture of a nontaxable combination kitchen heater-range. See Rev. Rul. 58–538, page 791.

Applicability of the manufacturers excise tax to the *use* of an electric or gas range in the manufacture of a nontaxable combination electric or gas and coal or wood kitchen range. See Rev. Rul. 58–543, page 792.

Use of a truck body by a person who purchases a taxable truck body kit and performs thereon some act of further manufacture. See Rev. Rul. 58–582, page 768.

SECTION 4220.—EXEMPTION FOR SALES OR RESALES TO MANUFACTURERS

Sales of ball point pens to a company which fastens on a clip and cap before resale. See Rev. Rul. 58–365, page 809.

Sale of automatic record changers by the manufacturer to dealers and other manufacturers. See Rev. Rul. 58–445, page 799.

Taxability of lubricating oil to be placed by automobile manufacturers in automatic transmissions. See Rev. Rul. 58–477, page 782.

SUBCHAPTER G.—EXEMPTIONS, REGISTRATION, ETC.

SECTION 4224.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

(Also Section 4061.) Rev. Rul. 58–413

Sales of automobiles by the manufacturer thereof to a county for resale to the county sheriff and his deputies for their official use are not exempt from the manufacturers excise tax under the provisions of section 4224 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of automobiles by the manufacturer thereof to a county for resale to the county sheriff and his deputies for their official use.

A county, which does not furnish automobiles to the county sheriff and his deputies for use in the performance of their official duties, purchases automobiles for them from the manufacturer thereof. The officers are allowed a period of time in which to pay the county for the vehicles. When the automobiles are fully paid for, title thereto passes to the sheriff and the deputies.

Section 4061(a)(2) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of automobile chassis and bodies. Pursuant to the provisions of section 4224 of the Code, no manufacturers excise tax applies to the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

The exemption from manufacturers excise taxes provided by section 4224 of the Code with respect to sales of articles to a State or political subdivision thereof is limited to the sale of articles which are purchased by the State or political subdivision for its exclusive use. In the instant case, it is held that, since the automobiles are purchased by the county expressly for resale to the sheriff, and his deputies, the sales of the automobiles by the manufacturer are not considered to be for the exclusive use of the State or political subdivision. Therefore, sales of the automobiles by the manufacturer thereof to the county for such purposes are subject to the manufacturers excise tax imposed by section 4061(a)(2) of the Code. See Revenue Ruling 99, C. B. 1953–1, 461, which holds that an automobile sold to a county sheriff, where payment is made from his personal funds, is subject to manufacturers excise tax.

(Also Sections 4055, 4292.) Rev. Rul. 58-492

An intercollegiate athletic association, composed of state colleges and universities and formed to control and manage the intercollegiate athletic activities of its member institutions, comes within the scope of the exemptions from certain excise taxes provided by sections 4224, 4055, and 4292 of the Internal Revenue Code of 1954.

Advice has been requested whether an intercollegiate athletic association comes within the scope of exemptions from certain excise taxes provided with respect to transactions with states and their political subdivisions.

An intercollegiate athletic association was formed to control and manage the intercollegiate athletic activities of its member institutions, establish standards and promote scholarship and high ideals in sportsmanship in these institutions, and formulate principles and disseminate information regarding the proper place of athletics in schools and colleges. Only state colleges and universities may become members of the association. Each institution is represented by a faculty representative and a director of athletics. The faculty representatives constitute the legislative body of the association, and the directors constitute the operating body. The faculty representatives elect an executive secretary who handles all of the receipts and disbursements of association funds. These funds consist of receipts from basketball tournaments, football games and track meets, and assessments against member institutions.

Sections 4224 and 4055 of the Internal Revenue Code of 1954 provide that the manufacturers and retailers excise taxes will not apply to the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Section 4292 of the Code provides that no tax shall apply to payments received for communication and transportation services and facilities furnished to the government of any State, Territory of the United States, or to any political subdivision of the foregoing, or the District of Columbia. Prior to the repeal of the tax on the transportation of property by P. L. 85-475, 72 Stat. 259, C. B. 1958-3, 73, section 4292 also provided that the tax shall not be imposed upon amounts paid for the transportation of property to or from such governmental units.

These state and local governmental exemptions apply to the Federal excise taxes tabulated below along with the applicable sections of the regulations which prescribe the manner of establishing the right to the exemptions. Those regulations issued under the 1939 Code have been made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47. They are as follows:

Tax	*Exemption section of Code*	*Applicable regulations*
(1) Retailers	Sec. 4055	Regs. 51, Sec. 320.20. Regs. 119, Sec. 324.30.
(2) Manufacturers	Sec. 4224	Regs. 44, Sec. 314.24. Regs. 46, Sec. 316.24.
(3) Communications	Sec. 4292	Regs. 42, Sec. 130.44.
(4) Transportation of persons	Sec. 4292	Sec. 42.4292-1 of the Facilities and Services Excise Tax Regulations.
(5) Transportation of property.	Sec. 4292	Regs. 113, Sec. 143.24.

The colleges and universities which constitute the intercollegiate athletic association, as described above, have been established by and are controlled by their respective states. Sales of articles to an association composed entirely of such state institutions are considered to be for the exclusive use of the respective states. Likewise, services and facilities furnished to the association are considered to be furnished to the respective states. Accordingly, it is held that the intercollegiate athletic association which is composed of these participating state colleges and universities comes within the scope of the exemptions set forth above.

(Also Sections 4061, 6416.) Rev. Rul. 58–572

The sales of new automobiles to a State are not exempt from the manufacturers excise tax on motor vehicles if sold under certain described agreements which provide that the State will trade the automobiles to the dealer after a limited period of ownership.

Advice has been requested whether automobiles may be considered as sold "for the exclusive use of" a State, for purposes of exemption from the manufacturers excise tax, when sold under agreements which provide that the State will trade the automobiles to the dealer after a limited period of ownership.

Situation (1). A retail automobile dealer sold new automobiles to a State under an agreement that within a specified number of months each automobile would be traded back to the dealer in an even exchange for a new automobile.

Situation (2). A retail automobile dealer sold new automobiles to a State under an agreement that, after being driven approximately a specified number of miles, each would be traded back to the dealer, with a cash payment by the State based upon the number of miles driven, in exchange for a new automobile.

Under the provisions of section 4224 of the Internal Revenue Code of 1954, the manufacturers excise tax is not imposed upon the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. Section 6416(b)(2)(A) of the Code provides for a credit or refund of the tax paid on any article which is resold for the exclusive use of any of those governmental units.

In each of the situations set forth above, the question is whether the agreement to trade the automobile back to the dealer after limited use by the State affects the applicability of the exemption provided for sales of taxable articles "for the exclusive use of" a State.

Because of the limitation upon the period of ownership by the State imposed by the agreements referred to above, it is held that such sales by the dealer to the State are not "for the exclusive use of" the State within the meaning and intent of section 4224 of the Code. Therefore, the manufacturer is not entitled, in either of the situations described, to a credit or refund of the manufacturers excise tax paid on its sales of the automobiles.

Rev. Rul. 58–610

An Indian tribe or council does not come within the scope of the exemption from the manufacturers excise taxes provided by section 4224 of the Internal Revenue Code of 1954 with respect to sales

made for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. Accordingly, the manufacturers excise tax imposed by section 4061(a) of the Code applies to the sale of an automobile to an Indian council to be used for police purposes.

Advice has been requested whether the exemption from the manufacturers excise tax with respect to sales made for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia applies to the sale of an automobile to an Indian tribal council to be used by the executive board of the tribe for police purposes. If not, advice has been further requested whether there is any other provision in the Internal Revenue Code or regulations which exempts the sale or resale of the automobile by the manufacturer to the Indian council from the manufacturers excise tax.

Section 4061 (a) of the Internal Revenue Code of 1954 imposes a tax on motor vehicles, including automobile chassis and bodies, when sold by the manufacturer, producer, or importer.

Section 4223 of the Code provides that no manufacturers excise tax shall be imposed on any article of native Indian handicraft manufactured or produced by Indians on Indian reservations, or in Indian schools, or by Indians under the jurisdiction of the United States Government in Alaska. This section is inapplicable to the instant case since it pertains only to articles manufactured by Indians and not to articles manufactured by others and sold to them.

Section 4224 of the Code provides that no manufacturers excise tax shall be imposed upon the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

An Indian tribe or council, although not a part of the United States Government, is under the supervision of the Bureau of Indian Affairs of the United States Department of the Interior. Although a tribe is granted a certain allotment of land within a particular state as a site for its reservation, such a tribe is not a political subdivision or agency of a state. Accordingly, it is held that an Indian council or Indian tribe does not come within the scope of the exemption provided by section 4224 of the Code pertaining to sales made for the exclusive use of a state or political subdivision thereof. Therefore, the sale of an automobile to an Indian tribe or council for police purposes is not exempt from the manufacturers excise tax under the provisions of that section.

The manufacturers excise tax applies to the sale of an automobile by the manufacturer. Although the manufacturer may pass the amount of the tax on to his customer in the form of an increased selling price, it is the manufacturer who is liable for the tax and who must file the return. There is no provision in the Code which exempts the sale or resale of an automobile to Indians for use by Indians. Accordingly, the manufacturers excise tax imposed by section 4061(a) of the Code will apply to the sale of an automobile by a manufacturer, or to the resale thereof by a dealer, to an Indian tribe or council, regardless of the purpose for which the automobile is to be used.

SECTION 4225.—EXEMPTION FOR EXPORTS

Sale of tread rubber to a retreader for use in retreading tires subsequently exported. See Rev. Rul. 58-400, page 774.

Taxability of articles of Puerto Rican manufacture which are imported into the United States and exported to foreign countries prior to sale or use, see Rev. Rul. 58-544, page 43.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART I.—ADMISSIONS

SECTION 4231.—IMPOSITION OF TAX

Rev. Rul. 58-366

The tax on admissions imposed by section 4231 of the Internal Revenue Code of 1954 must be reported on Form 720, Quarterly Federal Excise Tax Return, for the tax quarter during which such tax is collected from a person purchasing admission, regardless of when such person is entitled to exercise his right to admission.

Advice has been requested whether the tax on admissions should be reported on Form 720, Quarterly Federal Excise Tax Return, for the tax quarter in which it is collected by the person selling the admission, or on the return for the tax quarter in which the person purchasing the admission is entitled to exercise his right to admission.

Section 4231(1) of the Internal Revenue Code of 1954 imposes a tax on the amount paid for admission to any place, including admission by means of season ticket or subscription. However, that section also provides that no tax shall be imposed (A) if the amount paid for admission is 90 cents or less, or (B) in the case of a season ticket or subscription, if the amount which would be charged to the holder or subscriber for a single admission is 90 cents or less.

Section 101.4(a) of Regulations 43, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, provides that the tax in each case is to be paid by the person paying for the admission. This tax applies to the amount paid for admission, not to the admission itself, and as soon as payment for admission is made the tax attaches, whether or not the admission ever takes place.

Section 101.33(a) of the regulations and Treasury Decision 6025, C. B. 1953-2, 400, provide that every person required to collect tax on admissions shall prepare a return each quarter and the original return, along with the amount of the tax, must be filed on or before the last day of the first month following the period for which it is made. However, if, and only if, the return is accompanied by depositary receipts,

showing timely deposits, in full payment of the taxes due for the calendar quarter, the return may be filed on or before the 10th day of the second month following the period for which it was made.

It is held that, since the tax does not apply to the admission itself, but to the payment for admission, and must be collected at the time such payment is made, the tax must be reported on Form 720, Quarterly Federal Excise Tax Return, for the quarter during which it is collected from a person purchasing admission, regardless of when the person purchasing the admission is entitled to exercise his right to admission.

(Also Sections 4241, 4251, 4261, 4271, 4286, 4301, 4311, 4321, 4331, 4361, 4371.) Rev. Rul. 58–510

The exemption of agencies of foreign governments from Federal excise taxes recognized by Revenue Ruling 296, C. B. 1953–2, 325, is applicable to representatives of the Free Zone of Colon in respect of transactions arising in the performance of their official functions for which payments are made from funds authorized and approved for such use by the Free Zone.

Advice has been requested whether the exemption from certain Federal excise taxes of agencies and officers (other than diplomatic representatives) of foreign governments recognized by Revenue Ruling 296, C. B. 1953–2, 325, is applicable to agencies and officers (other than diplomatic representatives) of the Free Zone of Colon.

The Free Zone of Colon was created by Decree Law Number 18, dated June 17, 1948, of the Republic of Panama as an institution of the State with the object of facilitating international exchanges and commerce through a free zone. It is autonomous in the conduct of its own business, but subject to the inspection and general supervision of the Executive Branch and the Office of the Comptroller-General of the Republic of Panama. The management, direction, and administration of the Free Zone are in charge of the Manager who is named by the President of the Republic, with the approval of the National Assembly, and the Board of Directors, members of which are appointed by the President of the Republic.

The Free Zone has the power at any time when it is thought suitable by the Board of Directors to engage the services of technical advisers, national or aliens, for the better installations, organization, and operation of the free commerce areas that it possesses or operates. The employees necessary for the operation of the Free Zone are named by the Manager. He has appointed a Director of Public Relations in the United States for the Free Zone. The Director's duties are to act as a public relations counsel and to promote the business of the Free Zone through the preparation and distribution of press material and through direct contact with American firms. The funds required for the operation of the office of the Director have been authorized and approved by the Board of Directors of the Free Zone.

Under the provisions of Revenue Ruling 296, consular officers of foreign governments, and other officers (other than diplomatic representatives), as well as agencies and commissions of foreign governments, are not required to pay Federal excise taxes, the legal incidence of which would otherwise fall upon them, in respect of transactions

arising in the performance of their official functions for which payment is made by the foreign government. Such taxes include certain, but not all, taxes with respect to admissions (Revenue Ruling 54–307, C. B. 1954–2, 377), and those with respect to dues, safe deposit boxes, communications, and transportation of persons and property imposed under chapter 33 of the Internal Revenue Code of 1954 and documentary stamp taxes imposed under chapter 34 of the Code.

It is held that the exemption from the Federal excise taxes named above is applicable to representatives of the Free Zone of Colon, in respect of transactions arising in the performance of their official functions, for which payments are made from funds authorized and approved for such use by the Free Zone.

(Also Section 4232.) Rev. Rul. 58–611

A restaurant at which a costumed waiter repeatedly bows before serving a particular dish or sings a song to a patron who is observing a birthday or other anniversary is not by reason of these facts a roof garden, cabaret, or other similar place, within the meaning of section 4231(6) of the Internal Revenue Code of 1954.

Advice has been requested whether the cabaret tax applies to amounts paid for admission, refreshment, service, or merchandise, at a restaurant under the circumstances described below.

A restaurant which serves a wide variety of foods specializes in serving a particular oriental dish. This dish is served on a flaming sword and is brought to the table by a waiter dressed in an oriental costume. Each time this particular dish is served the waiter stands before the patron's table and bows repeatedly with his arms extended before him. The waiter also says a few words of congratulation and sings a song whenever a birthday or other anniversary of a patron is being observed. Of the many waiters employed by this restaurant, only one is dressed in a costume.

Section 4231(6) of the Internal Revenue Code of 1954 imposes a tax upon all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. Subject to certain exceptions not applicable to the instant case, section 4232(b) of the Code provides that the term "roof garden, cabaret, or other similar place" shall include any hotel, restaurant, hall, or other public place where music and dancing privileges or any other entertainment, except instrumental or mechanical music alone, are afforded the patrons in connection with the serving or selling of food, refreshment, or merchandise.

It is held that a restaurant at which a costumed waiter bows repeatedly at a patron's table while a particular dish is being served is not a roof garden, cabaret, or other similar place, within the meaning of the statute solely by reason of these facts. The serving of food on a flaming sword and the wearing of a particular costume by the waiter is merely a colorful manner of serving food to add to the oriental atmosphere of the meal. It is further held that if the establishment does not otherwise qualify as a cabaret it will not be

so regarded simply because a waiter occasionally sings a song or says a few words of congratulation to a patron who is observing a birthday or other anniversary. Accordingly, no liability for the cabaret tax is incurred in the instant case.

SECTION 4242.—DEFINITIONS

Whether a restaurant at which a costumed waiter repeatedly bows before serving a certain dish and sings a song to a patron who is celebrating a birthday, etc., is a roof garden, cabaret, etc. See Rev. Rul. 58–611, page 819.

PART II.—CLUB DUES

SECTION 4241.—IMPOSITION OF TAX

Rev. Rul. 58–493

Under the circumstances, where ownership of a lot within the boundaries of a social, athletic, or sporting club or organization is a requirement for membership in such club, the amount paid to obtain a lot, whether paid directly to the club, to a retiring member, or by a coowner of a lot to his partner, is considered to be an amount paid as an initiation fee, and is subject to the tax imposed by section 4241 (a) (2) of the Internal Revenue Code of 1954. However, where a cottage or other building has been erected on the lot, the tax attaches only to the price of the lot. An annual assessment made against the lot is considered to be a charge for club privileges or facilities and is subject to the tax on dues imposed by section 4241(a) (1) of the Code.

Advice has been requested whether the payments described below, which entitle a person to membership in, and the rights and privileges of, a social, athletic, or sporting club or organization, are considered to be dues or membership fees, or initiation fees, within the meaning of section 4242 of the Internal Revenue Code of 1954, and subject to the taxes imposed by section 4241.

A sporting club was organized to provide hunting, fishing, and boating privileges for its members and their guests. The club property includes approximately 300 acres of land, about 75 acres being covered by a lake. The club has constructed a ditch to bring fresh water into the lake and a dam to control the water level. The lake is kept stocked with an ample supply of trout at all times. Access roads, a reservoir to supply water for domestic consumption, a caretaker's cabin, and other necessary buildings have been erected and are maintained by the club. The land surrounding the lake has been divided into lots which are sold to prospective members. Most of the members have built summer homes or cottages on their property. The remainder of the land, the lake, and other constructions and installations are the property of the club.

Ownership of a lot within the club boundaries is the first condition which must be met for membership in the club. A lot may be purchased individually, or by two or more persons collectively, but where a lot is purchased by two or more unrelated persons collectively, the

rights and privileges of a single owner only accrue from such a purchase, and the dues, fees, and assessments in such a case are the same as those paid by a single owner. An assessment of $60 per year is made against each lot. In order to become a voting member and to be eligible to hold office, a lot owner also must pay a fee of $300 and club dues of $150 per year. All members, both voting and nonvoting, are entitled to equal use of all club facilities.

Specifically stated, the questions with respect to which advice has been requested are (1) whether the amount paid for a lot is considered to be an initiation fee; (2) if the amount paid for a lot is considered to be an initiation fee, whether the coowner of a lot who buys the interest of his partner and thereby becomes a member of the club, is liable for the tax on initiation fees with respect to the amount paid for that additional interest; (3) if the price paid for a lot is taxable, whether the tax on initiation fees applies to the total amount paid to a retiring member by a new member for a lot on which a summer home or cottage has been erected; (4) whether liability for the tax on initiation fees is incurred where membership is obtained by inheritance of a lot, no membership fee being required of the new member; and (5) whether the annual assessments against the lots are taxable as dues or membership fees in those cases where the lot owners do not become voting members.

Section 4241(a)(1) of the Code imposes a tax on any amount paid as dues or membership fees to any social, athletic or sporting club or organization, if the dues or fees of an active resident annual member are in excess of $10 per year. Section 4241(a)(2) of the Code imposes a tax on any amount paid as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees, not including initiation fees, of an active resident annual member are in excess of $10 per year.

The term "dues" as used in section 4241(a)(1) of the Code is defined in section 4242(a) of the Code to include any assessment, irrespective of the purpose for which made, and any charges for social privileges or facilities, or for golf, tennis, polo, swimming, or other athletics or sporting privileges or facilities, for any period of more than 6 days.

The term "initiation fees" as used in section 4241(a)(1) of the Code is defined in section 4242(b) of the Code to include any payment, contribution, or loan required as a condition precedent to membership, whether or not any such payment, contribution, or loan is evidenced by a certificate of interest or indebtedness, or share of stock, and irrespective of the person or organization to whom paid, contributed, or loaned.

In the instant case, it is held that, since the only way in which a person may become eligible for membership in the club and obtain the right to full use of the club facilities is by ownership of a lot within the club boundaries, such ownership is a condition precedent to membership, and the amount paid to obtain the lot, irrespective of the person or organization to whom paid, constitutes an initiation fee. Accordingly, the price paid for a lot, whether purchased directly from the club or from a retiring member is subject to the tax on initiation fees. Likewise, where a coowner buys his partner's interest in their

lot, and thereby becomes entitled to membership in the club, the tax on initiation fees applies to the amount paid by the coowner for such additional interest.

Where a new member purchases from a retiring member a lot on which a summer home or cottage has been erected, the tax on initiation fees applies to the price of the lot, but does not apply to that portion of the total price paid to the retiring member which is attributable to any buildings erected thereon. Where membership is transferred by inheritance of a lot, and no assessment is made against the beneficiary, no liability for tax is incurred. In all cases, however, the tax on initiation fees applies to the amount paid to become a voting member, and the tax on dues or membership fees applies to the annual payment required to be paid by each voting member.

Since the owner of a lot is entitled to the use of the club facilities, even though he does not pay the amounts required to become a voting member of the club, it is further held that the annual assessment against his lot constitutes a charge for the privileges and facilities offered by the club within the meaning of section 4242(a) of the Code. Therefore, the tax on dues or membership fees applies to the payment of that assessment.

Rev. Rul. 58-494

A member of a hunting and fishing club, in consideration of the office facilities furnished and services performed by him as secretary-treasurer of the club, is relieved from payment of any dues, assessments, contributions, fees, or other levies, but is entitled to the full rights and privileges of the club. *Held*, any member of any social, athletic, or sporting club or organization who, in consideration of the services performed or facilities furnished by him to the club, is relieved from payment of dues or membership fees is, nevertheless, liable for the tax on dues or membership fees imposed by section 4241(a)(1) of the Internal Revenue Code of 1954. The services performed and the facilities furnished by the employee-member are equal in value, at least, to the amount paid as dues or membership fees by other members who enjoy the same rights and privileges as the employee-member, and he is liable for the tax on dues or membership fees in an amount equal to the tax paid by such other members.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58-510, page 818.

SECTION 4242.—DEFINITIONS

Rev. Rul. 58-459

Charges made by a yacht club to its members for the use of boat docking and mooring facilities for a period of more than six days constitute "dues" within the meaning of section 4242(a) of

the Internal Revenue Code of 1954, and payments of such charges are subject to the tax on club dues imposed by section 4241(a) of the Code.

Advice has been requested whether the tax on club dues, imposed by section 4241(a) of the Internal Revenue Code of 1954, applies to charges made by a yacht club to its members for the use of boat docking and mooring facilities.

A yacht club, which was organized to promote and encourage yachting and aquatic sports, owns and maintains docking and mooring facilities and a clubhouse for the social enjoyment of its members. The club has several classes of memberships. All members have the same club privileges, except that only two classes of members are entitled to maintain and operate boats in the harbor and to use the docking and mooring facilities. The club makes a charge to each member using the docking or mooring facilities, the amount of the charge depending upon the size of the member's boat and the location of the docking or mooring facilities used. A member using the facilities is required to enter into a contract with the club for a period of six months, and the sale or removal of the member's boat for any reason does not release that member from payment of the total docking or mooring charge.

Section 4241(a) of the Code imposes a tax on 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 4242(a) of the Code defines "dues" to include any assessment, irrespective of the purpose for which made, and any charges for social privileges or facilities, or for golf, tennis, polo, swimming, or other athletic or sporting privileges or facilities, for any period of more than six days.

Under Revenue Ruling 55-318, C. B. 1955-1, 509, any charge made by a social, athletic, or sporting club or organization to any of its members for the use of any social, athletic, or sporting privilege or facility, for a period of more than six days, *irrespective of whether the members have the option to decide whether they will avail themselves of such privilege or facility*, would come within the meaning of the term "dues" as defined by section 4242(a) of the Code. By virtue of the provisions of section 7805(b) of the Code (and section 3791(b) of the 1939 Code), that ruling was applied nonretroactively from May 23, 1955, the date of its publication in the Internal Revenue Bulletin. See also Revenue Ruling 56-620, C. B. 1956-2, 834, which relates to the taxability of charges for the cleaning and storage of golf clubs.

It is held that the charges made by the yacht club to its members for the use of docking and mooring facilities are charges for athletic or sporting privileges or facilities for a period of more than six days within the meaning of section 4242(a) of the Code. Whether the docking and mooring facilities are available to every member of the club, or whether the club has sufficient docking and mooring facilities to accommodate all the members entitled to use such facilities, is immaterial. Accordingly, payments made on and after May 23, 1955, on account of such charges are subject to the tax on club dues imposed by section 4241(a) of the Code.

Rev. Rul. 58-460

The excise tax on club dues, imposed by section 4241 of the Internal Revenue Code of 1954, applies to mandatory minimum charges for food and drinks, required to be paid by all members of a social, athletic, or sporting club as a requisite to continued membership in the club.

Advice has been requested concerning the applicability of the excise tax on club dues to mandatory minimum charges for food and drinks imposed by a social, athletic, or sporting club upon its members.

A social club operates a restaurant and bar for the use of its members. In order to meet the expenses of the restaurant and bar, the club requires from each member a minimum expenditure of $200 for food and drinks during the year. If a member does not make actual purchases totaling $200, he is billed for an additional amount equal to the difference between his actual purchases and $200. If a member makes purchases of food and drinks totaling $200 or more, he will not be billed for any amount in addition to such purchases. This minimum charge is in addition to the initiation fee and other items denominated annual dues paid by each member.

Section 4241(a) of the Internal Revenue Code of 1954 imposes a tax on any amount paid as dues or membership fees to any social, sporting, or athletic club or organization, if the dues or fees of an active resident annual member are in excess of ten dollars per year. Section 4242(a) defines the term "dues" to include any assessment, irrespective of the purpose for which made, and any charges for social privileges or facilities, or for golf, tennis, polo, swimming, or other athletic or sporting privileges or facilities, for any period of more than six days.

It is the position of the Internal Revenue Service that any amount required to be paid and/or spent by a member of a social, athletic, or sporting club or organization as a requisite to continued membership, or to continued membership in a particular membership class, constitutes a payment of dues within the meaning of section 4242 (a) of the Code.

Accordingly, it is held that, since in the instant case each member must pay the club a minimum of $200, for food and drink and/or the additional amount referred to, as a requisite to continued membership in the club, the minimum of $200 is considered to be dues and, therefore, is subject to the tax imposed by section 4241(a) of the Code.

Under the authority contained in section 7805(b) of the Code, this ruling will not be applied to amounts paid by members to a club prior to November 1, 1958.

SUBCHAPTER B.—COMMUNICATIONS

SECTION 4251.—IMPOSITION OF TAX

Rev. Rul. 58-542

Amounts paid to a company furnishing a racing information wire service by subscribers to such service are subject to the tax on wire and equipment service imposed by section 4251 of the Internal Reve-

nue Code of 1954. If one of the subscribers contracts with a third party to furnish to such third party a drop from the wire between the information company and the subscriber, such subscriber is considered to be furnishing a taxable wire and equipment service to the third party.

Advice has been requested concerning the applicability of the excise tax on communication services or facilities to the situation described below.

M company furnishes racing information to various subscribers over a nationwide network of wires which *M* leases from a telegraph company. A segment of this network consists of a wire to *N* company, one of *M*'s subscribers which, in turn, furnishes racing information to its own local subscribers. *O* company, as well as other companies which are located at points between *M* and *N*, negotiated a contract with *N* under which *O* obtains, by means of a "drop" from the wire between *M* and *N* the same information furnished by *M* to *N*. There are no negotiations between *M* and *O*. *N* pays *M* for the entire service furnished by *M*, including any charges which are attributable to the drop. *O* pays *N* for the information which *O* receives by means of the drop.

Section 4251 of the Internal Revenue Code of 1954 imposes a tax on amounts paid for certain communication services or facilities. Included in the taxable communication services or facilities are "leased wire, teletypewriter or talking circuit special service" and "wire and equipment service."

Section 4252(d) of the Code provides that the term "leased wire, teletypewriter or talking circuit special service" does not include any service used exclusively in rendering a service taxable as "wire and equipment service." Section 4252(e) of the Code provides that the term "wire and equipment service" shall include stock quotation and information services, burglar alarm or fire alarm services, and all other similar services, but not including any service taxable as "leased wire, teletypewriter or talking circuit special service."

Section 130.38(a)(2) of Regulations 42, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that, in general, "leased wire, teletypewriter or talking circuit special service" relates to private line service where channels, equipment, and other facilities are furnished (usually, but not necessarily, on a contractual basis), to enable users to communicate between specified locations continuously or for specified periods, as distinguished from the sending of single dispatches, messages and conversations by telephone, radio-telephone, telegraph, cable or radio for which tolls are charged by the carrier.

Section 130.38(b) of the regulations specifies numerous services which come within the category of "wire and equipment service." All of the services specified are subscriber services, that is, the subscribers receive such services as information, statistical data, warning signals, music, protective service, etc.

It is held that the racing information service furnished by *M* constitutes a taxable "wire and equipment service." Furthermore, since *O* contracts with *N* for the same racing information service furnished by *M* to *N*, *N* is considered to be furnishing a taxable "wire and equipment service" to *O*. In other words, *N* is using a "wire and equipment service" to render another taxable "wire and equipment service."

The exclusion from the tax provided by section 4252(d) of the Code for "leased wire, teletypewriter, or talking circuit special service" used exclusively in rendering a taxable "wire and equipment service" is not an exemption; rather, it is a statutory assurance that the single use of a transmission facility shall not be subjected to more than one communications tax. There is no like provision in section 4252(e) of the Code to cover situations where "wire and equipment service" is used in rendering another taxable "wire and equipment service." However, it is the apparent intent of the statute to subject the use of a single communication facility to only one excise tax.

Therefore, it is construed that the amounts paid by the initial subscriber are not subject to the tax, if he collects charges from others for the same service and if transmission is continuous and without a break from the original furnisher of the service until ultimate reception by the parties who pay the initial subscriber for the service. Amounts paid to the initial subscriber by his subscribers will be subject to the tax. Where, however, the initial subscriber *retransmits* the information to others, the tax will apply to any amounts he might pay to the originator of the service, as well as any charges he collects from others.

For example, *M* collects $2,000 from *N* for "wire and equipment service" furnished to *N* and *O* for a given period. Twenty percent of the charge, or $400, is applicable to the service furnished to *O*. *M* must collect the tax from *N* on $1,600 ($2,000 less 400). *O* pays *N* $600 for the service *O* receives during the same period. *N* must collect tax on the entire amount paid by *O*.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

SECTION 4252.—DEFINITIONS

Applicability of the communications tax imposed on leased wire service and on wire and equipment service to music terminal devices in which the insertion of a coin permits a patron to request and hear a particular recording. See Rev. Rul. 58–368, page 855.

SECTION 4253.—EXEMPTIONS

Rev. Rul. 58–541

A racing news publication does not qualify as the "public press," nor does a racing news wire service qualify as "a news ticker service furnishing a general news service similar to that of the public press" for the purposes of the exemption from the communications tax provided by section 4253(b) of the Internal Revenue Code of 1954.

Advice has been requested whether, for the purposes of the exemption from the communications tax provided by section 4253(b) of the Internal Revenue Code of 1954, a racing news publication qualifies as the "public press," and whether a racing news wire service qualifies as "a news ticker service furnishing a general news service similar to that of the public press.

A company publishes a paper which is devoted predominantly to horse racing news and related information. The company also transmits racing information to subscribers over wires leased from a telegraph company. The subscribers pay the racing news company for this service. The company collects, by wires leased from a telegraph company, the news and information which it publishes in its paper and transmits over its wire service.

Section 4251 of the Code imposes a tax on the amounts paid for certain communication services or facilities, including "leased wire, teletypewriter, or talking circuit special service," and "wire and equipment service." Section 4253(b) of the Code provides that no tax shall be imposed under section 4251, except with respect to local telephone service, upon any payment received from any person for services or facilities utilized in the collection of news for the public press, or a news ticker service furnishing a general news service similar to that of the public press, or radio broadcasting, or in the dissemination of news through the public press, or a news ticker service furnishing a general news service similar to that of the public press, or by means of radio broadcasting, if the charge for such services or facilities is billed in writing to such person.

Section 130.45(a) of Regulations 42, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that the exemption provided by section 4253(b) of the Code applies only with respect to payments for services and facilities which are utilized exclusively (1) in the collection of news for the public press or radio broadcasting or in the dissemination of news through the public press or by means of radio broadcasting, or (2) in the collection or dissemination of news by news ticker service furnishing a general news service similar to that of the public press. Section 130.45(c) of the regulations provides that the exemption does not extend to the collection and dissemination of information or matter for publication in magazines, periodicals, and trade and scientific publications issued to supply information on certain subjects of interest to particular groups.

Horse racing news is considered to be of interest only to a particular group of people and is not news of general interest to the public at large. Accordingly, since the publication in the instant case is devoted predominantly to racing news and related subjects, it is held that the racing news publication does not qualify as the "public press." It is further held that the racing news wire service furnished by the same company does not qualify as "a news ticker service furnishing a general news service similar to that of the public press." Therefore, the exemption from the communications tax provided by section 4253(b) of the Code does not apply to payments made by the company for the collection of racing news, by means of wire, to be disseminated through the company's publication or wire service.

SUBCHAPTER C.—TRANSPORTATION

PART I.—PERSONS

SECTION 4261.—IMPOSITION OF TAX

Rev. Rul. 58-389

The term "ministers" as used in Revenue Ruling 296, C. B. 1953-2, 325, does not include ministers of the gospel, and they are not exempt from the excise tax on transportation of persons imposed by section 4261 of the Internal Revenue Code of 1954.

Advice has been requested whether ministers of the gospel are considered "ministers" within the meaning of Revenue Ruling 296, C. B. 1953-2, 325, for purposes of exemption from the excise tax on transportation of persons imposed by section 4261 of the Internal Revenue Code of 1954.

Revenue Ruling 296 provides in part that ambassadors, ministers, and other duly accredited diplomatic representatives of foreign governments, together with the members of their families living with them, and members of their households, including attaches, secretaries, and clerks (but not servants), who are not citizens of the United States, nor permanent residents of the United States in an immigrant status, and who are nationals of the country of the diplomatic mission where employed, are not required to pay Federal excise taxes, the legal incidence of which would otherwise fall upon them.

The term "ministers" as used in Revenue Ruling 296 refers only to diplomatic representatives of foreign governments duly accredited to the United States with the rank of minister and does not include ministers of the gospel. Furthermore, there is no provision in the Internal Revenue Code of 1954 for the exemption of religious organizations from payment of the tax imposed by section 4261 of the Code, and there is no exemption provided for persons who are traveling for religious purposes.

Accordingly, there is no authority for exempting ministers of the gospel from payment of the excise tax on transportation of persons.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58-510, page 818.

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26 CFR 42.4261-2: Rate and application of tax. Rev. Rul. 58-591

A so-called "luxury service" furnished by a bus company on certain runs constitutes a part of its taxable transportation service to the extent that it includes providing the services of an attending stewardess, furnishing magazines, and making electric razors available for the passengers' use. However, the excise tax on the transportation of persons does not apply to any portion of the additional charge for the luxury service which is attributable to food and refreshments furnished, provided that this portion is separable and is shown on the records of the bus company.

Revenue Ruling 58-60, C. B. 1958-1, 436, distinguished.

Advice has been requested whether the amounts paid for certain extra services provided by a bus company, under the circumstances described below, are subject to the tax on the transportation of persons.

A bus company which operates in interstate commerce as a motor common carrier of passengers offers a so-called "luxury service" on certain runs. On the busses offering the luxury service, an attending stewardess is provided; soft drinks, coffee, and sandwiches are served; magazines are available; and the use of an electric razor is provided. Each passenger desiring to take advantage of the luxury service must purchase a regular first class ticket and, in addition, a second ticket evidencing the charge for the special services. No portion of the special service charge represents the privilege of occupying a reserved seat. The charge for occupying a reserved seat is included in the cost of the first class ticket on which the tax on the transportation of persons is paid. The special service charge is recorded separately on the books of the bus company.

Section 4261(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within the United States for taxable transportation (as defined in section 4262) of any person by rail, motor vehicle, water, or air. Section 4261(c) of the Code imposes a tax upon the amount paid for seating or sleeping accommodations in connection with transportation with respect to which a tax is imposed by section 4261(a) of the Code.

Section 42.4261–2(d) of the Facilities and Services Excise Tax Regulations provides that where a payment covers charges for nontransportation services as well as for transportation of a person such as charges for meals, hotel accommodations, etc., the charges for the nontransportation services may be excluded in computing the tax payable with respect to such payment, provided such charges are separable and are shown in the exact amounts thereof in the records pertaining to the transportation charge. If the charges for nontransportation services are not separable from the charge for the transportation of the person, the tax must be computed on the full amount of the payment.

Section 42.4261–8(f)(4) of the regulations provides that charges for admissions, guides, meals, hotel accommodations, and other nontransportation services are exempt from the tax where such charges are separable from the payment for the transportation of a person and are shown in the exact amount thereof on the records pertaining to the transportation payment.

Revenue Ruling 58–60, C. B. 1958–1, 436, holds that where a sightseeing company furnishes, in addition to the driver of the vehicle, a separate guide-lecturer for a sightseeing tour, the services performed by the guide-lecturer constitute nontransportation services and the charges for such services may be excluded from the total charge for the tour in determining the basis for computing the tax on the transportation of persons. It is contended that there is no valid distinction between a charge for a "guide" as discussed in Revenue Ruling 58–60 and a charge for a "hostess" or "stewardess" used on the luxury runs described above.

The charges made by certain carriers for various classes of accommodations include the services of employees, such as porters and stewards, to attend to the passengers' wants, and some carriers pro-

vide more elaborate equipment and facilities for the use of the passengers purchasing the better classes of accommodations. Nevertheless, the tax is imposed upon the "amount paid" for the transportation and seating or sleeping accommodations without regard to the class of accommodations purchased. Therefore, under the provisions of the statute, the amount of tax a passenger is required to pay is to be measured by the total charge made by the carrier for the particular class of accommodations the passenger purchases without regard to the specific nature of the services performed by employees provided by the carrier to attend to the passengers' wants, or to the particular types of facilities provided by the carriers for the use of the passengers while they are being transported. Services performed by employees, such as porters, stewards, stewardesses, etc., provided by a carrier to attend to the passengers' wants while they are being transported are clearly not services of the same nature as those described in Revenue Ruling 58–60 which are performed by a separate guide-lecturer on a sightseeing tour.

In the instant case, it is held that, with the exception of the portion of the special service charge which represents the charge for sandwiches, soft drinks, and coffee served to a passenger, the entire amount paid by a passenger utilizes the luxury service constitutes a payment for transportation and for seating accommodations within the meaning of section 4261 of the Code. Accordingly, only the charge for food and drink is excludable from the total payment for the luxury service in computing the tax payable with respect to such payment. In order for such charge to be excluded, it must be separable from the payment for the transportation of a person and be shown in the exact amount thereof on the records of the bus company pertaining to the transportation charge.

PART II.—PROPERTY [REPEALED, AUGUST 1, 1958]

SECTION 4271.—IMPOSITION OF TAX

Rev. Rul. 58-427

The shifting of cargo by a terminal and dock company from the face of the dock to a storage point on the premises does not constitute transportation of property within the meaning of section 4271 of the Internal Revenue Code of 1954, where such shifting is at the discretion of, and for the convenience of, the dock company in furnishing storage facilities and in performing loading and unloading services, even though the shifting is performed by switching the cargo in railroad cars.

Advice has been requested whether, under the circumstances described below, the shifting of cargo by a terminal and dock company constitutes transportation of property within the meaning of section 4271 of the Internal Revenue Code of 1954.

A terminal and dock company located near a major city handles large quantities of iron and steel products, some of which are stored on the company's premises until orders are received to load them on rail cars for reshipment. These products are transported to the dock by steamships and are unloaded from the ships by means of overhead

cranes which operate along the face of the dock. If an open storage pile can be reached by a crane, the cargo to be stored is unloaded from the vessel directly onto the storage pile. If an open storage pile cannot be reached by the crane, the cargo to be stored is unloaded onto railroad cars and shifted by the dock company's locomotive to a storage pile on its premises where it is unloaded and stored. The average distance of the shifting movement from the face of the dock to the storage point is 150 feet. In all cases, the storage site and the means of transporting the material to that site are chosen by the dock company. The charges for unloading and/or reloading and for storage facilities are the same, regardless of the location of the storage site.

Section 4271 of the Code, prior to its repeal by P. L. 85–475, 72 Stat 259, C. B. 1958–3, 73, imposed a tax, with certain exceptions not here applicable, upon the amount paid for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 4272 of the Code provided that the tax imposed under section 4271 of the Code shall apply only to amounts paid to a person engaged in the business of transporting property for hire, including amounts paid to a freight forwarder, express company, or similar person, but not including amounts paid by a freight forwarder, express company, or similar person for transportation with respect to which tax has previously been paid under this section.

Section 143.1(d) of Regulations 43, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "transportation" to mean the movement of property by a person engaged in the business of transporting property for hire, including interstate, intrastate, and inter-city or other local movements, as well as towing, ferrying, switching, etc. In general, it includes accessorial services furnished in connection with a transportation movement, such as loading, unloading, and similar services and facilities.

It is held that where, as under the circumstances described above, the shifting of cargo by a terminal and dock company to or from a storage point on the dock premises, is wholly at the discretion of and for the convenience of the dock company in furnishing storage facilities and performing loading and unloading services, such shifting does not in itself constitute taxable transportation of property, within the meaning of the Code, even though the shifting is performed by switching the cargo in railroad cars. Accordingly, except in cases where the dock company performs the handling of the iron and steel products in connection with a taxable transportation movement of such products to an outside point, the tax does not apply to amounts paid directly to the dock company by the shipper or consignee for handling cargo to or from the storage points, regardless of the means used to perform such handling.

Rev. Rul. 58–363

The tax on the transportation of property imposed by section 4271 of the Internal Revenue Code of 1954 does not apply to amounts paid for c. o. d. collection services where other merchandise is picked up from the consignee and returned to the consignor in lieu of collecting cash.

Revenue Ruling 54–298, C. B. 1954–2, 427, amplified.

Advice has been requested whether the tax on the transportation of property applies to amounts paid for so-called "c. o. d. exchanges" under the circumstances described below.

A company operates a parcel delivery service for several department stores. The amount the company charges for the delivery of a package is computed at an established fee per unit. The unit count is arrived at by applying a unit rating to each parcel based on its size, weight, bulk, etc. In instances where the company is unsuccessful in completing a delivery because of absence of the purchaser, etc., after three attempts at delivery the undelivered parcel is returned to the department store and the store is charged the same delivery fee as if the delivery had been successful. The tax on the transportation of property is added to the amount charged for total delivery package units.

The delivery company also performs a c. o. d. collection service for the stores. In addition to the delivery charge, the company charges one-half unit on each c. o. d. package to compensate for the services of collecting, remitting, and accounting for the c. o. d. charges on such package. This charge is called a c. o. d. fee and is billed separately from the charges for delivery of such parcels. The c. o. d. fees are based on the total number of c. o. d. packages received for collection and not on the c. o. d. charges collected. The tax on the transportation of property is not added to the c. o. d. fees in accordance with Revenue Ruling 54–298, C. B. 1954–2, 427, which holds that the service of collecting c. o. d. charges is not considered accessorial to a transportation movement and fees paid for such service, if shown separately from the transportation charges on the bill rendered by the carrier, are not subject to the tax on the transportation of property.

Included in the amount of c. o. d. fees are so-called "c. o. d. exchanges." The "c. o. d. exchanges" represent parcels received from the stores that are to be delivered to customers in exchange for unsatisfactory merchandise which the customer had previously purchased and has in his possession. On such transactions, the delivery company is authorized to collect in cash the amount shown on the c. o. d. stub or to accept in lieu thereof the unsatisfactory merchandise from the customer. The delivery company makes the same unit charge for the transportation of "c. o. d. exchanges" as it would on any other similar package received for delivery regardless of whether such package is a "c. o. d.," a "paid," or a "charge" package. Its charge for the c. o. d. services on a "c. o. d. exchange" is one-half unit which is the same charge made on all other parcels received for c. o. d. collection and such charge is billed separately from the transportation charge. The specific question involved here is whether, in case of a "c. o. d. exchange," where the delivery company accepts the unsatisfactory merchandise in lieu of cash, the one-half unit c. o. d. charge on such transactions is taxable as a charge for transporting the unsatisfactory merchandise back to the department store or a nontransportation charge for collecting c. o. d. charges.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within the United States for the transportation of property, except coal, by rail, motor vehicle, water, or air from one point in the United States to another.

It is held that in any case where a carrier undertakes to collect from the consignee, upon delivery, for and on behalf of the con-

signor, the charges for the goods, the service rendered the consignor by the carrier in carrying out, or endeavoring to carry out, this undertaking is a service separate and distinct from the transportation of the goods and that it is immaterial whether the carrier collects the charges for the goods in cash or the equivalent thereof in merchandise or that the carrier may be unable to effect collection of such charges. Accordingly, in the instant case, the c. o. d. fee of one-half unit charged by the delivery company for all c. o. d. packages received for collection, which includes "c. o. d. exchanges," is not subject to the tax on the transportation of property when billed separately from the transportation charges.

Revenue Ruling 54–298, C. B. 1954–2, 427, is amplified.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

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26 CFR 42.4271–4273–1: Applicability of tax and cross-reference to regulations. (Also Sections 4281–4283; 42.4281–4283–1.) T. D. 6337[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER D, PART 42.—FACILITIES AND SERVICES EXCISE TAXES

Regulations under sections 4271–4273 and 4281–4283 of the Internal Revenue Code of 1954, as amended, relating to the tax on the amount paid for the transportation of property and on the transportation of oil by pipeline.

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 Facilities and Services Excise Tax Regulations (26 CFR Part 42) are amended as set forth in paragraph 1 to insert provisions relating to the scope and applicability of the regulations prescribed under parts II and III of subchapter C of chapter 33 of the Internal Revenue Code of 1954, as amended.

The Facilities and Services Excise Tax Regulations (26 CFR Part 42) set forth in paragraph 2 are hereby prescribed under parts II and III of subchapter C of chapter 33 of the Internal Revenue Code of 1954, as amended, relating to the facilities and services excise tax on the amount paid for the transportation of property and on the transportation of oil by pipeline.

PARAGRAPH 1. Section 42.0–3 of the Facilities and Services Excise Tax Regulations (26 CFR Part 42) is amended:

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

[1] 23 F. R. 9478.

(d) *Subpart E.*—The regulations in Subpart E of this part relate to amounts paid on or after January 1, 1955, and before August 1, 1958, for the transportation of property.

(B) By striking paragraph (e) and inserting in lieu thereof the following:

(e) *Subpart F.*—The regulations in Subpart F of this part relate to:

(1) Any transportation of oil by pipeline on or after January 1, 1955, for which payment is made before August 1, 1958; and

(2) Any transportation of oil by pipeline on or after January 1, 1955, exclusive of any such transportation which begins on or after August 1, 1958, for which no charge is made or the amount paid (other than pursuant to an arm's length transaction) is less than the fair charge therefor.

PAR. 2. The following regulations are prescribed under parts II and III of subchapter C of chapter 33 of the Internal Revenue Code of 1954, as amended, relating to the tax on the amount paid for the transportation of property and on the transportation of oil by pipeline:

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Subpart E—Transportation of Property

Section	
42.4271–4273	Statutory provisions; imposition of tax; exemptions; registration.
42.4271–4273–1	Applicability of tax and cross-reference to regulations.

Subpart F—Transportation of Oil by Pipeline

42.4281–4283	Statutory provisions; imposition of tax; definition of fair charge; exemption for oil transported within premises of a plant.
42.4281–4283–1	Applicability of tax and cross-reference to regulations.

AUTHORITY: §§ 42.4271–4273, 42.4271–4273–1, 42.4281–4283, and 42.4281–4283–1 issued under sec. 7805, I. R. C. 1954; 68A Stat. 917, 26 U. S. C. 7805.

SUBPART E—TRANSPORTATION OF PROPERTY

§ 42.4271–4273 STATUTORY PROVISIONS; IMPOSITION OF TAX; EXEMPTIONS; REGISTRATION.

SEC. 4271. IMPOSITION OF TAX.

(a) PROPERTY OTHER THAN COAL.—There is hereby imposed upon the amount paid within or without the United States for the transportation of property, except coal, by rail, motor vehicle, water, or air from one point in the United States to another, a tax equal to 3 percent of the amount so paid.

(b) COAL.—There is hereby imposed upon the amount paid within or without the United States for the transportation of coal by rail, motor vehicle, water, or air from one point in the United States to another, a tax equal to 4 cents per short ton for the coal so transported.

(c) APPLICATION OF TAX TO TRANSPORTATION PARTIALLY WITHIN THE UNITED STATES.—In the case of property transported from a point without the United States to a point within the United States, the tax shall apply to the amount paid within the United States for that part of the transportation which takes place within the United States.

(d) BY WHOM PAID.—The taxes imposed by this section shall be paid by the person making the payment subject to the tax.

SEC. 4272. EXEMPTIONS.

(a) NOT IN BUSINESS FOR HIRE.—The tax imposed under section 4271 shall apply only to amounts paid to a person engaged in the business of transporting property for hire, including amounts paid to a freight forwarder, express company, or similar person, but not including amounts paid by a freight forwarder, express company, or similar person for transportation with respect to which a tax has previously been paid under such section.

(b) CONSTRUCTION PROJECTS.—The tax imposed by section 4271 shall not apply to the transportation of earth, rock, or other material excavated within the boundaries of, and in the course of, a construction project and transported to any place within, or adjacent to, the boundaries of such project.

(c) COAL PREVIOUSLY TAXED.—The tax imposed by section 4271 (b) on the transportation of coal shall not apply to the transportation of coal with respect to which there has been a previous taxable transportation.

(d) CERTAIN ORGANIZATIONS.—The tax imposed by section 4271 shall not apply to amounts paid for the transportation of property to or from an international organization, or any corporation created by act of Congress to act in matters of relief under the treaty of Geneva of August 22, 1864.

(e) POST OFFICE DEPARTMENT.—The tax imposed by section 4271 shall not apply to amounts paid to the Post Office Department for the transportation of property.

SEC. 4273. REGISTRATION.

Every person engaged in the business of transporting property for hire, including freight forwarders, express companies, and similar persons, shall, within 60 days after first engaging in the business of transportation of property for hire, register his name and his place or places of business with the Secretary or his delegate.

SEC. 4 OF THE TAX RATE EXTENSION ACT OF 1958 (72 Stat. 260)

SEC. 4. REPEAL OF TAXES ON TRANSPORTATION OF PROPERTY.

(a) REPEAL.—Effective as provided in subsection (c), part II (relating to tax on transportation of property) * * * of subchapter C of chapter 33 of the Internal Revenue Code of 1954 are hereby repealed.

* * * * * * *

(c) EFFECTIVE DATES.—(1) * * * the repeals and amendments made by subsections (a) * * * shall apply only with respect to amounts paid on or after August 1, 1958.

* * * * * * *

§ 42.4271–4273–1 APPLICABILITY OF TAX AND CROSS-REFERENCE TO REGULATIONS.—(a) *Applicability of tax.*—Section 4271 imposes a tax on amounts paid before August 1, 1958, for the transportation of property.

(b) *Applicable regulations.*—For rules relating to the imposition of tax under section 4271, the applications of the exemptions from such tax under section 4272, and the requirement of registration under section 4273, see Regulations 113 (1943 edition, as amended), 26 CFR (1939) Part 143, as prescribed under and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, 19 F. R. 5167, August 17, 1954 [C. B. 1954–2, 47].

SUBPART F—TRANSPORTATION OF OIL BY PIPELINE

§ 42.4281–4283 STATUTORY PROVISIONS; IMPOSITION OF TAX; DEFINITION OF FAIR CHARGE; EXEMPTION FOR OIL TRANSPORTED WITHIN PREMISES OF A PLANT.

SEC. 4281. IMPOSITION OF TAX.

There is hereby imposed upon all transportation of crude petroleum and liquid products thereof by pipeline a tax equivalent to 4½ percent of the amount paid for such transportation. If no charge for transportation is made (either by reason of ownership of the commodity transported or for any other reason), or if the payment for transportation is less than the fair charge therefor (other than in the case of an arm's length transaction), such tax shall be imposed on the fair charge for such transportation. The tax imposed by this section is to be paid by the person furnishing such transportation.

SEC. 4282. DEFINITION OF FAIR CHARGE.

For the purposes of section 4281, the fair charge for transportation shall be computed—

(1) From actual bona fide rates or tariffs; or

(2) If no such rates or tariffs exist, then on the basis of the actual bona fide rates or tariffs of other pipelines for like services, as determined by the Secretary or his delegate; or

(3) If no such rates or tariffs exist, then on the basis of a reasonable charge for such transportation, as determined by the Secretary or his delegate.

SEC. 4283. EXEMPTION FOR OIL TRANSPORTED WITHIN PREMISES OF A PLANT.

For the purposes of section 4281, the term "transportation" shall not include any movement through lines of pipe within the premises of a refinery, a bulk plant, a terminal, or a gasoline plant, if such movement is not a continuation of a taxable transportation. The crossing of rights-of-way, streets, highways, railroads, levees, or narrow bodies of water, in connection with such a movement, shall not of itself constitute such movement as being "transportation."

SEC. 4 OF THE TAX RATE EXTENSION ACT OF 1958 (72 Stat. 260)

SEC. 4. REPEAL OF TAXES ON TRANSPORTATION OF PROPERTY.

(a) REPEAL.—Effective as provided in subsection (c), * * * part III (relating to tax on transportation of oil by pipeline) of subchapter C of chapter 33 of the Internal Revenue Code of 1954 are hereby repealed.

* * * * * * *

(c) EFFECTIVE DATES.—

(1) Except as provided in paragraph (2), the repeals and amendments made by subsections (a) * * * shall apply only with respect to amounts paid on or after August 1, 1958.

(2) In the case of transportation with respect to which the second sentence of section 4281 of the Internal Revenue Code of 1954 applies, the repeals and amendments made by subsections (a) * * * shall apply only if the transportation begins on or after August 1, 1958.

§ 42.4281–4283–1 APPLICABILITY OF TAX AND CROSS-REFERENCE TO REGULATIONS.—(a) *Applicability of tax.*—Section 4281 imposes a tax in respect of amounts paid before August 1, 1958, for the transportation of oil by pipeline. Section 4281 also imposes a tax in respect of the fair charge for the transportation of oil by pipeline in any case where—

(1) No charge is made for such transportation or the payment for such transportation is less than the fair charge therefor (other than in the case of an arm's length transaction), and

(2) The transportation begins before August 1, 1958.

(b) *Applicable regulations.*—For rules relating to the imposition of tax under section 4281, the definition of fair charge contained in section 4282, and the application of the exemption for oil transported within the premises of a plant under section 4283, see Regulations 42 (1942 edition, as amended), 26 CFR (1939) Part 130, as prescribed under and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, 19 F. R. 5167, August 17, 1954 [C. B. 1954–2, 47].

Because this Treasury Decision merely provides for the continuance of existing rules, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

DANA LATHAM,
Commissioner of Internal Revenue.

Approved December 3, 1958.

DAN THROOP SMITH,
Deputy to the Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 5, 1958, 8:48 a. m., and published in the issue of the Federal Register for December 6, 1958, 23 F. R. 9478.)

PART III.—OIL BY PIPELINE [REPEALED, AUGUST 1, 1958]

SECTION 4281.—IMPOSITION OF TAX

26 CFR 42.4281–4283–1: Applicability of tax and cross-reference to regulations.

Regulations under the Internal Revenue Code of 1954. See T. D. 6337, page 833.

SUBCHAPTER D.—SAFE DEPOSIT BOXES

SECTION 4286.—IMPOSITION OF TAX

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

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SUBCHAPTER E.—SPECIAL PROVISIONS APPLICABLE TO SERVICES AND FACILITIES TAXES

SECTION 4291.—CASES WHERE PERSONS RECEIVING PAYMENTS MUST COLLECT TAX

Liability for the collection, return, and remittance of the admissions tax where a theater is leased to performers under stated circumstances. See Rev. Rul. 58-574, page 876.

SECTION 4292.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

Whether an intercollegiate athletic association comes within the scope of the exemption from certain Federal excise taxes provided with respect to transactions with States and local governmental units. See Rev. Rul. 58-492, page 814.

SECTION 4293.—EXEMPTION FOR UNITED STATES AND POSSESSIONS

26 CFR 42.4293-1. Exemption for the United States and Possessions. Rev. Rul. 58-367

Amounts paid by the governments of possessions of the United States (which include, among others, the Virgin Islands, Guam, and American Samoa) for the transportation of persons are not exempt from the tax imposed by section 4261 of the Internal Revenue Code of 1954, unless such transportation is furnished upon United States of America transportation requests.

Advice has been requested whether amounts paid by the governments of possessions of the United States for the transportation of persons are exempt from the tax on transportation of persons.

The Internal Revenue Code of 1954 contains no provisions for the exemption from tax of payments made by the Government of the United States or by the governments of possessions of the United States for the transportation of persons. However, pursuant to the provisions of section 307(c) of the Revenue Act of 1943, the Secretary of the Treasury authorized exemption from the tax imposed by section 3469 of the Internal Revenue Code of 1939 as to any payment for the transportation of persons furnished to the United States upon a United States Government transportation request (now United States of America transportation request). See Mim. 6194, C. B. 1947-2, 210, and Authorization of the Secretary of the Treasury, C. B. 1947-2, 211. This exemption continues in effect with respect to the tax imposed on the transportation of persons by section 4261 of the Internal Revenue Code of 1954.

It is held that amounts paid by the governments of possessions of the United States (which include, among others, the Virgin Islands, Guam, and American Samoa) for the transportation of persons are not exempt from the tax imposed by section 4261 of the Code, unless the transportation is furnished upon Standard Form 1169, United States of America transportation request.

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

Rev. Rul. 58-441

Where an investor's periodic payment investment trust certificate is terminated simultaneously with making application for a new single payment certificate and the proceeds of the terminated certificate are applied on the new single payment certificate, the new certificate is subject to the documentary stamp tax imposed by section 4301 of the Internal Revenue Code of 1954 as an original issue of shares of stock.

Advice has been requested concerning the applicability of the documentary stamp tax imposed by section 4301 of the Internal Revenue Code of 1954 to the issuance of a single payment investment trust certificate purchased from the proceeds of a terminated periodic payment investment trust certificate.

In the instant case, a trust fund issues and offers for sale to investors periodic payment (monthly payment) investment trust certificates and single payment (fully paid) investment trust certificates. Payments received under both plans are used to purchase an undivided interest in the entire trust estate, and funds in the trust estate are used to purchase one or more stock units consisting of the common capital stock of certain corporations. The single payment plan provides for minimum payments of $500 and upwards in multiples of $100, while the periodic payment plan provides for payments of $10 per month and upwards in multiples of $5 per month. The trustee registers and authenticates the certificates, opens an investment trust account in the name of the investor, and records the amount paid by such investor. Under each plan, the certificates are issued and the documentary stamp tax on the original issue of shares of stock is paid at the time the investor makes his initial payment.

Under the terms set forth in these certificates, an investor, upon making a written request in form acceptable to the trustee and upon presentation of his certificates, if requested by the trustee, will at any time be entitled to terminate his account and to withdraw, subject to certain deductions, the current market value of such account.

The certificates carry no conversion rights. However, an investor, at any time his periodic payment certificate has a liquidating value of not less than $500, may acquire a single payment certificate by surrendering his periodic payment certificate to the trustee for cancellation, making application for the new certificate, and directing that the proceeds of his terminated account be applied on the new single payment certificate.

To illustrate, an investor purchased and completed payment on a $3,000 periodic payment certificate which, during the period held,

earned dividends of $885. This latter amount, together with the $3,000 was used to purchase an undivided interest in the entire trust fund. The investor had his account terminated at a time when its current market value was $4,493. The total payments made ($3,000), the reinvested income ($885), and the appreciation in value of the periodic payment account ($608), were applied, at his direction, to the purchase of a new $4,500 single payment certificate for which he made application upon termination of his periodic payment account. Since the single payment certificate could only be issued in multiples of $100 it was necessary that the investor pay the difference between $4,500, the next even multiple, and $4,493, or $7.

Section 4301 of the Internal Revenue Code of 1954 imposes a tax on each original issue of shares or certificates of stock, issued by a corporation, whether on organization or reorganization.

It is held that the (new) single payment investment trust certificate is subject to the original issue tax imposed by section 4301 of the Code. Since it is required under the terms of these certificates that an investor's periodic payment account be terminated simultaneously with the making of application for a new single payment certificate, the current market value of the account upon termination plus the cash differential is the total amount invested in the new certificate. The transaction is one of original investment with respect to the single payment certificate, and there is no provision in the law which would exclude from the measure of the tax any part of the maximum aggregate amount payable shown on the face of such a certificate. Therefore, the basis of the tax incurred upon the original issue of the $4,500 single payment certificate in the example shown above is $4,500.

(Also Section 4321.) Rev. Rul. 58-478

Shares of stock issued by a Puerto Rican corporation are not subject to the documentary stamp tax imposed by section 4301 of the Internal Revenue Code of 1954 regardless of where the stock is issued. However, the tax imposed by section 4321 of the Code applies to subsequent transfers of that stock when transferred within the geographical United States.

Advice has been requested whether the documentary stamp tax imposed by section 4301 of the Internal Revenue Code of 1954 is applicable to the issuance of shares of stock of a Puerto Rican corporation.

The corporation here concerned was organized under the laws of Puerto Rico where all of its activities were pursued. It issued stock, and warrants entitling the holders to purchase stock, in compliance with the laws of Puerto Rico.

Section 4301 of the Code imposes a tax on each original issue of shares or certificates of stock issued by a corporation.

Section 4321 of the Code imposes a tax on each sale or transfer of shares or certificates of stock, or of rights to subscribe for or to receive such shares or certificates, issued by a corporation.

Section 7701(a)(9) of the Code defines the term "United States," when used in a geographical sense, as including only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

It is held that the documentary stamp tax imposed by section 4301 of the Code applies only to issuances of stock by corporations organized under the laws of the States, the Territories of Alaska and Hawaii, and the District of Columbia. Therefore, since this corporation's stock is issued in compliance with the laws of Puerto Rico, the documentary stamp tax does not apply to the issuance of its stock, regardless of whether issued in Puerto Rico or in the United States as defined above.

However, it is further held that the tax imposed by section 4321 of the Code applies to transfers of stock within the United States, without regard to the place of incorporation of the corporation. Accordingly, the tax imposed by that section applies to the transfer within the United States of the stock of the Puerto Rican corporation but does not apply to the transfer of that stock outside the United States.

Rev. Rul. 58-530

Where, pursuant to provisions of a merger agreement, shares of stock of merging corporations are converted into shares of stock in the surviving corporation, liability for the original issue tax is incurred when the merger becomes effective even though the certificates of stock of the surviving corporation have not been issued. In such case, the tax is computed with respect to each stockholder as though he received a single certificate representing all of the shares of stock to which he was entitled in the surviving corporation.

Advice has been requested concerning the applicability of the documentary stamp tax imposed by section 4301 of the Internal Revenue Code of 1954 to the issuance of shares of stock by a surviving corporation to the stockholders of the merging corporations pursuant to an agreement of merger.

Under a plan of merger, corporations *M* and *N* were merged into corporation *O*, the surviving corporation. Certain shares of *N*'s stock held by *M* and certain shares of *M*'s stock held by *M* in its treasury were cancelled and the remaining outstanding shares were converted by certain provisions of the merger agreement into par value stock of *O*. As provided in the merger agreement, after approval by the required number of stockholders the merger was consummated and became effective on the date the agreement was filed with the proper State authorities. Certificates of stock of the surviving corporation were not issued to the stockholders of the merging corporation until they surrendered their certificates of stock in the merging corporations. The specific questions asked are whether liability for the original stock issue tax is incurred on the effective date of the merger even though the stock certificates had not been issued at that time, and whether the original issue tax should be computed as though each stockholder received a single certificate representing all of the shares of stock to which he was entitled in the surviving corporation or whether the tax should be computed on the assumption that no stockholder would receive a certificate representing more than 100 shares.

Section 4301 of the Code imposes a tax on each original issue of shares of certificates or stock, issued by a corporation, whether on organization or reorganization. Section 113.22 of Regulations 71,

made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that stock is deemed to be issued when it is subscribed for and the subscription is accepted.

For the purpose of the original stock issue tax, it is not necessary that certificates evidencing the shares be issued. An acceptance of an offer to subscribe to stock constitutes an issuance. Therefore, the shares of stock in the instant case were issued when the merger became effective because at that time the agreement of merger had been finally approved and filed with the proper State authorities, thus the offer and acceptance of the shares as set forth in the agreement had been consummated. Accordingly, it is held that liability for the original issue tax was incurred when the merger became effective even though the certificates evidencing the shares of stock had not been issued. Such tax should be computed with respect to each stockholder as though the stockholder received a single certificate representing all of the shares of stock to which he was entitled in the surviving corporation.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

PART II.—ISSUANCE OF CERTIFICATES OF INDEBTEDNESS

SECTION 4311.—IMPOSITION OF TAX

(Also Section 4314.) Rev. Rul. 58–587

The exchange of new debentures with coupons attached for outstanding debentures in registered form without coupons does not in and of itself effect such a material change in the terms as to constitute a new issue subject to original issue tax under sections 4311 and 4313 of the Internal Revenue Code of 1954.

Advice has been requested whether certain modifications made in debentures constitute such material changes as to effect a new issuance taxable under sections 4311 and 4313 of the Internal Revenue Code of 1954.

A company had two classes of debentures in registered form which entitled the holders thereof to interest at a specified percentage. In order to eliminate the necessity of payment of the interest to the registered holders of the securities by check, new debentures bearing the same rate of interest with coupons attached were issued to replace the old debentures. In all other respects the old and the new debentures are substantially identical.

Section 4311 of the Code provides that a tax shall be imposed on all certificates of indebtedness issued by a corporation. Section 4313 of the Code provides that every renewal of any certificate of indebtedness shall be taxed as a new issue.

The exchange of the new debentures with coupons attached for the old debentures without coupons merely changes the method of

paying interest thereon. Accordingly, it is held that the new debentures do not effect such material changes in terms as to constitute a new issue subject to the original issue tax under sections 4311 and 4313 of the Code.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

Applicability of the tax on the issuance of bonds by a nonprofit corporation on behalf of a county. See Rev. Rul. 58–559, page 851.

SECTION 4313.—RENEWALS

Whether the exchange of debentures with coupons attached for outstanding debentures without coupons constitutes a renewal taxable as a new issue. See Rev. Rul. 58–587, page 842.

SUBCHAPTER B.—SALES OR TRANSFERS OF CAPITAL STOCK AND CERTIFICATES OF INDEBTEDNESS OF A CORPORATION

PART I.—SALES OR TRANSFERS OF CAPITAL STOCK AND SIMILAR INTERESTS

SECTION 4321.—IMPOSITION OF TAX

Rev. Rul. 58–573

Pursuant to a power of appointment granted by a deed of trust executed by a testator prior to his death and by the testator's will, a beneficiary in her will transferred corporate securities held for her benefit in a testamentary trust to another trustee for the benefit of her children. *Held*, a new and separate trust was created by the beneficiary's will, and the transfer is subject to the transfer tax imposed by sections 4321 and 4331 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the documentary stamp tax imposed by sections 4321 and 4331 of the Internal Revenue Code of 1954 to the transfer of corporate securities from a testamentary trust to a trust created under the beneficiary's will pursuant to a deed of trust executed by the testator and to a power of appointment contained in that testator's will.

A testator by his will created a testamentary trust in which certain corporate securities were placed for his daughter's benefits for life. The testator's will appointed his sons (beneficiary's brothers) trustees of the trust. During his lifetime, the testator executed a deed of trust transferring certain securities to the trustees for his daughter's benefit. The will and the deed of trust authorized and empowered the beneficiary to appoint and dispose of the principal of the trust estate at her death. The beneficiary, pursuant to the power of appointment

granted in the will and the deed of trust, directed in her will that the securities held in trust for her be transferred to a bank, as trusts, for the benefit of her sons and their descendents. Specifically, the question arises whether this transaction constitutes a transfer of securities from one trust to a new and separate trust, or whether it is merely a substitution of trustees of the same trust.

Sections 4321 and 4331 of the Code impose a tax on the sale or transfer of legal title to shares or certificates of stocks and to certificates of indebtedness issued by a corporation, respectively. Section 113.33(c) of Regulations 71, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that transfers of stock to or by trustees are subject to tax. Section 4343(a)(8) of the Code provides that deliveries or transfers of securities from trustees to surviving, substituted, succeeding, or additional trustees of "the same trust" are not subject to tax.

A transfer of legal title of corporate securities is taxable unless specifically exempt from tax by law. The exemption authorized by section 4343(a)(8) of the Code is only available when the transfer involves "the same trust."

In the instant case, both the deed of trust and the testator's will authorized and empowered the beneficiary to appoint and dispose of the principal of the trust estate at her death. In her will the beneficiary expressly exercised this power of appointment and made disposition of the principal of the trust estate created by her father by directing that at her death the trust estate be transferred and paid over to the bank in trust for the benefit of her children. Accordingly, it is held that a new and separate trust was created by the will of the beneficiary and the transfer was not to a substituted trustee of "the same trust." Therefore, the transfer of the securities from the trustees under the testator's will to the bank as trustee under the will of the beneficiary is subject to the transfer tax imposed by sections 4321 and 4331 of the Code.

Transfers, within the United States, of shares of stock issued by a Puerto Rican corporation. See Rev. Rul. 58–478, page 840.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

PART II.—SALES OR TRANSFERS OF CERTIFICATES OF INDEBTEDNESS

SECTION 4331.—IMPOSITION OF TAX

Rev. Rul. 58–379

Applicability of the documentary stamp tax imposed by section 4331 of the Internal Revenue Code of 1954 to the transfer of corporate bonds and a mortgage note upon which installment payments were made but not allocated by either the debtor or creditor to any specific instrument of indebtedness.

Advice has been requested concerning the applicability of the documentary stamp tax imposed by section 4331 of the Internal Revenue Code of 1954 to the transfer of corporate bonds and a mortgage note upon which payments made had not been allocated by either the debtor or creditor among the various debts.

Corporate bonds, secured by mortgages, were held by a savings bank. The corporate-obligor, a New York corporation which owned the mortgaged property located in New York, executed its mortgage note in favor of the savings bank, the holder of the corporate bonds. The corporate-obligor then entered into a consolidation agreement with the bank whereby the note and mortgage were combined and consolidated with the bonds and mortgages so as to form a single lien for the aggregate obligation. The bonds and mortgage note were later assigned to another bank. Principal payments made under the consolidation agreement, in amounts insufficient to satisfy the unpaid balance due either on the note or the bonds, were not allocated by either the debtor corporation or the creditor bank between the unpaid balance due on the respective corporate bonds and on the mortgage note. The question arises whether payments received on the consolidated indebtedness may be allocated to the oldest debt held by the creditor for the purpose of determining the basis upon which the transfer tax should be computed with respect to the assignment of the bonds and mortgage note.

Section 4331 of the Code imposes a tax on each sale or transfer of any certificate of indebtedness issued by a corporation.

The mortgage note executed by the corporation does not come within the classification of instruments subject to the documentary stamp tax upon issuance. See Rev. Rul. 54–505, C. B. 1954–2, 384. Therefore, since stamp tax was not incurred on the issuance of this note, the tax is not incurred on the transfer of such note.

The rule in the State of New York as to the application of payments in a case of this kind appears to be well settled in that a debtor has the privilege of applying payments made on his debt in the manner in which and to the account he designates. If he fails to do this, the creditor may apply payments against such debts as he chooses, whether secured or unsecured. See *Foss* v. *Riordan*, 84 N. Y. S. (2d) 224. Where the parties evidence an intention of making an application of payments to a particular account, such intention is binding as between the parties and will not be upset by the court. See *Wright* v. *Wright*, 72 N. Y. 149. Where neither the debtor nor the creditor makes an application of the payments, such successive payments and credits are appropriated in discharge of the items of debt antecedently due in the order of time in which they stand in the account, the first payments extinguishing the oldest debts. See *Carson et al.* v. *Federal Reserve Bank of New York*, 172 N. E. 475, at 480.

In the instant case, the payments made by the debtor corporation were not specifically allocated between the bonds and the note by either the debtor or creditor. Therefore, in view of the settled rule in the State of New York, these payments should be allocated against the oldest obligation, which, in this case, is the corporate bonds. Compare *Thompson et al.* v. *St. Nicholas National Bank*, 21 N. E. 57; also *Delaware Dredging Co. et al.* v. *Tucker Stevedoring Co.*, 25 Fed. (2d) 44, at 46. The balance represents the unpaid amount due on

these bonds at the time of their assignment and is the basis for computing the transfer tax imposed by section 4331 of the Code. Since no transfer tax is due on the assignment of the mortgage note, the amount of such note is not to be included in the computation in arriving at the transfer tax upon the assignment of the bonds and such mortgage note.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

Applicability of the tax on the issuance of bonds by a nonprofit corporation on behalf of a county. See Rev. Rul. 58–559, page 851.

SUBCHAPTER C.—CONVEYANCES

SECTION 4361.—IMPOSITION OF TAX

Rev. Rul. 58–377

Where an indebtedness, which was secured by a deed of trust and which had been accepted for insurance by the Federal Housing Administration, was foreclosed and the property bid in by the mortgagee, who instructed the trustee to make the conveyance direct to that agency, only one conveyance tax is incurred. The tax, computed on the consideration paid by such agency, is payable by the nonexempt party or parties to the transaction.

Advice has been requested concerning the applicability of the documentary stamp tax imposed by section 4361 of the Internal Revenue Code of 1954 where a mortgagee, who bid in the mortgaged property at a foreclosure sale, instructed the trustee to convey it direct to the Federal Housing Commissioner.

In the instant case, default had been made in the payment of an indebtedness which was secured by a deed of trust and which had been accepted for insurance by the Federal Housing Administration, an agency of the United States Government. The mortragee requested the trustee to foreclose under the terms of the deed of trust, and at the foreclosure sale the mortgagee bid in the property for $300,000. Pursuant to authorization and instructions of the Federal Housing Administration, the mortgagee directed the trustee to convey the property by one deed direct to the Federal Housing Commissioner. The mortgagee joined in the trustee's deed making the conveyance and received from the Commissioner debenture bonds in the amount of $500,000, which was the approximate amount of the mortgage on the date of the foreclosure. The specific question presented is whether liability for two documentary stamp taxes is incurred, one based on the amount bid for the property at the foreclosure sale and the second on the consideration represented by the amount of the debentures issued by the Federal Housing Administration to the mortgagee.

Section 4361 of the Code imposes a tax on each deed, instrument, or writing, whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers when the consideration or value of the interest or property conveyed, exclusive of the value of any liens or encumbrance remaining thereon at the time of sale, exceeds $100.

Section 4383 of the Code provides that the documentary stamp tax shall be paid by any person who makes, signs, issues, or sells any of the documents or instruments subject to tax, or for whose use or benefit the same are made, signed, issued, or sold. The United States or any agency or instrumentality thereof shall not be liable for the tax with respect to an instrument to which it is a party, and affixing of stamps thereby shall not be deemed payment for the tax, which may be collected by assessment from any other party liable therefor.

In the instant case, it is held that, since there is only one conveyance and one deed, that being from the trustee to the Federal Housing Administration, only one conveyance tax is imposed and that is based on the amount of the consideration supporting such conveyance, namely, $500,000, the amount of the bonds issued by the Federal Housing Administration for the property. Since the Federal Housing Administration is an agency of the United States, it is not liable for the documentary stamp tax with respect to a conveyance of real property acquired by it in a foreclosure proceeding. However, this does not relieve the other party to the transaction from his liability for such tax in view of the dual liability provisions of section 4383 of the Code, under which the tax is payable by and collectible from the grantor or the grantee, unless otherwise specifically exempt. See Rev. Rul. 57–373, C. B. 1957–2, 775; and Rev. Rul. 57–72, C. B. 1957–1, 415.

Rev. Rul. 58–511

Where a "Declaration of Taking" is filed pursuant to the provisions of 40 U. S. C. 258(a) for taking of real property in eminent domain proceedings by the United States or any agency or instrumentality thereof, the documentary stamp tax imposed by section 4361 of the Internal Revenue Code of 1954 is incurred on the date the "Declaration of Taking" is filed and is based upon the amount finally awarded.

Advice has been requested concerning the applicability of the documentary stamp tax imposed by section 4361 of the Internal Revenue Code of 1954 with respect to "Declarations of Taking" filed by agencies of the United States Government when real property is taken for public use.

Section 4361 of the Code imposes a tax on each deed, instrument, or writing, whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred or otherwise conveyed to, or vested in, the purchaser or purchasers when the consideration or value of the interest or property conveyed, exclusive of the value of any liens or encumbrances remaining thereon at the time of sale, exceeds $100.

Section 4383 of the Code provides that the documentary stamp tax shall be paid by any person who makes, signs, issues, or sells any of the documents or instruments subject to tax, or for whose use or benefit the same are made, signed, issued, or sold. The United States or any

agency or instrumentality thereof is not liable for the tax with respect to an instrument to which it is a party, and affixing of stamps thereby shall not be deemed payment for the tax, which may be collected by assessment from any other party liable therefor.

Where real property is acquired by the United States or any agency or instrumentality thereof in condemnation proceedings, the instrument whereby title is vested in the condemnor is subject to the documentary stamp tax imposed by section 4361 of the Code. A "Declaration of Taking" which is sometimes filed in a condemnation proceeding, is an instrument or writing whereby title to realty sold is vested in the condemnor and the documentary stamp tax is payable with respect thereto by the condemnee, the non-exempt party to the condemnation proceeding. See Revenue Ruling 57–72, C. B. 1957–1, 415. Specific questions relating to "Declarations of Taking" filed pursuant to the provisions of the Act of February 26, 1931, Public Law 736, 71st Cong., 46 Stat. 1421, 40 U. S. C. 258 (a), and the answers thereto, are as follows:

Question 1. When does the tax attach?

Answer: Section 258 (a) of Title 40 of the United States Code provides, in part, that upon the filing of a "Declaration of Taking" and of the deposit in the court, to the use of the persons entitled thereto, of the estimated compensation stated in such declaration, title to lands in fee simple absolute shall vest in the United States of America, and such lands shall be deemed to be condemned and taken for the use of the United States, and the right to just compensation for the same shall vest in the persons entitled thereto; and the compensation shall be ascertained and awarded in the proceeding and established by judgment therein.

Section 258(b) of Title 40 of the United States Code provides that no appeal in any cause under section 258 of that title nor any bond or undertaking given therein shall operate to prevent or delay the vesting of title to such lands in the United States.

In the case of *United States* v. *Sunset Cemetery Co.*, 132 Fed. (2d) 163, the Court of Appeals for the Seventh Circuit held that, under the above-mentioned sections, condemnation of land for public use is effected and title completely vested in the government by the mere filing of the "Declaration of Taking", and judgment adjudging title in the government is unnecessary. The court said, "Thereafter the court had only jurisdiction to determine what was just compensation for the tract,...."

In *United States* v. *243.22 Acres of Land Situate in Village of Farmingdale, Town of Babylon, Suffolk County, State of New York et al.*, 41 Fed. Supp. 469, it was stated that in a condemnation proceeding by the United States title to the property vested in the United States on the date of filing of the "Declaration of Taking", pursuant to section 258(a) of Title 40 of the United States Code, and depositing with the clerk of the court the estimated just compensation.

In view of the foregoing, it is held that the tax attaches on the date the "Declaration of Taking" is filed, since that is the date that title to the property vests in the United States. The filing of an appeal by a taxpayer to a higher court would not affect the government's title to such property.

Question 2. What is the basis for the tax?

Answer: Section 113.82(c) of Regulations 71, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 77, provides that the tax is based upon net value where the amount of the consideration is indefinite, or is left open to be fixed by future contingencies. Therefore, the amount finally awarded by the court as the value of the property is the basis for the tax.

Question 3. Where should the stamps be affixed?

Answer: Section 113.85 of the regulations provides that the stamps must be affixed to the deed, instrument, or other writing by which realty is conveyed. Accordingly, the stamps must be affixed to the "Declaration of Taking" since that is the instrument by which title is vested in the United States.

Rev. Rul. 58–558

Where an individual who owned land needed by the city for street improvements agreed to sell such realty to the city for a certain price and to remove a building from the land for an additional amount, the agreement constitutes an indivisible contract to transfer the land free of any building thereon and the consideration upon which the documentary stamp tax is imposed is the total amount received for the land and for the removal of the building.

Advice has been requested as to the basis upon which the documentary stamp tax imposed by section 4361 of the Internal Revenue Code of 1954 should be computed where an individual who owned land needed for city street purposes agreed to sell such realty to the city for a certain price and to remove a building from the land for an additional amount.

An individual owned a parcel of land, upon which his residence was located, that was needed by the city for widening, opening, and extending streets. The owner submitted an offer in writing to the city whereby he agreed to sell the land for $500 and to accept $12,000 for moving the residence located thereon to another location for his own benefit. The city, by resolution of its common council, agreed to accept the owner's offer. The recorded deed disclosed the figure of $12,500 as the net consideration for the land.

Section 4361 of the Code imposes a tax on each deed, instrument, or writing, whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers when the consideration or value of the interest or property conveyed, exclusive of the value of any liens or encumbrances remaining thereon at the time of sale, exceeds $100.

In the instant case, the city wanted the land for street purposes. It did not want the building, but only the physically unencumbered property and the property owner in effect undertook to sell the land free of the building. The agreement, therefore, constitutes an indivisible contract to transfer land free of any building thereon. In exchange for the physically unencumbered land the city agreed to pay the owner $12,500. On the other hand, the property owner asked for and received $12,500 in return for transferring title to only his land. Even though the agreement showed an apportionment of the consideration which the city paid to the owner, the total amount was apparently considered a fair value for the land acquired. Accord-

ingly, it is held that, for purposes of computing the documentary stamp tax, the amount of actual consideration paid for the land was $12,500 as stated in the deed.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. 58–510, page 818.

SUBCHAPTER D.—POLICIES ISSUED BY FOREIGN INSURERS

SECTION 4371.—IMPOSITION OF TAX

Rev. Rul. 58–612

A policy of reinsurance issued by a foreign insurer covering any of the hazards, risks, losses, or liabilities described in section 4371(1) and (2) of the Internal Revenue Code of 1954 is subject to documentary stamp tax imposed by section 4371(3) of the Code, regardless of whether the primary insurance policy was issued by a domestic or foreign insurer.

Advice has been requested whether a policy of reinsurance issued by a foreign insurer, not authorized to do business in the United States, is subject to the documentary stamp tax imposed by section 4371(3) of the Internal Revenue Code of 1954 where the primary or direct insurance policy was issued by a domestic insurance company.

An insurance company, which is authorized to do business in the District of Columbia, all of the 48 states, and several foreign countries, is engaged in the business of writing life, accident, and sickness insurance policies and annuity contracts. The company ceded to a foreign insurance company, which is not authorized to do business in the United States, reinsurance of life insurance policies that were made with respect to lives of residents of the United States.

Section 4371 of the Code provides as follows:

> There shall be imposed a tax on each policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer at the following rates:
>
> (1) CASUALTY INSURANCE AND INDEMNITY BONDS.—Four cents on each dollar, or fractional part thereof, of the premium charged on the policy of casualty insurance or the indemnity bond, if issued to or for, or in the name of, an insured as defined in section 4372(d);
>
> (2) LIFE INSURANCE, SICKNESS, AND ACCIDENT POLICIES AND ANNUITY CONTRACTS.—One cent on each dollar, or fractional part thereof, of the premium charged on the policy of life, stickness, or accident insurance, or annuity contract, unless the insurer is subject to tax under section 816;
>
> (3) REINSURANCE.—One cent on each dollar, or fractional part thereof, of the premium charged on the policy of reinsurance covering any of the contracts taxable under paragraph (1) or (2).

There is no documentary stamp tax on policies of insurance or reinsurance issued by domestic insurance companies.

Section 4372(f) of the Code provides that, for the purpose of section 4371(3), the term "policy of reinsurance" means any policy or other instrument by whatever name called whereby a contract of reinsurance is made, continued, or renewed against, or with respect to, any of the hazards, risks, losses, or liabilities covered by contracts taxable under paragraph (1) or (2) of section 4371.

Section 4371 of the Code imposes a tax on original or primary insurance policies as well as reinsurance policies issued by a foreign insurer. The reference made in paragraph (3) of section 4371 of the Code to paragraphs (1) and (2) of that section limits the application of paragraph (3) only to reinsurance contracts which cover the same kinds of hazards, risks, losses or liabilities insured by taxable original or primary insurance policies. In other words, a policy of reinsurance issued by a foreign insurer is taxable under the provisions of section 4371(3) of the Code if it covers a hazard, etc., which would render it taxable under the provisions of section 4371(1) and (2) of the Code. This would be true even though the primary insurance policy was issued by a domestic insurer.

Accordingly, it is held that a policy of reinsurance issued by a foreign insurer covering any of the hazards, risks, losses or liabilities covered by contracts taxable under section 4371(1) and (2) of the Code is subject to the tax imposed on reinsurance policies by section 4371(3) of the Code, regardless of whether the primary insurer was a domestic or foreign insurer. Therefore, in the instant case, the reinsurance policy issued by the foreign insurer is subject to the tax.

Whether agencies and officers (other than diplomatic representatives) of the Free Zone of Colon are required to pay the tax in respect of transactions arising in the performance of their official functions and for which payment is made by the Free Zone. See Rev. Rul. Rul. 58–510, page 818.

SUBCHAPTER E.—MISCELLANEOUS PROVISIONS APPLICABLE TO DOCUMENTARY STAMP TAXES

SECTION 4382.—EXEMPTIONS

(Also Sections 4311, 4331.) Rev. Rul. 58–559

A nonprofit corporation was organized to own and operate a recreational park for the benefit of the people of the county in which the facilities were located. Bonds were issued to finance the construction of a lake and other facilities. All profits will be paid to the school land fund of the county and no profits will inure to any private individual or corporation. The corporation is controlled by public officials of the county. *Held*, the bonds are issued on behalf of the county and the exemption from documentary stamp tax afforded by section 4382 of the Internal Revenue Code of 1954 is applicable.

Advice has been requested whether the exemption from documentary stamp tax afforded by section 4382 of the Internal Revenue Code of 1954 is applicable to bonds issued by the nonprofit corporation described below.

A nonprofit corporation was organized under the laws of a certain state without capital stock and with perpetual existence. Its purposes are to own and operate a recreational park or parks with a lake or lakes for fishing, swimming, boating, water skiing, and related activities for the benefit of the people of the county where these facilities are located and for the benefit of the general public. It is also the purpose of the corporation to promote in such county the conservation and fullest beneficial use and disposition of the water in and from such lake or lakes, and to render more productive in revenue the land upon which the lake or lakes are located for the benefit of the school land fund of that county.

In pursuance of this purpose the corporation leased from the county the major part of a section of land for a period of 25 years at an annual minimum rental and built a lake thereon. Bonds were issued for the purpose of financing the construction of the project. In order to amortize the bonds and to pay operating costs and rent, the corporation entered into a contract with a public utility company wherein the company agreed to pay a fixed rental per year for use of water from the lake or lakes. Any balance of income over and above the operation and maintenance expenses, reserve and contingent fund requirement, and payment of principal and interest on the indebtedness will be paid to the school land fund of the county.

The corporation is controlled by public officials, and no profits from the project go to any private individual or anyone other than the school land fund of the county. At the expiration of the lease the land and the recreational lake or lakes will revert to county ownership. The Board of Supervisors of the county, by resolution, resolved to accept the benefits derived from the corporation, and recognized that the corporation was organized for the benefit of the county.

Section 4311 of the Code imposes a tax on all certificates of indebtedness issued by a corporation. Section 4331 of the Code imposes a tax on each sale or transfer of any certificates of indebtedness issued by a corporation.

Section 4382(a)(1) of the Code provides that no documentary stamp tax shall be imposed on any certificate of indebtedness, note, or other instrument, issued by the United States, or by any foreign Government, or by any State, Territory, or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power.

Under the circumstances described above, it is held that the issuance of the bonds was on behalf of the county, a local subdivision of the State, and that the exemption afforded by section 4382(a)(1) of the Code is applicable. Therefore, no documentary stamp tax will be incurred on the issuance or transfer of the bonds.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES

SUBCHAPTER A.—PLAYING CARDS

SECTION 4451.—IMPOSITION OF TAX

Rev. Rul. 58–531

Where a company opens the packs and imprints the backs of playing cards for a purchaser after title to the tax-paid playing cards has passed from the company to the purchaser, that company incurs no liability for the excise tax on playing cards imposed by section 4451 of the Internal Revenue Code of 1954.

Advice has been requested as to the applicability of the excise tax on playing cards under the circumstances described below.

A company buys plain-back playing cards, with tax stamps affixed, from a manufacturer for the purpose of resale. After resale, the company removes the cards from the packs, thereby breaking the stamp, and imprints the backs in accordance with the purchaser's instructions. The company then delivers the cards to the purchaser, under the contract of sale, with the tax stamp broken.

Section 4451 of the Internal Revenue Code of 1954 imposes a tax 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. This tax shall be in addition to any import duties imposed on such articles of foreign manufacture.

Section 4452 of the Code provides 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 manufacture 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.

Article 8 of Regulations 66, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that where packages of playing cards are sent out from the factory duly stamped and are thereafter opened and the stamp broken, the cards cannot be returned to the package and sold under the broken stamp, but a new stamp must be affixed to each package and duly canceled.

Article 11 of the regulations provides that each pack of playing cards, except under circumstances not material here, shall prior to sale, or before removal from the place where manufactured, packed, reassembled, or repacked, have securely affixed thereto proper internal revenue stamp or stamps of such denomination as will cover fully the tax thereon. Such stamp or stamps shall be affixed in such manner as to seal the pack and to necessitate the stamp or stamps being torn in two pieces when the pack is opened.

Additional tax on the playing cards would be incurred by the company mentioned above only if the tax stamp were broken and the playing cards were imprinted before title to the cards passed to the

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purchaser. Accordingly, it is held that the tax on playing cards does not apply where the company imprints the backs of playing cards for a purchaser, under the circumstances described above, after title to the tax-paid playing cards has passed from the company to the purchaser prior to the opening of the packs of playing cards. However, the purchaser may not resell or expose these playing cards for resale without affixing new stamps.

SUBCHAPTER B.—OCCUPATIONAL TAX ON COIN-OPERATED DEVICES

SECTION 4461.—IMPOSITION OF TAX

(Also Section 4462.) Rev. Rul. 58-346

The occupational tax on coin-operated gaming devices, imposed by section 4462(a)(2) of the Internal Revenue Code of 1954, applies to a device into which a person may drop a penny and, if successful in catching the coin in a shovel after it descends through a maze of nails, may win a five-cent candy bar.

Advice has been requested whether the device described below is considered to be a coin-operated amusement device or a coin-operated gaming device for purposes of the occupational tax.

The device, which usually is placed on a counter top, consists of a shallow rectangular box set on end, with a glass front and an opening in the top through which a coin is dropped. It has a maze of nails fastened to the front of the inside wall of the box, a shovel below the maze which can be slid from side to side, and a coin receiving compartment in the base. A penny dropped through the opening at the top of this device bounces through the maze of nails in no particular set pattern until it reaches the compartment at the bottom. The object of the game is to catch the penny, as it descends, after bouncing off the nails, by placing the shovel in the place where it is expected the coin will pass just before it enters the compartment in the base. In the event the player is successful, he is entitled to receive a five-cent candy bar. No part of the game is electrical.

Section 4461 of the Internal Revenue Code of 1954 provides that every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device shall pay a special tax of ten dollars per year with respect to each amusement device and $250 per year with respect to each gaming device.

Section 4462(a)(1) of the Code provides that a coin-operated amusement device means any amusement or music machine operated by the insertion of a coin, token, or similar object. Section 4462(a)(2) of the Code provides that a coin-operated gaming device means so-called "slot" machines which operate by the insertion of a coin, token, or similar object and which, by application of the element of chance, may deliver or entitle the person playing or operating the machine to receive cash, premiums, merchandise or tokens.

In the instant case, once the operator releases the penny, he does not control the path which it takes as it bounces from nail to nail toward the base of the device. Therefore, its successful operation

depends upon the element of chance, even though a certain degree of skill may be involved in the manipulation of the shovel. Accordingly, it is held that, since the successful operation of this device entitles the person playing or operating the device to receive a prize, it is a coin-operated gaming device within the meaning of section 4462(a)(2) of the Code.

(Also Section 4252.) Rev. Rul. 58–368

Applicability of the communications tax to amounts paid for a recorded music service whereby a patron in an establishment at a remote location may, by the insertion of a coin in a terminal device, request from an operator in a central studio that a particular recording be played; also, applicability of the occupational tax on coin-operated amusement devices to the maintenance for use of the terminal devices from which the recordings are requested and through which the recordings are heard.

Advice has been requested relative to the applicability of the communications tax to amounts paid, by the insertion of a coin in a terminal device, for a recorded music service furnished to an establishment at a remote location. Advice has also been requested whether the maintenance of such terminal devices creates a liability for the occupational tax on coin-operated amusement devices.

A company operates a central music studio from which it provides recorded music service to business establishments (usually taverns or restaurants). In order to provide this service, the company installs a terminal device having a microphone and a speaker connected to the central studio by means of a closed telephone circuit. The insertion of a coin in the device registers in the central studio on a master switchboard. The switchboard operator in the studio asks the patron which recording he desires to hear and places the requested record on a phonograph turntable. The same telephone circuit over which the recording was requested is used to transmit the recorded selection. The income obtained from the terminal devices is divided equally between the company which provides the music service and the person on whose premises the devices are installed.

Section 4461 of the Internal Revenue Code of 1954 provides that an occupational tax shall be paid by every person who maintains for use or permits the use of, at any place or premises occupied by him, a coin-operated amusement device, which is defined by section 4462 of the Code to mean any amusement or music machine operated by means of the insertion of a coin, token, or similar object.

Section 4251 of the Code imposes a communications tax upon amounts paid for "leased wire, teletypewriter, or talking circuit special service," as defined in section 4252(d), and upon amounts paid for "wire and equipment service," as defined in section 4252(e). Section 130.38(b)(3) of Regulations 42, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, includes, among several examples of services of the type which constitute wire and equipment service, musical programs rendered over channels between a point of origin and the subscriber's premises. Section 130.38(c) of the regulations provides that, in determining the amount of tax due, there shall be included all charges made in connection with the furnishing of any of the services enumerated.

The term "coin-operated amusement device," as used in sections 4461 and 4462 of the Code, is not considered to include a music terminal device which is connected by wire to a central studio, where the insertion of a coin merely alerts an operator in the central studio, the musical selection must be made through a communication by telephone, and the selected recording must be played by manual operation of a phonograph. On the other hand, such a music terminal device would be considered to be a coin-operated amusement device if the patron were able to hear recorded music by the mere insertion of a coin, token, or similar object, with no telephone conservation or manual operation of a phonograph being required.

Accordingly, it is held that no liability for the occupational tax on coin-operated amusement devices, imposed by section 4461 of the Code, is incurred with respect to the maintenance for use of the music terminal devices described in the instant case.

It is further held that, if control of such a music terminal device remains at all times with the company which operates the central music studio and if there is no agreement whereby the operator of the establishment in which the terminal device is located is required to make any payment to the owner of the device either as a minimum guarantee or otherwise, the amounts taken from the coin boxes in the device do not constitute amounts paid for wire and equipment service within the meaning of section 4252(e) of the Code; therefore, such amounts are not subject to the communications tax imposed on wire and equipment service by section 4251. However, the central music studio company is liable for the communications tax on leased wire service on all amounts paid to the telephone company for the lease of wires, channels, etc., used in connection with the music program service.

SECTION 4462.—DEFINITION OF COIN-OPERATED AMUSEMENT OR GAMING DEVICE

A penny operated device which awards a five cent candy bar prize. See Rev. Rul. 58–346, page 854.

SUBCHAPTER C.—OCCUPATIONAL TAX ON BOWLING ALLEYS, BILLIARD AND POOL TABLES

SECTION 4473.—EXEMPTIONS

Rev. Rul. 58–521

The exemption from the occupational tax on bowling alleys, billiard tables, or pool tables, provided by section 4473 (2) of the Internal Revenue Code of 1954 with respect to alleys or tables maintained exclusively for the use of members of the Armed Forces, does not apply where such facilities are used by the dependents of members of the Armed Forces.

Advice has been requested whether the exemption provided by section 4473 (2) of the Internal Revenue Code of 1954 applies to bowling alleys which are maintained on a military post for the exclusive use of Armed Forces personnel and their dependents.

A servicemen's club is operated on a military post for the entertainment and recreation of Armed Forces personnel. The club maintains bowling alleys for the use of servicemen and their dependents. No charge is made to either the servicemen or their dependents for use of the alleys.

Section 4473(2) of the Code exempts from the occupational tax imposed by section 4471 of the Code any bowling alley, billiard table, or pool table maintained exclusively for the use of members of the Armed Forces on any property owned, reserved, or used by, or otherwise acquired for the use of the United States, if no charge is made for their use.

This exemption was originally provided by the Act of July 17, 1952, Public Law 576, 82nd Congress, C. B. 1954–2, 361. The Committee Reports relating to that legislation state that it would exempt alleys or tables "used exclusively by members of the Armed Forces."

Accordingly, it is held that bowling alleys, billiard tables, or pool tables which are used by the dependents of servicemen do not come within the scope of the exemption provided by section 4473(2) of the Code.

SUBCHAPTER D.—TAX ON USE OF CERTAIN VEHICLES

SECTION 4482.—DEFINITIONS

26 CFR 41.4482(a)–1: Definition of highway motor vehicle. Rev. Rul. 58–378

> Mobile fire fighting units, used by an oil company at its refinery, are highway motor vehicles as defined by section 41.4482(a)–1(a) of the Highway Motor Vehicle Use Tax Regulations. Accordingly, in the event the vehicles are required to be registered under the law of the state in which they are operated, the highway motor vehicle use tax imposed by section 4481(a) of the Internal Revenue Code of 1954 will attach at such time as the units are required to use a city street, or any roadway which is not a private roadway.

Advice has been requested whether mobile fire fighting equipment falls within the classification of "highway motor vehicles" for purposes of the highway motor vehicle use tax and whether occasional travel on a city street is a taxable "use" under the circumstances described below.

An oil company purchased two units of mobile fire fighting equipment for use at its refinery. Each unit consists of a solution tank and a pump with a proportionating system mounted on a truck chassis. These two units will be used within the refinery premises and will not go off the company property except when it may be necessary to reach the company's wharf property. On such occasions the units will have to travel on a city street for a distance of approximately one-half mile.

Section 4481(a) of the Internal Revenue Code of 1954 imposes a tax on the use of any highway motor vehicle that has a taxable gross weight of more than 26,000 pounds. Section 4481(b) of the Code provides that the tax is payable by the person in whose name the highway

motor vehicle is, or is required to be, registered under the law of the State in which such vehicle is, or is required to be, registered. Section 4482(a) of the Code provides that the term "highway motor vehicle" means any motor vehicle which is a highway vehicle.

Section 41.4481–1(a) of the Highway Motor Vehicle Use Tax Regulations provides, in part, that the tax is imposed upon the use of a highway motor vehicle only if, at the time of the use of such vehicle, it is registered or required to be registered in the name of a person (whether or not such person is the person who uses the vehicle).

In accordance with section 41.4481–3(a) of the regulations, the term "registered" when used with reference to a highway motor vehicle, means registered, or required to be registered, under the law of any State or Territory of the United States or, in case the vehicle is operated or situated in the District of Columbia, under the law of the District of Columbia. Section 41.4482(a)–1(a) of the regulations defines the term "highway motor vehicle" as a vehicle which is propelled by means of its own motor and which is of a type used for highway transportation.

Section 41.4482(c)–1(c) of the regulations defines the term "use," with reference to a highway motor vehicle, as the operation of the vehicle on any roadway (whether a Federal highway, State highway, city street, or otherwise) in the United States that is not a private roadway.

In the instant case, it is held that the mobile fire fighting units are highway motor vehicles as defined by section 41.4482(a)–1(a) of the regulations. Accordingly, in the event the vehicles are required to be registered under the law of the state in which they are operated, the oil company will become liable for the tax imposed by section 4481(a) of the Code at such time as the mobile fire fighting units are first required to use a city street, or any roadway which is not a private roadway.

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26 CFR 41.4482(b)–1: Definition of taxable gross weight. Rev. Rul. 58–469

> The weight of air-conditioning assemblies mounted on or attached to buses, including their separate fuel supply tanks or hydromatic drives, should be excluded in determining the "actual unloaded weight" of the vehicles for purposes of the highway motor vehicle use tax, where such equipment performs no function in the movement or maintenance of the vehicles.

Advice has been requested whether the weight of air-conditioning equipment that is mounted on or attached to buses should be included in determining the "actual unloaded weight" of the vehicles for purposes of the highway motor vehicle use tax.

Many single-deck buses are equipped with air-conditioning assemblies. Each assembly consists of a separate gasoline or diesel engine, a compressor, an evaporator, and a condenser. In many cases these assemblies have separate fuel supply tanks which are exclusively for their operation. The assemblies are mounted in a separate compartment on the side of the buses and are removable through a hinged door which remains in place at all times regardless of whether the assemblies are on the buses. Air-conditioning assemblies of the same

type are mounted on double-deck buses, except that each assembly is operated by means of a hydromatic drive which receives power from one of the vehicle's two propulsion motors. During the season when air-conditioning is not desirable these assemblies are removed from the buses and stored. No part of the assemblies is essential to the movement or maintenance of the vehicles.

Section 4481(a) of the Internal Revenue Code of 1954 imposes a tax on 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 more than 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 vehicle 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).

Section 41.4482(b)-1(b) of the Highway Motor Vehicle Use Tax Regulations provides:

MEANING OF TERMS.—For purposes of the schedule of taxable gross weights prescribed in paragraph (c) of this section—

(1) The term "actual unloaded weight" means the empty (or tare) weight of the truck, truck-tractor, or bus, fully equipped for service.

(2) The term "fully equipped for service" includes body (whether or not designed and adapted primarily for transporting cargo, as for example, concrete mixers); all accessories; all equipment attached to or carried on such truck, truck-tractor, or bus, for use in connection with the movement of the vehicle by means of its own motor or for use in the maintenance of the vehicle; and a full complement of lubricants, fuel, and water. The term does not include driver, any equipment (not including body) attached to or carried on the vehicle for use in handling or transporting cargo; or any special equipment (such as air compressor, crane, specialized oil-field machinery, etc.) mounted on the vehicle for use on construction jobs, in oil field operations, etc.

Since the air-conditioning assemblies that are mounted on or attached to single-deck buses are not a part of the bodies of the vehicles and perform no function in the movement or maintenance of the vehicles, but are carried on the buses only for use in connection with the comfort of the passengers transported, it is held that the weight of the entire air-conditioning assemblies, including the separate fuel supply tanks, should be excluded in determining the "actual unloaded weight" of the vehicles for purposes of the highway motor vehicle use tax. Likewise, it is held that the weight of the air-conditioning assemblies that are mounted on or attached to double-deck buses, including their hydromatic drives, should be excluded in determining the "actual unloaded weight" of such vehicles.

CHAPTER 38.—IMPORT TAXES

SUBCHAPTER F.—OLEOMARGARINE

SECTION 4591.—IMPOSITION OF TAX

(Also Section 7652.) Rev. Rul. 58–522

Section 4591 of the Internal Revenue Code of 1954 imposes a tax on all oleomargarine imported from foreign countries. There is no tax on the domestic manufacture of oleomargarine. Section 7652 of the Code provides, so far as applicable here, that articles of merchandise of Puerto Rican manufacture coming into the United States and withdrawn for consumption or sale shall be subject to a tax equal to the internal revenue tax imposed in the United States upon the like articles of merchandise of domestic manufacture. *Held*, oleomargarine manufactured in Puerto Rico and shipped to the United States is not subject to tax under section 7652 of the Code since no tax is imposed on the domestic manufacture of oleomargarine. Furthermore, the tax imposed under section 4591 of the Code does not apply to oleomargarine manufactured in Puerto Rico and shipped to the United States since Puerto Rico is not a foreign country. However, the tax imposed under section 4591 of the Code does apply if the oleomargarine is manufactured in a foreign country, shipped to Puerto Rico, and then shipped to the United States.

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 5702.—DEFINITIONS

26 CFR 270.13: Cigar. Rev. Rul. 58–553

Section 270.13 of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers) provides that "cigar" shall mean any roll of tobacco wrapped in tobacco. Selection 270.14 of such regulations provides that "cigarette" shall mean any roll of tobacco, wrapped in paper or any substance other than tobacco. *Held*, the use of paper as a binder in the manufacture of cigars does not cause the finished product to be classified as a cigarette and subject to the rate of tax imposed on cigarettes, provided the wrapper of the product is tobacco.

26 CFR 296.91: Application of existing regulations to export warehouses and export warehouse proprietors.
(Also Section 5712; 296.92.)

T. D. 6333 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 296.—MISCELLANEOUS REGULATIONS RELATING TO TOBACCO MATERIALS, TOBACCO PRODUCTS, AND CIGARETTE PAPERS AND TUBES

Prescribing interim regulations to implement Public Law 85-859, Excise Tax Technical Changes Act of 1958, as it relates to the permit and bond provisions applicable to export warehouse proprietors.

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 permit a proper administration of the Internal Revenue Code of 1954, as amended by the Excise Tax Technical Changes Act of 1958 (Public Law 85-859, 72 Stat. 1275), with respect to the qualification of persons engaging in or commencing to engage in business as export warehouse proprietors until 26 CFR Part 290, "Exportation of Tobacco Materials, Tobacco Products, and Cigarette Papers and Tubes," is issued, Subpart D of 26 CFR Part 296 (sections 296.91 through 296.97) is prescribed in furtherance of the purposes of sections 5702, 5703, 5704, 5711, 5712, and 5713 of the Code as follows:

SUBPART D—INTERIM REGULATIONS RELATING TO EXPORT WAREHOUSES

Sec. 296.91 APPLICATION OF EXISTING REGULATIONS TO EXPORT WAREHOUSES AND EXPORT WAREHOUSE PROPRIETORS.—The provisions of regulations in Subpart B, Subpart E, Subpart F, Subpart G, and Subpart I (except as any provision of such subparts is manifestly incompatible or inconsistent with the provisions and intent of this subpart) of 26 CFR Part 270, "Cigars and Cigarettes—Manufacturers, Importers, and Dealers," (which relate to permits and bonds of manufacturers of cigars and cigarettes), shall, as hereinafter modified, apply to every person who engages in business as an export warehouse proprietor and to the establishment and operation of an export warehouse. The terms "export warehouse" and "export warehouse proprietor", as they appear in this subpart, shall have the meanings ascribed by section 5702, I. R. C. Any references in Subpart B, Subpart E, Subpart F, Subpart G, or Subpart I of 26 CFR Part 270 to manufacturers of cigars and cigarettes or to the factory, plant, or premises of such manufacturers, shall, for the purpose of this subpart, be treated as references to an export warehouse proprietor and to the premises on which such a proprietor operates or intends to operate such export warehouse, as the case may be.

Sec. 296.92 QUALIFICATION.—Every person before commencing business as an export warehouse proprietor shall qualify in the same manner as if commencing business as a manufacturer of cigars and cigarettes under 26 CFR Part 270: *Provided*, That persons who were

[1] 23 F. R. 8699.

on September 2, 1958, lawfully engaged in business as proprietors of bonded internal revenue sea stores warehouses or bonded internal revenue tobacco export warehouses under 26 CFR (1939) Part 141 and Part 451, respectively, and who desire to operate an export warehouse shall have 30 days after the effective date of this subpart within which to file with the assistant regional commissioner the required application for a permit to engage in business as an export warehouse proprietor, and such application shall be accompanied by a duly executed bond on Form 2103, "Bond—Proprietor of Internal Revenue Tobacco Export Warehouse." Such persons shall, as provided in section 5712, I. R. C., be entitled to carry on such business pending final action on such application.

Sec. 296.93 BOND.—The bond, required by section 5711, I. R. C., to be filed by an export warehouse proprietor, shall be on Form 2103, "Bond—Proprietor of Internal Revenue Tobacco Export Warehouse." The amount of the bond shall be not less than the estimated amount of tax which may at any time constitute a charge against the bond: *Provided*, That the amount of such bond (or the total amount where original and strengthening bonds are filed) shall not exceed $200,000 nor be less than $1,000. The charge against such bond shall be subject to increase upon receipt of tobacco products and cigarette papers and tubes into the warehouse and to decrease as satisfactory evidence of exportation, or satisfactory evidence of such other disposition as may be used as the lawful basis for crediting such a bond, is received by the assistant regional commissioner with respect to such articles transferred or removed.

Sec. 296.94 ISSUANCE OF PERMIT.—If the application for permit, bond, and supporting documents are approved by the assistant regional commissioner, the permit shall be issued on Form 2096, "Permit—Under Chapter 52, Internal Revenue Code."

Sec. 296.95 OPERATIONS.—Except as otherwise provided in this subpart, the operations of an export warehouse shall be conducted in conformity with the applicable provisions of existing regulations (26 CFR (1939) Parts 141 and 451) until such regulations are superseded.

Sec. 296.96 FORMS PRESCRIBED.—The Director, Alcohol and Tobacco Tax Division, is authorized to prescribe all forms in furtherance of the purposes of this subpart, including bonds, applications, permits, and reports. The information called for in the forms shall be furnished in accordance with the instructions on the forms or issued in respect thereto.

Sec. 296.97 LIMITATIONS.—This subpart does not amend the provisions of 26 CFR Part 270, "Cigars and Cigarettes—Manufacturers, Importers, and Dealers," as to matters within the scope of such regulations.

Because this Treasury Decision adopts procedures previously approved in other regulations, and prescribes interim regulations effective only until regulations in 26 CFR Part 290 are issued, to conform to the intent of proviisons of the Excise Tax Technical Changes Act of 1958 (Public Law 85–859, 72 Stat. 1275), effective September 3, 1958, as they relate to the qualification of persons engaging in or commencing to engage in business as export warehouse proprietors, in order to facilitate the qualification of persons who desire to engage in

this business, it is found that it is impracticable and contrary to the public interest to incur the delay which would result if this Treasury Decision were issued with notice and public procedure under section 4(a) of the Administrative Procedure Act (60 Stat. 238; 5 U. S. C. 1003) or subject to the effective date limitation of section 4(c) of such Act. Accordingly, this Treasury Decision shall become effective on 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).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved November 4, 1958.

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

(Filed by the Division of the Federal Register on November 6, 1958, 8:47 a. m., and published in the issue of the Federal Register for November 7, 1958, 23 F. R. 8699.)

SECTION 5703.—LIABILITY FOR TAX AND METHOD OF PAYMENT

26 CFR 270.194: Stamps for affixture in foreign countries.

List of reciprocating foreign countries to which tobacco stamps may be shipped for attachment to tobacco products prior to exportation to the United States. See Rev. Proc. 58–12, page 1123.

26 CFR 270.220: Return. T. D. 6303[1]

TITLE 26—INTERNAL REVENUE 1954.—CHAPTER I, SUBCHAPTER E, PART 270.—CIGARS AND CIGARETTES—MANUFACTURERS, IMPORTERS, AND DEALERS

Timely filing of cigar tax returns

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 that the period for filing cigar tax returns will be extended if the last day for filing falls on a legal holiday in the District of Columbia, regardless of whether the return is required to be filed in the District of Columbia (consistent with the provisions in 26 CFR 301.7503–1, Procedure and Administration Regulations), regulations in 26 CFR Part 270 are amended as follows:

Paragraph 1. Section 270.220, relating to returns, is amended by striking the expression "(of the particular State or of the District of Columbia wherein the return is required to be filed)" and inserting, in lieu thereof, the expression "of the District of Columbia, or on a Statewide legal holiday of the particular State where the return is required to be filed".

[1] 23 F. R. 6344.

Because the amendment made by this Treasury Decision is liberalizing in character, it is found that it is 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 upon 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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved August 14, 1958.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register, August 18, 1958, at 8:53 a. m., and published in the issue of the Federal Register for August 19, 1958, 23 F. R., 6344.)

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26 CFR 275.183: Stamps for affixture in foreign countries.

List of reciprocating foreign countries to which tobacco stamps may be shipped for attachment to tobacco products prior to exportation to the United States. See Rev. Proc. 58–12, page 1123.

SECTION 5708.—LOSSES CAUSED BY DISASTER

26 CFR 296.50: Scope of subpart. T. D. 6325[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 296.—MISCELLANEOUS REGULATIONS RELATING TO TOBACCO MATERIALS, TOBACCO PRODUCTS, AND CIGARETTE PAPERS AND TUBES

Losses of tobacco products and cigarette papers and tubes caused by disaster.

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:

The purpose of this Treasury Decision is to provide regulations implementing section 209 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

Section 209 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) reads as follows:

SEC. 209. LOSSES OF TOBACCO PRODUCTS CAUSED BY DISASTER.

(a) AUTHORIZATION.—Where the President has determined under the Act of September 30, 1950 (42 U. S. C., sec. 1855), that a "major disaster" as defined in such Act has occurred in any part of the United States, the Secretary of the Treasury or his delegate shall pay (without interest)

[1] 23 F. R. 8058.

to the person specified in subsection (b) an amount equal to the amount of the internal revenue taxes paid or determined 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 such disaster occurring in such part of the United States after December 31, 1954, and not later than the date of enactment of this Act, if such tobacco products or cigarette papers or tubes were at the time of such disaster in the possession of—

(1) the person paying such tax, or such tax and duty, or obligated to pay a determined tax, on such tobacco products or cigarette papers or tubes,

(2) the manufacturer or importer, or

(3) a wholesale or retail dealer,

all referred to in this section as the possessor or possessors.

(b) To Whom Made.—Any payment authorized by this section may be made—

(1) to the possessor, or

(2) to any manufacturer, importer, or wholesaler who replaced (or to any manufacturer or importer who has given credit or made replacement to a wholesaler who replaced) for the possessor the full equivalent of the tobacco products or cigarette papers or tubes so lost or rendered unmarketable or condemned, without compensation, remuneration, or credit of any kind in respect of the tax, or tax and duty, on such tobacco products or cigarette papers or tubes.

(c) Claims.—No claim shall be allowed under this section unless—

(1) filed within 6 months after the date of enactment of this Act, and

(2) the claimant furnishes proof to the satisfaction of the Secretary of the Treasury or his delegate that—

(A) neither the claimant nor any possessor was indemnified by any valid claim of insurance or otherwise in respect of the tax, or tax and duty, on the tobacco products or cigarette papers or tubes covered by the claim, and

(B) the claimant is entitled to payment under this section.

Claims under this section shall be filed under such regulations as the Secretary of the Treasury or his delegate shall prescribe.

(d) Destruction of Tobacco Products or Cigarette Papers or Tubes.—Before the Secretary of the Treasury or his delegate makes payment under this section in respect of the tax, or tax and duty, on the tobacco products or cigarette papers or tubes rendered unmarketable or condemned by a duly authorized official, such tobacco products or cigarette papers or tubes shall be destroyed under such supervision as the Secretary of the Treasury or his delegate may prescribe, unless such tobacco products or cigarette papers or tubes were previously destroyed under supervision satisfactory to the Secretary of the Treasury or his delegate.

(e) Other Laws Applicable.—All provisions of law, including penalties, applicable in respect of internal revenue taxes on tobacco products and cigarette papers and tubes shall, insofar as applicable and not inconsistent with this section, be applied in respect of the payments provided for in this section to the same extent as if such payments constituted refunds of such taxes.

In order to implement the above provisions of law, 26 CFR Part 296, "Miscellaneous Regulations Relating to Tobacco Materials, Tobacco Products, and Cigarette Papers and Tubes," is promulgated.

SUBPART A—(RESERVED)

SUBPART B—LOSSES OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES CAUSED BY A DISASTER OCCURRING AFTER DECEMBER 31, 1954, AND NOT LATER THAN THE DATE OF ENACTMENT OF THE EXCISE TAX TECHNICAL CHANGES ACT OF 1958

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AUTHORITY: Sections 296.50 to 296.63, inclusive, issued under section 7805, I. R. C. (68A Stat. 917; 26 U. S. C. 7805), and section 209 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

SECTION 296.50 SCOPE OF SUBPART.—This subpart prescribes the requirements necessary to implement section 209 of the act, concerning payments which may be made by the United States in respect to the internal revenue taxes paid or determined 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 disaster occurring in the United States after December 31, 1954, and not later than the date of enactment of the act.

DEFINITIONS

SEC. 296.51 MEANING OF TERMS.—When used in this subpart, 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 shall include the singular, and vice versa, and words importing the masculine gender shall include the feminine as well. The terms "includes" and "including" do not exclude things not enumerated which are in the same general class.

Act.—The Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

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.

Claimant.—The person to whom payment may be made as provided in section 296.53.

Commissioner.—The Commissioner of Internal Revenue.

Commissioner of Customs.—The Commissioner of Customs, Bureau of Customs, Treasury Department, Washington, D. C.

Disaster.—A flood, drought, fire, hurricane, earthquake, storm, or other catastrophe which has occurred in any part of the United States, after December 31, 1954, and not later than the date of enactment of the act, and which the President of the United States has determined, under the Act of September 30, 1950 (64 Stat. 1109; 42 U. S. C. 1855), was a "major disaster" as defined in such Act.

Duly authorized official.—Any Federal, State, or local government official in whom has been vested authority to condemn tobacco products or cigarette papers or tubes made the subject of a claim under this subpart.

Duty or duties.—Any duty or duties paid under the customs laws of the United States.

Full equivalent.—A quantity of manufactured tobacco, cigars, cigarettes, cigarette papers, or cigarette tubes equal to the quantity lost, rendered unmarketable, or condemned.

Person paying the tax or tax and duty.—The person, such as a manufacturer of cigars, a manufacturer of cigarette papers, or a proprietor of a customs bonded cigar manufacturing warehouse, class 6, who has determined the tax on such articles at the time of their removal subject to tax payable by return.

Person paying the tax or taxes and duty.—The person, such as a manufacturer or importer or a proprietor of a customs bonded cigar manufacturing warehouse, class 6, who paid the internal revenue tax on the tobacco products or cigarette papers or tubes or the person who paid such tax and customs duties on imported tobacco products or cigarette papers or tubes.

Possessor.—The person in whose possession tobacco products or cigarette papers or tubes made the subject of a claim under this subpart were held at the time of a disaster.

Tax.—The internal revenue tax paid or determined on tobacco products and cigarette papers and tubes.

Tobacco products.—Manufactured tobacco, cigars, and cigarettes.

United States.—When used in a geographical sense, includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

PAYMENTS

SEC. 296.52 CIRCUMSTANCES UNDER WHICH PAYMENT MAY BE MADE.—Assistant regional commissioners shall allow payment (without interest) of an amount equal to the amount of tax paid or determined, and the Commissioner of Customs shall allow payment (without interest) of an amount equal to the amount of customs duties paid, on tobacco products and cigarette papers and tubes removed, which are lost, rendered unmarketable, or condemned by a duly authorized official by reason of a disaster occurring in the United States after December 31, 1954, and not later than the date of enactment of the act. Such payments may be made only if, at the time of such disaster, such tobacco products and cigarette papers and tubes were in the possession of (a) the person paying such tax, or such tax and duty, or obligated to pay a determined tax on such tobacco products or cigarette papers or tubes, (b) the manufacturer, importer, or proprietor of a customs bonded cigar manufacturing warehouse, class 6, or (c) a wholesale or retail dealer in such tobacco products or cigarette papers or tubes.

SEC. 296.53 PERSONS TO WHOM PAYMENT MAY BE MADE.—Claims may be filed by and payment made to any of the possessors referred to in section 296.52. Claims may also be filed by and payment made to any manufacturer, importer, proprietor of a customs bonded cigar manufacturing warehouse, class 6, or wholesale dealer who replaced (or to any manufacturer, importer, proprietor of a customs bonded cigar manufacturing warehouse, class 6, or wholesale dealer who has given credit or made replacement to a wholesale dealer who replaced) for the possessor the full equilavent of the tobacco products or cigarette papers or tubes rendered unmarketable, or condemned, without compensation, remuneration, or credit of any kind in respect of the tax, or tax and duty, on such tobacco products or cigarette papers or tubes.

CLAIMS PROCEDURE

SEC. 296.54 EXECUTION AND FILING OF CLAIMS.—Claims shall be executed on Form 843 (Internal Revenue) in accordance with such instructions thereon as are applicable, and must be filed with the assistant regional commissioner of the internal revenue region in which the tobacco products or cigarette papers or tubes were lost, rendered unmarketable, or condemned, within 6 months after the date of enactment of the act. In any instance where the tobacco products or cigarette papers or tubes were replaced or where credit therefor was given, the person replacing or giving credit therefor and the recipient thereof shall join in the claim. Any claim under this subpart filed after the specified 6-month period will be rejected in full.

SEC. 296.55 RETURN OF CLAIMS FOR COMPLETION OR CORRECTION.—The regulations in this subpart contemplate that claims will be filed (a) where the possessor has received the full equivalent of the tobacco products or cigarette papers or tubes before the filing of the claim, and (b) where the completion of the claim is to await determination, as provided in section 296.60, of the quantity of tobacco products or cigarette papers or tubes lost, rendered unmarketable, or condemned, and the quantity which may be replaced or for which credit may be given. In the event of (b), the claim will be returned to the claimant, on completion of such determination, for insertion of the necessary data. Claims will also be returned which are otherwise defective in any respect.

SEC. 296.56 SEPARATION OF IMPORTED AND DOMESTIC TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES; SEPARATE CLAIMS FOR TAXES AND DUTIES.—If a claim involves taxes on domestic tobacco products or cigarette papers or tubes and imported tobacco products or cigarette papers or tubes, the quantities of each must be shown separately in the claim. A separate claim must be filed in respect of customs duties.

SEC. 296.57 CLAIMANT TO FURNISH SATISFACTORY PROOF.—The claimant shall furnish proof to the satisfaction of the assistant regional commissioner regarding the following:

(a) that the tax, or tax and duty, on the tobacco products or cigarette papers or tubes has been paid (or determined in the case of a person obligated to pay a determined tax):

(b) that such tobacco products or cigarette papers or tubes were lost, rendered unmarketable, or condemned by a duly authorized official, by reason of damage sustained as the result of a disaster;

(c) the type and date of occurrence of the disaster and the location of the tobacco products or cigarette papers or tubes at that time;

(d) that neither the claimant nor the possessor was indemnified by any valid claim of insurance or otherwise in respect of the tax, or tax and duty, on the tobacco products or cigarette papers or tubes covered by the claim; and

(e) that the claimant is entitled to payment under this subpart.

SEC. 296.58 SUPPORTING EVIDENCE.—The claimant shall support his claim with any evidence (such as inventories, statements, invoices, bills, records, stamps, and labels) that he is able to submit, relating to the tobacco products or cigarette papers or tubes on hand at the time of the disaster and averred to have been lost, rendered unmarketable, or condemned as a result thereof. If the claim is for refund of duty the claimant shall furnish, if practicable, the customs entry number, date of entry, and the name of the port of entry.

SEC. 296.59 SUPPORTING STATEMENT.—In an instance of replacement of tobacco products or cigarette papers or tubes for a possessor, or of credit or replacement of tobacco products or cigarette papers or tubes to a wholesale dealer who replaced tobacco products or cigarette papers or tubes for a possessor, the claimant shall attest in his claim that he, as a manufacturer, importer, proprietor of a customs bonded cigar manufacturing warehouse, class 6, or dealer, as the case may be, replaced for the possessor, either directly or indirectly, the full equivalent of the tobacco products or cigarette papers or tubes which were lost, rendered unmarketable, or condemned, as a result of a disaster, without compensation, remuneration, or credit of any kind in respect of the tax, or tax and duty, on such tobacco products or cigarette papers or tubes.

SEC. 296.60 REPLACEMENT OR CREDIT.—The replacement of tobacco products or cigarette papers or tubes for a possessor, either direct or by the giving of credit or the making of replacement to a wholesale dealer who is to replace, and the completion of the claim by the claimant, may be delayed until a determination has been made by the assistant regional commissioner as to the quantities of tobacco products or cigarette papers or tubes lost, rendered unmarketable, or condemned, as provided in section 296.61. The findings of the assistant regional commissioner in this respect may be made available to the persons involved in the transaction. The claim shall be fully completed with respect to evidence of the various aspects of the replacement before being further processed by the assistant regional commissioner as provided in section 296.61. Nothing in this section is to be construed as extending the 6-month period provided in section 296.54 for the filing of claims.

SEC. 296.61 ACTION BY ASSISTANT REGIONAL COMMISSIONER.—The assistant regional commissioner will date stamp and examine each claim filed under this subpart and will determine the validity of the claim in respect of the quantities of tobacco products or cigarette papers or tubes covered thereby, and of any replacement claimed. The claim will then be processed by him in accordance with existing procedures. Claims involving customs duties will be forwarded to the Commissioner of Customs with a summary statement by the assistant regional commissioner concerning his findings.

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DESTRUCTION OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES

SEC. 296.62 SUPERVISION.—Before payment is made under this subpart in respect of the tax, or tax and duty, on tobacco products or cigarette papers or tubes rendered unmarketable or condemned by a duly authorized official, such tobacco products or cigarette papers or tubes shall be destroyed by suitable means under the supervision of an internal revenue officer who will be assigned for that purpose by the assistant regional commissioner, unless such tobacco products or cigarette papers or tubes were previously destroyed under supervision satisfactory to the assistant regional commissioner. The Commissioner of Customs will notify the assistant regional commissioner as to allowance under this subpart of claims for duty in respect of unmarketable or condemned tobacco products and cigarette papers and tubes.

PENALTIES

SEC. 296.63 PENALTIES.—Penalties are provided in sections 7206 and 7207 of the Internal Revenue Code for execution under the penalties of perjury of any false or fraudulent statement in support of any claim and for the filing of any false or fraudulent document under this subpart. All provisions of law, including penalties, applicable in respect of internal revenue taxes on tobacco products and cigarette papers and tubes shall, insofar as applicable and not inconsistent with this subpart, be applied in respect of the payments provided for in this subpart to the same extent as if such payments constituted refunds of such taxes.

Because the time limitation for filing claims under these regulations is limited, it is found that it is impracticable and contrary to the public interest to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act (60 Stat. 238, 5 U. S. C. 1003), or subject to the effective date limitation of section 4(c) of such Act. Accordingly, this Treasury Decision shall be effective on the day following the date of enactment of the Excise Tax Technical Changes Act of 1958 (H. R. 7125–85th Congress).

(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 section 209 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

D. B. STRUBINGER,
Acting Commissioner of Customs.

Approved October 15, 1958.

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

(Filed by the Division of the Federal Register on October 17, 1958, 8:50 a. m., and published in the issue of the Federal Register for October 18, 1958, 23 F. R. 8058.)

SUBCHAPTER B.—QUALIFICATION REQUIREMENTS FOR MANUFACTURERS OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES, EXPORT WAREHOUSE PROPRIETORS, AND DEALERS IN TOBACCO MATERIALS

SECTION 5712.—APPLICATION FOR PERMIT

26 CFR 296.92: Qualification.

Qualifications required for persons engaging in or commencing to engage in business as tobacco export warehouse proprietors. See T. D. 6333, page 861.

SUBCHAPTER C.—OPERATIONS BY MANUFACTURERS AND IMPORTERS OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES AND EXPORT WAREHOUSE PROPRIETORS

SECTION 5722.—REPORTS

26 CFR 270.143: Reports. (Also 275.133.) T. D. 6328 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 270 AND 275

Manufacturers' reports

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, 1958, a notice of proposed rulemaking with respect to regulations designated as Parts 270 and 275 of Title 26 of the Code of Federal Regulations was published in the Federal Register (23 F. R. 6142). The purpose of the proposal were to eliminate the requirements that manufacturers of tobacco, cigars, and cigarettes include in their reports the quantities of tobacco materials received, shipped, and lost or destroyed, and to make certain editorial and clarifying changes. No data, views, or arguments pertaining thereto were received within the period of 30 days prescribed. Accordingly, the amendments so published are hereby adopted.

PARAGRAPH 1. 26 CFR Part 270 is amended as follows:

(A) Section 270.143 is amended to read as follows:

SEC. 270.143 REPORTS.—(a) *General.*—Every manufacturer of cigars and cigarettes shall make a report, on Form 2136, to the assistant regional commissioner, of all (1) cigars and cigarettes manufactured, received, removed, furnished for personal consumption by employees, used for experimental purposes, reduced to material, and lost or destroyed, and (2) stamps received, used, and lost or destroyed. Such report shall be made at the times specified in this

[1] 23 F. R. 8262.

section and shall be made whether or not any operations or transactions occurred during the period covered by the report. A copy of each report shall be retained by the manufacturer for two years following the close of the calendar year covered in such reports, and made available for inspection by any revenue officer upon his request.

(b) *Opening.*—An opening report, covering the period from the date of the opening inventory, or inventory made in connection with a superseding bond, to the end of the month, shall be made on or before the 20th day following the end of the month in which the business was commenced.

(c) *Monthly.*—A report for each full month shall be made on or before the 20th day following the end of the month covered in the report.

(d) *Special.*—A special report, covering the unreported period to the day preceding the date of any special inventory required by a revenue officer, shall be made with such inventory. Another report, covering the period from the date of such inventory to the end of the month, shall be made on or before the 20th day following the end of the month in which the inventory was made.

(e) *Closing.*—A closing report, covering the period from the first of the month to the date of the closing inventory, or the day preceding the date of an inventory made in connection with a superseding bond, shall be made with such inventory.

(68A Stat. 713; 26 U. S. C. 5722)

(B) Section 270.158 is amended by striking from the second sentence "sections 270.142 and 270.143" and inserting in lieu thereof "section 270.142".

(C) Section 270.159 is amended by striking "sections 270.142 and 270.143" and inserting in lieu thereof "section 270.142".

PAR. 2. 26 CFR Part 275 is amended as follows:

(A) Section 275.133 is amended to read as follows:

SEC. 275.133 REPORTS.—(a) *General.*—Every manufacturer of tobacco shall make a report, on Form 2134, to the assistant regional commissioner, of all (1) manufactured tobacco produced, received, removed, furnished for personal consumption or use by employees, used for experimental purposes, reduced to material, and lost or destroyed, and (2) stamps received, used, and lost or destroyed. Such report shall be made at the times specified in this section and shall be made whether or not any operations or transactions occurred during the period covered by the report. A copy of each report shall be retained by the manufacturer for two years following the close of the calendar year covered in such reports, and made available for inspection by any revenue officer upon his request.

(b) *Opening.*—An opening report, covering the period from the date of the opening inventory, or inventory made in connection with a superseding bond, to the end of the month, shall be made on or before the 20th day following the end of the month in which the business was commenced.

(c) *Monthly.*—A report for each full month shall be made on or before the 20th day following the end of the month covered in the report.

(d) *Special.*—A special report, covering the unreported period to the day preceding the date of any special inventory required by a revenue officer, shall be made with such inventory. Another report, covering the period from the date of such inventory to the end of the month, shall be made on or before the 20th day following the end of the month in which the inventory was made.

(e) *Closing.*—A closing report, covering the period from the first of the month to the date of the closing inventory, or the day preceding the date of an inventory made in connection with a superseding bond, shall be made with such inventory.

(68A Stat. 713; 26 U. S. C. 5722)

(B) Section 275.147 is amended by striking from the second sentence "sections 275.132 and 275.133" and inserting in lieu thereof "section 275.132".

(C) Section 275.148 is amended by striking "sections 275.132 and 275.133" and inserting in lieu thereof "section 275.132".

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days following the date of publication in the Federal Register.

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

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved: October 20, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury,

(Filed by the Division of the Federal Register on October 24, 1958, at 8:49 a. m., and published in the issue of the Federal Register for October 25, 1958, 23 F. R. 8262.)

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26 CFR 275.133: Reports.

Recording of the quantities of tobacco materials received, shipped, lost or destroyed, eliminated from the reports of tobacco manufactures. See T. D. 6328, page 871.

SECTION 5723.—PACKAGES, MARKS, LABELS, NOTICES, AND STAMPS

26 CFR 270.190: Packages. T. D. 6330 [1]
(Also 275.180.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 270 AND 275

Amendments to implement the provisions of Public Law 85-211

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, 1958, a notice of proposed rulemaking with respect to regulations designated as Part 270 and Part 275 of Title 26 of the Code of Federal Regulations was published in the Federal Register (23 F. R. 6142) in order to conform regulations to the provisions of Public Law 85-211 [C. B. 1957-2, 1060], relative to the importation of certain samples of tobacco products without payment of the internal revenue tax imposed on, or by reason of, importation.

No data, views, or arguments pertaining thereto were received within the 30-day period prescribed. Accordingly, the amendments so published are hereby adopted.

PARAGRAPH 1. Paragraph (a) of section 270.190 is amended by inserting a colon in place of the period at the end of the second sentence and adding, immediately thereafter, the expression "*Provided*, That cigars and cigarettes removed as samples pursuant to the provisions of section 270.196a shall be exempt from the provisions of this paragraph."

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[1] 23 F. R. 8607.

PAR. 2. A new section 270.196a to read as follows is added:

SEC.270.196a EXEMPTION OF CERTAIN SAMPLES FROM INTERNAL REVENUE TAXES.—Samples of cigars and cigarettes, to be used in the United States by persons importing tobacco products in commercial quantities, are, subject to the limitations in this section, exempt from payment of any internal revenue tax imposed on, or by reason of, importation. These exemptions apply only to samples to be used for soliciting orders for products of foreign countries. Only one sample of cigars and cigarettes of the same brand, blend, size, shape, and weight, and having the same kind of wrapper, filter, mouthpiece, etc., shall be so admitted during any calendar quarter for the use of each such person. No such sample shall contain more than 3 cigars or 3 cigarettes.
(71 Stat. 486; 19 U. S. C. 1201)

PAR. 3. Paragraph (a) of section 275.180 is amended by inserting a colon in place of the period at the end of the second sentence and adding, immediately thereafter, the expression "*Provided*, That manufactured tobacco removed as samples pursuant to the provisions of section 275.185a shall be exempt from the provisions of this paragraph."

PAR. 4. A new section 275.185a to read as follows is added:

SEC. 275.185a EXEMPTION OF CERTAIN SAMPLES FROM INTERNAL REVENUE TAXES.—Samples of manufactured tobacco, to be used in the United States by persons importing tobacco products in commercial quantities, are, subject to the limitations in this section, exempt from payment of any internal revenue tax imposed on, or by reason of, importation. These exemptions apply only to samples to be used for soliciting orders for products of foreign countries. Only one sample of manufactured tobacco of the same kind, brand, blend, form, flavor, cut, grind, etc., shall be so admitted during any calendar quarter for the use of each such person. No such sample shall contain more than 1/8th of an ounce of manufactured tobacco.
(71 Stat. 486; 19 U. S. C. 1201)

Since the amendments made by Public Law 85–211 apply to articles entered for consumption or withdrawn from warehouse for consumption on or after October 17, 1957, the date on which the International Convention To Facilitate the Importation of Commercial Samples and Advertising Materials came into force for the United States, these regulations are being made retroactively effective to that date, pursuant to section 7805 of the Internal Revenue Code of 1954.

(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).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved October 29, 1958.

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

(Filed by the Division of the Federal Register on November 3, 1958, 8:47 a. m., and published in the issue of the Federal Register for November 4, 1958, 23 F. R. 8607.)

275.180: Packages.

Certain samples of manufactured tobacco imported into the United States in commercial quantities without payment of internal revenue tax. See T. D. 6330, page 873.

CHAPTER 53.—MACHINE GUNS AND CERTAIN OTHER FIREARMS

SUBCHAPTER A.—TAXES

PART I.—SPECIAL (OCCUPATIONAL) TAXES

SECTION 5801.—TAX

26 CFR 179.15: Dealer (Also Part II, Federal Firearms Act, Section 901, Section 177.22.) Rev. Rul. 58–432

The Internal Revenue Service has had occasion to consider the status of a person who represented himself as a dealer; registered and paid the special (occupational) tax, imposed under section 5801 of the Internal Revenue Code of 1954, as a "dealer" in firearms coming within the purview of the National Firearms Act (Chapter 53, Internal Revenue Code), made application for, and was duly issued, a license as a "dealer" under the Federal Firearms Act 15 U. S. C. 901 (5); and it was subsequently established that the person procured the special tax stamp and the license to facilitate the purchase of firearms for his personal collection. *Held*, the mere possession of a license and a special (occupational) tax stamp as a dealer in firearms does not qualify a person to receive firearms transfer-tax-free. Any person holding a license and a special tax stamp as a dealer in firearms and not engaged within the United States in the business of selling firearms may not lawfully receive firearms without the transfer tax having been paid by the transferor. If such person receives firearms without the transfer tax having been paid, it will be necessary for the Internal Revenue Service to impose the sanctions of Chapter 53 of the Internal Revenue Code, including the seizure for forfeiture of all firearms which have been transferred without payment of the transfer tax.

SUBCHAPTER B.—GENERAL PROVISIONS

SECTION 5848.—DEFINITIONS

26 CFR 179.28: Machine gun. Rev. Rul. 58–417

The Internal Revenue Service has had occasion to consider the classification status of the new U. S. Army M14 "rifle" chambered for the 7.62 mm NATO cartridge, in the light of the provisions of the National Firearms Act (Chapter 53 of the Internal Revenue Code of 1954). *Held*, (1) that since the M14 "rifle" operates either fully automatically or semi-automatically on a selective basis, it is in basic design and function a "machine gun" as defined in Section 5848(2) of the Internal Revenue Code of 1954 and, accordingly, subject to the provisions of the National Firearms Act, and (2) that the substitution of a selector shaft lock, in lieu of a selector lever

assembly, on the M14 "rifle" is of temporary nature and, therefore, does not materially alter the classification thereof for purposes of the National Firearms Act.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART II.—TAX RETURNS OR STATEMENTS

Subpart A.—General Requirement

SECTION 6011.—GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST

(Also Section 4291.) Rev. Rul. 58–574

Where the lessee of a theater conducts performances in the theater and controls the sale of admissions thereto, he is liable for the collection, return, and remittance of the tax on admissions, imposed by section 4231(1) of the Internal Revenue Code of 1954, whether the payments for admissions are made to the lessee himself or to his agent.

Advice has been requested as to where the responsibility lies for the collection, return, and remittance of the tax on admissions when a theater is leased to performers under the circumstances described below.

The management of a theater leases the theater to various performers but does not lease the box office of the theater to them. The management has a contract with a company under which the company is granted the exclusive privilege of selling tickets in the theater's box office as long as it does so in compliance with the terms of the contract. If the lessees of the theater wish to utilize the theater's box office, they must negotiate a separate agreement with the ticket selling company. The lessees are at liberty to arrange the sale of tickets outside the theater through brokers and others and do not necessarily have to avail themselves of the services of the box office. The lessees determine the nature of the attraction to be offered, the content of the program to be presented and the scale of prices to be charged.

Section 4291 of the Internal Revenue Code of 1954 provides that every person receiving any payment for facilities or service on which a tax is imposed upon the payor thereof shall collect the amount of the tax from the person making such payment.

Section 6011(a) of the Code provides that when required by regulations prescribed by the Secretary of the Treasury or his delegate any person made liable for any Federal tax, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required

to make a return or statement shall include therein the information required by such forms or regulations.

Section 101.31(d) of Regulations 43, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, states that in each case there rests on the respective person collecting the tax the corresponding duty of then paying such tax in accordance with the provisions of section 101.33 of the regulations and that the amount of tax collected constitutes a special fund in trust for the United States.

Section 101.36 of the regulations provides that whenever a theater, hall, park, ballroom, or other place is leased for any occasion, there is imposed on the lessee the duty of collecting any taxes due on admissions to such place on that occasion. However, for the convenience of the parties and the safeguarding of the revenue, the lessor will be permitted, if properly registered, to assume responsibility for the collection of the tax in such cases.

The person liable for the collection, return, and remittance of the tax on the amount paid for admission to any place is the person who receives the payments for admission. Such person may delegate to his agents the authority to physically take in the payments but this in no way lessens or affects his liability with respect to the admissions tax under the law. In the instant case, the company operating the box office is merely a conduit for the transmission of the payments made by members of the public at the box office and is not itself receiving such payments within the meaning of the Code. Since the lessees of the theater determine the nature of the program to be offered, the content of the program to be presented and the scale of prices to be charged, they are the persons who receive the payments for admission. There is no agreement between the lessor and any lessee which gives the lessor the authority to collect the admissions tax. The fact that the lessees are willing to utilize the services of the box office and to be governed by the terms of the contract between the theater management and the company which operates the box office, makes the lessees no less liable for the collection, return and remittance of the tax than if brokers or others with whom the lessor has no contract had sold the tickets. Therefore, it is held that the lessees of the theater, who give performances and control the sales of tickets thereto, are liable for the collection, return and remittance of the tax on admissions whether the payments for admission are made to the lessees themselves or to their agents.

Subpart B.—Income Tax Returns

SECTION 6012.—PERSONS REQUIRED TO MAKE RETURNS OF INCOME

26 CFR 1.6012: Statutory provisions; persons required to make returns of income.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

PART III.—INFORMATION RETURNS

Subpart A.—Information Concerning Persons Subject to Special Provisions

SECTION 6033.—RETURNS BY EXEMPT ORGANIZATIONS

26 CFR 1.6033: Statutory provisions; returns by exempt organizations.

Regulations under the Internal Revenue Code of 1954. See T. D. 6301, page 197.

26 CFR 1.6033–1: Returns by exempt organizations.

Effective period of ruling or determination letters granting exemption. See Rev. Rul. 58–617, page 260.

SECTION 6037.—RETURN OF ELECTING SMALL BUSINESS CORPORATION

Temporary rules under subchapter S, comprising sections 1371 through 1377, and section 6037, as added to the 1954 Code by the Technical Amendments Act of 1958. See T. D. 6317, page 1096.

Subpart B.—Information Concerning Transactions With Other Persons

SECTION 6041.—INFORMATION AT SOURCE

(Also Section 74; 26 CFR 1.74–1.) Rev. Rul. 58–347

The producer of a television show which awards prizes of merchandise to contestants, the fair market value of which prizes is not readily ascertainable, may report, for the purpose of section 6041(a) of the Internal Revenue Code of 1954, the manufacturer's suggested retail selling price of such prizes on information returns, Form 1099, and file the U. S. Annual Information Return, Form 1096, summarizing the payments so reported.

Advice has been requested by the producer of a television show concerning the amounts he should report on information returns, Forms 1099 and 1096, as the value of merchandise prizes awarded to contestants appearing in the telecasts.

Under the provisions of section 6041(a) of the Internal Revenue Code of 1954, any person engaged in a trade or business and making payment in the course of such trade or business to another person of salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits and income with certain exceptions not here material, totaling $600 or more, must file a U. S. Annual Information Return, Form 1096, and transmit an information return, Form 1099, therewith.

Under section 1.74–1 of the Income Tax Regulations, prizes and awards which are includible in gross income include (but are not limited to) amounts received from radio and television giveaway

shows; and, if the prize or award is not made in money, but is made in goods or services, the fair market value of the goods or services is the amount to be included in income. See also I. T. 3987, C. B. 1950–1, 9.

For the purpose of section 6041, when payment is made in any medium other than cash, the amount that should be reported is the fair market value of the items constituting the payments.

In view of the foregoing, in those cases where merchandise prizes are awarded to contestants, the fair market value of which is not readily ascertainable, the requirements of the law will be deemed to be satisfied if the producer of the show in respect of which the prizes are awarded reports the manufacturer's suggested retail selling price of such prizes on information returns, Form 1099, and files the U. S. Annual Information Return, Form 1096, summarizing the payments so reported. Under such report procedure, the contestant will be afforded an opportunity, at the time the Internal Revenue Service makes an examination of his final income tax return, to substantiate any claim he may make that the fair market value of the merchandise he received as a prize was less than the retail value reported by the producer.

Subpart C.—Information Regarding Wages Paid Employees

SECTION 6051.—RECEIPTS FOR EMPLOYEES

26 CFR 31.6051–1: Statements for employees. Rev. Rul. 58–532
(Also Section 3121; 31.3121(i)–1.)

> The amount shown as wages in the social security information portion of the Withholding Tax Statements, Form W–2, furnished a member of the uniformed services on active duty is not necessarily the same as that shown on such form for income tax withholding purposes since only the member's basic pay constitutes wages for purposes of the taxes under the Federal Insurance Contributions Act.

Advice has been requested whether the amount shown as wages under the Federal Insurance Conributions Act in the Withholding Tax Statement, Form W–2, furnished a member of the uniformed services should be the same as the total wages reported for income tax withholding purposes.

Under the Career Compensation Act of 1949, 37 U. S. C. 231, a member of the uniformed services may receive, in addition to his regular monthly pay, other amounts, such as sea and foreign duty pay, hazardous duty pay, and diving duty pay. Such additional payments constitute "wages," as that term is defined in section 3401(a) of the Internal Revenue Code of 1954, and are subject to the withholding of income tax. Accordingly, such additional payments should be included in the amount shown in Form W–2 as the total wages paid for income tax withholding purposes.

Section 3121(i)(2) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), as amended by the Servicemen's and Veterans' Survivor Benefits Act, 70 Stat. 878, C. B. 1956–2, 1196, at 1201, provides as follows:

For purposes of this chapter, in the case of an individual performing service, as a member of a uniformed service, to which the provisions of subsection (m)(1) are applicable, the term "wages" shall, subject to the provisions of subsection (a)(1) of this section, include as such individual's remuneration for such service only his basic pay as described in section 102(10) of the Servicemen's and Veterans' Survivor Benefits Act.

Section 3121(m)(1) of the Federal Insurance Contributions Act provides in part that the term "employment" shall include services performed after December 1956 by an individual as a member of a uniformed service on active duty.

Section 102(10) of the Servicemen's and Veterans' Survivor Benefits Act defines "basic pay" as the monthly pay prescribed by the Career Compensation Act of 1949, *supra*, for a member of a uniformed service on active duty.

In view of the specific provisions of section 3121(i)(2) of the Federal Insurance Contributions Act, in the case of services performed on and after January 1, 1957, the portion of pay in excess of the "basic pay" of a member of a uniformed service on active duty do not constitute "wages" for purposes of the taxes imposed by such Act and, therefore, should not be included in the amount shown in the social security information portion of Form W-2.

Printing of substitutes for Form W-2, Withholding Tax Statement—1959. See Rev. Proc. 58-17, page 1128.

PART IV.—SIGNING AND VERIFYING OF RETURNS AND OTHER DOCUMENTS

SECTION 6065.—VERIFICATION OF RETURNS

Rev. Rul. 58-390

Revenue Ruling 55-149, C. B. 1955-1, 139, relative to the preparation of income tax returns by a person other than the taxpayer, provides that if a firm is responsible for the preparation of the return, the statement of verification shall be signed with the firm name and that if the firm name is stamped or typed, it should be followed by the signature of a person authorized to sign the verification on behalf of the firm. *Held*, that ruling applies in the case of estate and gift tax returns as well as income tax returns. Revenue Ruling 55-149, *supra*, is hereby supplemented accordingly.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6103.—PUBLICITY OF RETURNS AND LISTS OF TAXPAYERS

Increases in the charge for preparing abstracts of Federal income tax returns and documents for State governments. See Rev. Proc. 58-16, page 1127.

SECTION 6104.—PUBLICITY OF INFORMATION REQUIRED FROM CERTAIN EXEMPT ORGANIZATIONS AND CERTAIN TRUSTS

26 CFR 301.6104–1: Public inspection of applications for tax exemption. T. D. 6331 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Regulations under section 6104 of the Internal Revenue Code of 1954, as amended by section 75(a) of the Technical Amendments Act of 1958, relating to publicity of information required from certain exempt organizations and certain 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:

The following regulations are hereby prescribed under section 6104 of the Internal Revenue Code of 1954, as amended by section 75(a) of the Technical Amendments Act of 1958 (72 Stat. 1660), relating to publicity of information required from certain exempt organizations and certain trusts. Except as otherwise specifically provided therein, such regulations shall be effective on and after August 17, 1954.

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301.6104 Statutory provisions; publicity of information required from certain exempt organizations and certain trusts.
301.6104–1 Public inspection of applications for tax exemption.
301.6104–2 Publicity of information on certain information returns.

AUTHORITY: §§ 301.6104 to 301.6104–2, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

§ 301.6104 STATUTORY PROVISIONS; PUBLICITY OF INFORMATION REQUIRED FROM CERTAIN EXEMPT ORGANIZATIONS AND CERTAIN TRUSTS.

SEC. 6104. PUBLICITY OF INFORMATION REQUIRED FROM CERTAIN EXEMPT ORGANIZATIONS AND CERTAIN TRUSTS.

(a) INSPECTION OF APPLICATIONS FOR TAX EXEMPTION—

(1) PUBLIC INSPECTION—

(A) IN GENERAL.—If an organization described in section 501(c) or (d) is exempt from taxation under section 501(a) for any taxable year, the application filed by the organization with respect to which the Secretary or his delegate made his determination that such organization was entitled to exemption under section 501(a), together with any papers submitted in support of such application, shall be open to public inspection at the national office of the Internal Revenue Service. In the case of any application filed after the date of the enactment of this subparagraph, a copy of such application shall be open to public inspection at the appropriate field office of the Internal Revenue Service (determined under regulations prescribed by the Secretary or his delegate). Any inspection under this subparagraph may be made at such times, and in such manner, as the Secretary or his delegate shall by regula-

[1] 23 F.R. 8539.

tions prescribe. After the application of any organization has been opened to public inspection under this subparagraph, the Secretary or his delegate shall, on the request of any person with respect to such organization, furnish a statement indicting the subsection and paragraph of section 501 which it has been determined described such organization.

(B) WITHHOLDING OF CERTAIN INFORMATION.—Upon request of the organization submitting any supporting papers described in subparagraph (A), the Secretary or his delegate shall withhold from public inspection any information contained therein which he determines relates to any trade secret, patent, process, style of work, or apparatus, of the organization, if he determines that public disclosure of such information would adversely affect the organization. The Secretary or his delegate shall withhold from public inspection any information contained in supporting papers described in subparagraph (A) the public disclosure of which he determines would adversely affect the national defense.

(2) INSPECTION BY COMMITTEES OF CONGRESS.—Section 6103 (d) shall apply with respect to—

(A) The application for exemption of any organization described in section 501(c) or (d) which is exempt from taxation under section 501(a) for any taxable year, and

(B) Any other papers which are in the possession of the Secretary or his delegate and which relate to such application, as if such papers constituted returns.

(b) INSPECTION OF ANNUAL INFORMATION RETURNS.—The information required to be furnished by sections 6033(b) and 6034, together with the names and addresses of such organizations and trusts, shall be made available to the public at such times and in such places as the Secretary or his delegate may prescribe.

[Sec. 6104 as amended by sec. 75(a), Technical Amendments Act 1958 (72 Stat. 1660)]

§ 301.6104–1 PUBLIC INSPECTION OF APPLICATIONS FOR TAX EXEMPTION.—(a) *Applications open to inspection.*—(1) *In general.*—An application for exemption, together with any supporting documents, filed by an organization described in section 501(c) or (d) of the Internal Revenue Code of 1954 (or in the corresponding provisions of any prior revenue law) shall be open to public inspection on or after November 3, 1958, in accordance with section 6104(a)(1) and the provisions of this section, if the Commissioner or district director has determined, on the basis of such application, that such organization is exempt from taxation for any taxable year under section 501(a) of the Internal Revenue Code of 1954 (or under the corresponding provisions of any prior revenue law). Certain applications for exemption have been destroyed pursuant to Congressional authorization and therefore will not be available for inspection.

(2) *Claim for exemption filed under section 503 or 504 and the regulations thereunder.*—Claims for exemption filed to reestablish exempt status after denial thereof under the provisions of section 503 or 504 of the Internal Revenue Code of 1954 (or under the corresponding provisions of any prior revenue law), relating to denial of exemption because of certain prohibited transactions or an unreasonable accumulation of income, are considered to be applications for exemption for purposes of section 6104(a)(1) and this section.

(3) *Requirement of exempt status.*—An application for exemption and supporting documents shall not be available for public inspection before the organization filing such application has been determined, on the basis of such application, to be exempt from taxation for any

taxable year. On the other hand, if the organization has been determined to be exempt for any taxable year, the application for exemption with respect to which such determination was made shall not be withheld from public inspection on the grounds that such organization is determined not to be entitled to exemption for any other taxable year or years.

(b) *Meaning of terms.*—(1) *Application for exemption.*—(i) For purposes of this section, the term "application for exemption" means the documents described in subdivision (ii) of this subparagraph which the organization was required to file when it applied for exemption.

(ii) (*a*) With respect to an organization for which an application for exemption form is prescribed, the application for exemption includes such form and all documents and statements required to be filed by such form.

(*b*) With respect to an organization described in section 501(c) or (d) for which no application for exemption form is prescribed, the application for exemption includes the application letter and a conformed copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization, and statements showing the character of the organization, the purpose for which it was organized, its actual activities, sources of income and receipts and the disposition thereof, and whether or not any of its income or receipts is credited to surplus or may inure to the benefit of any private shareholder or individual.

(*c*) With respect to a mutual insurance company, the application for exemption shall, in addition to the statements and documents required to be submitted by the form, include copies of the policies or certificates of membership issued by such company.

(*d*) With respect to a title holding company described in section 501(c)(2), if the organization for which title is held has not been specifically notified in writing by the Internal Revenue Service that it is held to be exempt under section 501(a), the application for exemption shall, in addition to the statements and documents required to be submitted by the form, include the statements or documents which would be considered to be included in the application for exemption of the organization for which title is held.

(*e*) With respect to a State chartered credit union described in section 501(c)(14), the application for exemption shall, in addition to the statements and documents indicated in (*b*) of this subdivision, include a statement indicating the State and date of incorporation and showing that the State credit union law with respect to loans, investments, and dividends, if any, is being complied with.

(iii) The term "application for exemption" does not include a request for a ruling as to whether a proposed transaction is a prohibited transaction under section 503 of the Internal Revenue Code of 1954 (or under the corresponding provisions of any prior revenue law).

(2) *Supporting document.*—For purposes of this section, the term "supporting document" means any statement or document submitted

by an organization in support of its application for exemption which is not specifically required by subdivision (ii) of subparagraph (1) of this paragraph. For example, a legal brief submitted in support of an application for exemption is a supporting document.

(c) *Withholding of certain information.*—(1) *Trade secrets, patents, processes, styles of work, or apparatus.*—(i) *In general.*—Any information which is submitted by an organization whose application for exemption is open to inspection under this section and which is determined by the Commissioner to relate to any trade secret, patent, process, style of work, or apparatus of the organization submitting such information shall, upon request in writing of such organization, be withheld from public inspection under section 6104(a)(1) and this section, if the Commissioner determines that the disclosure of such information would adversely affect the organization.

(ii) *Request for withholding of information.*—Requests for the withholding of information from public inspection as provided in subdivision (i) of this subparagraph shall—

(*a*) In the case of applications for exemption filed before November 3, 1958, be made to the Commissioner of Internal Revenue, Attention: Public Information Division, Washington 25, D. C.; or

(*b*) In the case of applications for exemption filed on or after November 3, 1958, be filed with the office with which the taxpayer filed the documents in which the material to be withheld is contained.

The request shall clearly identify the material desired to be withheld (the document, page, paragraph, and line) and shall include the reasons for the organization's position that the information is of the type which may be withheld from public inspection.

(iii) *Determination.*—An organization which has filed a request under the provisions of this subparagraph will be notified of the determination as to whether the information to which the request relates will be withheld from public inspection.

(2) *National defense material.*—The Internal Revenue Service shall withhold from public inspection any information which is submitted by an organization whose application for exemption is open to inspection under this section the public disclosure of which the Commissioner determines would adversely affect the national defense.

(d) *Place of inspection.*—Applications for exemption, together with any supporting documents, which are open to public inspection under section 6104(a)(1) shall be available for inspection on or after November 3, 1958, in the Office of the Director, Public Information Division, Internal Revenue Service, Washington 25, D. C., regardless of when or where such applications were filed except for such applications as have been destroyed pursuant to Congressional authority. In addition, in the case of an application for exemption filed on or after September 3, 1958, a copy of such application (as defined in paragraph (b)(1) of this section), but not the supporting documents, shall also be available for public inspection on or after November 3, 1958, in the office of the district director of internal revenue with whom the application was required to be filed.

(e) *Procedure for public inspection of applications for exemption.*—(1) *Request for inspection.*—Applications for exemption and

the supporting documents shall be available for public inspection only upon request. If inspection at the national office is desired, the request shall be made in writing to the Commisisoner of Internal Revenue, Attention: Director, Public Information Division, Washington 25, D. C. Requests for inspection in the office of a district director of internal revenue shall be made in writing to the appropriate district director. All requests for inspection must include the name and address of the organization which filed the application for exemption the inspection of which is requested. In addition, if such organization has more than one application for exemption open to public inspection under the provisions of section 6104(a)(1), only the most recent of such applications shall be made available for inspection unless the request for inspection specifically states otherwise.

(2) *Time and extent of inspection.*—A person requesting public inspection in the manner specified in subparagraph (1) of this paragraph shall be notified by the Internal Revenue Service when the material he desires to inspect will be made available for his inspection. An application for exemption will be made available for public inspection at such reasonable and proper times as not to interfere with its use by the Internal Revenue Service or to exclude other persons from inspecting it. In addition, the Commissioner or district director may limit the number of applications for exemption to be made available to any person for inspection on a given date. The public inspection authorized by section 6104(a)(1) will be allowed only in the presence of an internal revenue officer or employee and only during the regular hours of business of the Internal Revenue Service office.

(3) *Copying of documents.*—Applications for exemption and supporting documents will be made available on an inspection basis only. Notes may be taken and copies may be made manually, but not photographically.

(f) *Statement of exempt status.*—A statement setting forth the following information with respect to an organization shall be furnished to any person, upon request in writing, after the application for exemption of such organization is open to public inspection under section 6104(a)(1):

(1) The subsection and paragraph of section 501 of the Internal Revenue Code of 1954 (or the corresponding provision of any prior revenue law) under which the organization has been determined, on the basis of such application, to qualify for exemption from taxation; and

(2) Whether the organization is currently held to be exempt. Request for such information may be made in writing to the Commissioner of Internal Revenue, Attention: Public Information Division, Washington 25, D. C., or to the district director of internal revenue with whom the organization's application for exemption was required to be filed.

§ 301.6104–2 Publicity of Information on Certain Information Returns.—(a) *In general.*—The following information, together with the name and address of the organization or trust furnishing such information, shall be a matter of public record:

(1) The information furnished, pursuant to section 6033(b) (relating to annual information required from certain organizations described in section 501(c)(3) which are exempt under section 501(a)), on pages 3 and 4 of Form 990–A; and

(2) The information furnished, pursuant to section 6034 (relating to annual information required of trusts claiming a charitable deduction under section 642(c)), on Form 1041–A.

Such information shall be available to any person during the regular hours of business in the office of the district director of internal revenue with whom the Form 990–A or 1041–A was required to be filed. Such information may be used by the Commissioner for the purpose of making and publishing statistical or other studies.

(b) *Copying of material available for inspection.*—The information which is a matter of public record under section 6104(b) will be made available on an inspection basis only. Notes may be taken and copies may be made manually, but not photographically.

Because this Treasury Decision constitutes a general statement of policy and establishes rules of Departmental practice and procedure and because of the immediate need of such rules, it is found that it is unnecessary and 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.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved October 30, 1958.

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

(Filed by the Division of the Federal Register on October 31, 1958, 8:57 a. m., and published in the issue of the Federal Register for November 1, 1958. 23 FR 8537.)

Procedures for the public disclosure of certain information relating to organizations which have been held to be exempt from income tax under section 501(a) of the Internal Revenue Code of 1954, and the corresponding provisions of prior revenue laws. See Rev. Proc. 58–20, page 1134.

CHAPTER 62.—TIME AND PLACE FOR PAYING TAX

SUBCHAPTER A.—PLACE AND DUE DATE FOR PAYMENT OF TAX

SECTION 6152.—INSTALLMENT PAYMENTS

(Also Section 6601; 26 CFR 301.6601–1.) Rev. Rul. 58–523

The establishment of reasonable cause for the late filing of a tax return does not reinstate the taxpayer's privilege to pay the tax on the installment basis when such privilege has been forfeited by late payment of the first installment of tax. Interest accrues under section 6601 of the Internal Revenue Code of 1954 on the entire unpaid balance of tax from the due date of the tax.

Advice has been requested whether a taxpayer's privilege of paying tax on the installment basis is reinstated upon the showing of reasonable cause for delinquency in filing the tax return with which the first installment of tax was paid.

The privilege of paying income tax in installments is a matter subject to strict statutory regulation. The privilege must be elected and acted upon by the payment of the first installment on or before the due date thereof.

Section 6152 (d) of the Internal Revenue Code of 1954 specifically provides that "If any installment * * * is not paid on or before the date fixed for its payment, the whole of the unpaid tax shall be paid upon notice and demand from the Secretary or his delegate."

The provisions of section 6651 (a) of the Code, governing the additions to tax for failure to file a return on the due date, specifically preclude such additions upon the showing of reasonable cause. This section operates independently of the provisions of sections 6151 and 6152 of the Code which prescribe dates for payment of tax and of section 6601 governing the charging of interest.

Accordingly, it is held that the establishment of reasonable cause for the late filing of a tax return does not reinstate the taxpayer's privilege to pay the tax on the installment basis when such privilege has been forfeited by late payment of the first installment of tax. Interest accrues under section 6601 of the Code on the entire unpaid balance of tax from the due date of the tax.

SUBCHAPTER B.—EXTENSIONS OF TIME FOR PAYMENT

SECTION 6166.—EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS

Temporary rules under section 6166, as added to the 1954 Code by the Small Business Tax Revision Act of 1958. See T. D. 6321, page 1102.

CHAPTER 63.—ASSESSMENT

SUBCHAPTER B.—DEFICIENCY PROCEDURES IN THE CASE OF INCOME, ESTATE AND GIFT TAXES

SECTION 6213.—RESTRICTIONS APPLICABLE TO DEFICIENCIES: PETITIONS TO TAX COURT

26 CFR 301.6213–1: Restrictions applicable to deficiencies; petitions to tax court.

For the policy of the Internal Revenue Service with respect to advance payments of tax deficiencies. See Rev. Proc. 58–18, page 1131.

CHAPTER 64.—COLLECTION

SUBCHAPTER C.—LIEN FOR TAXES

SECTION 6321.—LIEN FOR TAXES

26 CFR 301.6321–1: Lien for taxes. Rev. Rul. 58–470

Domestic building and loan associations, acting in the ordinary course of business with a holder of a savings account, without actual knowledge (as distinguished from constructive notice) of a Federal tax lien against the property or rights to property of the holder, and in the absence of negligence or fraud, will not incur liability to the Government in making payments of amounts in such savings accounts to or on order of such holder if holder's accounts with the association are withdrawable on demand subject only to customary notice of intention to withdraw.

Advice has been requested whether the term "bank" as used in Revenue Ruling 57–367, C. B. 1957–2, 846, relative to the rule of constructive notice of a Federal tax lien, includes a domestic building and loan association.

Revenue Ruling 57–367 holds, in part, that where a bank, acting in the ordinary course of business with a depositor, does not have actual notice or knowledge of the existence of a Federal tax lien (as distinguished from constructive notice given by the filing of a notice of lien as prescribed in the Internal Revenue Code of 1954), and in the absence of negligence or fraud, the bank will not incur liability to the Government in making payments to a depositor or on order of a depositor, against whom a Federal tax lien is outstanding, to the extent of the amount such depositor has on deposit with the bank.

It is held that the principles of Revenue Ruling 57–367 apply to domestic building and loan associations where accounts with such organizations are held under a relationship similar to that of a bank to a depositor in that the account is withdrawable on demand subject only to customary notice of intention to withdraw.

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6416.—CERTAIN TAXES ON SALES AND SERVICES

(Also Sections 4001, 4011, 4021, 4031.) Rev. Rul. 58–348

Credit or refund of retailers excise tax is allowable to a retailer where a taxable article sold by him is returned prior to use by the purchaser or his donee and the retailer refunds the full purchase price of the article, or allows such an amount toward the purchase price of another article.

Advice has been requested whether credit or refund of retailers excise tax is allowable to a retailer under the circumstances described below.

It is a common practice for prospective brides to register their silverware patterns with retail establishments. The purpose of this practice is to enable the retailer to advise purchasers of gifts for the bride to select those which do not duplicate other purchases or to confine their choices to silverware of the registered pattern. Despite this, it frequently happens that the bride receives duplicate gifts or gifts of patterns which do not match her own. Accordingly, it is the general custom and usage in the trade, or in any case there may be a specific agreement to that effect between the retailer and the purchaser, to permit the donee (the bride) to return the article given to her and to select another item in its place, or to receive in cash an amount equal to the tax-included purchase price of the article.

Section 320.74 (b) and (c) of Regulations 51, made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, provides for the allowance of credit or refund of retailers excise tax paid with respect to the sale of an article where, prior to its use, the sale is rescinded by a return of the article to the retailer and refund or credit of the amount of the purchase price, including tax, is made to the purchaser.

It is held that the situations described above come within the purview of this section of the regulations. Accordingly, where an article purchased as a gift is returned to the retailer by the donee because of a duplication or for other valid reasons, the return of the article prior to use and a refund or credit to the donee of the entire tax-included selling price entitles the retailer to a credit or refund of the tax paid.

If the article is returned by the donee prior to use and the donee is allowed credit for the entire tax-included purchase price in an exchange of the article for another taxable article, tax will attach to the full price of the second article including the allowance made with respect to the returned article. In such case, the retailer is entitled to a credit or refund of the tax paid with respect to the first or returned article.

While this situation occurs most commonly in the case of brides, it is not intended that the principles stated in this Revenue Ruling be confined wholly to wedding or engagement gifts. The same principles may be applied to other comparable situations involving the return of gifts prior to use, for example Christmas gifts, graduation gifts, confirmation gifts, etc.

Rev. Rul. 58–575

Tax-paid diesel fuel, which is used to power the motor of special equipment mounted on diesel-powered highway vehicles, qualifies for a credit or refund of the retailers excise tax under the provisions of section 6416(b)(2)(C) of the Internal Revenue Code of 1954, whether such fuel is drawn from a separate fuel supply tank or from the tank which supplies fuel for the motor of the vehicle.

However, no credit or refund is allowable with respect to diesel fuel used to power the motor of the vehicle where the special equipment is operated by means of a "power take off" from that motor.

Advice has been requested whether a credit or refund of the retailers excise tax is allowable where tax-paid diesel fuel is used to operate special equipment mounted on diesel-powered highway vehicles.

Many diesel-powered highway buses are equipped with air conditioning units. One of the units is mounted in a compartment on the side of each bus along with a separate motor which operates the unit. The motor of the unit and the motor of the bus are activated by diesel fuel drawn from the same fuel supply tank.

Also, some diesel-powered highway tank trucks are equipped with pumping units which are used to discharge various liquids from the truck tanks into customers' storage facilities. In some cases, the pump is activated by means of a "power take-off" from the motor of the vehicle. Other similar tank trucks are equipped with separate fuel supply tanks from which fuel is drawn to activate the motor of the pumping unit.

Under the provisions of section 6416(b)(2)(C) of the Internal Revenue Code of 1954 the Secretary of the Treasury or his delegate shall credit or refund (without interest) the overpayments on diesel fuel sold for use as a fuel in a diesel-powered highway vehicle if the vendee used such liquid otherwise than as fuel in such vehicle, motorboat, or airplane, or resold such liquid.

It is held that diesel fuel used to activate the motor which operates special equipment, such as air conditioners, pumping units, generators, and cranes, qualifies for a credit or refund under the provisions of section 6416(b)(2)(C) of the Code. However, the provisions of section 6416(a) of the Code and of the applicable regulations must be complied with as a condition precedent to the allowance of the credit or refund. Where a diesel-powered highway vehicle has two separate motors and one fuel supply tank, a determination of the amount of fuel used in the separate motor based on actual consumption or actual operating experience and supported by the records of the consumer will be accepted for refund purposes.

It is further held that no credit or refund is allowable with respect to the retailers excise tax on diesel fuel used to power the motor of a diesel-powered highway vehicle even though the motor is also used to activate special equipment, where the equipment is operated by means of a "power take-off" from the motor of the vehicle.

Sales of ball point pens to a company which fastens on a clip and cap before resale. See Rev. Rul. 58–365, page 809.

Whether a timely filed claim for refund is rendered invalid because certain evidence supporting the claim is filed after the statutory period of limitation has expired. See Rev. Rul. 58–563, page 892.

Allowability of a credit or refund of the manufacturers excise tax paid on automobiles sold to a State under an agreement that within a limited time the automobiles would be traded back to the dealer. See Rev. Rul. 58–572, page 815.

SECTION 6421.—GASOLINE USED FOR CERTAIN NON-HIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS

Rev. Rul. 58–349

A payment of one cent for each gallon of gasoline used in a highway vehicle which is owned by the United States will not be allowed if such vehicle had been used on the highway at any time during the period covered by the claim. However, the claim will be allowed if the vehicle had been used exclusively off the highway during the period covered by the claim.

The Internal Revenue Service has been asked whether the Department of the Army is entitled to a payment of one cent per gallon on gasoline used as fuel in highway vehicles which are owned by the Army and which are used both in on-the-highway service and on military reservations. These vehicles are not required to be registered with any state or foreign country.

Section 6421(a) of the Internal Revenue Code of 1954 provides that if gasoline is used otherwise than as a fuel in a highway vehicle (1) 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 (2) which, in the case of a highway vehicle owned by the United States, is used on the highway, 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. Under the provisions of section 6421(c) of the Code, a claim may be filed under subsection (a) by any person with respect to gasoline used during the one-year period ending on June 30 of any year.

Section 6421(a) of the Code establishes a uniform rule that no payment shall be made under that section for gasoline used in any highway vehicle which is used on the highway, or any vehicle which is registered for highway use. Clause (1) of section 6421(a) states the rule for privately owned vehicles which are registered or required to be registered for highway use under the laws of any state or foreign country. Clause (2) was inserted in section 6421(a) to cover Government-owned highway vehicles which ordinarily are not registered or required to be registered for highway use under the laws of any state, but which are used on the highway.

In view of the foregoing it is held that, in the case of gasoline used as fuel in any highway vehicle owned by the United States, no payment may be made under section 6421(a) of the Code if the vehicle in which the gasoline was used actually had been used on a public highway at any time during the period covered by the claim. However, payment may be made if such vehicle had been used exclusively off the highway during the period covered by the claim.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER B.—LIMITATIONS ON CREDIT OR REFUND

SECTION 6511.—LIMITATIONS ON CREDITS AND REFUNDS

26 CFR 301.6511(a)-1: Period of limitation on filing of claim.
(Also, Section 6416.)
(Also Part II, Sections 3313, 3443.)

Rev. Rul. 58-563

A timely filed claim for refund of amounts erroneously paid as manufacturers excise tax is not rendered invalid because the written consents of ultimate purchasers, required by the statute and regulations, were filed after the expiration of the statutory period of limitation.

Advice has been requested whether a claim for refund is considered to be filed within the statutory period of limitation under the circumstances described below.

A maufacturer sold certain articles which he, at the time of sale, considered to be subject to the manufacturers excise tax. After the tax had been reported and paid to the Government, the manufacturer discovered that the articles were not subject to the tax. To recover the erroneously paid tax, he then filed a Form 843, Claim for Refund, within the statutory period of limitation, with the District Director of Internal Revenue for the district in which the tax was paid. The written consents of the ultimate purchasers were not filed with the claim, but were submitted at a date subsequent to the expiration of the statutory period of limitation.

Section 6511(a) of the Internal Revenue Code of 1954, as amended by the Technical Amendments Act of 1958, Public Law 85-866, provides that a claim for credit or refund of an overpayment of any tax imposed by the Code in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever of these periods expires the later or, if no return was filed by the taxpayer, within two years from the time the tax was paid.

Under the provisions of section 6416(a) of the Code, no credit or refund of any overpayment of the manufacturers excise taxes, with certain exceptions not here material, shall be allowed unless the person who paid the tax establishes, under regulations prescribed by the Secretary of the Treasury or his delegate, that he (1) has not included the tax in the price of the article with respect to which it was imposed or has not collected the amount of the tax from the vendee; (2) has repaid the amount of the tax to the ultimate purchaser of the article; or (3) has filed with the Secretary of the Treasury or his delegate the written consent of such ultimate purchaser to the allowance of the credit or refund.

Section 316.204(c) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, provides, in part,

that a claim for refund must be supported by a statement satisfactorily explaining the reason for claiming the credit or refund and, in cases where the written consent of the ultimate purchaser to the allowance of the credit or refund is necessary, such written consent of the ultimate purchaser must accompany the statement filed with the credit or refund claim.

The provisions of section 6416 of the Code relate to certain evidence which, under the circumstances, is required as a condition precedent to the allowance of a claim. These provisions have no relation to the timely filing of a claim. While section 316.204(c) of the regulations does provide that written consents of ultimate purchasers must accompany the statement filed with a claim, this does not mean that the written consents must be attached to or submitted with the claim or that failure to do so renders the claim faulty so far as timely filing is concerned. Like any other evidence necessary to support a claim, written consents of ultimate purchasers may be filed with the claim or subsequent thereto.

Accordingly, it is held that the date on which the written consents of ultimate purchasers are received in the office of the District Director of Internal Revenue has no bearing on the question of whether the claim to which they relate was timely filed. Therefore, in the instant case, the claim is considered to have been filed within the statutory period of limitation although the consents of ultimate purchasers were filed subsequent thereto.

The conclusion reached in this Revenue Ruling is equally applicable to similar claims for credit or refund of manufacturers excise taxes paid under the provisions of the Internal Revenue Code of 1939.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

26 CFR 301.6601–1: Interest on underpayments.

Effect of deficiency interest in determining the decrease in tax under section 1341(a)(5)(B) of the Code. See Rev. Rul. 58–456, page 415.

Assessment of interest in cases involving installment payments. See Rev. Rul. 58–523, page 886.

Computation of interest on underpayments of tax under section 3403 of the Internal Revenue Code of 1954 in those cases where section 3402(d) of the Code is applicable. See Rev. Rul. 58–577, page 744.

CHAPTER 68.—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

SUBCHAPTER A.—ADDITIONS TO THE TAX AND ADDITIONAL AMOUNTS

SECTION 6654.—FAILURE BY INDIVIDUAL TO PAY ESTIMATED INCOME TAX

26 CFR 1.6654–2: Exceptions to imposition of the addition to the tax in the case of individuals. Rev. Rul. 58–369

The addition to the tax for underpayment of estimated tax will not be asserted against an individual taxpayer for his failure to pay any estimated tax for the current year when his prior year's return reflects no taxable income after giving effect to the taxpayer's status with respect to personal exemptions under section 151 of the Internal Revenue Code of 1954 for the current taxable year.

Advice has been requested whether an addition for underpayment of estimated tax may be asserted against a taxpayer under the facts and circumstances described below.

The taxpayer, an individual, files his Federal income tax returns on a calendar-year basis. The return filed by the taxpayer for the calendar year 1956 reported an item of adjusted gross income but no taxable income after applying a net operating loss carry-over. The taxpayer's status with respect to personal exemptions under section 151 of the Internal Revenue Code of 1954 will be the same for the year 1957 as it was in 1956 and his income for the year 1957 will approximate his 1956 income before application of the net operating loss deduction. The tax rates for the two years in question are the same.

Section 6654 of the Code reads, in part, as follows:

(a) ADDITION TO THE TAX.—In case of any underpayment of estimated tax by a individual, except as provided in subsection (d), there shall be added to the tax under chapter 1 for the taxable year an amount determined at the rate of 6 percent per annum upon the amount of the underpayment * * *.

* * * * * * *

(d) EXCEPTION.—Notwithstanding the provisions of the preceding subsections, the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of such installment equals or exceeds whichever of the following is the lesser—

(1) The amount which would have been required to be paid on or before such date if the estimated tax were whichever of the following is the least—

* * * * * * *

(B) An amount equal to the tax computed, at the rate applicable to the taxable year, on the basis of the taxpayer's status with respect personal exemptions undersection 151 for the taxable year, but otherwise on the basis of the facts shown on his return for, and the law applicable to, the preceding taxable year, * * *.

It is clear that section 6654(d)(1)(B) of the Code provides for an exception to the addition to the tax imposed by section 6654(a)

where the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of such installations equals or exceeds an amount equal to the tax computed, at the rates applicable to the taxable year, on the basis of the taxpayer's status with respect to personal exemptions for the taxable year, but otherwise on the basis of the facts shown on his return for, and the law applicable to, the preceding taxable year.

Accordingly, it is held that section 6654(d)(1)(B) of the Code precludes the assertion of the addition to the tax for underpayment of estimated tax for the current year when the return for the prior year reflects no taxable income after giving effect to the taxpayer's status with respect to personal exemptions under section 151 of the Code for the current taxable year.

CHAPTER 76.—JUDICIAL PROCEEDINGS

SUBCHAPTER B.—PROCEEDINGS BY TAXPAYERS

SECTION 7422.—CIVIL ACTIONS FOR REFUND

Ct. D. 1827

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

1. SUIT FOR REFUND—PAYMENT OF ENTIRE TAX AS CONDITION PRECEDENT TO SUIT.

A taxpayer must pay the entire amount of an income tax deficiency before he may challenge the correctness of such deficiency by a suit for refund. The legislative history of 28 U. S. C. section 1346(a)(1), which confers jurisdiction upon the United States District Courts over civil suits against the United States to recover "any sum," shows that it was not intended to effect any change in the principle of requiring full payment as a condition precedent to suit.

2. JUDGMENT AFFIRMED

Judgment of the United States Court of Appeals for the Tenth Circuit, 246 F. 2d 929, affirmed.

SUPREME COURT OF THE UNITED STATES

Walter W. Flora, Petitioner v. *United States of America*

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

[June 16, 1958]

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

The issue in this case is whether a taxpayer must pay the full amount of an income tax deficiency before he may challenge its correctness by a suit for refund under 28 U. S. C. § 1346(a)(1).

During 1950 petitioner suffered losses on the sale of certain commodities and futures. He reported them as ordinary losses, but the Commissioner of Internal Revenue characterized them as capital losses. A deficiency assessment was levied in the amount of $28,908.60, including interest. Petitioner made two payments that totaled $5,058.54, and then submitted a claim for refund of that amount. The claim was disallowed. On Aug. 3, 1956, petitioner brought this action under 28 U. S. C. § 1346(a)(1) for refund. The United States moved to dismiss for want of jurisdiction and for failure to state a claim upon which relief could be granted. The district judge held that because petitioner had not paid the full amount of the deficiency he "should not maintain" the action. Because the question had not been resolved by the Court of Appeals, however, he deemed

it advisable to pass upon the merits, and upon doing so entered judgment for defendant United States. 142 F. Supp. 602. The Court of Appeals for the Tenth Circuit vacated the judgment and remanded with instructions to dismiss, holding that the complaint "failed to state a claim" because petitioner had not paid the entire assessment for the period in question. 246 F. 2d 929.[1] We granted certiorari, 355 U. S. 881, to resolve the conflict between that decision and *Bushmiaer* v. *United States*, 230 F. 2d 146 (C. A. 8th Cir.).[2]

The pertinent jurisdictional statute, 28 U. S. C. § 1346(a)(1), reads as follows:

> "(a) The district courts shall have original jurisdiction, concurrent with the Court of Claims, of:
>
> "(1) Any civil action against the United States for the recovery of any internal-revenue *tax* alleged to have been erroneously or illegally assessed or collected, or any *Penalty* claimed to have been collected without authority or any *sum* alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws; . . . ." [Emphasis supplied.]

In matters of statutory construction the duty of this Court is to give effect to the intent of Congress, and in doing so our first reference is of course to the literal meaning of words employed. The principle of strict construction to waivers of sovereign immunity, *United States* v. *Michel*, 282 U. S. 656 [Ct. D. 310, C. B. X–1297 (1931)], and the sharp division of opinion among the lower courts on the meaning of the pertinent statutory language suggest the presence of ambiguity in what might otherwise be termed a clear authorization to sue for the refund of "any sum." Consequently, a thorough consideration of the relevant legislative history is required.

Section 1346 was originally enacted as Section 1310(c) of the Revenue Act of 1921.[3] Its essential language seems to have been copied from R. S. § 3226, the predecessor of the present claim-for-refund statute, 26 U. S. C. § 7422(a). Those statutes use language identical to that appearing above to provide that no suit for the refund of a "tax," "penalty," or "sum" shall be maintained until similar relief has been sought from the Secretary or his delegate.[4] The meaning that has been ascribed to this language in the claim-for-refund statute provides the key to what Congress intended when it used that language in the jurisdictional provision.

The original claim-for-refund statute, Section 19 of the Revenue Act of July 13, 1866, provided that no suit should be maintained in any court for the recovery of "any tax alleged to have been erroneously or illegally assessed or collected, until appeal shall have been duly made to the commissioner of internal revenue . . . ."[5] On this "appeal" the Commissioner was empowered to "remit, refund, and pay back" all taxes or penalties improperly assessed or collected.[6] When the appeal requirement was restated in Section 3226 of the Revised Statutes,[7] Congress added the "penalty" and "sum" clauses, bringing together for the first time the three-way division that survives in 26 U. S. C. § 7422(a) and 28 U. S. C. § 1346(a)(1). The revisers left no indication of what significance, if any, was to be attached to this addition.

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[1] See also *Suhr* v. *United States*, 18 F. 2d 81 (C. A. 3d Cir.) [T. D. 4033, C. B. VI–2, 135 (1927)]. But cf. *Sirian Lamp Co.* v. *Manning*, 123 F. 2d 776 (C. A. 3d Cir.).

[2] See also *Sirian Lamp Co.* v. *Manning*, 123 F. 2d 776 (C. A. 3d Cir.); *Coates* v. *United States*, 111 F. 2d 609 (C. A. 2d Cir.). But cf. *Bendheim* v. *Commissioner*, 214 F. 2d 26, 28 (C. A. 2d Cir.); *Elbert* v. *Johnson*, 164 F. 2d 421, 423–424 (C. A. 2d Cir.).

[3] 42 Stat. 311.

[4] 26 U. S. C. § 7422(a): "No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof." R. S. § 3226 is quoted in note 7, *infra*.

[5] 14 Stat. 152.

[6] 14 Stat. 111.

[7] "No suit shall be maintained in any court for the recovery of [1] any internal tax alleged to have been erroneously or illegally assessed or collected, or of [2] any penalty claimed to have been collected without authority, or of [3] any sum alleged to have been excessive or in any manner wrongfully collected, until appeal shall have been duly made to the Commissioner of Internal Revenue. . . ." R. S. § 3226.

This language is practically identical to that used by the 1866 Act in giving the Commissioner his refunding powers. 14 Stat. 111, restated in R. S. § 3220. The first category dates back to the 1863 Act. 12 Stat. 729. The third category was added in 1864. 13 Stat. 239. The 1866 Act rounded out the three categories by adding the second. 14 Stat. 111. An examination of the legislative history discloses no indication of the purpose of these successive additions.

During the period of this formative legislation refund suits could not be brought against the United States because if its sovereign immunity. Tax litigation took the form of an action of assumpsit against the collector. See *Philadelphia* v. *Collector*, 5 Wall. 720.[8] Such suits were of course subject to the provision in Section 19 of the 1866 Act that they must be preceded by "appeal" to the Commissioner. The meaning of that command, which later became R. S. § 3226 and eventually, as amended, 26 U. S. C. § 7422(a), was considered in *Cheatham* v. *United States*, 92 U. S. 85. There, in response to an appeal the Commissioner of Internal Revenue had set aside the first assessment of taxpayer's 1864 income taxes and directed the local assessor to make a second one. The taxpayer paid the second assessment and sued the collector for refund. The Court held that by failing to appeal from the second assessment the taxpayer failed to comply with Section 19 and hence had no right of action. In the course of its opinion the Court made this careful statement of the remedies then available to taxpayers who sought to contest the correctness of their tax:

> "So, also, in the internal-revenue department, the statute which we have copied allows appeals from the assessor to the commissioner of internal revenue; and, if dissatisfied with his decision, *on paying the tax* the party can sue the collector; and, if the money was wrongfully exacted, the courts will give him relief by a judgment, which the United States pledges herself to pay.
>
> ". . . While a free course of remonstrance and appeal is allowed within the departments before the money is finally exacted, the general government has wisely made *the payment of the tax claimed*, whether of customs or of internal revenue, a condition precedent to a resort to the courts by the party against whom the tax is assessed . . . If the compliance with this condition [that suit must be brought within six months of the Commissioner's decision] requires the party aggrieved to pay the money, he must do it. He cannot, after the decision is rendered against him, protract the time within which he can contest that decision in the courts by his own delay in paying the money. It is essential to the honor and orderly conduct of the government that its taxes should be promptly paid, and drawbacks speedily adjusted; and the rule prescribed in this class of cases is neither arbitrary nor unreasonable . . .
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> "The objecting party can take his appeal. He can, if the decision is delayed beyond twelve months, rest his case on that decision; or he can *pay the amount claimed*, and commence his suit at any time within that period. So, after the decision, he can pay at once, and commence suit within the six months. . . ."[9] (Emphasis added.)

From this carefully considered dictum it is unmistakably clear that the Court understood the statutes of that time to require full payment of an assessed tax as a condition precedent to the right to sue the collector for a refund. This understanding of the statutory scheme appears to have prevailed for the succeeding fifty or sixty years. It was never suggested that the addition in R. S. § 3226 of the clause beginning "any sum" effected any change. The *Cheatham* case was decided after that addition was made, and it gave no indication that the "condition precedent" of which it spoke had already been abrogated by Congress. Consistent with that understanding, there does not appear to be a single case before 1940 in which a taxpayer attempted a suit for refund of income taxes without paying the full amount the Government alleged to be due. Court opinions that took occasion to comment on the extent of payment are consistent with the *Cheatham* declaration,[10] and that case has continued to be cited with approval to

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[8] Initially such suits depended upon diversity jurisdiction. *Collector* v. *Hubbard*, 12 Wall 1. Later Congress created jurisdiction for "all causes arising under any law providing internal revenue. . . ." R. S. § 629 (4). With slight modification that provision became Section 24 (5) of the Judicial Code, 36 Stat. 1092, and is presently 28 U. S. C. § 1340. See *Lowe Bros. Co.* v. *United States*, 304 U. S. 302, 305 [Ct. D. 1347, C. B. 1938–1, 327].

[9] 92 U. S., at 88–89.

[10] *Kings County Savings Institution* v. *Blair*, 116 U. S. 200, 205 (1885) ("No claim for the refunding of taxes can be made according to law and the regulations until after the taxes have been paid [and] . . . no suit can be maintained for taxes illegally collected unless a claim therefor has been made within the time prescribed by the law."); *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 609 (1894) (dissenting opinion) ("The same authorities [including the *Cheatham* case] have established the rule that the proper course, in a case of illegal taxation, is to pay the tax under protest or with notice of suit, and then bring an action against the officer who collected it."); *Dodge* v. *Osborn*, 240 U. S. 118, 120 (1915) ("The remedy of a suit to recover back the tax after it is paid is provided by statute. . . ."); see note 20, *infra*.

the present day.[11] Such was the understanding of the necessity for full payment in the suit against the collector.

Since the statute now under consideration, 28 U. S. C. § 1346(a)(1), employs language identical to that in the statute under which the full-payment understanding developed, R. S. § 3226, a construction requiring full payment would appear to be more consistent with the established meaning of the statutory language. Furthermore, the situation with respect to tax suits against the United States at the time 28 U. S. C. § 1346(a)(1) was enacted, the express purpose of its enactment, and subsequent expressions of congressional intent all suggest that the principle of full payment was to be preserved.

The jurisdictional provision that is now 28 U. S. C. § 1346(a)(1) was first enacted in Section 1310(c) of the Revenue Act of 1921.[12] At that time the United States was already suable in the District Courts. Since 1887 the Tucker Act had allowed suit against the United States for claims less than $10,000 "founded upon * * * any law of Congress * * * ,"[13] and that language included suits to obtain refund of income taxes. *United States* v. *Emery, Bird, Thayer, Realty Co.*, 237 U. S. 28. Since R. S. § 3226 was cast in the broadest of terms, its requirement that refund suits be preceded by an "appeal" to the Commissioner clearly applied to the Tucker Act cases, *United States* v. *Michel*, 282 U. S. 656, and the related requirement that full payment must be made prior to suit seems to have been assumed to be equally applicable. For amounts in excess of the $10,000 Tucker Act limitation the taxpayer could invoke his old remedy against the collector.

The complementary nature of the two District Court remedies was impaired when this Court re-emphasized the rule requiring the collector to be sued personally. A suit against the office or the successor in office of a deceased collector could not be maintained. *Smietanka* v. *Indiana Steel Co.*, 257 U. S. 1 (1921) [Ct. D. 17, C. B. 5, 251 (1921)]. Senator Jones of New Mexico interrupted floor debate on the Revenue Act of 1921 to call attention to this decision. In his view it meant that when the particular collector was dead a taxpayer suing for more than $10,000 had to bring suit in the Court of Claims. In addition to the extra expense and inconvenience of litigating in Washington, a Court of Claims judgment carried no interest. The Senator proposed an amendment, stating:

> "What is here proposed is that we shall remedy that situation by providing that where the collector to whom the revenue was paid has died then the claimant may sue the United States. It simply brings about an equitable situation and prevents the taxpayer from having to suffer the hardships which would be brought upon him simply through the accident of the death of the collector to whom he paid the money. I offer the amendment for the purpose of remedying that situation."[14]

The amendment, which was accepted without further comment, conferred jurisdiction on the District Court,

> "Concurrent with the Court of Claims, of any suit or proceeding, commenced after the passage of the Revenue Act of 1921, for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws, even if the claim exceeds $10,000, if the collector of internal revenue by whom such tax, penalty, or such was collected is dead at the time such suit or proceeding is commenced."[15]

The amendment's narrow-stated purpose refutes any suggestion that Congress intended further to expand or even to restate the jurisdiction of the District Court in refund suits brought against the United States. As we have seen, the District Courts already had such jurisdiction under the Tucker Act, and there is no indication that Congress intended any change in the terms on which that action was made available other than the change that was clearly set forth. The statute that

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[11] *E. g., Phillips* v. *Commissioner*, 283 U. S. 589, 595 [Ct. D. 350, C. B. X–1, 264 (1931)]; *United States* v. *Jefferson Electric Co.*, 291 U. S. 386, 395–396 [Ct. D. 803, C. B. XIII–1, 393 (1934)]; *Dobson* v. *Commissioner*, 320 U. S. 489, 496 [Ct. D. 1597, C. B. 1944, 56].

[12] 42 Stat. 311.

[13] 24 Stat. 505, 28 U. S. C. § 1346(a)(2).

[14] 61 Cong. Rec. 7506–7507.

[15] 61 Cong. Rec. 7507. A second amendment provided that interest should be allowed in any judgment against the United States in these refund suits. *Ibid.* A special amendment in 1925 added the right to bring such refund suits when the collector "is not in office." 43 Stat. 972.

is now 28 U. S. C. § 1346(a)(1) was enacted merely to remove the jurisdictional amount limitation of the Tucker Act in the special situation where the collector could not be sued. See *Lowe Bros. Co.* v. *United States*, 304 U. S. 302, 305. The House Conference Report and a contemporary Treasury Department declaration confirm this view of the statute's effect.[16]

The similarity of essential language leaves no doubt that the terms of the jurisdictional provision were copied from the claim-for-refund statute, R. S. § 3226, as amended by Section 1318 of the Revenue Act of 1921.[17] The fact that this language had for many years been considered to require full payment before suing the collector, and the fact that the avowed purpose of the 1921 amendment was merely to cure an inadequacy in the suit against the collector, combine as persuasive indications that no change was intended in the full-payment principle declared in *Cheatham* v. *United States*, *supra*.

When Congress created the Board of Tax Appeals in 1924,[18] it demonstrated a clear understanding that refund suits could only be maintained upon full payment of the tax alleged to be due. The House Committee proposing the bill explained its purpose as follows:

> "The committee recommends the establishment of a Board of Tax Appeals to which a taxpayer may appeal prior to the payment of an additional assessment of income, excess-profits, war-profits, or estate taxes. Although a taxpayer may, after payment of his tax, bring suit for the recovery thereof and thus secure a judicial determination of the questions involved, he can not, in view of section 3224 of the Revised Statutes, which prohibits suits to enjoin the collection of taxes, secure such a determination prior to the payment of the tax. The right of appeal after payment of the tax is an incomplete remedy, and does little to remove the hardship occasioned by an incorrect assessment. The payment of a large additional tax on income received several years previous and which may have, since its receipt, been either wiped out by subsequent losses, invested in nonliquid assets, or spent, sometimes forces taxpayers into bankruptcy, and often causes great financial hardship and sacrifice. These results are not remedies by permitting the taxpayer to sue for the recovery of the tax after his payment. He is entitled to an appeal and to a determination of his liability for the tax prior to its payment." [19]

Petitioner argues that the "hardship" the Board of Tax Appeals was created to alleviate was not the taxpayer's inability to sue without paying the whole tax—for petitioner erroneously concludes that the 1921 amendment conferred that right—but the Government's power to collect the balance due while a refund suit was in progress. But the Committee Report quoted above clearly demonstrates that the hardship about which the Congress was concerned was the hardship of pre-litigation payment, not post-litigation collection. *Old Colony Trust Co.* v. *Commissioner of Internal Revenue*, 279 U. S. 716, 721 [20] [Ct. D. 80, C. B. VIII–2, 222 (1929)]

The final step in the evolvement of 28 U. S. C. § 1346(a)(1) took place in the Act of July 30, 1954,[21] which removed the $10,000 jurisdictional limitation and eliminated the condition about the collector being dead or out of office. Far from indicating an intent to allow suit without full payment of the tax due, the legislative history of that amendment shows a clear understanding of the *Cheatham* requirement, and demonstrates a narrow purpose in no way inconsistent with that requirement. The House Report states:

> "The purpose of this bill is to permit taxpayers a greater opportunity to sue the United States in the district court of their own residence to recover taxes which they feel have been wrongfully collected. This is done by removing the jurisdictional limitation of $10,000 now imposed on such suits." [22]

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[16] H. R. Rep. No. 486, 67th Cong., 1st Sess. 57; II–1 Cum. Bull. 224, 225.
[17] 42 Stat. 314. The 1921 Act substituted "claim for refund or credit" where the statute formerly referred to an "appeal" to the Commissioner.
[18] 43 Stat. 336.
[19] H. R. Rep. No. 179, 68th Cong., 1st Sess. 7. The Senate Committee on Finance made a similar explanation. S. Rep. No. 398, 68th Cong., 1st Sess. 8.
[20] "The Board of Tax Appeals . . . was created by Congress to provide taxpayers an opportunity to secure an independent review of the Commissioner of Internal Revenue's determination of additional income and estate taxes by the board in advance of their paying the tax found by the Commissioner to be due. Before the Act of 1924 the taxpayer could only contest the Commissioner's determination of the amount of the tax after its payment."
[21] 68 Stat. 589.
[22] H. R. Rep. No. 659, 83d Cong., 1st Sess. 1.

In explaining the present state of the law the Report goes on to point out that a taxpayer may contest a deficiency assessment by a petition in the Tax Court. "The taxpayer may, however," the Report continues, "elect to pay his tax and thereafter bring suit to recover the amount claimed to have been illegally exacted." [23]

The foregoing study of the legislative history of 28 U. S. C. § 1346(a)(1) and related statutes leaves no room for contention that their broad terms were intended to alter in any way the *Cheatham* principle of "pay first and litigate later." [24] For many years that principle has been reinforced by the rule that no suit can be maintained for the purpose of restraining the assessment or collection of any tax.[25] More recently, Congress took care to except from the operation of the Federal Declaratory Judgments Act any controversies "with respect to Federal taxes." [26] To ameliorate the hardship produced by these requirements Congress created a special court where tax questions could be adjudicated in advance of any payment. But there is no indication of any intent to create the hybrid remedy for which petitioner contends.

It is suggested that a part-payment remedy is necessary for the benefit of a taxpayer too poor to pay the full amount of the tax. Such an individual is free to litigate in the Tax Court without any advance payment. Where the time to petition that court has expired, or where for some other reason a suit in the District Court seems more desirable, the requirement of full payment may in some instances work a hardship. But since any hardship would grow out of an opinion whose effect Congress in successive statutory revisions has made no attempt to alter, if any amelioration is required it is now a matter for Congress, not this Court.

The judgment of the Court of Appeals is

Affirmed.

MR. JUSTICE WHITTAKER, believing that *Bushmiaer* v. *United States*, 230 F. 2d 146 (C. A. 8th Cir.); *Sirian Lamp Co.* v. *Manning*, 123 F. 2d 776 (C. A. 3d Cir.), and *Coates* v. *United States*, 111 F. 2d 609 (C. A. 2d Cir.), properly apply the statutes involved and should be followed, would reverse the judgment below.

CHAPTER 77.—MISCELLANEOUS PROVISIONS

SECTION 7510.—EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES

(Also Sections 4001, 4011, 4021, 4031.) Rev. Rul. 58–592

Retail sales of clocks and watches to an agency of the United States Government for its use are not exempt from the retailers excise tax on jewelry and related items imposed by section 4001 of the Internal Revenue Code of 1954.

Advice has been requested whether retail sales of clocks and watches to an agency of the United States Government for its use are exempt from the retailers excise tax on jewelry and related items.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon retail sales of jewelry and related items, including clocks and watches.

Section 7510 of the Code, relating to the exemption from tax of domestic goods purchased for the United States, provides that the privilege existing by provision of law on December 1, 1873, or thereafter, of purchasing supplies of goods imported from foreign countries for the use of the United States, duty free, shall be extended, under

[23] *Id.*, at 2. And see S. Rep. No. 115, 83d Cong., 1st Sess.
[24] *Allen* v. *Regents of University System of Ga.*, 304 U. S. 439, 456 (concurring opinion). [Ct. D. 1344, C. B. 1938–1, 530].
[25] 14 Stat. 475 (1867), re-enacted in R. S. § 3224, presently in force as 26 U. S. C. § 7421.
[26] 49 Stat. 1027, 28 U. S. C. § 2201. See S. Rep. No. 1240, 74th Cong., 1st Sess. 11.

such regulations as the Secretary of the Treasury or his delegate may prescribe, to all articles of domestic production which are subject to tax by provisions of the Internal Revenue Code of 1954.

Section 301.7510–1 of the Regulations on Procedure and Administration, relating to miscellaneous provisions, provides that for any regulations under section 7510 of the Code, the applicable regulations with respect to the various taxes should be consulted.

Section 320.20(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that sales of articles by the retailer to the United States on or after June 1, 1944, are not exempt from tax unless the sale is made pursuant to a contract entered into prior to such date, or to any agreement or change order supplemental to such contract bearing the same Government contract number.

Section 7510 of the Code relates to those products which are subject to excise tax upon the manufacture thereof, with payment postponed until the products are withdrawn from consumption or sale. There is no provision in the law or regulations under which exemption from the retailers excise tax is extended to sales to an agency of the United States for its exclusive use. Accordingly, it is held that sales at retail of clocks and watches to an agency of the United States are not exempt from the excise tax on jewelry and related items imposed by section 4001 of the Code.

SECTION 7512.—SEPARATE ACCOUNTING FOR CERTAIN COLLECTED TAXES, ETC.

26 CFR 301.7512–1: Separate accounting for certain collected taxes. T. D.6299 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER 1

SUBCHAPTER C, PART 39.—MONTHLY RETURNS AND PAYMENT OF EMPLOYMENT TAXES

SUBCHAPTER D, PART 149.—MONTHLY RETURNS AND PAYMENT OF EXCISE TAXES

SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Regulations relating to monthly returns and payment of employment taxes and excise taxes; and Regulations on Procedure and Administration amended to conform to amendments made to chapter 77 of the Internal Revenue Code of 1954 by Act of February 11, 1958 (Public Law 85–321), relating to separate accounting for certain collected taxes.

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 6, 1958, notice of proposed rulemaking was published in the Federal Register (23 F. R. 3004) with respect to regulations relating

[1] The publication of this Treasury Decision in 23 F. R. 5006, dated July 1, 1958, contains (1) instructions for modifying the notice of proposed rule making published in 23 F. R. 3004, dated May 6, 1958, 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 monthly returns and payment of employment taxes and excise taxes, and to separate accounting for certain collected taxes pursuant to section 7512 of the Internal Revenue Code of 1954, as added by the Act of February 11, 1958 (Public Law 85–321, 72 Stat. 5, C. B. 1958–1, 629). After consideration of all such relevant material as was presented by interested persons regarding the rules proposed, regulations are hereby adopted.

Regulations on Monthly Returns and Payment of Employment Taxes (26 CFR Part 39)

PARAGRAPH 1. The following regulations, relating to monthly returns and payment of certain employment taxes imposed by subtitle C of the Internal Revenue Code of 1954, are hereby prescribed under those administrative provisions of subtitle F of such Code which are applicable to such taxes:

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39.1–6 Application of regulations.

AUTHORITY: §§ 39.1–1 to 39.1–6, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 39.1–1 INTRODUCTION.—(a) The purpose of the regulations in this part is to provide rules for (1) the filing by employers, under certain circumstances, of monthly returns of employment taxes in lieu of quarterly returns, (2) the payment of the taxes required to be reported on such monthly returns, (3) the filing of quarterly information returns disclosing information similar to the information called for in Schedule A of Form 941, Form 941PR, or Form 941VI, and (4) the filing of Forms W–3 or similar statements, together with the district director's copies of Forms W–2, by employers who are required to file such monthly returns.

(b) The terms used in the regulations in this part have the same meaning as when used in the Employment Tax Regulations (Part 31 of this chapter), and as when used in Regulations 120 (26 CFR (1939) Part 406), and Regulations 128 (26 CFR (1939) Part 408), whichever is appropriate, to the extent such Regulations 120 and 128 are not superseded by such Employment Tax Regulations.

§ 39.1–2 MONTHLY TAX RETURNS.—(a) *Requirement.*—(1) The provisions of this section are applicable in respect of the taxes reportable on Form 941, Form 941PR, or Form 941VI pursuant to § 406.601 of Regulations 120 (26 CFR (1939) 406.601) or § 408.601 of Regulations 128 (26 CFR (1939) 408.601). An employer who is required by such § 406.601 or § 408.601 to make quarterly returns on any such form shall, in lieu of making such quarterly returns, make returns of such taxes in accordance with the regulations in this part if he is so notified in writing by the district director. The district director may so notify any employer (i) who, by reason of notification as provided in § 301.7512–1 of the Regulations on Procedure and Administration (Part 301 of this chapter), is required to comply with the provisions

of such § 301.7512–1, or (ii) who has failed to (*a*) make any such return on Form 941, Form 941PR, or Form 941VI, (*b*) pay tax reportable on any such form, or (*c*) deposit any such tax pursuant to regulations relating to section 6302(c) of the Code, at the time and in the manner prescribed by applicable regulations. Every employer so notified by the district director shall make a return for the calendar month in which the notice is received and for each calendar month thereafter (whether or not wages are paid in any such month) until he has filed a final return or is required to make quarterly returns pursuant to notification as provided in paragraph (b) of this section. However, if the notice provided for in this subparagraph is received after the close of the first month of a calendar quarter, the first return under this section shall be made for the period beginning with the first day of such quarter and ending with the last day of the month in which the notice is received.

(2) Each return required under this section shall be made on the form prescribed for making the return which would otherwise be required of the employer under the provisions of § 406.601 of Regulations 120 (26 CFR (1939) 406.601) or § 408.601 of Regulations 128 (26 CFR (1939) 408.601), except that, if some other form is furnished by the district director for use in lieu of such prescribed form, the return shall be made on such other form.

(3) Each return required under this section shall be filed on or before the fifteenth day following the period for which it is made. No extension of time for filing such return may be granted by the district director.

(b) *Termination of requirement.*—The district director, in his discretion, may notify the employer in writing that he shall discontinue the filing of monthly returns under this section. If the employer is so notified, the last month for which a return shall be made under this section is the last month of the calendar quarter in which such notice of discontinuance is received. Thereafter, the employer shall make quarterly returns in accordance with the provisions of § 406.601 of Regulations 120 (26 CFR (1939) 406.601) or § 408.601 of Regulations 128 (26 CFR (1939) 408.601).

§ 39.1–3 Payment of Tax.—(a) The taxes required to be reported on each return required pursuant to § 39.1–2 are due and payable to the district director at the time prescribed in paragraph (a)(3) of § 39.1–2 for filing such return.

(b) The provisions of paragraph (b) of § 406.606 of Regulations 120 (26 CFR (1939) 406.606) and of paragraph (b) of § 408.607 of Regulations 128 (26 CFR (1939) 408.607), relating to deposits of taxes pursuant to section 6302(c) of the Internal Revenue Code of 1954, do not apply to taxes for the month in which the employer receives notice from the district director that returns are required under § 39.1–2, or for any subsequent month for which such a return is required.

§ 39.1–4 Information Returns or Statements.—(a) *Federal Insurance Contributions Act.*—(1) Every employer who is required under § 39.1–2 to make a return of tax under the Federal Insurance Contributions Act for any period within a calendar quarter shall make an information return for such calendar quarter. The information

reported on such return shall include, with respect to each employee to whom the employer pays wages as defined in the Federal Insurance Contributions Act, the account number of the employee, the employee's name, the total amount of such wages paid by the employer to the employee during the calendar quarter, and such other information as may be called for on the form provided for making such return.

(2) Each return required under subparagraph (1) of this paragraph shall be made on Schedule A of Form 941, or the equivalent schedule of Form 941PR or Form 941VI, except that, if some other form or schedule is furnished by the district director for the purpose of making the return required by subparagraph (1) of this paragraph, the return shall be made on such other form or schedule.

(3) Each information return required under this paragraph shall be filed on or before the fifteenth day following the calendar quarter for which it is made, except that, if a tax return under § 39.1–2 is made as a final return for a period ending prior to the last day of a calendar quarter, the information return shall be filed on or before the fifteenth day following the period for which the tax return is filed.

(b) *Income tax withheld from wages.*—(1) Every employer who is required under § 39.1–2 to make a return of income tax withheld from wages for a period ending December 31, or for any period for which such return is made as a final return, shall make an information statement for the calendar year which includes such period.

(2) Each information statement required under subparagraph (1) of this paragraph shall be made on Form W–3, except that, if some other form is furnished by the district director for use in lieu of Form W–3, the information statement shall be made on such other form. The information statement shall be accompanied by the district director's copy of each withholding statement on Form W–2 required to be furnished by the employer with respect to wages paid during the calendar year (as well as such copy of each corrected statement for a prior year).

(3) Each information statement required by this paragraph shall be filed on or before January 31 following the calendar year, except that, if a return under § 39.1–2 is filed as a final return for a period ending prior to December 31, the information statement shall be filed on or before the last day of the month following such period.

§ 39.1–5 Extensions of Time for Filing Information Returns.—The district director may, upon application of the employer, grant an extension of time in which to file any information return required under paragraph (a) of § 39.1–4. Such extension of time shall not extend beyond the last day of the calendar month in which occurs the due date prescribed in paragraph (a) of § 39.1–4 for filing the information return. Each application for an extension of time for filing an information return shall be made in writing, shall be addressed to the district director with whom the employer will file the return, and shall contain a full recital of the causes for the delay. The application shall be filed with the district director on or before the due date prescribed in paragraph (a) of § 39.1–4 for filing the return.

§ 39.1–6 Application of Regulations.—The regulations in this part supplement and modify provisions of existing regulations relating to returns, deposits, and payments of employment taxes, and shall be

applicable after June 30, 1958, notwithstanding any existing regulation to the contrary.

Regulations on Monthly Returns and Payment of Excise Taxes (26 CFR Part 149)

PAR. 2. The following regulations, relating to monthly returns and payment of certain excise taxes imposed by subtitle D of the Internal Revenue Code of 1954, are hereby prescribed under those administrative provisions of subtitle F of such Code which are applicable to such taxes:

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Section
149.1–1 Introduction.
149.1–2 Monthly tax returns.
149.1–3 Payment of tax.
149.1–4 Application of regulations.

AUTHORITY: §§ 149.1–1 to 149.1–4, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 149.1–1 INTRODUCTION.—The purpose of the regulations in this part is to provide rules for (a) the filing, under certain circumstances, of monthly returns of excise taxes in lieu of quarterly returns, and (b) the payment of the taxes required to be reported on such monthly returns.

§ 149.1–2 MONTHLY TAX RETURNS.—(a) *Requirement.*—(1) The provisions of this section are applicable in respect to the taxes reportable on Form 720 pursuant to § 477.3(a) of Treasury Decision 6025, approved July 3, 1953 [C. B. 1953–2, 400] (26 CFR (1939) 1957 Supp., 477.3(a)). A person who is required by such § 477.3(a) to make quarterly returns on Form 720 shall, in lieu of making such quarterly returns, make returns of such taxes in accordance with the regulations in this part if he is so notified in writing by the district director. The district director may so notify any person (i) who, by reason of notification as provided in § 301.7512–1 of the Regulations on Procedure and Administration (Part 301 of this chapter), is required to comply with the provisions of such § 301.7512–1, or (ii) who failed to (*a*) make any such return on Form 720, (*b*) pay any tax reportable on Form 720, or (*c*) deposit any such tax pursuant to regulations relating to section 6302(c) of the Code, at the time and in the manner prescribed by applicable regulations. Every person so notified by the district director shall make a return for the calendar month in which the notice is received and for each calendar month thereafter (whether or not tax liability is incurred in any such month) until he has filed a final return or is required to make quarterly returns pursuant to notification as provided in paragraph (b) of this section. However, if a person filing returns on a quarterly basis receives the notice provided for in this subparagraph after the close of the first month of a calendar quarter, the first return under this section shall be made for the period beginning with the first day of such quarter and ending with the last day of the month in which the notice is received.

(2) Each return required under this section shall be made on Form 720, except that, if some other form is furnished by the district director for use in lieu of Form 720, the return shall be made on such other form.

(3) Each return required under this section shall be filed on or

before the fifteenth day following the period for which it is made. No extension of time for filing such return may be granted by the district director.

(b) *Termination of requirement.*—The district director, in his discretion, may notify the person in writing that he shall discontinue the filing of monthly returns under this section. If the person is so notified, the last month for which a return shall be made under this section is the last month of the calendar quarter in which such notice of discontinuance is received. Thereafter, the person shall make quarterly returns in accordance with the provisions of § 477.3(a) of Treasury Decision 6025 (26 CFR (1939) 1957 Supp., 477.3(a)).

§ 149.1–3 PAYMENT OF TAX.—(a) The taxes required to be reported on each return required pursuant to § 149.1–2 are due and payable to the district director at the time prescribed in paragraph (a)(3) of § 149.1–2 for filing such return.

(b) The provisions of § 477.4(c) of Treasury Decision 6025 (26 CFR (1939) 1957 Supp., 477.4(c)), relating to deposits of taxes pursuant to section 6302 (c) of the Internal Revenue Code of 1954, do not apply to taxes for any month, required to be reported on a return made pursuant to § 149.1–2, unless the due date prescribed in such § 477.4(c) for making the deposit for such month occurs prior to the due date prescribed in paragraph (a)(3) of § 149.1–2 for filing such return.

§ 149.1–4 APPLICATION OF REGULATIONS.—The regulations in this part supplement and modify provisions of existing regulations relating to returns, deposits, and payments of excise taxes, and shall be applicable after June 30, 1958, notwithstanding any existing regulation to the contrary. However, any notice in effect under the provisions of § 477.3(b) of Treasury Decision 6025 (26 CFR (1939) 1957 Supp., 477.3(b)) requiring the filing of a return for the month in which the regulations in this part are published in the Federal Register shall continue in effect as a notice under § 149.1–2 received in the month following the month of such publication.

Regulations on Procedure and Administration (26 CFR Part 301)

PAR. 3. The Regulations on Procedure and Administration (26 CFR Part 301) are amended to conform to the amendments made to chapter 77 of the Internal Revenue Code of 1954 by the Act of February 11, 1958 (Public Law 85–321, 72 Stat. 5 [I. R. B. 1958–11, 53]), relating to separate accounting for certain collected taxes, by inserting immediately after § 301.7511 the following new sections:

§ 301.7512 STATUTORY PROVISIONS; SEPARATE ACCOUNTING FOR CERTAIN COLLECTED TAXES, ETC.

SEC. 7512. SEPARATE ACCOUNTING FOR CERTAIN COLLECTED TAXES, ETC.

(a) GENERAL RULE.—Whenever any person who is required to collect, account for, and pay over any tax imposed by subtitle C or by chapter 33—

(1) At the time and in the manner prescribed by law or regulations (A) fails to collect, truthfully account for, or pay over such tax, or (B) fails to make deposits, payments, or returns of such tax, and

(2) Is notified, by notice delivered in hand to such person, of any such failure,

then all the requirements of subsection (b) shall be complied with. In the case of a corporation, partnership, or trust, notice delivered in hand

to an officer, partner, or trustee, shall, for purposes of this section, be deemed to be notice delivered in hand to such corporation, partnership, or trust and to all officers, partners, trustees, and employees thereof.

(b) REQUIREMENTS.—Any person who is required to collect, account for, and pay over any tax imposed by subtitle C or by chapter 33, if notice has been delivered to such person in accordance with subsection (a), shall collect the taxes imposed by subtitle C or chapter 33 which become collectible after delivery of such notice, shall (not later than the end of the second banking day after any amount of such tax is collected) deposit such amount in a separate account in a bank (as defined in section 581), and shall keep the amount of such taxes in such account until payment over to the United States. Any such account shall be designated as a special fund in trust for the United States, payable to the United States by such person as trustee.

(c) RELIEF FROM FURTHER COMPLIANCE WITH SUBSECTION (b).—Whenever the Secretary or his delegate is satisfied, with respect to any notification made under subsection (a), that all requirements of law and regulations with respect to the taxes imposed by subtitle C or chapter 33, as the case may be, will henceforth be complied with, he may cancel such notification. Such cancellation shall take effect at such time as is specified in the notice of such cancellation.

[Sec. 7512 as added by sec. 1, Act of Feb. 11, 1958 (Pub. Law 85-321, 72 Stat. 5)]

§ 301.7512-1 SEPARATE ACCOUNTING FOR CERTAIN COLLECTED TAXES.—(a) *Scope.*—The provisions of section 7512 and this section apply to—

(1) The following taxes imposed by subtitle C of the Code in respect of wages or compensation paid after February 11, 1958, for pay periods beginning after such date:

(i) The employee tax imposed by section 3101 of chapter 21 (Federal Insurance Contributions Act),

(ii) The employee tax imposed by section 3201 of chapter 22 (Railroad Retirement Tax Act), and

(iii) The income tax required to be withheld on wages by section 3402 of chapter 24 (Collection of Income Tax at Source on Wages); and

(2) The following taxes imposed by chapter 33 of the Code in respect of taxable payments made after February 11, 1958:

(i) The taxes imposed by section 4231 (1), (2), and (3) on amounts paid for admissions,

(ii) The taxes imposed by section 4241 on amounts paid as club dues,

(iii) The taxes imposed by section 4251 on amounts paid for communications services or facilities,

(iv) The taxes imposed by sections 4261 and 4271 on amounts paid for transportation of persons and property, respectively, and

(v) The tax imposed by section 4286 on amounts collected for the use of safe deposit boxes.

(b) *Requirement.*—If the district director determines that any person required to collect, account for, and pay over to any tax described in paragraph (a) of this section has, at the time and in the manner prescribed by law or regulations, failed to collect truthfully account for, or pay over any such tax, or make deposits, payments, or returns of any such tax, such person, if notified to do so by the district director in accordance with section 7512 and paragraph (d) of this section, shall—

(1) Collect, at the times and in the manner provided by the law and the regulations in respect of the various taxes described in paragraph (a), all of the taxes described in such paragraph which become collectible by him after receipt of such notice;

(2) Deposit the taxes so collected, not later than the end of the second banking day after collection, with a bank, as defined in section 581, in a separate account established in accordance with paragraph (c) of this section; and

(3) Keep in such account the taxes so deposited until payment thereof is made to the United States as required by the law and the regulations in respect of such taxes.

The separate accounting requirements contained in subparagraphs (1), (2), and (3) of this paragraph are applicable, in the case of the taxes described in

paragraph (a)(1) of this section, to taxes with respect to wages or compensation paid after receipt of the notice from the district director, irrespective of whether such wages or compensation was earned prior to or after receipt of the notice; and, in the case of the taxes described in paragraph (a)(2) of this section, to taxes with respect to taxable payments made after receipt of the notice from the district director, irrespective of whether the transactions with respect to which such payments were made occurred prior to or after receipt of the notice.

(c) *Trust fund account.*—The separate bank account referred to in paragraph (b) of this section shall be established under the designation, "(Name of person required to establish account), Trustee, Special Fund in Trust for U. S. under Sec. 7512, I. R. C." The taxes deposited in such account shall constitute a fund in trust for the United States payable only to the Internal Revenue Service on demand by the trustee.

(d) *Notice.*—Notice to any person requiring his compliance with the provisions of section 7512(b) and this section shall be in writing and shall be delivered in hand to such person by an internal revenue officer or employee. In the case of a trade or business carried on other than as a sole proprietorship, such as a corporation, partnership, or trust, notice delivered in hand to an officer, partner, or trustee shall be deemed to be notice delivered in hand to such corporation, partnership, or trust and to all officers, partners, trustees, and employees thereof.

(e) *Cancellation of notice.*—The district director may relieve a person to whom notice requiring separate accounting has been given pursuant to section 7512 and this section from further compliance with such separate accounting requirements whenever he is satisfied that such person will comply with all requirements of the Code and the regulations applicable, in respect of the taxes to which the notice relates, in the case of persons not required to comply with the provisions of section 7512(b). Notice of cancellation of the requirement for separate accounting shall be made in writing and shall take effect at such time as is specified in the notice of cancellation.

(f) *Penalties.*—For criminal penalty for failure to comply with any provision of section 7512, see section 7215. For criminal penalties for failure to file return, supply information, or pay tax, for failure to collect or pay over tax, and for attempt to evade or defeat tax, see sections 7203, 7202, and 7201, respectively.

AUTHORITY: §§301.7512 and 301.7512–1 issued under Sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved June 27, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 30, 1958 at 8:53 a. m., and published in the issue of the Federal Register for July 1, 1958, 23 F. R. 5006.)

CHAPTER 78.—DISCOVERY OF LIABILITY AND ENFORCEMENT OF TITLE

SUBCHAPTER D.—POSSESSIONS

SECTION 7651.—ADMINISTRATION AND COLLECTION OF TAXES IN POSSESSIONS

Taxability of articles of Puerto Rican manufacture which are imported into the United States and exported to foreign countries prior to sale or use, see Rev. Rul. 58–554, page 909.

SECTION 7652.—SHIPMENTS TO THE UNITED STATES

(Also Sections 4225, 7651.) Rev. Rul. 58-554

The tax imposed by section 7652 of the Internal Revenue Code of 1954 on articles of Puerto Rican manufacture coming into the United States is applicable to any articles withdrawn from places of government supervision (*i. e.*, customs or bonded warehouses) for consumption or sale in the United States where there is a tax on the act of manufacturing as distinguished from the sale of like articles of domestic manufacture. Section 7651 of the Code does not impose on United States' possessions all taxes imposed within the United States. The manufacturers excise taxes are not applicable to articles which, though otherwise subject thereto, are imported into the United States and then exported to a foreign country prior to their sale or use.

Advice has been requested whether the manufacturers excise taxes imposed under Chapter 32 of the Internal Revenue Code of 954 apply to articles of Puerto Rican manufacture which are imported into the United States and exported to foreign countries prior to their sale or use.

A company, located in the United States, imports certain articles from Puerto Rico. These articles are manufactured in Puerto Rico but are of the type which, when manufactured, produced, or imported in the United States, are subject to the manufacturers excise taxes imposed by Chapter 32 of the Code. The importing company, however, does not use or sell the articles in the United States but exports them to foreign countries prior to any sale or use.

Section 4225 of the Code provides that no tax under Chapter 32 of the Code shall be imposed upon the sale of any article for export or for shipment to a possession of the United States, and in due course is so exported or shipped. Section 7701(c) of the Code states that, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, references in the Internal Revenue Code to possessions of the United States shall be treated as also referring to the Commonwealth of Puerto Rico.

Section 7651(1) of the Code provides that all provisions of the laws of the United States applicable to the assessment and collection of any tax imposed by the Code or of any other liability arising under the Code (including penalties) shall, in respect of such tax or liability, extend to and be applicable in any possession of the United States in the same manner and to the same extent as if such possession were a State and as if the term 'United States' when used in a geographical sense included such possession. Section 7651(2) of the Code provides further that in the case of any tax which is imposed by the Internal Revenue Code in any possession of the United States, all provisions of the laws of the United States applicable to the administration, collection, and enforcement of such tax (including penalties) shall, in respect of such tax, extend to and be applicable in such possession of the United States in the same manner and to the same extent as if such possession were a State and as if the term 'United States' when used in a geographical sense included such possession.

These sections might imply that all taxes imposed within the United States are also imposed in its possessions. However, the House Com-

mittee on Ways and Means in its Report No. 1337, March 9, 1954 (to accompany H. R. 8300, 83rd Congress, 2nd Session), states, in referring to section 7651(1) of the Code, that this section extends the collection authority and powers of the Internal Revenue Service to possessions of the United States so that if a delinquent taxpayer should remove himself or his property to a possession of the United States, the Service will have the same authority and power to collect the tax from him, or to reach his property, in the possession as it would have within the United States. In referring to section 7651(2) of the Code, the Committee Report further states that this section provides that, where tax arises within a possession, such tax shall be collected by the Secretary of the Treasury and paid into the treasury of the United States as internal revenue collections, and all laws applicable to the administration, collection, and enforcement of such tax within the United States shall also be applicable in the possession.

Section 7652(a)(1) of the Code provides that, with the exception of certain specific alcohol tax provisions, articles of merchandise of Puerto Rican manufacture coming into the United States and *withdrawn* for consumption or sale shall be subject to a tax equal to the internal revenue tax imposed in the United States upon the like articles of merchandise of domestic manufacture. The legislative history of this section indicates that the tax imposed therein has always been applicable only to articles of merchandise of Puerto Rican manufacture which are *withdrawn* from places under Government supervision (*i. e.*, customs or bonded warehouses) for consumption or sale. Under the earliest law, liquor and tobacco were the principal articles subjected to this tax. However, the general wording of the statute, references thereto by Congress, and its purpose as expressed by the Supreme Court of the United States indicate that any articles may be so subjected, provided the tax relating thereto is laid on the act of manufacturing rather than the act of sale. H. R. Report No. 249, 56th Congress; Congressional Record, 56th Congress, First Session, p. 2477; *Jordan* v. *Roche*, 228, U. S. 436, at 443 (1913). Administrative considerations and departmental policy further indicate that the only taxes imposed by section 7652 of the Code are those which can be imposed at the time of entry of the goods into the United States or at the time they are withdrawn from places of government supervision. Taxes imposed by Chapter 52 of the Code on tobacco and by Chapter 51 on the Code on liquor are examples; however, any tax on the act of manufacturing, as distinguished from a tax on the act of sale, would be within the purview of section 7652 of the Code. The manufacturers excise tax imposed by Chapter 32 of the Code and the retailers excise taxes imposed by Chapter 31 of the Code are examples of taxes excluded from the meaning of the phrase "the internal revenue tax" in section 7652(a)(1) of the Code. Those taxes are imposed on the sale and not on the act of manufacturing.

It is held, therefore, that section 7651(1) of the Code is applicable only to the administration, collection, and enforcement of taxes arising in the United States but where the delinquent taxpayer or his property is located in a possession, and section 7651(2) of the Code applies to the administration, collection, and enforcement of those taxes arising within a possession itself.

It is further held that section 7652(a) of the Code is applicable to any articles of Puerto Rican manufacture withdrawn from a place of Government supervision for consumption or sale in the United States and that such articles are subject to a tax equal to any tax on the act of manufacturing, as distinguished from a tax on the act of sale, of like articles of domestic manufacture. Finally, the manufacturers excise taxes imposed by Chapter 32 of the Code do not apply to articles of Puerto Rican manufacture upon their withdrawal from a place of Government supervision, but do apply upon their sale or use in the United States. Furthermore, under section 4225 of the Code, such articles may be sold tax-free in the United States for export provided the articles are exported in due course in accordance with section 316.25 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47.

In the instant case, since the articles imported from Puerto Rico were neither sold nor used in the United States prior to exportation to a foreign country, the manufacturers excise taxes imposed by Chapter 32 of the Code do not apply.

Oleomargarine shipped to the United States from Puerto Rico. See Rev. Rul. 58–522, page 860.

CHAPTER 79.—DEFINITIONS

SECTION 7701.—DEFINITIONS

Whether the certificates of membership held by directors of an incorporated nonprofit taxable foundation meet the capital stock requirement of a personal holding company. See Rev. Rul. 58–556, page 355.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

Introduction to and explanation of regulations relating to retailers and manufacturers excise taxes imposed by chapters 31 and 32 of the Internal Revenue Code of 1954. See T. D. 6320, page 1099.

Introduction to and explanation of regulations relating to facilities and services excise taxes imposed by Chapter 33 of the Internal Revised Code of 1954. See T. D. 6327, page 1104.

PART II

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939 AND OTHER RELATED 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 application of provisions of the Internal Revenue Code of 1939 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954, or the Federal Firearms Act or other public laws.

SUBTITLE A.—TAXES SUBJECT TO THE JURISDICTION OF THE BOARD OF TAX APPEALS

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART II.—COMPUTATION OF NET INCOME

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

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

Amounts received by the transferor, upon the transfer of rights to patents, in a case not within the scope of section 117(q) of the Code. See Rev. Rul. 58-353, page 408.

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

Taxability of annuities under United States Civil Service Retirement Act where services are performed partly within the United States and partly within a possession. See Rev. Rul. 58-472, page 30.

REGULATIONS 118, SECTION 39.22(b)(3)–1: Gifts and bequests. Rev. Rul. 58–613 [1]

In view of a number of adverse court decisions in cases involving voluntary payments to widows by their deceased husbands' employers, the Internal Revenue Service will no longer litigate, under the Internal Revenue Code of 1939, cases involving the taxability of such payments unless there is clear evidence that they were intended as compensation for services, or unless the payments may be considered as dividends. Payments which will be considered as "voluntary" in applying this policy do not include payments made pursuant to a contract or otherwise binding obligation or pursuant to a plan or statute in effect before the husband's death.

In line with this new litigation policy, field offices of the Service will similarly dispose of 1939 Code cases not yet in litigation.

The foregoing represents a litigation policy, to be implemented by consistent administrative action, pertaining to 1939 Code cases only. The position of the Service with respect to cases in this area arising under the Internal Revenue Code of 1954 involves other considerations and will be made the subject of a future announcement.

SECTION 22(c).—GROSS INCOME: INVENTORIES

REGULATIONS 118, SECTION 39.22(c)–6: Inventories of livestock raisers and other farmers.

Determination of inventories under the community property laws of the State of Texas where one spouse dies during a taxable year. See Rev. Rul. 58–393, page 174.

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. 58–451

(Also Section 23(u), Regulation 118, Section 39.23(u)–1.)

(Also Part I, Sections 71, 215; 26 CFR 1.71–1, 1.215–1.)

> Periodic payments made by a husband to his former wife may be within section 22(k) of the Internal Revenue Code of 1939 if they are made under a written instrument incident to the *status* of divorce or separate maintenance. It is not necessary that the written instrument be shown to be "in contemplation of divorce or legal separation."

Advice has been requested as to the interpretation of the phrase "incident to such divorce or separation," which appears in section

[1] Based on Technical Information Release 87, dated August 25, 1958.

22(k) of the Internal Revenue Code of 1939; that is, whether (1) the written instrument must have been made in contemplation of divorce or legal separation in order for it to be "incident" to the divorce or legal separation later obtained, and (2) whether "incident to such divorce" means "incident to such divorce *decree*" or rather "incident to such status of divorce."

Section 22(k) of the 1939 Code provides that where a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, and periodic payments received by her subsequent to such decree are imposed under such decree or "under a written instrument *incident to such divorce or separation*," the payments shall be included in the gross income of the wife. Section 23(u) of the Code, under these circumstances, allows the husband to deduct these payments from his gross income.

Several United States Courts of Appeals have rejected the notion that the written instrument must have been drawn in contemplation of divorce or legal separation. An analysis of those cases supports this proposition.

In the Second Circuit (where many of the cases have arisen), the court, in dictum, at first took the position that the payments must be made under a decree in order for the section to apply. Interpreting the phrase "incident to such divorce," the court said, "Clearly, the use of 'such' * * * has reference to the prior language, namely a separation resulting 'under a decree' * * *. Thus the periodic payments may be deducted only if made *under a decree of divorce or separate maintenance*." (Italics supplied.) *Harold S. Smith* v. *Commissioner*, 168 Fed. (2d) 446 at 447. This is the strictest position to be found and it was not followed by the later decisions of the Second Circuit. No Court of Appeals has demanded that the payments be made under a decree in order to meet the requirements of sections 22(k) and 23(u) of the 1939 Code.

The Second Circuit cases clearly rejected the "contemplation of divorce" theory. In *Joseph J. Lerner* v. *Commissioner*, 195 Fed. (2d) 296, the court stated that the statute merely required the existence of the obligation to pay at the time the decree occurs; that it is enough if the payments take the place of alimony. In *Commissioner* v. *Florence B. Moses*, 214 Fed. (2d) 912, certiorari denied, 348 U. S. 913, where the wife clearly intended there should be no divorce subsequent to the separation agreement, the court pointed out that the mere fact that she realized divorce was a possibility was sufficient. The court noted that the separation agreement was by its terms to survive divorce and the divorce followed quickly upon the separation agreement (six months later). The court quoted the *Lerner* decision, *supra*, to the effect that the payments were to take the place of alimony. In *Margaret C. Izrastzoff* v. *Commissioner*, 193 Fed. (2d) 625, the court accepted as proper evidence proof that the parties contemplated divorce at the time of the separation agreement; but, the court specifically noted that the agreement could still be "incident to" regardless of proof or absence of proof that it was "in contemplation" of divorce. Most recently, in *Harold Holt* v. *Commissioner*, 226 Fed. (2d) 757, certiorari denied, 350 U. S. 982, the court held that it is of no consequence

that neither party intends divorce at the time of the separation agreement.

The Third Circuit has taken a similar position. In *George J. Feinberg* v. *Commissioner*, 198 Fed. (2d) 260, the court specifically stated that it would not look to see what the parties contemplated. It looked rather to the fact that the separation agreement payments were to survive divorce and were to cease upon remarriage, thus clearly indicating they were in the nature of or in lieu of alimony.

The Ninth Circuit has taken a similar position, citing *Lerner*, *supra*, and *Feinberg*, *supra*, with approval, in *Commissioner* v. *Cecil A. Miller*, 199 Fed. (2d) 597. The court noted therein that the separation instrument was to survive divorce and that the divorce followed quickly (eight days), and then stated, at page 600:

> To require, in addition to all this, proof that the parties mutually planned a divorce and that the instrument was an integral part of their plan, would, we think, be to import something into the statute that Congress did not require. We think that the instrument became "incident to" the divorce in the sense of the statute at least when, in conformity with its terms, it was filed with and approved by the court granting the divorce.

The second problem is whether "incident to such divorce" means "incident to such divorce *decree*" or rather "incident to such *status* of divorce." It is the position of the Internal Revenue Service that *status* rather than *decree* was intended. *Raoul Walsh* v. *Commissioner*, 21 T. C. 1063; acquiescence C. B. 1954-2, 6. This is in accord with the interpretation of the same language in the Internal Revenue Code of 1954 as set forth in section 1.71-1(b)(1)(i) of the Income Tax Regulations.

Accordingly, it is held that periodic payments may be within section 22(k) of the 1939 Code if they are made under a written instrument incident to the *status* of divorce or separate maintenance. It is not necessary that the written instrument be shown to be "in contemplation of divorce or legal separation."

SECTION 23(a).—DEDUCTIONS FROM GROSS INCOME

REGULATIONS 118, SECTION 39.23(a)-2: Traveling expenses. Ct. D. 1832

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. DEDUCTIONS FROM GROSS INCOME—BUSINESS EXPENSES—LIVING AND TRAVELING EXPENSES WHILE AWAY FROM HOME.

Construction workers employed on projects some distance from their permanent residences for periods ranging from eight and one-half months to twenty and one-half months are not entitled to deduct, under section 23(a)(1)(A) of the 1939 Code, amounts expended for board and lodging while employed at the job site and for transportation to their permanent residences upon termination of employment, since as the case was presented their employment was not temporary. The Supreme Court of the United States held that the court below had made a fair assessment of the record on the factual determination involved.

2. DECISION AFFIRMED.

Decision of the United States Court of Appeals for the Fourth Circuit, 254 F. 2d 483, affirmed.

SUPREME COURT OF THE UNITED STATES

James E. Peurifoy, Paul V. Stines, Betty O. Stines, et al., Petitioners, v. *Commissioner of Internal Revenue.*

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

[November 10, 1958.]

PER CURIAM.

The petitioners were employed as construction workers at a site in Kinston, North Carolina, for continuous periods of 20½ months, 12½ months, and 8½ months, respectively, ending in the year 1953. Each of the petitioners maintained a permanent residence elsewhere in North Carolina. In reporting his adjusted gross income for 1953 each petitioner deducted amounts expended for board and lodging at Kinston during the period of employment there, and for transportation from Kinston to his permanent residence upon leaving that employment. These deductions were disallowed by the respondent. Ensuing Tax Court proceedings resulted in a decision in favor of the petitioners. 27 T. C. 149. The Court of Appeals reversed. 254 F. 2d 483. We granted certiorari, 356 U. S. 956, to consider certain questions as to the application of § 23(a)(1)(A) of the Internal Revenue Code of 1939* raised by the course of decisions in the lower courts since our decision in *Commissioner* v. *Flowers*, 326 U. S. 465. However, as the case has been presented to us we have found it inappropriate to consider such questions.

The issue is whether the amounts in question constituted allowable deductions under § 23(a)(1)(A). Generally, a taxpayer is entitled to deduct unreimbursed travel expenses under this subsection only when they are required by "the exigencies of business." *Commissioner* v. *Flowers*, *supra*. Application of this general rule would require affirmance of the judgment of the Court of Appeals in the present case.

To this rule, however, the Tax Court has engrafted an exception which allows a deduction for expenditures of the type made in this case when the taxpayer's employment is "temporary" as contrasted with "indefinite" or "indeterminate." Compare *Schurer* v. *Commissioner*, 3 T. C. 544; *Leach* v. *Commissioner*, 12 T. C. 20; *Albert* v. *Commissioner*, 13 T. C. 129, with *Warren* v. *Commissioner*, 13 T. C. 205; *Whitaker* v. *Commissioner*, 24 T. C. 750. The respondent does not in the present case challenge the validity of this exception to the general rule.

Resolution of this case as presented to us turns, therefore, upon a narrow question of fact—Was the petitioners' employment "temporary" or "indefinite"? The Tax Court, stating that "each case must be decided upon the basis of its own facts and circumstances," 29 T. C. 157, found that their employment was temporary. The Court of Appeals, also recognizing that the question was "one of fact," held that on the record the Tax Court's finding of temporary employment was "clearly erroneous." 254 F. 2d, at 487.

In reviewing the Tax Court's factual determination, the Court of Appeals has made a fair assessment of the record. 26 U. S. C. (Supp. 1952 ed.) § 7482; Rule 52(A), Fed. Rules Civ Proc; cf. *Universal Camera Corp.* v. *Labor Board*, 340 U. S. 474. That being so, this Court will not intervene. *Federal Trade Commission* v. *Standard Oil Co.*, 355 U. S. 396, 400–401; *Labor Board* v. *Pittsburgh S. S. Co.*, 340 U. S. 498, 502–503.

Affirmed.

MR. JUSTICE DOUGLAS, with whom MR. JUSTICE BLACK and MR. JUSTICE WHITTAKER join, dissenting, in a separate opinion.

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*"§ 23. DEDUCTIONS FROM GROSS INCOME.
"In computing net income there shall be allowed as deductions:
"(a) EXPENSES.
"(1) TRADE OR BUSINESS EXPENSES.
"(A) IN GENERAL.
"All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including . . . traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; . . . ." (26 U. S. C. (1952 ed.) § 23(a)(1)(A).)

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

REGULATIONS 118, SECTION 39.23(u)-1:
Periodic alimony payments.

Periodic payments to a divorced wife not incident to a decree of divorce. See Rev. Rul. 58-451, page 914.

SECTION 26.—CREDITS OF CORPORATIONS

REGULATIONS 111, SECTION 29.26-5: Credit for dividends paid on preferred stock of public utilities.

Credit in respect of dividends paid on public utility preferred stock issued on or after October 1, 1942, to replace preferred stock issued by another corporation not a "public utility" at the time of such replacement. See Rev. Rul. 58-621, below.

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

REGULATIONS 118, SECTION 39.26(h)-1: Credit for dividends paid on preferred stock of public utilities. Rev. Rul. 58-621
(Also Regulations 111, Section 29.26-5.)
(Also Part I, Section 247; 26 CFR 1.247-1.)

A public utility will not be denied the dividends paid credit in respect of dividends paid on preferred stock issued by it on or after October 1, 1942, to replace preferred stock issued prior to such date by another corporation merely because such other corporation, at the time of replacement, was not a "public utility" within the meaning of section 26(h)(2)(A) of the Internal Revenue Code of 1939. Revenue Ruling 57-45, C. B. 1957-1, 509, revoked.

Reconsideration has been given by the Internal Revenue Service to the holding in Revenue Ruling 57-45, C. B. 1957-1, 509, in light of the decision by the United States Court of Claims in *Public Service Electric & Gas Co.* v. *United States*, 157 Fed. Supp. 846.

Revenue Ruling 57-45, *supra*, holds that a public utility is not entitled to a dividends paid credit in respect of dividends paid on preferred stock issued by it on or after October 1, 1942, to replace preferred stock issued prior to that date by another corporation which, at the time of such replacement, was not a "public utility" as defined in section 26(h)(2)(A) of the Internal Revenue Code of 1939 (section 247(b)(1) of the Internal Revenue Code of 1954) and was not entitled to the section 26(h) credit in respect of any dividends paid by it on its own preferred stock so replaced. This holding was based upon the view that the purpose of the statutory provisions, relating to the

replacement of preferred stock issued prior to October 1, 1942, by one corporation by preferred stock of another corporation issued on or after that date, is to prevent the loss of credit allowable to the first corporation prior to the replacement of its preferred stock by the stock of the latter corporation, and not to grant the latter corporation a credit not previously allowable to the former. However, in the case of *Public Service Electric & Gas Co.* v. *United States*, *supra*, the court concluded that in the absence of legislative history indicating that Congress intended something different, it would apply the reasonably clear language of the statute, and entered judgment for the taxpayer contrary to the holding of the Revenue Ruling.

In view of the foregoing, the Internal Revenue Service will follow the decision in the *Public Service* case. Accordingly, it is held that a public utility will not be denied a dividends paid credit, in respect of dividends paid on preferred stock issued by it on or after October 1, 1942, to replace preferred stock issued prior to such date by another corporation merely because such other corporation, at the time of replacement, was not a "public utility" within the meaning of section 26(h)(2)(A) of the 1939 Code, or section 247 of the 1954 Code, where the provisions of those sections are otherwise satisfied.

Revenue Ruling 57–45, *supra*, is hereby revoked.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

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

REGULATIONS 118, SECTION 39.42–6: Non-interest-bearing obligations issued at discount.

Effect of the election, by the executor of an estate, to treat the increment in value of Series E, United States Savings bonds accruing in the taxable year as income received in such taxable year. See Rev. Rul. 58–435, page 370.

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 55(b).—PUBLICITY OF RETURNS: INSPECTION BY STATES

REGULATIONS 118, SECTION 39.55–1: Inspection of returns.

Increases in the charge for preparing abstracts of Federal income tax returns and documents for State governments. See Rev. Proc. 58–16, page 1127.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion. — Rev. Rul. 58–593

Gypsum is "stone" within the meaning of that word as it is used in section 114(b)(4)(A)(i) of the Internal Revenue Code of 1939. Revenue Ruling 55–67, C. B. 1955–1, 357, revoked.

The Internal Revenue Service has reconsidered the definition of gypsum for percentage depletion purposes under section 114(b)(4)(A)(i) of the Internal Revenue Code of 1939.

Revenue Ruling 55–67, C. B. 1955–1, 357, holds that gypsum, in its natural state, is a mineral which may occur in rocklike masses but is very soft and rarely mined or used as stone for ordinary commercial purposes. Therefore, it is not to be classified as "stone" unless it is used, or sold for use, by the mine owner or operator as "stone."

In the case of *United States Gypsum Company* v. *United States*, 253 Fed. (2d) 738, the United States Court of Appeals for the Seventh Circuit held that gypsum is "stone" regardless of its use.

In view of the above, it is now the position of the Service that gypsum is "stone" within the meaning of that word as it is used in section 114(b)(4)(A)(i) of the Code.

Revenue Ruling 55–67, *supra*, is hereby revoked.

SECTION 115(g).—DISTRIBUTIONS BY CORPORATIONS: REDEMPTION OF STOCK

REGULATIONS 118, SECTION 39.115(g)–1: Distribution in redemption or cancellation of stock taxable as a dividend. — Rev. Rul. 58–614[1]

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Third Circuit, rendered September 3, 1958, in the case of *Joseph R. Holsey et ux* v. *Commissioner*, in cases involving similar facts and circumstances.

The decision holds that a remaining shareholder of a corporation does not receive a constructive dividend by way of enhancement in the value of his stock as a result of a purchase by the corporation of another shareholder's stock.

In the future, the Service will not treat the purchase by a corporation of one shareholder's stock as a dividend to the remaining shareholders merely because their percentage interests in the corporation are increased. On the other hand, if the stock is in reality purchased by a

[1] Based on Technical Information Release 109, dated October 30, 1958.

remaining shareholder and paid for by the corporation, then, regardless of the form of the transaction, the payment will be considered a dividend to the shareholder who made the purchase. This position is in accord with the decisions of *H. F. Wall* v. *Commissioner*, 164 Fed. (2d) 462, *Louis H. Zipp* v. *Commissioner*, affirmed by the United States Court of Appeals for the Sixth Circuit, May 21, 1958, and similar court holdings.

In these transactions, if a shareholder surrenders stock to a corporation for less than its fair market value, such surrender may be a gift or compensation to the shareholders who remain interested in the corporation. Conversely, if a corporation pays more than fair market value for its stock, the payment may be compensation to the shareholder surrendering stock or may be a gift to him from the shareholders who remain interested in the corporation.

SECTION 117(a).—CAPITAL GAINS AND LOSSES: DEFINITIONS

REGULATIONS 118, SECTION 39.117(a)-1:
Meaning of terms.

Amounts received by the transferor, upon the transfer of patents, in a case not within the scope of section 117(q) of the Code. See Rev. Rul. 58-353, page 408.

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. T. D. 6329 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 39.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951

Regulations 118 amended to conform to sections 1 and 2 of Public Law 399 (84th Cong.) approved January 28, 1956, relating to the allowance of certain credits in computing the alternative tax of a corporation with respect to its capital gains.

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 the Act of January 28, 1956 (Public Law

[1] 23 F. R. 8261.

399, 84th Cong., 70 Stat. 8) [C. B. 1956–1, 853], such regulations are amended as follows:

PARAGRAPH 1. Section 39.117(c) is amended—

(A) By changing paragraph (1)(A) of section 117(c), set forth therein, to read as follows:

(A) A partial tax shall first be computed upon the net income reduced (except for the purposes of determining the credits allowable under subsections (b), (h), and (i) of section 26) by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted.

(B) By changing the historical note at the end thereof to read as follows:

[Sec. 117(c) as amended by sec. 150(c), Rev. Act 1942; sec. 301(c)(2), (3), Rev. Act 1950; secs. 123 and 322 (b), Rev. Act 1951; sec. 1, Act of Jan 28, 1956 (Pub. Law 399, 84th Cong)]

PAR. 2. Paragraph (b) of § 39.117(c)–1 is amended to read as follows:

(b) In case the net long-term capital gain of any corporation exceeds the net short-term capital loss, section 117(c)(1) imposes an alternative tax in lieu of the tax imposed by sections 13, 15, 204, 207(a)(1) or (3), 421, and 500, if and only if such alternative tax is less than the tax imposed by such sections. This alternative tax is the sum of (1) a partial tax computed at the rates provided by sections 13, 15, 204, 207(a)(1) or (3), 421, and 500 on the net income of the taxpayer, excluding therefrom for this purpose the amount of such excess of the net long-term capital gain over the net short-term capital loss, plus (2) 25 percent (26 percent if the taxable year begins before April 1, 1954) of such excess. In the computation of the partial tax for taxable years beginning after December 31, 1951, and before January 1, 1954, the special credits allowable under subsections (b), (h), and (i) of section 26 shall not be recomputed as the result of the exclusion from net income of the excess of net long-term capital gain over net short-term capital loss. However, if in any taxable year beginning after December 31, 1951, and before January 1, 1954, such a recomputation of credits was made and resulted in an overpayment of tax, no interest shall be allowed or paid on such overpayment.

Because this Treasury Decision merely amends Regulations 118 to reflect a statutory change liberalizing in nature, 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 62 of the Internal Revenue Code of 1939 (53 Stat. 32; 26 U. S. C. 62).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved October 20, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on Oct. 24, 1958; 8:49 a. m., and published in the issue of the Federal Register for Oct. 25, 1958, 23 F. R. 8261.)

SECTION 117(q).—CAPITAL GAINS AND LOSSES: TRANSFER OF PATENT RIGHTS

REGULATIONS 118, SECTION 39.117(q)-1: T. D. 6324[1]
Transfer of patent rights.

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

Regulations 118 amended with respect to transfer of patent rights

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) to section 1 of the Act of June 29, 1956 (Public Law 629, 84th Cong., 70 Stat. 404) [C. B. 1956-2, 1165], such regulations are amended as follows:

PARAGRAPH 1. There are added immediately after § 39.117(p)-(1) the following new sections:

§ 39.117(q) STATUTORY PROVISIONS; TRANSFER OF PATENT RIGHTS.

SEC. 117. CAPITAL GAINS AND LOSSES. * * *

(q) TRANSFER OF PATENT RIGHTS—

(1) GENERAL RULE.—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—

(A) Payable periodically over a period generally coterminous with the transferee's use of the patent, or

(B) Contingent on the productivity, use, or disposition of the property transferred.

(2) "HOLDER" DEFINED.—For purposes of this subsection, the term "holder" means—

(A) Any individual whose efforts created such property, or

(B) Any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

(i) The employer of such creator, nor

(ii) Related to such creator (within the meaning of paragraph (3)).

(3) EXCEPTIONS.—This subsection shall not apply to any transfer described in paragraph (1)—

(A) By a nonresident alien individual, or

(B) Between an individual and any related person.

For purposes of this paragraph, the term "related person" means a person, other than a brother or sister (whether of the whole or half blood), with respect to whom a loss resulting from the transfer would be disallowed under section 24 (b).

(4) APPLICABILITY.—This subsection shall apply with respect to any amount received, or payment made, pursuant to a transfer de-

[1] 23 F. R. 7883.

scribed in paragraph (1) in any taxable year beginning after May 31, 1950, regardless of the taxable year in which such transfer occurred.

[Sec. 117(q) as added by Act of June 29, 1956, P. L. 629, 84th Cong.]

§ 39.117(q)-1 TRANSFER OF PATENT RIGHTS.—(a) *General rule.*—Section 117(q) provides that a transfer (other than by gift, inheritance, or devise) of all substantial rights to a patent, or of an undivided interest in all such rights to a patent, by a holder who is not a nonresident alien to a person other than a related person constitutes the sale or exchange of a capital asset held for more than six months, whether or not payments therefor are—

(1) Payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) Contingent on the productivity, use, or disposition of the property transferred.

(b) *Scope of section 117(q).*—If a transfer is not one described in paragraph (a) of this section, section 117(q) shall be disregarded in determining whether or not such transfer is the sale or exchange of a capital asset. For example, a transfer by a person other than a holder or a transfer by a holder to a related person is not governed by section 117(q). The tax consequences of such transfers shall be determined under other provisions of the internal revenue laws.

(c) *Special rules.*—(1) *Payments for infringement.*—If section 117(q) applies to the transfer of all substantial rights to a patent (or an undivided interest therein), amounts received in settlement of, or as the award of damages in, a suit for compensatory damages for infringement of the patent shall be considered payments attributable to a transfer to which section 117(q) applies to the extent that such amounts relate to the interest transferred.

(2) *Payments to an employee.*—Payments received by an employee as compensation for services rendered as an employee under an employment contract requiring the employee to transfer to the employer the rights to any invention by such employee are not attributable to a transfer to which section 117(q) applies. However, whether payments received by an employee from his employer (under an employment contract or otherwise) are attributable to the transfer by the employee of all substantial rights to a patent (or an undivided interest therein) or are compensation for services rendered the employer by the employee is a question of fact. In determining which is the case, consideration shall be given not only to all the facts and circumstances of the employment relationship but also to whether the amount of such payments depends upon the production, sale, or use by, or the value to, the employer of the patent rights transferred by the employee. If it is determined that payments are attributable to the transfer of patent rights, and all other requirements under section 117(q) are met, such payments shall be treated as proceeds derived from the sale of a patent.

(3) *Successive transfers.*—The applicability of section 117(q) to transfers of undivided interests in patents, or to successive transfers of such rights, shall be determined separately with respect to each transfer. For example, X, who is a holder, and Y, who is not a holder, transfer their respective ⅔ and ⅓ undivided interests in a patent to Z. Assume the transfer by X qualifies under section 117(q) and that

X in a later transfer acquires all the rights with respect to Y's interest, including the rights to payments from Z. One-third of all the payments thereafter received by X from Z are not attributable to a transfer to which section 117(q) applies.

(d) *Payor's treatment of payments in a transfer under section 117(q).*—Payments made by the transferee of patent rights pursuant to a transfer satisfying the requirements of section 117(q) are payments of the purchase price for the patent rights and are not the payment of royalties.

(e) *Effective date.*—Amounts received or accrued, and payments made or accrued, during any taxable year beginning after May 31, 1950, pursuant to a transfer satisfying the requirements of section 117(q), whether such transfer occurred in a taxable year to which the Internal Revenue Code of 1939 applies, or in a year prior thereto, are subject to the provisions of section 117(q).

§ 39.117(q)-2 DEFINITION OF TERMS.—For the purposes of section 117(q) and § 39.117(q)-1—

(a) *Patent.*—The term "patent" means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. It is not necessary that the patent or patent application for the invention be in existence if the requirements of section 117(q) are otherwise met.

(b) *All substantial rights to a patent.*—(1) The term "all substantial rights to a patent" means all rights which are of value at the time the rights to the patent (or an undivided interest therein) are transferred. The circumstances of the whole transaction, rather than the particular terminology used in the instrument of transfer, shall be considered in determining whether or not all substantial rights to a patent are transferred in a transaction. A transfer limited in duration by the terms of the instrument to a period less than the remaining life of the patent is not a transfer of all substantial rights to a patent.

(2) Rights which are not considered substantial for purposes of section 117(q) may be retained by the holder. Examples of such rights are:

(i) The retention by the transferor of legal title for the purpose of securing performance or payment by the transferee in a transaction involving transfer of an exclusive license to manufacture, use, and sell for the life of the patent;

(ii) The retention by the transferor of rights in the property which are not inconsistent with the passage of ownership, such as the retention of a security interest (such as a vendor's lien), or a reservation in the nature of a condition subsequent (such as a provision for forfeiture on account of nonperformance).

(3) Examples of rights which may or may not be substantial, depending upon the circumstances of the whole transaction in which rights to a patent are transferred, are:

(i) The retention by the transferor of an absolute right to prohibit sublicensing or subassignment by the transferee;

(ii) The failure to convey to the transferee the right to use or to sell the patent property.

(4) The retention of a right to terminate the transfer at will is the retention of a substantial right for the purposes of section 117(q).

(c) *Undivided interest.*—A person owns an "undivided interest" in all substantial rights to a patent when he owns the same fractional share of each and every substantial right to the patent. It does not include, for example, a right to the income from a patent, or a license limited geographically, or a license which covers some, but not all, of the valuable claims or uses covered by the patent. A transfer limited in duration by the terms of the instrument to a period less than the remaining life of the patent is not a transfer of an undivided interest in all substantial rights to a patent.

(d) *Holder.*—(1) The term "holder" means any individual—

(i) Whose efforts created the patent property and who would qualify as the "original and first" inventor, or joint inventor, within the meaning of title 35 of the United States Code, or

(ii) Who has acquired his interest in the patent property in exchange for a consideration paid to the inventor in money or money's worth prior to the actual reduction of the invention to practice (see paragraph (e) of this section): *Provided*, That such individual was neither the employer of the inventor nor related to him (see paragraph (f) of this section). The requirement that such individual is neither the employer of the inventor nor related to him must be satisfied at the time when the substantive rights as to the interest to be acquired are determined, and at the time when the consideration in money or money's worth to be paid is definitely fixed. For example, if prior to the actual reduction to practice of an invention an individual who is neither the employer of the inventor nor related to him agrees to pay the inventor a sum of money definitely fixed as to amount in return for an undivided one-half interest in rights to a patent and at a later date, when such individual has become the employer of the inventor, he pays the definitely fixed sum of money pursuant to the earlier agreement, such individual will not be denied the status of a holder because of such employment relationship.

(2) Although a partnership cannot be a holder, each member of a partnership who is an individual may qualify as a holder as to his share of a patent owned by the partnership. For example, if an inventor who is a member of a partnership composed solely of individuals uses partnership property in the development of his invention with the understanding that the patent when isued will become partnership property, each of the inventor's partners during this period would qualify as a holder. If, in this example, the partnership were not composed solely of individuals, nevertheless, each of the individual partners' distributive shares of income attributable to the transfer of all substantial rights to the patent or an undivided interest therein, would be considered proceeds from the sale or exchange of a capital asset held for more than six months.

(3) An individual may qualify as a holder whether or not he is in the business of making inventions or in the business of buying and selling patents.

(e) *Actual reduction to practice.*—For the purposes of determining whether an individual is a holder under paragraph (d) of this section, the term "actual reduction to practice" has the same meaning as it does under section 102(g) of title 35 of the United States Code. Generally, an invention is reduced to actual practice when it has been tested

and operated successfully under operating conditions. This may occur either before or after application for a patent but cannot occur later than the earliest time that commercial exploitation of the invention occurs.

(f) *Related person.*—(1) The term "related person" means one whose relationship to another person at the time of the transfer is described in section 24(b), except that the term does not include a brother or sister, whether of the whole or the half blood. Thus, if a holder transfers all his substantial rights to a patent to his brother or sister, or both, such transfer is not to a related person. However, if a holder transfers all his substantial rights to a patent to a corporation in which he owns more than 50 percent in value of the outstanding stock, he is considered as transferring such rights to a related person for the purpose of section 117(q). On the other hand, if a holder transfers all his substantial rights to a patent to a corporation in which he owns 50 percent or less in value of the outstanding stock and his brother owns the remaining stock, he is not considered as transferring such rights to a related person since the brother relationship is to be disregarded for purposes of section 117(q).

(2) If a relationship described in section 24(b) exists independently of family status, the brother-sister exception, described in subparagraph (1) of this paragraph, does not apply. Thus, if a holder transfers all his substantial rights to a patent to the fiduciary of a trust of which the holder is the grantor, the holder and the fiduciary are related persons for purposes of section 117(q)(3). (See section 24(b)(1)(D).) The transfer, therefore, would not qualify under section 117(q)(1). This result obtains whether or not the fiduciary is the brother or sister of the holder since the disqualifying relationship exists because of the grantor-fiduciary status and not because of family status.

PAR. 2. The provisions of §§ 39.117(q), 39.117(q)-1, and 39.117(q)-2 of Regulations 118, covering taxable years beginning after December 31, 1951, set forth in this Treasury Decision, are hereby made applicable to taxable years beginning after May 31, 1950, and before January 1, 1952 (such years being covered by Regulations 111).

Because this Treasury Decision, in substance, merely restates the regulations under section 1235 of the 1954 Code, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

(This Treasury Decision is issued under authority contained in section 3791 of the Internal Revenue Code of 1939 (53 Stat. 467; 26 U. S. C. 3791).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved October 8, 1958.

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

(Filed by the Division of the Federal Register, October 10, 1958; 8:50 a. m. and published in the issue of the Federal Register for October 11, 1958, 23 F. R. 7883.)

Transfer of rights to patents for a consideration of the type described in section 117(q)(1) (A) or (B) of the Code. See Rev. Rul. 58-353, page 408.

SECTION 126(c).—INCOME IN RESPECT OF DECEDENTS: DEDUCTION FOR ESTATE TAX

REGULATIONS 118, SECTION 39.126(c)-1: Deduction for estate tax attributable to income in respect of decedent.

Deduction of estate tax attributable to the increment in value of Series E, United States savings bonds and included as part of the estate of a decedent. See Rev. Rul. 58-435, page 370.

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 207.—MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE

REGULATIONS 118, SECTION 39.207-1: Tax on mutual insurance companies other than life or marine or fire insurance companies subject to the tax imposed by section 204.
(Also Part I, Section 821; 26 CFR 1.821-1.)

Rev. Rul. 58-616

Whether democratic control is in the policyholders of a mutual insurance company depends on the circumstances of each case and is determined by the control which the policyholders actually exercise, to the exclusion of any group other than policyholders, and not upon the unexercised power to control which such other group has by statute or otherwise.
Revenue Ruling 55-240, C. B. 1955-1, 406, clarified.

Reconsideration has been given to Revenue Ruling 55-240, C. B. 1955-1, 406, relative to mutual insurance companies, in view of the decisions in *Holyoke Mutual Fire Insurance Company* v. *Commissioner*, 28 T. C. 112; *Citizens Fund Mutual Fire Insurance Company* v. *Commissioner*, 28 T. C. 1017; and *Property Owners Mutual Insurance Company* v. *Commissioner*, 28 T. C. 1007, acquiescences, page 7 this Bulletin.

In the *Holyoke*, *Citizens Fund* and *Property Owners* cases, *supra*, the Tax Court of the United States held that the companies therein, chartered as mutual companies, were taxable as such under section 207 of the Internal Revenue Code of 1939 (section 821 of the Internal Revenue Code of 1954) even though each had guaranty fund certificates outstanding. The court emphasized the fact that, since the term "mutual insurance company" is not defined in the 1939 Code, or in Regulations 118 with respect thereto, the classification of an insurance company as a mutual or a stock company depends on the circumstances of each case. One of the most important factors in making this de-

termination relates to democratic ownership and control of the company by the policyholders which is as equally a fundamental characteristic of a mutual insurance company as the company's furnishing insurance to the policyholders substantially at cost. *Keystone Automobile Club Casualty Co.* v. *Commissioner*, 122 Fed. (2d) 886, at 889 and 890, certiorari denied, 315 U. S. 814.

Revenue Ruling 55–240 holds that, in the absence of democratic control by the policy members, an insurance company may not qualify as a mutual insurance company taxable under the provisions of section 207 of the 1939 Code. It is the position of the Internal Revenue Service that whether democratic control is in the policyholders of a mutual insurance company depends on the circumstances of each case and is determined by the control which the policyholders actually exercise, to the exclusion of any group other than policyholders, and not upon the unexercised power to control which such other group has by statute or otherwise. On the facts presented in Revenue Ruling 55–240, there was insufficient evidence to establish that the policyholders had democratic ownership and control and, as a consequence, the taxpayer could not qualify as a mutual insurance company.

Revenue Ruling 55–240, C. B. 1955–1, 406, clarified.

SUPPLEMENT J.—POSSESSIONS OF THE UNITED STATES

SECTION 251.—INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES

REGULATIONS 118, SECTION 39.251(a)–1: Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States.

Taxability of annuities under United States Civil Service Retirement Act where services are performed partly within the United States and partly within a possession. See Rev. Rul. 58–472, page 30.

SUPPLEMENT I.—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SECTION 275.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

REGULATIONS 111, SECTION 29.275–1: Period of limitation upon assessment of tax. Ct. D. 1828

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. ASSESSMENT AND COLLECTION OF TAX—LIMITATIONS—SUBSTANTIAL OMISSIONS OF GROSS INCOME.

The Commissioner determined that taxpayer corporation understated gross profits from sales of certain lots as the result of having overstated the basis of such lots by erroneously including in cost certain unallowable items of development expense. This resulted

in gross income being understated by more than 25% as shown on the returns. Waivers extending the assessment period were executed more than three years, but less than five years, after the dates on which the returns were filed. The Supreme Court stated that in view of the legislative history of section 275(c) of the 1939 Code the statutory language should be limited to the situation in which specific receipts or accruals of income are left out of the computation of gross income and should exclude situations in which there are errors in computation of gross income arising from other causes, and held that the three year period, and not the five year period, applied in this case. Therefore, the waivers were not timely and assessment is barred.

2. DECISION REVERSED.

Decision of the United States Court of Appeals for the Sixth Circuit, 244 F. 2d 75, reversed.

SUPREME COURT OF THE UNITED STATES

The Colony, Inc., petitioner v. *Commissioner of Internal Revenue*

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

[June 9, 1958]

MR. JUSTICE HARLAN delivered the opinion of the Court.

The sole question in this case is whether assessments by the Commissioner of two asserted tax deficiencies were barred by the three-year statute of limitations provided in the Internal Revenue Code of 1939.

Under the 1939 Code the general statute of limitations governing the assessment of federal income tax deficiencies is fixed at three years from the date on which the taxpayer filed his return, section 275(a), 53 Stat. 86, except in cases involving a fraudulent return or failure to file a return, where a tax may be assessed at any time. Section 275(a), 53 Stat. 87. A special five-year period of limitations is provided when a taxpayer, even though acting in good faith, "omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return * * *." Section 275(c), 53 Stat. 86. In either case the period of limitation may be extended by a written waiver executed by the taxpayer within the statutory or any extended period of limitation. Section 276(b), 53 Stat. 87.[1]

The Commissioner assessed deficiencies in the taxpayer's income taxes for each of the fiscal years ending October 31, 1946, and 1947, within the extended period provided in waivers which were executed by the taxpayer more than three but less than five years after the returns were filed. There was no claim that the taxpayer had inaccurately reported its gross receipts. Instead, the deficiencies were based upon the Commissioner's determination that the taxpayer had understated the gross profits on the sales of certain lots of land for residential purposes as a result of having overstated the "basis" of such lots by erroneously including in their cost certain unallowable items of development expense. There was no claim that the returns were fraudulent.

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[1] The pertinent provisions of the 1939 Code are:

"SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

"Except as provided in section 276—

"(a) GENERAL RULE.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

"(c) OMISSION FROM GROSS INCOME.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

"SEC. 276. SAME—EXCEPTIONS.

"(a) FALSE RETURN AND NO RETURN.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

"(b) WAIVER.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements made before the expiration of the period previously agreed upon."

The Tax Court sustained the Commissioner. It held that substantial portions of the development costs were properly disallowed, and that these errors by the taxpayer had resulted in the understatement of the taxpayer's total gross income by 77.2% and 30.7%, respectively, of the amounts reported for the taxable years 1946 and 1947. In addition, the Tax Court held that in these circumstances the five-year period of limitation provided for in section 275(c) was applicable. It took the view that the statutory language, "omits from gross income any amount includible therein," embraced not merely the omission from a return of an item of income received by or accruing to a taxpayer, but also an understatement of gross income resulting from a taxpayer's miscalculation of profits through the erroneous inclusion of an excessive item of cost. 26 T. C. 30. On the taxpayer's appeal to the Court of Appeals the only question raised was whether the three-year or the five-year statute of limitations governed the assessment of these deficiencies. Adhering to its earlier decision in *Reis* v. *Commissioner*, 142 F. 2d 900, the Court of Appeals affirmed. 244 F. 2d 75. We granted certiorari because this decision conflicted with rulings in other Courts of Appeals on the same issue,[2] and because the question as to the proper scope of section 275(c), although resolved for the future by section 6501(e)(1(A) of the Internal Revenue Code of 1954, p. 933, *infra*, remains one of substantial importance in the administration of the income tax laws for earlier taxable years. 355 U. S. 811.

In determining the correct interpretation of section 275(c) we start with the critical statutory language, "omits from gross income an amount properly includible therein." The Commissioner states that the draftsman's use of the word "amount" (instead of, for example, "item") suggests a concentration on the quantitative aspect of the error—that is, whether or not gross income was understated by as much as 25%. This view is somewhat reinforced if, in reading the above-quoted phrase, one touches lightly on the word "omits" and bears down hard on the words "gross income," for where a cost item is overstated, as in the case before us, gross income is affected to the same degree as when a gross receipt item of the same amount is completely omitted from a tax return.

On the other hand, the taxpayer contends that the Commissioner's reading fails to take full account of the word "omits," which Congress selected when it could have chosen another verb such as "reduces" or "understates," either of which would have pointed significantly in the Commissioner's direction. The taxpayer also points out that normally "statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them." *DeGanay* v. *Lederer*, 250 U. S. 376, 381. "Omit" is defined in Webster's New International Dictionary (2d ed. 1939) as "to leave out or unmentioned; not to insert, include or name," and the Court of Appeals for the Sixth Circuit has elsewhere similarly defined the word. *Ewald* v. *Commissioner*, 141 F. 2d 750, 753. Relying on this definition, the taxpayer says that the statute is limited to situations in which specific receipts or accruals of income items are *left out* of the computation of gross income. For reasons stated below we agree with the taxpayer's position.

Although we are inclined to think that the statute on its face lends itself more plausibly to the taxpayer's interpretation, it cannot be said that the language is unambiguous. In these circumstances we turn to the legislative history of section 275(c). We find in that history persuasive evidence that Congress was addressing itself to the specific situation where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in that computation arising from other causes.

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[2] In conflict with this case are decisions in four different Courts of Appeals. *Uptegrove Lumber Co.* v. *Commissioner*, 204 F. 2d 570 (C. A. 3d Cir.); *Deakman-Wells Co.* v. *Commissioner*, 213 F. 2d 894 (C. A. 3d Cir.); *Slaff* v. *Commissioner*, 220 F. 2d 65 (C. A. 9th Cir.); *Davis* v. *Hightower*, 230 F. 2d 549 (C. A. 5th Cir.); *Goodenow* v. *Commissioner*, 238 F. 2d 20 (C. A. 8th Cir.). The Court of Claims has also held to the contrary of the present case. *Lazarus* v. *Commissioner*, 142 F. Supp. 897.

Three Courts of Appeals decisions antedating *Uptegrove Lumber Co.* v. *Commissioner*, *supra*, provided support for the Government's construction of sec 275(c). *Foster's Estate* v. *Commissioner*, 131 F. 2d 405 (C. A. 5th Cir.); *Ketcham* v. *Commissioner*, 142 F. 2d 996 (C. A. 2d Cir.); *O'Bryan* v. *Commissioner*, 148 F. 2d 456 (C. A. 9th Cir.). But neither *Foster's Estate* nor *O'Bryan* can be regarded as the controlling authority within their respective circuits in view of the more recent decisions in *Davis* v. *Hightower*, *supra*, and *Slaff* v. *Commissioner*, *supra*. *Ketcham* is distinguishable on its facts.

The Sixth Circuit has consistently maintained its current position. The Tax Court has also regularly upheld the Commissioner. *E. g.*, *American Liberty Oil Co.* v. *Commissioner*, 1 T. C. 386; *Estate of Gibbs* v. *Commissioner*, 21 T. C. 443.

Section 275(c) first appeared in the Revenue Act of 1934. 48 Stat. 680. As introduced in the House the bill simply added the gross-income provision to section 276 of the Revenue Act of 1932, 47 Stat. 168, relating to fraudulent returns and cases where no return had been filed, and carried with it no period of limitations. The intended coverage of the proposed provision was stated in a Report of a House Ways and Means Subcommittee as follows:

> "Section 276 provides for the assessment of the tax without regard to the statute of limitations in case of a failure to file a return or in case of a false or fraudulent return with intent to evade tax.
>
> "Your subcommittee is of the opinion that the limitation period on assessment should also not apply to certain cases where the taxpayer has understated his gross income on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer has failed to disclose in his return an amount of gross income in excess of 25 percent of the amount of the gross income stated in the return. The Government should not be penalized where a taxpayer is so negligent as to leave out items of such magnitude from his return." House Hearings before Committee on Ways and Means, 73d Cong., 2d Sess., p. 139.

This purpose of the proposal was related to the full Committee in the following colloquy between Congressman Cooper of Tennessee, speaking for the Subcommittee, and Mr. Roswell Magill, representing the Treasury:

> "MR. COOPER. What we really had in mind was just this kind of situation: Assume that a taxpayer left out, say, a million dollars; he just forgot it. We felt that whenever we found that he did that we ought to get the money on it, the tax on it.
>
> "MR. MAGILL. I will not argue against you on that score.
>
> "MR. COOPER. In other words, if a man is so negligent and so forgetful, or whatever the reason is, that he overlooks an item amounting to as much as 25 percent of his gross income, that we simply ought to have the opportunity of getting the tax on that amount of money." House Hearings, *supra*, p. 149.

The full Committee revealed the same attitude in its report:

> "It is not believed that taxpayers who are so negligent as to leave out of their returns items of such magnitude should be accorded the privilege of pleading the bar of the statute." H. R. Rep. No. 704, 73d Cong., 2d Sess., p. 35 [C. B. 1939–1 (Part 2), 554].

The Senate Finance Committee approved of the intended coverage and language of the bill, except that it believed the statute of limitations should not be kept open indefinitely in the case of an honest but negligent taxpayer. Its report stated:

> "* * * Your committee is in general accord with the policy expressed in this section of the House bill. However, it is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly, your committee has provided for a 5-year statute in such cases." S. Rep. No. 558, 73d Cong., 2d Sess., pp. 43–44 [C. B. 1939–1 (Part 2), 586].

Except for embodying the five-year period of limitation, section 275(c), as passed, reflects no change in the original basic objective underlying its enactment.

As rebutting these persuasive indications that Congress merely had in mind failures to report particular income receipts and accruals, and did not intend the five-year limitation to apply whenever gross income was understated, the Commissioner stresses the occasional use of the phrase "understates gross income"

in the legislative materials. The force of this contention is much diluted, however, when it is observed that wherever this general language is found its intended meaning is immediately illuminated by the use of such phrases as "failed to disclose" or "to leave out" items of income. See *Uptegrove Lumber Co.* v. *Commissioner*, 204 F. 2d 570, 572.

The Commissioner also suggests that in enacting section 275(c) Congress was primarily concerned with providing for a longer period of limitations where returns contained relatively large errors adversely affecting the Treasury, and that effect can be given this purpose only by adopting the Government's broad construction of the statute. But this theory does not persuade us. For if the mere size of the error had been the principal concern of Congress, one might have expected to find the statute cast in terms of errors in the total tax due or in total taxable net income. We have been unable to find any solid support for the Government's theory in the legislative history. Instead, as the excerpts set out above illustrate, this history shows to our satisfaction that the Congress intended an exception to the usual three-year statute of limitations only in the restricted type of situation already described.

We think that in enacting section 275(c) Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage. And this would seem to be so whether the error be one affecting "gross income" or one, such as overstated deductions, affecting other parts of the return. To accept the Commissioner's interpretation and to impose a five-year limitation when such errors affect "gross income," but a three-year limitation when they do not, not only would be to read section 275(c) more broadly than is justified by the evident reason for its enactment, but also to create a patent incongruity in the tax law. See *Uptegrove Lumber Co.* v. *Commissioner*, *supra*, at 573.

Finally, our construction of section 275(c) accords with the interpretations in the more recent decisions of four different Courts of Appeals. See note 2, *supra*. The force of the reasoning in these opinions was recognized by the Court of Appeals in the present case, which indicated that it might have agreed with those courts had the matter been *res nova* in its circuit. 244 F. 2d, at 76. And without doing more than noting the speculative debate between the parties as to whether Congress manifested an intention to clarify or to change the 1939 Code, we observe that the conclusion we reach is in harmony with the unambiguous language of section 6501(e)(1)(A) of the Internal Revenue Code of 1954.[3]

We hold that both tax assessments before us were barred by the statute of limitations.

Reversed.

THE CHIEF JUSTICE and MR. JUSTICE BLACK would follow the interpretation consistently given section 275(c) by the Tax Court for many years and affirm the judgment of the Court of Appeals in this case. See cases cited in Note 2 of the Court's opinion.

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[3] "SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

* * * * * * *

"(e) OMISSION FROM GROSS INCOME.—Except as otherwise provided in subsection (c)—

"(1) INCOME TAXES.—In the case of any tax imposed by subtitle A—

"(A) GENERAL RULE.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

"(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

"(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item."

SECTION 311.—TRANSFERRED ASSETS

REGULATIONS 118, SECTION 39.311–1: Ct. D. 1829
Claims in cases of transferred assets.
(Also Section 3670.)

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. ASSESSMENT AND COLLECTION OF TAX—TRANSFEREE LIABILITY—BENEFICIARY OF LIFE INSURANCE.

Under the applicable New Jersey State law, and in the absence of a Federal tax lien, there would be no liability on the part of the beneficiary of a policy of life insurance on the life of a deceased taxpayer for income taxes of the deceased.

2. SUIT BY THE UNITED STATES—LIEN FORECLOSURE—BENEFICIARY OF LIFE INSURANCE.

A beneficiary receiving the proceeds of a life insurance policy on the life of a deceased taxpayer is liable to the United States, in a lien foreclosure suit, to the extent of the cash surrender value of the policy at date of death, where (1) under applicable New Jersey State law, the insured reserved in the policy "property" or "rights to property" within the meaning of Section 3670, and (2) a Federal tax lien attached to such "property" or "rights to property" prior to death.

3. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Third Circuit, 243 F. 2d 675, affirmed.

SUPREME COURT OF THE UNITED STATES

United States of America, Petitioner v. *Molly G. Bess*

Molly G. Bess, Petitioner v. *United States of America*

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

[June 9, 1958.]

MR. JUSTICE BRENNAN delivered the opinion of the Court.

The United States filed this civil action in the District Court for the District of New Jersey to recover, in equity, from the beneficiary of life insurance policies the amount of federal income taxes owed by the insured at the time of his death.

Herman Bess died a resident of Monmouth County, New Jersey, on June 29, 1950. His wife, Molly G. Bess, was the beneficiary of eight insurance policies on his life from which she received $63,576.95 in proceeds. The cash surrender value of these policies at his death was $3,362.53. Seven of the policies were issued to Mr. Bess from 1934 to 1937 and the eighth, a group policy, in 1950. He retained the right until death to change the beneficiary, to draw down or borrow against the cash surrender value and to assign the policies, except that under the group insurance policy he retained only the right to change the beneficiary. Mr. Bess paid all premiums and it is conceded that none was paid in fraud of his creditors.

The federal income taxes were owing for the several years from 1945 to 1949. The assets of Mr. Bess' estate were applied to payment of the amounts owing for 1948 and 1949, but a total of $8,874.57 remained owing for 1945, 1946 and 1947 when the estate was adjudged insolvent by the Monmouth County Court in 1952. The amounts owing were $4,159.31 for 1945, $3,789.32 for 1946, and $925.94 for 1947.

The District Court held Mrs. Bess liable for the total taxes owing of $8,874.57. 134 F. Supp. 467. The Court of Appeals for the Third Circuit reduced the judgment to the amount of the total cash surrender value of the policies of $3,362.53. 243 F. 2d 675. We granted certiorari on the Government's petition and Mrs.

Bess' cross-petition, 355 U. S. 861, and set the case for argument with *Commissioner* v. *Stern*, [Ct. D. 1830, page 46, this Bulletin.] The Government seeks in No. 395 the reinstatement of the District Court's judgment in the full amount of the taxes owing. Mrs. Bess seeks in No. 410 the reversal of the Court of Appeals judgment in the amount of the cash surrender value.

I.

As in *Commissioner* v. *Stern*, the Government argues that Mrs. Bess, as beneficiary of her husband's life-insurance policies, is liable for his unpaid federal income taxes.[1] We held today in the *Stern* case that recovery of unpaid federal income taxes from a beneficiary of insurance, in the absence of a lien, can be sustained only to the extent that state law imposes such liability in favor of other creditors of the insured. Under New Jersey law the beneficiary of a policy of life insurance is entitled to its proceeds against all creditors except to the extent of the amount of any premiums for the insurance paid in fraud of creditors. N. J. Stat. Ann., 1937, § 17 : 34–29; *Slurszberg* v. *Prudential Ins. Co.*, 15 N. J. Misc. 423, 192 A. 451; *Middlesex County Welfare Board* v. *Motolinsky*, 134 N. J. Eq. 323, 35 A. 2d 463. If in the instant case no lien were involved, our holding in *Commissioner* v. *Stern* would require an affirmance in No. 395 and a reversal in No. 410, since it is conceded that Mr. Bess did not pay any premiums in fraud of his creditors.

II.

However, the Government contends that it is also seeking in this action to enforce, as to the 1945 and 1946 deficiencies, liens perfected under § 3670 of the Internal Revenue Code of 1939 against the property of Mr. Bess in his lifetime. Section 3670 provides that "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount * * * 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." On July 30, 1948, and again on August 9, 1948, before Mr. Bess died, notice and demand were made upon him for payment of the deficiencies formally consented to by him as owing for 1945 and 1946. He made periodic payments on the amount owing for 1945, reducing that amount from $11,514 to $4,713.59 before his death. This balance was further reduced to $4,159.31 by a payment of $554.28 from his estate pursuant to an order of the Monmouth County Court. However, no payment on account of the $3,789.32 owing for 1946 was made either in his lifetime or after his death.

First. As to the tax lien theory, Mrs. Bess contends that the Government did not assert this basis for recovery before the District Court and therefore should not be heard to assert that theory in this Court. But the essential facts pertinent to a decision on the merits of the tax lien theory were stipulated in the District Court. Moreover, the issue was fully briefed and argued both in the Court of Appeals and in this Court. We therefore see no basis for any inference of prejudice in the circumstances, and accordingly proceed to a determination of the question.

Second. Mrs. Bess argues that in any event no lien attached to any property of Mr. Bess since a lien does not attach under § 3670 unless and until the delinquent taxpayer "neglects or refuses to pay the same after demand." She urges that the facts stipulated as to the payments on account of 1945 taxes made by Mr. Bess in his lifetime proves that he did not neglect or refuse to pay taxes after demand. Since, in the view we take of this case, the liability of Mrs. Bess is limited to the cash surrender value of $3,362.53, it suffices that whatever may be the case as to the 1945 taxes the requisite neglect or refusal was plainly established as to the 1946 delinquency of $3,789.32, for it is admitted that Mr. Bess neither paid nor attempted to pay anything on account of those taxes.

Third. We must now decide whether Mr. Bess possessed in his lifetime, within the meaning of § 3670, any "property" or "rights to property" in the insurance policies to which the perfected lien for the 1946 taxes might attach. Since § 3670 creates no property rights but merely attaches consequences, federally defined,

[1] The proceeding against Mrs. Bess was not by the summary method authorized by § 311 of the Internal Revenue Code of 1939 but by the alternative method of a proceeding in equity in the District Court, *Leighton* v. *United States*, 289 U. S. 506 [Ct. D. 684, C. B. XII–1, 305 (1933)]. The courts below erred in applying § 311 in this case. As we held in *Commissioner* v. *Stern*, *ante*, § 311 is a purely procedural statute and has no bearing upon the liability of Mrs. Bess.

to rights created under state law, *Fidelity & Deposit Co.* v. *New York City Housing Authority*, 241 F. 2d 142, 144, we must look first to Mr. Bess' right in the policies as defined by state law.

(a) It is not questioned that the rights of the insured are measured by the policy contract as enforced by New Jersey law. Manifestly the insured could not enjoy the possession of the proceeds in his lifetime. His right to change the beneficiary, even to designate his estate to receive the proceeds, gives him no right to receive the proceeds while he lives. *Cf. Rowen* v. *Commissioner*, 215 F. 2d 641, 644. It would be anomalous to view as "property" subject to lien proceeds never within the insured's reach to enjoy, and which are reducible to possession by another only upon the insured's death when his right to change the beneficiary comes to an end. We therefore do not believe that Mr. Bess had "property" or "rights to property" in the proceeds, within the meaning of § 3670, to which the federal tax lien might attach. *Cannon* v. *Nicholas*, 80 F. 2d 934 [Ct. D. 1113, C. B. XV–1, 313 (1936)]; see *United States* v. *Burgo*, 175 F. 2d 196. This conclusion is in harmony with the decision in *Everett* v. *Judson*, 228 U. S. 474, that the cash surrender value of a policy on the life of a bankrupt is the extent of the property which is vested in the trustee under § 70a of the Bankruptcy Act.

(b) The cash surrender value of the policy, however, stands on a different footing. The insured has the right under the policy contract to compel the insurer to pay him this sum upon surrender of the policy. This right may be borrowed against, assigned or pledged. *Slurszberg* v. *Prudential Ins. Co., supra.* Thus Mr. Bess "possessed just prior to his death, a chose in action in the amount stated [*i. e.*, the cash surrender value] which he could have collected from the insurance companies in accordance with the terms of the policies." 243 F. 2d 675, 678. It is therefore clear that Mr. Bess had "property" or "rights to property," within the meaning of § 3670, in the cash surrender value. *United States* v. *Hoper*, 242 F. 2d 468; *Knox* v. *Great Western Life Assurance Co.*, 212 F. 2d 784; *United States* v. *Royce Shoe Co.*, 137 F. Supp. 786; *Smith* v. *Donnelly*, 65 F. Supp. 415; *United States* v *Aetna Life Ins. Co.*, 46 F. Supp. 30.

But it is contended that under state law the insured's property right represented by the cash surrender value is not subject to creditor's liens, whether asserted by a private creditor, *Slurszberg* v. *Prudential Ins. Co., supra*, or by a state agency, *Middlesex County Welfare Board* v. *Motolinsky, supra.* However, once it has been determined that state law creates sufficient interests in the insured to satisfy the requirements of § 3670, state law is inoperative to prevent the attachment of liens created by federal statutes in favor of the United States. Such state laws "are not laws for the United States . . . unless they have been made such by Congress itself." *Fink* v. *O'Neil*, 106 U. S. 272, 276; cf. *Commissioner* v. *Tower*, 327 U. S. 280.[2] The provisions of the Internal Revenue Act creating liens upon taxpayer's property for unpaid income taxes, unlike § 6 of the Bankruptcy Act, 30 Stat. 548, as amended, 11 U. S. C. § 24, do not specifically provide for recognition of such state laws. The fact that in § 3691 Congress provided specific exemptions from distraint is evidence that Congress did not intend to recognize further exemptions which would prevent attachment of liens under § 3670. *Knox* v. *Great Western Life Assurance Co., supra; United States* v. *Heffron*, 158 F. 2d 657; *Shambaugh* v. *Scofield*, 132 F. 2d 345; *Smith* v. *Donnelly, supra.*

Fourth. The transfer of property subsequent to the attachment of the lien does not affect the lien, for "it is of the very nature and essence of a lien, that no matter into whose hands the property goes, it passes cum onere . . ." *Burton* v. *Smith*, 13 Pet. 464, 483; see *Michigan* v. *United States*, 317 U. S. 338, 340 [Ct. D. 1568, C. B. 1943, 1130]. The question therefore is whether the cash surrender values with the lien attached were transferred to Mrs. Bess as beneficiary when Mr. Bess died.

It is argued that the right to receive the cash surrender value expires with the death of the insured and that thus no property of his passes to the beneficiary. The contention is that the beneficiary receives the proceeds of the

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[2] Once a federal tax lien attaches to the insured's interest, of course, the Government, in a proper action joining the appropriate parties, can enforce the lien in the insured's lifetime and thereby recover the cash surrender value. *Knox* v. *Great Western Life Assurance Co.*, 212 F. 2d 784; *Kyle* v. *McGuirk*, 82 F. 2d 212 [Ct. D. 1142, C. B. XV–2, 270 (1936)]; *Smith* v. *Donnelly*, 65 F. Supp. 415. See also *Cannon* v. *Nicholas* 80 F. 2d 934; *United States* v. *Royce Shoe Co.*, 137 F. Supp. 786. Compare *United States* v. *Metropolitan Life Ins. Co.*, 130 F. 2d 149; *United States* v. *Gilmore*, 147 F. Supp. 902.

policies as performance by the insurance company of a separate promise to pay upon the death of the insured. It is said to follow that "there is no logical escape from holding that the 'surrender value' comes to an end on the insured's death, if we dispose of the controversy in accordance with the ordinary rules governing contracts." *United States* v. *Behrens*, 230 F. 2d 504, 506–507. This is to say that the cash surrender value is no part of the proceeds, but represents merely the right of the insured to cancel the policy and thereupon receive back from the insurer the amount accumulated from premiums paid in the past and held to cover the risk to be incurred in the future.[8] Therefore it is said that the property represented by the cash surrender value disappears on the insured's death and no lien can survive in any part of the proceeds.

But the courts have long recognized that the surplus of the paid premiums accumulated to make up the cash surrender value should be treated for some purposes as though in fact a "fund" held by the insurer for the benefit of the insured. Judge Addison Brown stated in *In re McKinney*, 15 F. 535, 537:

"Though this excess of premiums paid is legally the sole property of the company, still in practical effect, though not in law, it is the moneys of the assured deposited with the company in advance to make up the deficiency in later premiums . . . . So long as the policy remains in force the company has not practically any beneficial interest in it, except as its custodian, with the obligation to maintain it unimpaired and suitably invested for the benefit of the insured. This is the practical, though not the legal, relation of the company to this fund."

This view was approved in *Hiscock* v. *Mertens*, 205 U. S. 202, 211, and *Burlingham* v. *Crouse*, 228 U. S. 459, 469. See also *United States* v. *Behrens*, *supra*, at 507. Thus in economic reality the insurer pays the beneficiary the insured's "fund," plus another amount sufficient to perform the insurer's promise to pay the proceeds on the insured's death. *Rowen* v. *Commissioner*, *supra*, at 647. Therefore we hold that, for purposes of § 3670, there was a transfer of property from the insured to Mrs. Bess, and that the lien attached to the property before his death follows the property into her hands.

Affirmed.

THE CHIEF JUSTICE, MR. JUSTICE BLACK and MR. JUSTICE WHITTAKER concur in the opinion of the Court insofar as it holds that the United States had a valid lien against the cash surrender value of the insurance policies involved here which was enforceable against the beneficiary, Mrs. Bess. They would also affirm the judgment of the Court of Appeals on the basis of the dissenting opinion of MR. JUSTICE BLACK in *Commissioner* v. *Stern*.

MR. JUSTICE HARLAN, whom MR. JUSTICE BURTON joins, concurring in part and dissenting in part, in a separate opinion.

Ct. D. 1830

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. ASSESSMENT AND COLLECTION OF TAX—TRANSFEREE LIABILITY—APPLICABILITY OF STATE LAW TO DETERMINE LIABILITY OF WIDOW-BENEFICIARY OF INSURANCE PROCEEDS.

Section 311 of the 1939 Code, providing for enforcement of transferee liability, does not create or define a substantive liability but is merely procedural, and the existence and extent of such liability should be determined by state law. Under applicable Ken-

[8] "In the level premium system of life insurance the net level premium must be higher than the monetary value of the annual risk during the early policy years, and the excess must be accumulated with interest to provide funds for payment of claims after the age is reached where the value of the annual risk exceeds the net level premium in the annual premium being paid. It is the necessary accumulation of these funds that makes possible non-forfeiture benefits. On surrender of a policy the insurer, being relieved of the obligation to provide death benefits during future years where the annual value of the risk exceeds the annual net level premium, no longer needs to retain the surrendering policyholder's contributions to the funds previously accumulated for such purpose. Since the surrendering policyholder made a contribution to these funds during the period from date of issue to date of surrender, he is *equitably* entitled to a return *equal to the prorata share* of the funds actually accumulated *from premiums paid by his group of policyholders* and no longer needed to assure solvency of the company for the protection of continuing policyholder." Krueger and Waggoner, The Life Insurance Policy Contract (1953 ed.), 194. (Footnote omitted; emphasis added.)

tucky law, the beneficiary of a life insurance policy is not liable to creditors. Since Kentucky law imposes no liability, the beneficiary of life insurance proceeds is not liable as transferee for taxes owed by the insured where a tax lien did not attach in the insured's lifetime.

2. DECISION AFFIRMED.

Decision of United States Court of Appeals for the Sixth Circuit, 242 F. 2d 322, affirmed.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, Petitioner, v. *Jean F. Stern.*

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

[June 9, 1958.]

MR. JUSTICE BRENNAN delivered the opinion of the Court.

Respondent petitioned the Tax Court for redetermination of the liability assessed against her for her deceased husband's unpaid income tax deficiencies. The Tax Court held that, as beneficiary of proceeds of her husband's life insurance exceeding the amount of the deficiencies, the respondent was liable for the full amount of the deficiencies. The Court of Appeals reversed, 242 F. 2d 322, holding that the respondent was not liable even to the extent of the amount of the cash surrender values of the policies, which was less than the amount of the deficiencies. We granted certiorari. 355 U. S. 810.

Dr. Milton J. Stern died a resident of Lexington, Kentucky, on June 12, 1949. Nearly six years later the Tax Court held that Dr. Stern had been deficient in his income taxes for the years 1944 through 1947 and was liable for the amount, including interest and penalties, of $32,777.51. Because the assets of the estate were insufficient to meet this liability, the Commissioner proceeded under § 311 of the Internal Revenue Code of 1939 [1] against respondent, Dr. Stern's widow, as the beneficiary of life insurance policies held by him. The proceeds and the cash surrender value of these policies at Dr. Stern's death totaled $47,282.02 and $27,259.68 respectively. The right to change the beneficiary and to draw down the cash surrender value of each policy had been retained until death by Dr. Stern. There were no findings that Dr. Stern paid any premiums with intent to defraud his creditors or that he was insolvent at any time prior to this death.

The Court of Appeals rested its decision upon two grounds: (1) that the respondent beneficiary was not a transferee within the meaning of § 311, *Tyson* v. *Commissioner,* 212 F. 2d 16; and (2) that in any event Kentucky statutes, Ky. R. S. §§ 297.140, 297.150, limit the beneficiary's liability to creditors of the deceased insured to the amount of the premiums paid by the insured in fraud of creditors, and consequently there was no liability since there was no evidence that Dr. Stern paid any premium in fraud of his creditors. Without intimating any view as to the correctness of the first holding of the Court of Appeals we find it unnecessary to decide whether the respondent was a transferee within the meaning of § 311 [2] because we hold that the Kentucky statutes govern the question of the beneficiary's liability and create no liability of the respondent to the Government in the circumstances of this case.

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[1] Section 311 provides:

"(a) Method of collection. The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

"(1) Transferees. The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

"(f) Definition of 'transferee.' As used in this section, the term 'transferee' includes heir, legatee, devisee, and distributee."

[2] The Court of Appeals in this case followed its own prior decision in *Tyson* v. *Commissioner,* 212 F. 2d 16, in holding that Mrs. Stern as beneficiary was not a "transferee" of any part of the proceeds within the meaning of § 311. Other Courts of Appeals have held that the beneficiary is a transferee only to the extent of the cash surrender value existing at the time of the insured's death. *Rowen* v. *Commissioner,* 215 F. 2d 641; *United States* v. *Bess,* 243 F. 2d 675. The Tax Court, on the other hand, has held that the beneficiary is the transferee of the entire proceeds. *Stoumen* v. *Commissioner,* 27 T. C. 1014.

First. Section 311 (a) provides that "The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax . . . imposed upon the taxpayer by this chapter" shall be "assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter . . . ." The decisions of the Court of Appeals and the Tax Court have been in conflict on the question whether the substantive liability enforced under § 311 is to be determined by state or federal law. Compare, *e. g.*, *Rowen* v. *Commissioner*, 215 F. 2d 641, and *Botz* v. *Helvering*, 134 F. 2d 538, with *United States* v. *Bess*, 243 F. 2d 675, and *Stoumen* v. *Commissioner*, 27 T. C. 1014. This Court has expressly left the question open. *Phillips* v. *Commissioner*, 283 U. S. 589, 602 [C. B. X–1, Ct. D. 350, 264 (1931)].

The courts have repeatedly recognized that § 311 neither creates nor defines a substantive liability but provides merely a new procedure by which the Government may collect taxes. *Phillips* v. *Commissioner*, *supra; Hatch* v. *Morosco Holding Co.*, 50 F. 2d 138; *Liquidators of Exchange National Bank* v. *United States*, 65 F. 2d 316 [Ct. D. 547, C. B. X1–2, 354 (1932)]; *Harwood* v. *Eaton*, 68 F. 2d 12; *Weil* v. *Commissioner*, 91 F. 2d 944; *Tooley* v. *Commissioner*, 121 F. 2d 350.[3] Prior to the enactment of § 280 of the Revenue Act of 1926, the predecessor of § 311, the rights of the Government as creditor, enforceable only by bringing a bill in equity or an action at law, depended upon state statutes or legal theories developed by the courts for the protection of private creditors, as in cases where the debtor had transferred his property to another. *Phillips* v. *Commissioner*, *supra*, at 592, n. 2; cf. *Pierce* v. *United States*, 255 U. S. 398; *Hospes* v. *Northwestern Mfg. & Car Co.*, 48 Minn. 174, 50 N. W. 1117. This procedure proved unduly cumbersome, however, in comparison with the summary administrative remedy allowed against the taxpayer himself, Rev. Stat. § 3187, as amended by the Revenue Act of 1924, 43 Stat. 343. The predecessor section of § 311 was designed "to provide for the enforcement of such liability to the Government by the procedure provided in the act for the enforcement of tax deficiencies." S. Rep. No. 52, 69th Cong., 1st Sess. 30 [C. B. 1939–1 (Part 2), 332]. "Without in any way changing the extent of such liability of the transferee under existing law, . . . [this section] enforces such liability . . . in the same manner as liability for a tax deficiency is enforced; that is, notice by the commissioner to the transferee and opportunity either to pay and sue for refund or else to proceed before the Board of Tax Appeals, with review by the courts. Such a proceeding is in lieu of the present equity proceeding . . . ." H. R. Rep. No. 356, 69th Cong., 1st Sess. 43–44 [C. B. 1939–1 (Part 2), 361]. Therefore, since § 311 is purely a procedural statute we must look to other sources for definition of the substantive liability. Since no federal statute defines such liability, we are left with a choice between federal decisional law and state law for its definition.

Second. The Government urges that, to further "uniformity of liability," we reject the applicability of Kentucky law in favor of having the federal courts fashion governing rules. Cf. *Clearfield Trust Co.* v. *United States*, 318 U. S. 363. But a federal decisional law in this field displacing state statutes as determinative of liability would be a sharp break with the past. Federal courts, in cases where the Government seeks to collect unpaid taxes from persons other than the defaulting taxpayer, have applied state statutes, *Hutton* v. *Commissioner*, 59 F. 2d 66 [Ct. D. 646, C. B. XII–1, 301 (1933)]; *Weil* v. *Commissioner*, *supra; United States* v. *Goldblatt*, 128 F. 2d 576; *Botz* v. *Helvering*, *supra*, and the Government itself has urged reliance upon such statutes in similar cases, G. C. M. 2514, VI–2 Cum. Bull. 99; G. C. M. 3491, VII–1 Cum. Bull. 147. The Congress was aware of the use of state statutes when the enactment of the predecessor section to § 311 was under consideration, for the Congress in disclaiming any intention "to define or change existing liability," S. Rep. No. 52, 69th Cong., 1st Sess. 30, identified "existing liability" as liability ensuing "[b]y reason of the trust fund doctrine and various State statutory provisions . . . ." H. R. Rep. No. 356, *supra*, at 43.

It is true that, in addition to reliance upon state statutes, the Government invoked principles judicially developed for the protection of private creditors,

[3] The Government argues that since § 311 and § 900 were originally enacted as correlative provisions of the Revenue Act of 1926 a substantive liability is imposed upon the beneficiary for both unpaid income and estate taxes of the decedent. But the 1939 Code "contains no provision in respect to income tax collection comparable to Section 827 (b) of the Code which expressly imposes liability for the estate tax on a 'beneficiary, who receives . . . property included in the gross estate under section [811 (b)].'" *Rowen* v. *Commissioner*, 215 F. 2d 641, 646.

in cases where the debtor had transferred his property to another and been left insolvent. Cf. *Pierce* v. *United States, supra; Hospes* v. *Northwestern Mfg. & Car Co., supra.* In such cases the federal courts applied a "general law" which did not distinguish between federal and state decisional law. But the fact remains that the varying definitions of liability under state statutes resulted in an absence of uniformity of liability. Yet Congress, with knowledge that this was "existing law" at the time the predecessor section to § 311 was enacted, has refrained from disturbing the prevailing practice. Uniformity is not always the federal policy. Under § 70 of the Bankruptcy Act, for instance, state law is applied to determine what property of the bankrupt has been transferred in fraud of creditors. 30 Stat. 565, as amended, 11 U. S. C. § 110. What is a good transfer in one jurisdiction might not be so in another.

Since Congress has not manifested a desire for uniformity of liability, we think that the creation of a federal decisional law would be inappropriate in these cases. In diversity cases, the federal courts must now apply state decisional law in defining state-created rights, obligations, and liabilities. *Erie R. Co.* v. *Tompkins,* 304 U. S. 64. They would, of course, do so in diversity actions brought by private creditors. Since the federal courts no longer formulate a body of federal decisional law for the larger field of creditor's rights in diversity cases, any such effort for the small field of actions by the Government as a creditor would be necessarily episodic. That effort is plainly not justified when there exists a flexible body of pertinent state law continuously being adapted to changing circumstances affecting all creditors. Accordingly we hold that, until Congress speaks to the contrary, the existence and extent of liability should be determined by state law.

Third. The Court of Appeals held in this case that under the applicable Kentucky law the beneficiary of a life insurance policy is not liable to the insured's creditors, at least where, as here, the premiums have not been paid in fraud of creditors, Ky. R. S. §§ 297.140, 297.150,[4] and that therefore no liability of the respondent exists under state law to any creditor, including the Government. The parties do not contest this construction of local law.

The Government, however, argues in its brief, "Just as in the situation where a tax lien has attached it is held that state law may not destroy that lien, so here, where a tax liability is imposed by Congress, the state may not provide exemptions." We agree that state law may not destroy a tax lien which has attached in the insured's lifetime. We held today in *United States* v. *Bess,* [Ct. D. 1829, page 42, this Bulletin], that a New Jersey statute, similar to the Kentucky statutes, could not defeat the attachment in the insured's lifetime of a federal tax lien under § 3670 against the cash surrender value of the policy, or prevent enforcement of the lien out of the proceeds received by the beneficiary on the insured's death. We might also agree that a State may not provide exemptions from a tax liability imposed by Congress. The fallacy in the Government's argument is in the premise that Congress has imposed a tax liability against the

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[4] Kentucky Revised Statutes provide:

"297.140 *Life insurance for benefit of a married woman; premiums paid in fraud of creditors.*—(1) A policy of insurance on the life of any person expressed to be for the benefit of, or duly assigned, transferred or made payable to, any married woman, or to any person in trust for her, or for her benefit, by whomsoever such transfer may be made, shall inure to her separate use and benefit and that of her children, independently of her husband or his creditors or any other person effecting or transferring the policy or his creditors.

"(2) A married woman may, without consent of her husband, contract, pay for, take out and hold a policy of insurance upon the life or health of her husband or children, or against loss by his or their disablement by accident. The premiums paid on the policy shall be held to have been her separate estate, and the policy shall inure to her separate use and benefit and that of her children, free from any claim of her husband or others.

"(3) If the premium on any policy mentioned in this section is paid by any person with intent to defraud his creditors, an amount equal to the premium so paid, with interest thereon, shall inure to the benefit of the creditors, subject to the statute of limitations.

"297.150 *Life insurance for the benefit of another; premiums paid in fraud of creditors.*—(1) When a policy of insurance is effected by any person on his own life or on another life in favor of some person other than himself having an insurable interest therein, the lawful beneficiary thereof, other than the person effecting the insurance or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same.

"(2) Subject to the statute of limitations, the amount of any premiums for such insurance paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds of the policy, but the company issuing the policy shall be discharged of all liability thereon by payment of its proceeds in accordance with its terms, unless, before such payment, the company received written notice by or in behalf of some creditor, with specification of the amount claimed, claiming to recover for certain premiums paid in fraud of creditors."

beneficiary. We have concluded that Congress has not seen fit to define that liability and that none exists except such as is imposed by state law. Thus there is no problem here of giving effect to state exemption provisions when federal law imposes such liability. The Government's rights in this case are precisely those which other creditors would have under Kentucky law. The respondent is not liable to the Government because Kentucky law imposes no liability against respondent in favor of Dr. Stern's other creditors.

Affirmed.

MR. JUSTICE BLACK, whom the CHIEF JUSTICE and MR. JUSTICE WHITTAKER join, dissenting, in a separate opinion.

CHAPTER 2.—ADDITIONAL INCOME TAXES

SUBCHAPTER A.—PERSONAL HOLDING COMPANIES

SECTION 502.—PERSONAL HOLDING COMPANY INCOME

REGULATIONS 111, SECTION 29.502-1: Personal holding company income.

Regulations 111 amended. See T. D. 6326, below.

REGULATIONS 118, SECTION 39.502-1: Personal holding company income.
(REGULATIONS 111, SECTION 29.502-1.)

T. D. 6326 [1]

TITLE 26—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER A, PARTS 39 AND 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951 AND DECEMBER 31, 1941

Regulations 118 and Regulations 111 amended in respect of compensation for the use of corporation property by a shareholder.

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 those provisions of Regulations 118 (26 CFR (1939) Part 39) and Regulations 111 (26 CFR (1939) Part 29) which relate to compensation for the use of corporation property by a shareholder to section 223 of the Revenue Act of 1950 (64 Stat. 947), as amended by the Act of August 11, 1955 (Public Law 370, 84th Cong., 69 Stat. 693), and the Act of February 11, 1958 (Public Law 85-319, 72 Stat. 4), such regulations are amended as follows:

REGULATIONS 118

PARAGRAPH 1. Section 39.502 (26 CFR (1939) 39.502) is amended by adding at the end thereof the following statutory provision:

§ 39.502 STATUTORY PROVISIONS; PERSONAL HOLDING COMPANY INCOME; DEFINITION.

* * * * * * *

[1] 23 F. R. 8056.

SEC. 223. PERSONAL HOLDING COMPANY INCOME [REVENUE ACT OF 1950 (64 STAT. 947)].

Section 502(f) of the Internal Revenue Code (relating to use of corporation property by a shareholder) shall not apply with respect to rents received during 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, in the operation of a bona fide commercial, industrial, or mining enterprise, of property of the taxpayer.

[Sec. 223 as amended by sec. 1, Act of Aug. 11, 1955 (Pub. Law 370, 84th Cong., 69 Stat. 693), and sec. 1, Act of Feb. 11, 1958 (Pub. Law 85–319, 72 Stat. 4)]

PAR. 2. Paragraph (i) of § 39.502–1 (26 CFR (1939) 39.502–1) is amended to read as follows:

§ 39.502–1 PERSONAL HOLDING COMPANY INCOME. * * *

(i) *Compensation for use of property.*—The compensation for the use of, or the right to use, property of the corporation which is to be included in personal holding company income consists of amounts received as compensation (however designated and from whomsoever received) for the use of, or the right to use, property of the corporation in any case which, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property, whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. The property may consist of a yacht, a city residence, a country house, or any other kind of property. However, personal holding company income does not include rents received for the use by the lessee, in the operation of a bona fide commercial, industrial, or mining enterprise, of property of the corporation. Pursuant to section 2 of the Act of August 11, 1955 (Public Law 370, 84th Cong., 69 Stat. 693), and section 2 of the Act of February 11, 1958 (Public Law 85–319, 72 Stat. 4), no interest shall be allowed or paid on any overpayment resulting from the application of the preceding sentence. See section 503 and the regulations thereunder and § 39.501–3(d).

REGULATIONS 111

PAR. 3. There is inserted immediately preceding § 29.502–1 (26 CFR (1939) 29.502–1) the following:

ACT OF AUGUST 11, 1955 (PUBLIC LAW 370, 84TH CONG., 69 STAT 693)

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 223 of the Revenue Act of 1950 (relating to use of corporation property by a shareholder) is hereby amended by striking out "January 1, 1950" and inserting in lieu thereof "January 1, 1954".

* * * * * * *

PAR. 4. Strike the last sentence of paragraph (9) of § 29.502–1 (26 CFR (1939) 29.502–1) as amended by Treasury Decision 5921, approved July 21, 1952, and insert in lieu thereof the following two sentences:

See also section 223 of the Revenue Act of 1950 (64 Stat. 947), as amended by section 1 of the Act of August 11, 1955 (Public Law 370, 84th Cong., 69 Stat. 693), under which section 502(f) is not applicable to rents received during taxable years ending after December 31, 1945, if such rents were received for the use by the lessee, in the operation of a bona fide commercial, industrial, or mining enterprise, of the property of the corporation. Pursuant to section 2 of the Act of August 11, 1955, no interest shall be allowed or paid on any

overpayment resulting from the application of the preceding sentence for the taxable years ending after December 31, 1949.

Because this Treasury Decision merely liberalizes the regulations under section 502 of the Internal Revenue Code of 1939 in conformity with the Act of August 11, 1955 (Public Law 370, 84th Cong., 69 Stat. 693), and the Act of February 11, 1958 (Public Law 85-319, 72 Stat. 4), it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(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).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved October 15, 1958.

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

(Filed by the Division of the Federal Register on October 17, 1958; 8:50 a. m., and published in the issue of the Federal Register for October 18, 1958, 23 F. R. 8056.)

SECTION 503.—PERSONAL HOLDING COMPANIES: STOCK OWNERSHIP

REGULATIONS 118, SECTION 39.503(a)-1:
Stock ownership.

Certificates of membership held by directors in a corporate nonprofit foundation not exempt from Federal income tax. See Rev. Rul. 58-556, page 355.

SUBTITLE B.—MISCELLANEOUS TAXES

CHAPTER 11.—DOCUMENTS, OTHER INSTRUMENTS, AND PLAYING CARDS

SUBCHAPTER A.—RATE OF PAYMENT OF TAX

SECTION 1802.—CAPITAL STOCK (AND SIMILAR INTERESTS)

REGULATIONS 71, SECTION 113.20: Scope of tax. Ct. D. 1831

DOCUMENTARY STAMP TAXES—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. CAPITAL STOCK—ORIGINAL ISSUE—CAPITAL INCREASED WITHOUT ISSUANCE OF NEW STOCK CERTIFICATES.

The mere transfer and dedication of surplus to capital does not result in the issuance of shares unless certificates are issued to evidence such shares. Accordingly, stamp tax liability under section 1802(a) of the Internal Revenue Code of 1939 was not incurred by taxpayer upon the increase in the stated

value of its remaining outstanding second preferred stock from $36.25 a share to $100.00 a share, where no new shares of preferred stock were issued and the common capital stock account remained unchanged.

2. JUDGMENT AFFIRMED.

Judgment of the United States District for the Eastern District of New York, 130 F. Supp. 322, affirmed.

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 386—October Term, 1957.

(Argued June 10, 1958 Decided June 20, 1958.)

Docket No. 23775

The F. M. Schaefer Brewing Co., Plaintiff-Appellee, v. *United States of America, Defendant-Appellant.*

Before: CLARK, Chief Judge, PICKETT, Circuit Judge, and RYAN, District Judge

Appeal from the United States District Court for the Eastern District of New York, Leo F. Rayfiel, *Judge.*

The United States appeals from a summary judgment against it for the refund of $7,189.57, together with interest and costs, for documentary stamp taxes, as paid by The F. & M. Schaefer Brewing Co., D. C. E. D. N. Y., 130 F. Supp. 322. Affirmed.

See also *United States* v. *F. & M. Schaefer Brewing Co.*, 356 U. S. 227, reversing *The F. & M. Schaefer Brewing Co.* v. *United States*, 2 Cir., 236 F. 2d 889.

THOMAS C. BURKE, of White & Case, New York City (Walter S. Orr and Edmund W. Pavenstedt, of White & Case, New York City, on the brief), *for plaintiff-appellee.*

KARL SCHMEIDLER, Atty., Dept. of Justice, Washington, D. C. (H. Brian Holland, Asst. Atty. Gen., Ellis N. Slack, Atty., Dept. of Justice, Washington, D. C., Leonard P. Moore, U. S. Atty., and Elliott Kahaner, Asst. U. S. Atty., E. D. N. Y., Brooklyn, N. Y., on the brief), *for defendant-appellant.*

PER CURIAM:

The United States appeals from a summary judgment granting The F. & M. Schaefer Brewing Co. recovery of the amount of stamp taxes which it alleged the government had illegally assessed and collected from it. I. R. C. 1939, §§ 1800, 1802, levies such a tax on "each original issue, whether or organization or reorganization, of shares or certificates of stock" by any corporation. The transaction here claimed to be subject to the tax did not involve the actual issue of any new stock certificates, but only an increase in the corporation's capital account by the transfer of $6,375,000 from its earned surplus account to its capital account, thus increasing the capital from $3,725,000 to $10,100,000, and the value of certain issued no-par-value stock from $36.25 to $100 per share. Judge Rayfiel, in his reasoned opinion, D. C. E. D. N. Y., 130 F. Supp. 322, quoted from and relied upon the detailed exposition in *United States* v. *National Sugar Refining Co.*, D. C. S. D. N. Y., 113 F Supp. 157, where Judge Leibell held that stamp taxes are required only on the actual issuance of capital stock, and not on a bookkeeping entry effecting an addition to the capital account where no new stock is issued. More recently this reasoning has been quoted and approved by Chief Judge Duffy for his court in *American Steel Foundries* v. *Sauber*, 7 Cir., 239 F. 2d 300, and Chief Judge Gardner for his court in *United States* v. *Archer-Daniels-Midland Co.*, 8 Cir., 243 F. 2d 130. We find the reasoning of these various opinions wholly persuasive. *Allied Chemical & Dye Corp.* v. *McMahon*, 2 Cir., 253 F. 2d 663, affirming D. C. S. D. N. Y., 156 F. Supp. 275, which deals with the recapitalization proviso of the same statute, is not in point; for there additional shares were actually issued, and the tax was required only on such additional shares.

Affirmed.

CHAPTER 28.—PROVISIONS COMMON TO MISCELLANEOUS TAXES

SUBCHAPTER A.—GENERAL PROVISIONS

PART II.—ASSESSMENT, COLLECTION, AND REFUND

SECTION 3313.—PERIOD OF LIMITATION UPON REFUNDS AND CREDITS

Whether a timely filed claim for refund is rendered invalid because certain evidence supporting the claim is filed after the statutory period of limitation has expired. See Rev. Rul. 58–563, page 892.

SUBTITLE C.—MANUFACTURERS' EXCISE TAXES AND IMPORT AND TEMPORARY TAXES

CHAPTER 29.—MANUFACTURERS' EXCISE AND IMPORT TAXES

SUBCHAPTER A.—MANUFACTURERS' EXCISE TAXES

SECTION 3413.—TAX ON LUBRICATING OILS

Applicability of the manufacturers excise tax on lubricating oils to the sale of oils for use in hot or cold forging operations and piercing operations. See Rev. Rul. 58–476, page 781.

SUBCHAPTER C.—GENERAL ADMINISTRATIVE PROVISIONS

SECTION 3443.—CREDITS AND REFUNDS

Whether a timely filed claim for refund is rendered invalid because certain evidence supporting the claim is filed after the statutory period of limitation has expired. See Rev. Rul. 58–563, page 892.

SUBTITLE D.—GENERAL ADMINISTRATIVE PROVISIONS

CHAPTER 36.—COLLECTION

SUBCHAPTER B.—LIEN FOR TAXES

SECTION 3670.—PROPERTY SUBJECT TO LIEN

Transferee liability of beneficiary of life insurance proceeds. See Ct. D. 1829, page 934.

SUBPART B.—RULINGS AND DECISIONS UNDER THE FEDERAL FIREARMS ACT

Rulings and decisions published in Part II, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Firearms Act.

SECTION 901.—DEFINITIONS

26 CFR 177.22: Dealers license.

Possession of a license and special tax stamp by collector of firearms assuming status of a dealer therein. See Rev. Rul. 58–432, page 875.

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 5001.—IMPOSITION, RATE AND ATTACHMENT OF TAX

26 CFR 251.49: Commercial samples of alcoholic beverages.
(Also Sections 5041, 5051.)

T. D. 6300 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 251.—IMPORTATION OF DISTILLED SPIRITS, WINES, AND BEER

Amendment to implement the provisions of Public Law 85-211

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 1, 1958, a notice of proposed rulemaking with respect to the amendment of the regulations in 26 CFR Part 251 was pub-

[1] 23 F. R. 5168.

lished in the Federal Register (23 FR 2129). The proposed amendments would conform regulations to the provisions of Public Law 85–211 [C. B. 1957–2, 1060] relative to the importation of certain samples of alcoholic beverages free of internal revenue tax imposed on or by reason of importation.

In accordance with the notice, interested parties were afforded an opportunity to submit written data, views, or arguments pertaining thereto. No written comments were received within the period of 30 days prescribed. Accordingly, the amendments so published are hereby adopted.

In order to conform regulations to the provisions of Public Law 85–211 relative to the importation of certain samples of alcoholic beverages free of internal revenue tax imposed on or by reason of importation, 26 CFR Part 251 is amended as follows:

PARAGRAPH 1. By inserting immediately following § 251.48 the following new undesignated centerhead and new section:

EXEMPTION OF CERTAIN SAMPLES FROM INTERNAL REVENUE TAXES

§ 251.49 COMMERCIAL SAMPLES OF ALCOHOLIC BEVERAGES.—Samples of distilled spirits, beer, and wine, to be used in the United States by persons importing alcoholic beverages in commercial quantities, are, subject to the limitations in this section, exempt from the payment of any internal revenue tax imposed on, or by reason of, importation. This exemption applies only to samples to be used for soliciting orders for products of foreign countries. In no case shall this exemption apply to more than one sample of each alcoholic beverage product admitted during any calendar quarter for the use of each such person. No sample of beer shall contain more than 8 ounces, no sample of wine shall contain more than 4 ounces, and no sample of distilled spirits shall contain more than 2 ounces. (71 Stat. 486; 19 U. S. C. 1201.)

PAR. 2. Section 251.74 is amended:

(A) By inserting ", other than those provided for in § 251.49," in the second sentence between the word "spirits" and the word "imported" so that the sentence will begin, "Samples of distilled spirits, other than those provided for in § 251.49, imported for any purpose * * *."

(B) By inserting the following new sentence between the present second and third sentences, "Samples of beer and wine brought into the United States pursuant to § 251.49 are exempt from the labeling requirements of the Federal Alcohol Administration Act and regulations issued thereunder." (71 Stat. 486; 19 U. S. C. 1201.)

Since the amendments made by Public Law 85–211 apply to articles entered for consumption or withdrawn from warehouse for consumption or or after October 17, 1957, the date on which the International Convention to Facilitate the Importation of Commercial Samples and Advertising Material came into force for the United States, these regulations are being made retroactively effective to that date, pursuant to section 7805 of the Internal Revenue Code of 1954.

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

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.
D. B. STRUBINGER,
Acting Commissioner of Customs.

Approved June 30, 1958.

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

(Filed by the Division of the Federal Register on July 7, 1958 at 8:50 a. m., and published in the issue of the Federal Register for July 8, 1958, 23 F. R. 5168.)

SECTION 5006.—DETERMINATION OF TAX

26 CFR 170.171: Scope of subpart. T. D. 6307[1]
(Also Section 5025, 170.185.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 170.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Extension of bonding period for distilled spirits and mingling of distilled spirits.

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 purpose of this Treasury Decision is to provide regulations implementing sections 206(a), (b), (c), and (f), and 210(a)(2) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

PARAGRAPH 1. Section 206 (a), (b), (c), and (f) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) reads as follows:

SEC. 206. EXTENSION OF BONDING PERIOD.

(a) Section 5006 (a) (2) is amended to read as follows:

(2) DISTILLED SPIRITS DEPOSITED IN INTERNAL REVENUE BONDED WAREHOUSES.—The tax on distilled spirits entered for deposit in internal revenue bonded warehouses shall be determined at the time the same are withdrawn therefrom and within 8 or 20 years from the date of original entry for deposit therein, whichever may be required by the bond covering such spirits (except that distilled spirits which on July 26, 1936, were 8 years of age or older and which were in bonded warehouses on that date, may remain therein).

(b) Section 5232 (a) is amended to read as follows:

(a) GENERAL.—The Secretary or his delegate shall, by regulations, prescribe the form and penal sums of bonds covering distilled spirits in internal revenue bonded warehouses and in transit to and between such warehouses: *Provided*, That the penal sums of such bonds covering distilled spirits shall not exceed in the aggregate $200,000 for

[1] 23 F. R. 6789.

each such warehouse. Such bonds shall be conditioned (1) on the withdrawal of the spirits from the internal revenue bonded warehouse within 20 years (or, in the discretion of the person or persons furnishing any bond, within 8 years) from the date of original entry for deposit; (2) on payment of the tax on the spirits as determined on withdrawal from the internal revenue bonded warehouse; and (3) on compliance with all provisions of law and regulations relating to the business of warehousing distilled spirits.

(c) The last sentence of section 5243(b) (relating to bottling requirements of certain distilled spirits known commercially as gin) is amended by striking out at any time within 8 years after entry in bond.

(f)(1) The amendments made by this section shall apply with respect to—

(A) distilled spirits which on the date of the enactment of this Act are in internal revenue bonded warehouses or are in transit to or between such warehouses, and in respect of which the 8-year bonding period has not expired before the date of enactment of this Act; and

(B) distilled spirits which after the date of the enactment of this Act are entered for deposit in an internal revenue bonded warehouse.

(2) If the 8 years from the date of original entry of any distilled spirits for deposit in internal revenue bonded warehouses expires at any time during the 10-day period which begins on the date of the enactment of this Act, the amendments made by this section shall apply with respect to such spirits if (and only if) before the close of such 10-day period there is filed with the Secretary of the Treasury or his delegate either—

(A) a consent of surety which changes (for periods on and after the date of the enactment of this Act) the condition based on the withdrawal of spirits from the internal revenue bonded warehouse within 8 years from the date of original entry for deposit to a condition based on the withdrawal of spirits from the internal revenue bonded warehouse within 20 years from the date of original entry for deposit, or

(B) a bond which applies to periods on and after the date of the enactment of this Act and which satisfies the requirements of the Internal Revenue Code of 1954, as amended by this section, and is conditioned on the withdrawal of spirits from the internal revenue bonded warehouse within 20 years from the date of original entry for deposit.

Pursuant to the above provisions of law, the following new subpart, Subpart J, is added to 26 CFR Part 170:

SUBPART J—EXTENSION OF BONDING PERIOD AND RELATED CHANGES

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170.179 Bottling for export.

AUTHORITY: §§ 170.171 to 170.178, incl., issued under sec. 7805, I. R. C., 68A Stat. 917; 26 U. S. C. 7805

§ 170.171 SCOPE OF SUBPART.—This subpart prescribes requirements pertaining to: the extension of the bonding period on distilled spirits stored in, or in transit to, internal revenue bonded warehouses on the date of enactment of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress); related changes in the conditions of the transportation and warehousing bonds covering such premises affected by section 206 (a), (b), and (f) of such act; and the elimination from existing law of the provision in section 5243(b), I. R. C., restricting the bottling in bond of gin for export to the period within 8 years after entry in bond.

DEFINITIONS

§ 170.172 MEANING OF TERMS.—When used in this subpart, 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 as well. The terms "includes" and "including" do not exclude things not enumerated which are in the same general class.

Act.—The Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

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.

Bonded warehouse or warehouse.—An internal revenue bonded warehouse as defined in this section.

Director.—The Director, Alcohol and Tobacco Tax Division Internal Revenue Service, Treasury Department, Washington 25, D. C.

Distilled spirits or spirits.—A substance (except alcohol produced at an industrial alcohol plant operated under 26 CFR Part 182) produced by the distillation of fermented grain, molasses, fruit, or other materials, commonly known as spirits, whisky, brandy, rum, gin, vodka, etc.

Internal revenue bonded warehouse.—A bonded warehouse established and operated under the provisions of 26 CFR Part 225.

I. R. C.—The Internal Revenue Code of 1954.

Person.—An individual, a trust, estate, partnership, association, company, or corporation.

Proprietor or warehouseman.—The person operating an internal revenue bonded warehouse, unless otherwise indicated.

U. S. C.—The United States Code.

EXTENSION OF BONDING PERIOD

§ 170.173 GENERAL.—Notwithstanding the provisions of 26 CFR Part 225, the tax on distilled spirits entered for deposit in internal revenue bonded warehouses in respect of which the 8-year bonding period has not expired before the date of enactment of the act, shall be determined at the time the same are withdrawn therefrom and within 8 or 20 years from the date of original entry for deposit therein

whichever may be required by the bond covering such spirits (except that distilled spirits which on July 26, 1936, were 8 years of age or older and which were in bonded warehouses on that date, may remain therein).

EXTENSION OF BONDING PERIOD DURING FIRST 10 DAYS OF THE ACT

§ 170.174 TIME LIMIT.—If the 8 years from the date of original entry for deposit of any distilled spirits on deposit in, or in transit to, any warehouse expires at any time during the 10-day period which begins on the date of the enactment of the act, the proprietor may have the bonding period for such spirits extended to 20 years if (and only if) he files before the close of such 10-day period either a properly executed consent of surety, as provided in § 170.175, or a new bond, as provided in § 170.176.

§ 170.175 CONSENTS OF SURETY.—Consents of surety filed pursuant to § 170.174 must be executed on Form 1533, in duplicate, by the proprietor of the internal revenue bonded warehouse and the surety (or sureties) on the proprietor's transportation and warehousing bond, Form 1571. The Form 1533 must properly identify the bond affected thereby and contain the following statement:

To change, for periods on and after the date of enactment of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress), the condition of said bond based on the withdrawal of distilled spirits from the internal revenue bonded warehouse within 8 years from the date of the first entry thereof in any internal revenue bonded warehouse to a condition based on the withdrawal of spirits from the internal revenue bonded warehouse within 20 years from the date of the original entry for deposit.

§ 170.176 NEW BOND.—Where, pursuant to the provisions of § 170.174, the proprietor desires to file a new bond which applies to periods on and after the date of the enactment of the act, he shall submit such bond on Form 1571, in duplicate. The new bond must be accompanied by a consent, as set forth in § 170.175, changing the condition that the tax will be paid within 8 years from the date of the first entry of the distilled spirits in an internal revenue bonded warehouse to a condition that the tax will be paid within 20 years from such date. The effective date of the bond must be the date of the enactment of the act. Where the proprietor has had the terms of the existing bond extended by approved consents of surety, and he desires to have the same terms apply under the new bond, he must at the time of filing the new bond execute and submit consent of surety which will extend the terms of the new bond to cover the same operations permitted under the superseded bond. The penal sum of the new bond shall be in accordance with the provisions of 26 CFR Part 225.

EXTENSION OF BONDING PERIOD AFTER THE FIRST 10 DAYS OF THE ACT

§ 170.177 FILING OF CONSENT OR BOND AND CONSENT.—Where, after the 10-day period provided for in § 170.174, the proprietor desires to have the bonding period covering distilled spirits in his warehouse changed from an 8-year period to a 20-year period, he must file a consent, Form 1533, in duplicate, on his warehousing and trans-

portation bond, Form 1571, or file a new bond, Form 1571, and proper consent, in duplicate. In such case the consent must be filed to take effect before the expiration of the 8-year bonding period in respect of any distilled spirits for which the extension of the bonding period is desired. The consent must identify the bond and contain the following statement:

To change the condition of said bond based on the withdrawal of distilled spirits from the internal revenue bonded warehouse within 8 years from the date of the first entry thereof in any internal revenue bonded warehouse to a condition based on the withdrawal of spirits from the internal revenue bonded warehouse within 20 years from the date of the original entry for deposit.

Where the proprietor has had the terms of the existing bond extended by approved consents of surety, and he desires to have the same terms apply under the new bond, he must at the time of filing the new bond execute and submit consent of surety which will extend the terms of the new bond to cover the same operations permitted under the superseded bond. The penal sum of the bond shall be in accordance with the provisions of 26 CFR Part 225.

APPROVAL OF BONDS AND CONSENTS OF SURETY

§ 170.178 AUTHORITY.—All consents and bonds provided for in this subpart shall be submitted to the assistant regional commissioner. Assistant regional commissioners are authorized to approve all bonds and consents of surety submitted under the provisions of this supbart. (68A Stat. 629, 630, 680; 26 U. S. C. 5176, 5177, 5551)

REMOVAL OF RESTRICTION ON BOTTLING OF GIN IN BOND FOR EXPORT

§ 170.179 BOTTLING FOR EXPORT.—Notwithstanding the requirements of the distilled spirits warehousing regulations, 26 CFR 225.953, gin reduced with pure water to not less than 80 proof may, at any time after entry in bond and before the expiration of the bonding period specified in the proprietor's bond, be bottled in bond for export: *Provided*, That gin which becomes 8 years of age in the 10-day period which begins on the date of enactment of the act may not be bottled for export unless the consent of surety of new bond provided for in § 170.174 is filed.

PAR. 2. Section 210(a)(2) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) reads as follows:

> SEC. 210(a) (2) MINGLING OF DISTILLED SPIRITS.—PROVISIONS HAVING THE EFFECT OF—
>
> (A) section 5025(e)(7) (exemption from laws pertaining to rectification), and
>
> (B) section 5234(a)(2) (permitting the mingling of distilled spirits for further storage in bond)
>
> of the Internal Revenue Code of 1954 (as such sections are included in chapter 51 of such Code as amended by section 201 of this Act) shall be deemed to be included in the Internal Revenue Code of 1954, effective on the day following the date of the enactment of this Act. In applying the provisions of such sections 5025(e)(7) and 5234(a)(2) during the period beginning on the day following the date of the enactment of this Act and ending at the close of June 30, 1959, references to bonded premises shall be treated as references to internal revenue bonded warehouses.

Sections 5025(e)(7) and 5234(a)(2) of the Internal Revenue Code of 1954 (as such sections are included in chapter 51 of such Code as amended by section 201 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) read as follows:

SEC. 5025(e) MINGLING OF DISTILLED SPIRITS.—SECTIONS 5021, 5081, and 5082 SHALL NOT APPLY TO—

* * * * * * *

(7) the mingling on bonded premises of distilled spirits for further storage in bond as authorized by section 5234(a)(2).

SEC. 5234(a)(2) CONSOLIDATION OF PACKAGES FOR FURTHER STORAGE IN BOND.

Under such regulations as the Secretary or his delegate shall prescribe, distilled spirits—

(A) of the same kind,

(B) distilled at the same distillery,

(C) distilled by the same proprietor (under his own or any trade name), and

(D) which have been stored in internal revenue bond in the same kind of cooperage for not less than 4 years (or 2 years in the case of rum or brandy).

may, within 8 years of the date of original entry for deposit of the spirits, be mingled on bonded premises for further storage in bond in as many as necessary of the same packages in which the spirits were stored before consolidation. Where distilled spirits produced in different distilling seasons are mingled under this paragraph, the mingled spirits shall consist of not less than 10 percent of spirits of each such season. No spirits mingled under the provisions of this paragraph shall be again mingled under the provisions thereof until at least one year has elapsed since the last prior mingling. For purposes of this chapter, the date of original entry for deposit of the spirits mingled under the provisions of this paragraph shall be the date of original entry for deposit of the youngest spirits contained in the mingled spirits, and the distilling season of such mingled spirits shall be the distilling season of the youngest spirits contained therein. Notwithstanding any other provisions of law, distilled spirits mingled under this paragraph may be bottled and labeled the same as if such spirits had not been so mingled. No statement claiming or implying age in excess of that of the youngest spirits contained in the mingled spirits shall be made on any stamp or label or in any advertisement.

Pursuant to the above provisions of law, the following new subpart, Subpart K, is added to 26 CFR Part 170:

SUBPART K—CONSOLIDATION OF PACKAGED DISTILLED SPIRITS

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170.185 Scope of subpart.
170.186 Authorized consolidation.
170.187 Consent of surety.
170.188 Equipment for mingling.
170.189 Application.
170.190 Dumping and gauging.
170.191 Determining date of original entry.
170.192 Filling and gauging consolidated packages.
170.193 Numbering, marking, and branding consolidated packages.
170.194 Withdrawal, bottling, and labeling of mingled spirits.
170.195 Restriction on age statement.
170.196 Monthly report.

AUTHORITY: §§ 170.185 to 170.195, incl., issued under sec. 7805, I. R. C., 68A Stat. 917; 26 U. S. C. 7805.

§ 170.185 SCOPE OF SUBPART.—This subpart prescribes the requirements for consolidation of packages of spirits for further storage in bond pursuant to section 210(a)(2) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

§ 170.186 AUTHORIZED CONSOLIDATION.—Within 8 years of the date of original entry for deposit, and with the prior approval of the internal revenue officer in charge, packages of spirits of the same kind, distilled by the same proprietor (under his own or any trade name) at the same distillery, and which have been stored in internal revenue bond in the same kind of cooperage for not less than 4 years (or 2 years in the case of rum or brandy) may, as provided in this subpart, be dumped and mingled in a warehouse tank, and immediately repackaged, in as many as necessary of the packages from which dumped, for further storage in bond. Where spirits produced in different distilling seasons are mingled under this subpart, the mingled spirits shall consist of not less than 10 percent of spirits of each such season. No spirits mingled under this subpart shall again be mingled under this subpart until at least one year has elapsed since the last prior mingling.

§ 170.187 CONSENT OF SURETY.—Where a proprietor desires to mingle spirits under this subpart, he shall first file with the assistant regional commissioner a properly executed consent of surety, Form 1533, in duplicate, which shall identify the bond affected and contain the following statement:

To extend the terms of the bond to cover any tax liability with respect to spirits mingled in accordance with provisions having the effect of the provisions of section 5234(a)(2), of the Internal Revenue Code of 1954 (as such section is included in section 201 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress)).

Consents given under this section shall be in accordance with 26 CFR Part 225.

§ 170.188 EQUIPMENT FOR MINGLING.—Bulk gauging tanks or storage tanks may be used in mingling and consolidation operations. Where such tanks are not to be so used, other suitable tanks must be provided.

§ 170.189 APPLICATION.—When it is desired to mingle spirits for further storage in packages, application for such mingling must be submitted on Form 2323, in triplicate, to the internal revenue officer. Where the warehouseman desires to subsequently withdraw such spirits on the original gauge of the consolidated packages he shall note on all copies of the application, "Withdraw on original gauge". If the internal revenue officer approves the application he will date and sign the application, return one copy to the proprietor, and retain the remaining two copies.

§ 170.190 DUMPING AND GAUGING.—When spirits in packages are to be dumped for mingling, the internal revenue officer will examine them. He will detain any package bearing evidence of unusual loss that cannot be satisfactorily explained, or of tampering, pending further investigation in accordance with the applicable provisions of 26 CFR Part 225, and will supervise the dumping of the spirits. All packages must be drained and packages which are not to be refilled

as consolidated packages must be thoroughly rinsed. The proof of the spirits in the tank shall be adjusted to a whole degree of proof and such adjusted proof shall be regarded as the proof of the spirits run into all packages filled from the tank. Rinse water not used in reducing the proof of the spirits must, in each instance, be destroyed, or disposed of as described in 26 CFR Part 225. All marks and brands must be obliterated from the empty packages: *Provided*, That appropriate marks may be left on packages that are to be used for storage of the spirits. Empty packages not needed for storage of the mingled spirits shall be promptly removed from the warehouse. In all cases the internal revenue officer shall verify the proof, see that all outlets in the tank are locked, determine (volume or weight) the quantity of spirits in the tank, and report the gauge on all copies of the application.

§ 170.191 Determining Date of Original Entry.—Where spirits are mingled under this subpart, the date of original entry for deposit of the youngest spirits in the lot shall, for the purposes of chapter 51, I. R. C., be the date of original entry for deposit for all the spirits in the lot, and the distilling season of such mingled spirits shall be the distilling season of the youngest spirits contained therein.

§ 170.192 Filling and Gauging Consolidated Packages.—At the time the mingled spirits are to be drawn into packages, the internal revenue officer shall see that all valves and openings of the tank other than the necessary outlet valves are closed and locked. All spirits drawn from the tank will be carefully gauged by the warehouseman, under the supervision of the internal revenue officer, and the details thereof will be entered by the warehouseman on Form 1520, in triplicate: *Provided*, That where the warehouseman has indicated on his application, Form 2323, that the consolidated packages are to be withdrawn on the original gauge, the internal revenue officer shall, unless the packages are to be withdrawn without payment of tax for use in wine production, make such gauge and report the details thereof on Form 1520, noting on Form 1520, "Withdraw on original gauge". There shall be noted on Form 1520 the date of the original entry for deposit of the youngest spirits mingled in the tank. Weights shall be determined in pounds and one-half pounds. Where the gauge is performed and reported by the warehouseman, the internal revenue officer shall, from time to time, verify the tares, gross weights, and tax gallonages. Where the internal revenue officer finds significant discrepancies in the warehouseman's report of gauge, or in the marks and brands required to be placed on any container, the warehouseman shall make such corrections as may be required by the internal revenue officer. Where a remnant package results, because of insufficient spirits remaining in the tank to fill the last package, such package shall be gauged and marked in the same manner as the other consolidated packages. Losses or gains of spirits resulting from the repackaging operation shall be reported by the internal revenue officer on the application, Form 2323, by indicating the difference between the total quantity in the tank prior to repackaging and the total quantity repackaged. On completion of the gauging and the preparation of the gauge report, one copy of the approved Form 2323 and one copy of the Form 1520 will be forwarded to the assistant regional

commissioner by the internal revenue officer, one copy of each will be retained by the proprietor, and one copy of each will be placed in the appropriate file in the Government office.

§ 170.193 NUMBERING, MARKING, AND BRANDING CONSOLIDATED PACKAGES.—Packages of spirits mingled under this subpart shall be marked and branded in accordance with 26 CFR 225.417f, except that such packages shall be serially numbered, beginning with the number "1" preceded by the letters "CS" (Consolidated for Storage). The symbol "CS" and the number and State shall be considered a part of the serial number and must be shown on all official forms and records.

§ 170.194 WITHDRAWAL, BOTTLING, AND LABELING OF MINGLED SPIRITS.—Packaged spirits which have been mingled under this subpart may be withdrawn, pursuant to the applicable provisions of 26 CFR Part 225, for any purpose for which the spirits could have been withdrawn before mingling. Distilled spirits mingled under this subpart may be bottled and labeled the same as if such spirits had not been so mingled.

§ 170.195 RESTRICTION ON AGE STATEMENT.—No statement claiming or implying age in excess of that of the youngest spirits contained in spirits mingled under this subpart shall be made on any stamp or label or in any advertisement.

§ 170.196 MONTHLY REPORT.—Proprietors shall submit a monthly report on Form 2546 of mingling and consolidation operations under this subpart. The report shall be prepared in duplicate and submitted to the internal revenue officer on or before the 10th day of the month following that for which the report is submitted. All of the information called for shall be furnished in accordance with the instructions on the form or issued in respect thereto.

Because sections 206(f) and 210(a)(2) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) are effective on the date of enactment of the act, and on the day following the date of enactment of the act, respectively, it is found that it is impractical and contrary to the public interest to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act (60 Stat. 238; 5 U. S. C. 1003) or subject to the effective date limitation of section 4(c) of such Act. Accordingly, paragraph 1 of this Treasury Decision shall be effective on the date of enactment of the Excise Tax Technical Changes Act (H. R. 7125—85th Congress) and paragraph 2 of this Treasury Decision shall be effective on the day following the date of enactment of said 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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved August 26, 1958.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on September 3, 1958, 9:18 a. m., and published in the issue of the Federal Register for September 4, 1958. 23 F. R. 6789.)

SECTION 5008.—STRIP STAMPS FOR DISTILLED SPIRITS

Search without warrant for illicit spirits. See Ct. D. 1826, page 1005.

Application to containers of finished products furnished as samples by extract manufacturers to prospective customers engaged in the manufacture of cordials and other liquors. See Rev. Rul. 58–428, page 975.

Subpart B.—Rectification

SECTION 5021.—IMPOSITION AND RATE OF TAX

26 CFR 235.452: Mixing with other spirits or materials prohibited. (Also Section 5025; 235.450.) — Rev. Rul. 58–560

> Vodka may be produced at a rectifying plant exempt from the rectification tax only when rectified according to an approved formula and packaged or bottled as vodka. It may not be bottled as neutral spirits and may not be used in blended whisky.
>
> Rev. Rul. 55–594, C. B. 1955–2, 700, and Rev. Rul. 58–253, C. B. 1958–1, 581, distinguished and reaffirmed.

Advice has been requested whether vodka produced exempt from the rectification tax at a rectifying plant may be reclassified as grain neutral spirits for bottling as such and for use in blended whisky.

In Revenue Ruling 55–594, C. B. 1955–2, 700, it is held, in part, that taxpaid vodka *received* at a rectifying plant may be reclassified as grain neutral spirits and so labeled when bottled, provided the vodka was produced from grain neutral spirits at a registered distillery in accordance with the appropriate regulations. Such ruling does not apply to vodka produced at a rectifying plant under exemption from the rectification tax and so states.

In Revenue Ruling 58–253, C. B. 1958–1, 581, it is held that Revenue Ruling 55–594, *supra*, and section 235.452 of the regulations relating to Rectification of Spirits and Wines, restricting the classification and use of vodka produced and bottled at a rectifying plant under exemption from the rectification tax, do not preclude the classification of the product as neutral spirits for use as such in taxable rectification.

In the light of Revenue Ruling 58–253, *supra*, permission is now requested to reclassify tax-exempt vodka produced at a rectifying plant as grain neutral spirits for (1) bottling as neutral spirits, and (2) use in blended whisky.

Vodka produced as a finished product in a rectifying plant under section 235.450 of the regulations is produced by a purifying and refining process which, under the law and regulations, is exempted from the rectification tax. Such product must be bottled or packaged and labeled as vodka in accordance with the approved formula under which produced. Vodka produced at a rectifying plant in any manner or by any means other than that specified in section 235.450 is subject

to the rectification tax. See Section 235.454 of the regulations. Under section 235.456 through section 235.461, inclusive, of the regulations, purified or refined spirits, other than vodka, produced in a rectifying plant are subject to the rectification tax unless used immediately in a taxable rectified product. It is therefore held that vodka *produced at a rectifying plant under exemption from the rectification tax* may not be bottled or packaged and labeled as neutral spirits.

It is emphasized that Revenue Ruling 58–253, *supra*, applies only to vodka produced exempt from the rectification tax under section 235.450 of the regulations and *bottled* or packaged.

Under section 235.452 of the regulations, vodka produced under a tax-exempt process may not be mixed with other spirits or treated by the addition or abstraction of any substance or material other than pure water before bottling or packaging. Therefore, it is further held that, although such section does not preclude the use of tax-exempt vodka which has been bottled or packaged as such in the further production of a taxable rectified product, as provided in Revenue Ruling 58–253, *supra*, it does preclude the production of tax-exempt vodka under section 235.450 of the regulations for use in blended whisky or for any other purpose other than for bottling or packaging as vodka.

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26 CFR 235.456: General. Rev. Rul. 58–414

A rectifier may, under specified conditions, recover distilled spirits by redistillation of rectified products manufactured at his rectifying plant which contain wine or alcoholic flavors or blenders and are held by him as distress merchandise.

Advice has been requested whether a rectifier may recover distilled spirits by redistillation from rectified products produced at his rectifying plant which contain wine or alcoholic flavors or blenders and are held by him as unmarketable merchandise.

A rectifier may recover distilled spirits by redistillation of rectified products manufactured at his rectifying plant which contain wine or alcoholic flavors or blenders and are held by him as distress merchandise, under authority of section 235.456 through 235.459, inclusive, of the Regulations relating to Rectification of Spirits and Wines, and subject to the following conditions:

(1) The rectifier must establish that the products to be redistilled were manufactured by him.

(2) The redistillation must be exclusively for the purpose of salvaging the taxpaid distilled spirits in the products and must be done pursuant to approved Form 27–B Supplemental, Formula and Process for Rectified Products, under the approval or supervision of a Government officer.

(3) Substantially 99 percent on a proof gallon basis of the alcoholic content of the products or mixtures to be redistilled must consist of fully taxpaid distilled spirits. Thus the alcoholic content contributed by the wine or other alcoholic flavors or blenders cannot exceed approximately one percent calculated on a proof gallon basis.

(4) The rectifier must establish and certify by appropriate letterhead application, to the Government officer, the percentage of fully taxpaid distilled spirits on a proof gallon basis and the percentage of wine or alcoholic flavors or blenders, on a proof and wine gallon basis, in the mixtures to be redistilled.

(5) The rectifier must pay rectification tax on the recovered spirits unless used immediately in the manufacture of taxable rectified products as provided by the Regulations relating to Rectification of Spirits and Wines.

This Revenue Ruling will not affect the redistillation exclusively of distressed distilled spirits, such as blended whiskies, none of which contain in excess of 2½ percent, by volume, of wine or alcoholic flavors or blenders, under approved formulas.

SECTION 5025.—EXEMPTION FROM RECTIFICATION TAX

26 CFR 170.185: Scope of subpart.

Requirements prescribed for consolidation of packages of spirits for further storage in bond. See T. D. 6307, page 949.

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26 CFR 235.450: Methods of production.

Prohibited bottling or use of tax-exempt vodka produced at a rectifying plant as neutral spirits. See Rev. Rul. 58–560, page 958.

Subpart C.—Wines

SECTION 5041.—IMPOSITION AND RATE OF TAX

Certain commercial samples of wine may be imported free from internal revenue tax. See T. D. 6300, page 947.

Subpart D.—Beer

SECTION 5051.—IMPOSITION AND RATE OF TAX

Certain commercial samples of beer may be imported free from internal revenue tax. See T. D. 6300, page 947.

SECTION 5053.—EXEMPTIONS

26 CFR 245.197: Reciprocating foreign countries.

Listing of foreign countries for which beer may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Proc. 58–13, page 1124.

SECTION 5056.—DRAWBACK OF TAX

26 CFR 252.154: Withdrawals of beer by brewer from brewery. Rev. Rul. 58–512

A brewer who operates breweries in more than one region, if he so elects, may file a claim for drawback of tax on exported beer with the Assistant Regional Commissioner, Alcohol and Tobacco Tax, for the region in which the beer was produced, provided the claim for drawback covers beer produced in only one region.

Advice has been requested whether a brewer who operates breweries in more than one region may file a claim, Form 1582–B, Drawback on Beer Exported, for drawback of tax on exported beer produced in one or more breweries within the same region with the Assistant Regional Commissioner of the region in which the beer was produced.

Section 252.154 of the regulations relating to Drawback on Liquors Exported provides, in part, that where the brewer operates more than one brewery in different regions, the brewer will file claim on Form 1582–B, with the Assistant Regional Commissioner, Alcohol and Tobacco Tax, of the region in which the principal office of the brewer is located.

Section 252.154 of the regulations facilitates the handling of a claim covering the product of two or more breweries operated in different regions by the same brewer, but it is not intended to prohibit such a brewer from filing a claim covering beer produced in one or more breweries in the same region with the Assistant Regional Commissioner of such region.

Accordingly, it is held that a brewer who operates breweries in more than one region, if he so elects, may file a claim for drawback of tax on exported beer with the Assistant Regional Commissioner of the region in which the beer was produced, provided the claim for drawback covers beer produced in one region only.

Subpart E.—General Provisions

SECTION 5062.—REFUND AND DRAWBACK IN CASE OF EXPORTATION

26 CFR 252.4: Reciprocating foreign countries.

Listing of foreign countries for which liquors may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Proc. 58–13, page 1124.

SECTION 5064.—LOSSES CAUSED BY DISASTER

26 CFR 170.101: Scope of subpart. T. D. 6315 [1]
(Also 170.121.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 170.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Losses of alcoholic liquors caused by disaster

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:

The purpose of this Treasury Decision is to provide regulations implementing sections 208 and 210(a)(3) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

PARAGRAPH 1. Section 208 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) reads as follows:

SEC 208. LOSSES OF ALCOHOLIC LIQUORS CAUSED BY DISASTER.

(a) AUTHORIZATION.—Where the President has determined under the Act of September 30, 1950 (42 U. S. C., sec. 1855), that a "major disaster" as defined in such Act has occurred in any part of the United States, the Secretary of the Treasury or his delegate shall pay (without interest) to the person specified in subsection (b) an amount equal to the amount of the internal revenue taxes paid or determined and customs 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 such disaster occurring in such part of the United States after December 31, 1954, and not later than the date of enactment of this Act, if such spirits, wines, rectified products, or beer were at the time of such disaster in the possession of—

(1) the person paying such tax, or such tax and duty, or obligated to pay a determined tax, on such spirits, wines, rectified products, or beer,

(2) a bottler of distilled spirits, wines, or rectified products, or a rectifier, or

(3) a wholesale or retail dealer in distilled spirits, wines, or beer,

all referred to in this section as the possessor or possessors.

(b) TO WHOM MADE.—Any payment authorized by this section may be made—

(1) to the possessor, or

(2) to any distiller, winemaker, brewer, rectifier, importer, wholesale liquor dealer, or wholesale beer dealer who replaced (or to any distiller, winemaker, brewer, rectifier, importer, or wholesale dealer who has given credit or made replacement to a wholesale dealer who replaced) for the possessor the full equivalent of distilled spirits, wines, rectified products, or beer so lost or rendered unmarketable or condemned, without compensation, remuneration, or credit of any kind in respect of the tax, or tax and duty, on such spirits, wines, rectified products, or beer.

(c) CLAIMS.—No claim shall be allowed under this section unless—

(1) filed within 6 months after the date of enactment of this Act, and

[1] 23 F. R. 7215.

(2) the claimant furnishes proof to the satisfaction of the Secretary of the Treasury or his delegate that—

(A) neither the claimant nor any possessor was indemnified by any valid claim of insurance or otherwise in respect of the tax or tax and duty on the distilled spirits, wines, rectified products, or beer covered by the claim, and

(B) the claimant is entitled to payment under this section.

Claims under this section shall be filed under such regulations as the Secretary of the Treasury or his delegate shall prescribe.

(d) DESTRUCTION OF DISTILLED SPIRITS, WINES, RECTIFIED PRODUCTS, OR BEER.—When the Secretary of the Treasury or his delegate has made payment under this section in respect of the tax, or tax and duty, on the distilled spirits, wines, rectified products, or beer condemned by a duly authorized official or rendered unmarketable, such distilled spirits, wines, rectified products, or beer shall be destroyed under such supervision as the Secretary of the Treasury or his delegate may prescribe, unless such distilled spirits, wines, rectified products, or beer were previously destroyed under supervision satisfactory to the Secretary of the Treasury or his delegate.

(e) PRODUCTS OF PUERTO RICO.—The provisions of this section shall not be applicable in respect of distilled spirits, wines, rectified products, and beer of Puerto Rican manufacture brought into the United States and so lost or rendered unmarketable or condemned.

(f) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable in respect of internal revenue taxes on distilled spirits, wines, rectified products, and beer shall, insofar as applicable and not inconsistent with this section, be applied in respect of the payments provided for in this section to the same extent as if such payments constituted refunds of such taxes.

Pursuant to the above provisions of law, the following new subpart, Subpart F, is added to 26 CFR Part 170:

SUBPART F.—LOSSES OF ALCOHOLIC LIQUORS CAUSED BY A DISASTER OCCURRING AFTER DECEMBER 31, 1954, AND BEFORE THE DAY FOLLOWING THE DATE OF ENACTMENT OF THE EXCISE TAX TECHNICAL CHANGES ACT OF 1958

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AUTHORITY: §§ 170.101 to 170.114, Incl., issued under sec. 208 of the Excise Tax Technical Changes Act of 1958.

§ 170.101 Scope of Subpart.—This subpart prescribes the requirements necessary to implement section 208 of the act, concerning payments which may be made by the United States in respect to the internal revenue taxes paid or determined and customs 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 in the United States after December 31, 1954, and not later than the date of enactment of the act. The provisions of this subpart shall not be applicable in respect of distilled spirits, wines, rectified products, and beer of Puerto Rican manufacture brought into the United States.

Definitions

§ 170.102 Meaning of Terms.—When used in this subpart, 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 shall include the singular, and vice versa, and words importing the masculine gender shall include the feminine as well. The terms "includes" and "including" do not exclude things not enumerated which are in the same general class.

Act.—The Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

Alcoholic liquors, or "liquors".—Distilled spirits, wines, rectified products, and beer lost, rendered unmarketable, or condemned, as provided in this subpart.

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.

Beer.—Beer, ale, porter, stout, and other similar fermented beverages (including saké or other similar products) of any name or description containing one-half of 1 percent or more of alcohol by volume on which the internal revenue tax has been paid or determined, and, if imported, on which duties have been paid at the rate applicable thereto.

Claimant. The person to whom payment may be made as provided in § 170.104.

Commissioner. The Commissioner of Internal Revenue.

Commissioner of Customs. The Commissioner of Customs, Bureau of Customs, Treasury Department, Washington, D. C.

Disaster. A flood, fire, hurricane, earthquake, storm, or other catastrophe which has occurred in any part of the United States, after December 31, 1954, and not later than the date of enactment of the act, and which the President of the United States has determined, under the Act of September 30, 1950, (64 Stat. 1109; 42 U. S. C. 1855), was a "major disaster" as defined in such act.

Distilled spirits, or spirits. Ethyl alcohol and other distillates, such as whisky, brandy, rum, gin, and vodka, on which the internal revenue tax has been paid or determined and, if imported, on which duties have been paid at the rate applicable thereto.

Duly authorized official.—Any Federal, State, or local government official in whom has been vested authority to condemn liquors made the subject of a claim under this subpart.

Duty or duties.—Any duty or duties paid under the customs laws of the United States.

Full equivalent.—A quantity of distilled spirits or of rectified products, in tax gallons; a quantity of wine, in wine gallons; or a quantity of beer, in barrels of 31 gallons, equal to the quantity lost, rendered unmarketable, or condemned.

Person paying tax or tax and duty. The person, such as a distiller, rectifier, winemaker, brewer, or importer who originally paid the internal revenue tax on the liquors or the person who paid such tax and customs duties on imported liquors.

Possessor. The person, bottler, or dealer in whose possession liquors subject to claim were held at the time of a disaster.

Rectified products. Liquors manufactured by rectifying, purifying, refining, mixing, or blending distilled spirits or wines and on which tax has been paid or determined, and, if imported, on which duty has been paid.

Tax. With respect to: (a) unrectified distilled spirits, the internal revenue distilled spirits tax paid or determined thereon; (b) wines, the internal revenue wine tax paid or determined thereon; (c) rectified products, the distilled spirits tax, the rectification tax (if any), the cordial tax (if any), and the wine tax (if any), paid or determined thereon, and (d) beer, the internal revenue beer tax paid or determined thereon.

United States.—When used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

Wines. All still wines, effervescent wines, and flavored wines, on which internal revenue wine tax has been paid or determined, and, if imported, on which duty has been paid.

Payments

§ 170.103 Circumstances Under Which Payment May Be Made.—Assistant regional commissioners shall allow payment (without interest) of an amount equal to the amount of tax paid or determined, and the Commissioner of Customs shall allow payment (without interest) of an amount equal to the amount of customs duties paid, on distilled spirits, wines, rectified products, and beer previously withdrawn, which are lost, rendered unmarketable, or condemned by a duly authorized official by reason of a disaster occurring in the United States after December 31, 1954, and not later than the date of enactment of the act. Such payments may be made only if, at the time of such disaster, such liquors were in the possession of (a) the person paying such tax, or such tax and duty, or obligated to pay a determined tax on such alcoholic liquors, (b) a bottler of such liquors, or (c) a wholesale or retail dealer in such liquors.

§ 170.104 Persons to Whom Payment May Be Made.—Claims may be filed by and payment made to any of the possessors referred to

in § 170.103. Claims may also be filed by and payment made to any distiller, winemaker, brewer, rectifier, importer, wholesale liquor dealer, or wholesale beer dealer who replaced (or to any distiller, winemaker, brewer, rectifier, importer, or wholesale dealer who has given credit or made replacement to a wholesale dealer who replaced) for the possessor the full equivalent of the liquors so lost, rendered unmarketable, or condemned, without compensation, remuneration, or credit of any kind in respect of the tax, or tax and duty, on such liquors.

Claims Procedure

§ 170.105 EXECUTION AND FILING OF CLAIMS.—Claims shall be executed on Form 843 (Internal Revenue) is accordance with such instructions thereon as are applicable, and must be filed with the assistant regional commissioner of the internal revenue region in which the liquors were lost, rendered unmarketable, or condemned, within 6 months after the date of enactment of the act. In any instance where the liquors were replaced or where credit therefor was given, the person replacing or giving credit therefor and the recipient thereof shall join in the claim. Any claim under this subpart filed after the specified 6-month period will be rejected in full.

§ 170.106 RETURN OF CLAIM FOR COMPLETION.—The regulations in this subpart contemplate that claims will be filed (a) where the possessor has received the full equivalent of the liquors before the filing of the claim, and (b) where the completion of the claim is to await determination, as provided in § 170.111, of the quantity of liquors lost, rendered unmarketable, or condemned, and the quantity which may be replaced or for which credit may be given. In the event of (b), the claim will be returned to the claimant, on completion of such determination, for insertion of the necessary data.

§ 170.107 SEPARATION OF IMPORTED AND DOMESTIC LIQUORS: SEPARATE CLAIMS FOR TAXES AND DUTIES.—If a claim involves taxes on domestic liquors and imported liquors, the quantities of each must be shown separately in the claim. A separate claim must be filed in respect of customs duties.

§ 170.108 CLAIMANT TO FURNISH SATISFACTORY PROOF.—The claimant shall furnish proof to the satisfaction of the assistant regional commissioner regarding the following:

(a) that the tax or tax and duty on the liquors has been paid (or determined in the case of a person obligated to pay a determined tax);

(b) that such liquors were lost, rendered unmarketable, or condemned by a duly authorized official, by reason of damage sustained as the result of a disaster;

(c) the type and date of occurrence of the disaster and the location of the liquors at that time;

(d) that neither the claimant nor the possessor was indemnified by any valid claim of insurance or otherwise in respect of the tax or tax and duty on the liquors covered by the claim; and

(e) that the claimant is entitled to payment under this subpart.

§ 170.109 SUPPORTING EVIDENCE.—The claimant shall support his claim with any evidence (such as inventories, statements, invoices,

bills, records, stamps, labels, and formulas) that he is able to submit, relating to the liquors on hand at the time of the disaster and averred to have been lost, rendered unmarketable, or condemned as a result thereof.

§ 170.110 SUPPORTING STATEMENT.—In an instance of replacement of liquors for a possessor, or of credit or replacement of liquors to a wholesale dealer who replaced liquors for a possessor, the claimant shall attest in his claim that he, as a distiller, winemaker, brewer, rectifier, importer, or dealer, as the case may be, replaced for the possessor, either directly or indirectly, the full equivalent of the liquors which were lost, rendered unmarketable, or condemned, as a result of a disaster, without compensation, remuneration, or credit of any kind in respect of the tax, or tax and duty, on such liquors.

§ 170.111 REPLACEMENT OR CREDIT.—The replacement of liquors for a possessor, either direct or by the giving of credit or the making of replacement to a wholesale dealer who is to replace, and the completion of the claim by the claimant, may be delayed until a determination has been made by the assistant regional commissioner as to the quantities of liquors lost, rendered unmarketable, or condemned, as provided in § 170.112. The findings of the assistant regional commissioner in this respect may be made available to the persons involved in the transaction. The claim shall be fully completed with respect to evidence of the various aspects of the replacement before being further processed by the assistant regional commissioner as provided in § 170.112. Nothing in this section is to be construed as extending the 6-month period provided in § 170.105 for the filing of claims.

§ 170.112 ACTION BY ASSISTANT REGIONAL COMMISSIONER.—The assistant regional commissioner will date stamp and examine each claim filed under this subpart and will determine the validity of the claim in respect of the quantities of liquors covered thereby, and of any replacement claimed. The claim will then be processed by him in accordance with existing procedures. Claims involving customs duties will be forwarded to the Commissioner of Customs with a summary statement by the assistant regional commissioner concerning his findings.

Destruction of Liquors

§ 170.113 SUPERVISION.—When allowance has been made under this subpart in respect of the tax, or tax and duty, on liquors condemned by a duly authorized official or rendered unmarketable, such liquors shall be destroyed by suitable means under the supervision of an internal revenue officer who will be assigned for that purpose by the assistant regional commissioner, unless such liquors were previously destroyed under supervision satisfactory to the assistant regional commissioner. The Commissioner of Customs will notify the assistant regional commissioner as to allowance under this subpart of claims for duty in respect of unmarketable or condemned liquors.

Penalties

§ 170.114 PENALTIES.—Penalties are provided in sections 7206 and 7207 of the Internal Revenue Code for execution under the penalties

of perjury of any false or fraudulent statement in support of any claim and for the filing of any false or fraudulent document under this subpart. All provisions of law, including penalties, applicable in respect of internal revenue taxes on distilled spirits, wines, rectified products, and beer, shall, insofar as applicable and not inconsistent with this subpart, be applied in respect of the payments provided for in this subpart to the same extent as if such payments constituted refunds of such taxes.

PAR. 2. Section 210(a)(3) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress), reads as follows:

SEC. 210(a)(3). LOSSES CAUSED BY DISASTER.

Provisions having the effect of section 5064 of the Internal Revenue Code of 1954 (as such section is included in chapter 51 of such Code as amended by section 201 of this Act) shall be deemed to be included in the Internal Revenue Code of 1954, effective on the day following the date of the enactment of this Act, and shall apply with respect to disasters occurring after such date of enactment, and not later than June 30, 1959.

Sec. 5064 of the Internal Revenue Code of 1954 (as such section is included in chapter 51 of such Code as amended by section 201 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress)) reads as follows:

SEC. 5064. LOSSES CAUSED BY DISASTER.

(a) AUTHORIZATION.—Where the President has determined under the Act of September 30, 1950 (42 U. S. C., sec. 1855), that a "major disaster" as defined in such Act has occurred in any part of the United States, the Secretary or his delegate shall pay (without interest) an amount equal to the amount of the internal revenue taxes paid or determined and customs 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 such disaster occurring in such part of the United States after June 30, 1959, if such distilled spirits, wines, rectified products, or beer were held and intended for sale at the time of such disaster. The payments authorized by this section shall be made to the person holding such distilled spirits, wines, rectified products, or beer for sale at the time of such disaster.

(b) CLAIMS.—No claim shall be allowed under this section unless—

(1) filed within 6 months after the date on which the President makes the determination that the disaster referred to in subsection (a) has occurred; and

(2) the claimant furnishes proof to the satisfaction of the Secretary or his delegate that—

(A) he was not indemnified by any valid claim of insurance or otherwise in respect of the tax, or tax and duty, on the distilled spirits, wines, rectified products, or beer covered by the claim; and

(B) he is entitled to payment under this section.

Claims under this section shall be filed under such regulations as the Secretary or his delegate shall prescribe.

(c) DESTRUCTION OF DISTILLED SPIRITS, WINES, RECTIFIED PRODUCTS, OR BEER.—When the Secretary or his delegate has made payment under this section in respect of the tax, or tax and duty, on the distilled spirits, wines, rectified products, or beer condemned by a duly authorized official or rendered unmarketable, such distilled spirits, wines, rectified products, or beer shall be destroyed under such supervision as the Secretary or his delegate may prescribe, unless such distilled spirits, wines, rectified products, or beer were previously destroyed under supervision satisfactory to the Secretary or his delegate.

(d) PRODUCTS OF PUERTO RICO.—The provisions of this section shall not be applicable in respect of distilled spirits, wines, rectified prod-

ucts, and beer of Puerto Rican manufacture brought into the United States and so lost or rendered unmarketable or condemned.

(e) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable in respect of internal revenue taxes on distilled spirits, wines, rectified products, and beer shall, insofar as applicable and not inconsistent with this section, be applied in respect of the payments provided for in this section to the same extent as if such payments constituted refunds of such taxes.

Pursuant to the above provisions of section 210(a)(3) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress), the following new subpart, Subpart G, is added to 26 CFR Part 170:

SUBPART G.—LOSSES CAUSED BY DISASTER

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170.130 Penalties.

AUTHORITY: §§ 170.121 to 170.130, incl., issued under sec. 210(a)(3) of the Excise Tax Technical Changes Act of 1958.

§ 170.121 SCOPE OF SUBPART.—The regulations in this subpart prescribe the requirements necessary to implement section 210(a)(3) of the act, concerning payments which may be made by the United States of amounts equal to the internal revenue taxes paid or determined and customs 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 "major disaster" occurring in the United States on and after the day following the date of enactment of the act, and not later than June 30, 1959. The provisions of this subpart shall not be applicable in respect of distilled spirits, wines, rectified products, and beer of Puerto Rican manufacture brought into the United States.

Definitions

§ 170.122 MEANING OF TERMS.—When used in this subpart, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in this sec-

tion. Words in the plural shall include the singular, and vice versa, and words importing the masculine shall include the feminine as well. The terms "includes" and "including" do not exclude things not enumerated which are in the same general class.

Act.—The Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

Alcoholic liquors, or "liquors".—Distilled spirits, wines, rectified products, and beer, lost, rendered unmarketable, or condemned, as provided in this subpart.

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.

Beer. Beer, ale, porter, stout, and other similar fermented beverages (includes saké or other similar products) of any name or description containing one-half of 1 percent or more of alcohol by volume on which the internal revenue tax has been paid or determined, and, if imported, on which duties have been paid at the rate applicable thereto.

Claimant. The person who held the liquors for sale at the time of the disaster and who files claim under this subpart.

Commissioner. The Commissioner of Internal Revenue.

Commissioner of Customs. The Commissioner of Customs, Bureau of Customs, Treasury Department, Washington, D. C.

Disaster. A flood, fire, hurricane, earthquake, storms, or other catastrophe which has occurred in any part of the United States on and after the day following the date of enactment of the act, and not later than June 30, 1959, and which the President of the United States has determined, under the Act of September 30, 1950 (64 Stat. 1109; 42 U. S. C. 1855), was a "major disaster" as defined in such act.

Distilled spirits, or spirits.—Ethyl alcohol and other distillates, such as whisky, brandy, rum, gin, and vodka, on which the internal revenue tax has been paid or determined, and, if imported, on which duties have been paid at the rate applicable thereto.

Duly authorized official.—Any Federal, State, or local government official in whom has been vested authority to condemn liquors made the subject of a claim under this subpart.

Duty or duties. Any duty or duties paid under the customs laws of the United States.

Rectified products.—Liquors manufactured by rectifying, purifying, refining, mixing, or blending distilled spirits or wines and on which tax has been paid or determined, and, if imported, on which duty has been paid.

Tax.—With respect to: (a) unrectified distilled spirits, the internal revenue distilled spirits tax paid or determined thereon; (b) wines, the internal revenue wine tax paid or determined thereon; (c) rectified products, the internal revenue distilled spirits tax, the rectification tax (if any), the cordial tax (if any), and the wine tax (if any), paid or determined thereon; and (d) beer, the internal revenue beer tax paid or determined thereon.

United States.—When used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

Wines.—All still wines, effervescent wines, and flavored wines, on which internal revenue wine tax has been paid or determined, and, if imported, on which duty has been paid.

Payments

§ 170.123 CIRCUMSTANCES UNDER WHICH PAYMENT MAY BE MADE.—Assistant regional commissioners shall allow payment (without interest) of an amount equal to the amount of tax paid or determined, and the Commissioner of Customs shall allow payment (without interest) of an amount equal to the amount of customs duty paid, on distilled spirits, wines, rectified products, and beer previously withdrawn, which are lost, rendered unmarketable, or condemned by a duly authorized official by reason of a disaster occurring in the United States on and after the day following the date of enactment of the act, and not later than June 30, 1959. Payments may be made only if, at the time of the disaster, such liquors were being held for sale by the claimant.

Claims Procedure

§ 170.124 EXECUTION AND FILING OF CLAIM.—Claims under this subpart shall be executed on Form 843 (Internal Revenue) in accordance with such instructions thereon as are applicable, and filed (original only) with the assistant regional commissioner of the internal revenue region in which the liquors were lost, rendered unmarketable, or condemned, within 6 months after the date on which the President makes the determination that the disaster has occurred. The claim shall state all the facts on which the claim is based, and shall set forth, in detail as to each class of liquor, the quantity (tax gallons, wine gallons, barrels, etc.), the kind of tax and rate or rates applicable to each item, and the amount claimed.

§ 170.125 SEPARATION OF IMPORTED, DOMESTIC, AND VIRGIN ISLAND LIQUORS; SEPARATE CLAIMS FOR TAXES AND DUTIES.—If a claim involves taxes on domestic liquors, imported liquors, and/or liquors of Virgin Island manufacture, the quantities of each must be shown separately in the claim. A separate claim must be filed in respect of customs duties.

§ 170.126 CLAIMANT TO FURNISH PROOF.—The Claimant shall furnish proof to the satisfaction of the assistant regional commissioner regarding the following:

(a) that the tax on such liquors, or the tax and duty if imported, was fully paid, or the tax, if not paid, was fully determined;

(b) that such liquors were lost, rendered unmarketable, or condemned by a duly authorized official, by reason of damage sustained as a result of a disaster;

(c) the type and date of occurrence of the disaster and the location of the liquors at that time;

(d) that the claimant was not indemnified by a valid claim of insurance or otherwise in respect of the tax, or tax and duty, on the liquors covered by the claim; and

(e) that the claimant is entitled to payment under this subpart.

§ 170.127 SUPPORTING EVIDENCE.—The claimant shall support his claim with any evidence (such as inventories, statements, invoices, bills, records, labels, formulas, stamps) that he is able to submit, relating to the quantities and identities of liquors, on which duty has been paid or tax has been paid or determined, on hand at the time of the disaster and averred to have been lost, rendered unmarketable, or condemned as a result thereof.

§ 170.128 ACTION OF CLAIMS.—The assistant regional commissioner shall date stamp and examine each claim filed under this subpart and will determine the validity of the claim. The claim will then be processed by him in accordance with existing instructions. Claims and supporting data involving customs duties will be forwarded to the Commissioner of Customs with a summary statement by the assistant regional commissioner regarding his findings.

Destruction of Liquors

§ 170.129 SUPERVISION.—When allowance has been made under this subpart in respect of the tax, or tax and duty, on liquors condemned by a duly authorized official or rendered unmarketable, such liquors shall be destroyed by suitable means under the supervision of an internal revenue officer assigned for that purpose by the assistant regional commissioner, unless such liquors were previously destroyed under supervision satisfactory to the assistant regional commissioner. The Commissioner of Customs will notify the assistant regional commissioner as to allowance under this subpart of claims for duty in respect of unmarketable or condemned liquors.

Penalties

§ 170.130 PENALTIES.—Penalties are provided in sections 7206 and 7207 of the Internal Revenue Code for the execution under the penalties of perjury of any false or fraudulent statement in support of any claim and for the filing of any false or fraudulent document under this subpart. All provisions of law, including penalties, applicable in respect of internal revenue taxes on distilled spirits, wines, rectified products, and beer, shall, insofar as applicable and not inconsistent with this subpart, be applied in respect of the payments provided for in this subpart to the same extent as if such payments constituted refunds of such taxes.

Because the time limitation for filing claims under these regulations is limited, it is found that it is impracticable and contrary to the public interest to issue this Treasury decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act (60 Stat. 238; 5 U. S. C. 1003), or subject to the effective date limitation of section 4(c) of such Act. Accordingly, this Treasury decision shall be effective on the day following the date of enactment of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

(This Treasury Decision is issued under the authority contained in sections 208 and 210(a)(3) of the Excise Tax Technical Changes Act of 1958.)

LEO SPEER,
Acting Commissioner of Internal Revenue.
D. B. STRUBINGER,
Acting Commissioner of Customs.

Approved September 12, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 17, 1958, 8:55 a. m., and published in the issue of the Federal Register for September 18, 1958, 23 F. R., 7215.)

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26 CFR 170.121: Scope of subpart.

Requirements prescribed for tax relief in respect of alcoholic liquors lost by reason of disasters occurring after September 2, 1958, and before July 1, 1959. See T. D. 6315, page 962.

PART II.—OCCUPATIONAL TAX

Subpart A.—Rectifier

SECTION 5082.—DEFINITION OF RECTIFIER

Application to extract manufacturers by reason of distribution of samples of finished products to propective customers engaged in the manufacture of cordials, etc. See Rev. Rul. 58-428, page 975.

Subpart D.—Wholesale Dealers

SECTION 5113.—EXEMPTIONS

26 CFR 225.1087: Exemption of distiller. Rev. Rul. 58-446

Section 5113(a) of the Internal Revenue Code of 1954 provides that no distiller who has given the required bond and who sells only distilled spirits of his own production after determination of tax, at the place of manufacture, or at the place of storage in bond, in the original packages shall be required to pay the special tax of a wholesale dealer in liquors on account of such sales. *Held*, in view of the obvious Congressional intent to exempt from the special tax, under certain conditions, distillers who sell only distilled spirits of their own production at the place of manufacture or storage in bond, the term

"original packages" as used in section 5113(a) of the Code includes "new packages" filled pursuant to the provisions of sections 225.415 to 225.417, inclusively, of the Regulations relating to the Warehousing of Distilled Spirits, provided the packages are filled during the period the whisky is stored in an internal revenue bonded warehouse.

SECTION 5114.—RECORDS

26 CFR 194.210; General requirements as to distilled spirits.

For the requirements and penalties attached to keeping of daily records of the receipt and disposition of distilled spirits which apply to "salesmen's samples" or "bonuses," see Rev. Rul. 58–429, page 986.

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26 CFR 194.233: Place of filing.

For instructions on the preparation of Form 338, Wholesale Liquor Dealer's Monthly Report, by a person qualified as both wholesaler and importer. See Rev. Proc. 58–19, page 1133.

Subpart F.—Nonbeverage Domestic Drawback Claimants

SECTION 5131.—ELIGIBILITY AND RATE OF TAX

26 CFR 197.95: Products requiring formulas. Rev. Rul. 58–350
(Also Section 197.105.)

> **Benefit of drawback of tax will not be denied on the distilled spirits used in the production of medicines, medicinal preparations, and flavors and flavoring extracts for use in products other than food or beverages, because of the presence of coumarin, tonka beans, or tonka extract therein.**

Advice has been requested as to the eligibility for drawback of tax on distilled spirits used in the manufacture of medicinal preparations and tobacco flavors, containing coumarin and/or tonka extract which products were manufactured under formulas filed with the Director, Alcohol and Tobacco Tax Division, on Form 1678, Formula and process for Nonbeverage Products, as provided by section 197.95 of the Regulations relating to Drawback on Distilled Spirits Used in Manufacturing Nonbeverage Products.

An order, effective March 5, 1954, issued by the Food and Drug Administration of the Department of Health, Education, and Welfare, considers a food, including beverages, as adulterated under the provisions of the Federal Food, Drug, and Cosmetic Act, 52 Stat. 1040, 21 U. S. C. 301, if it contains coumarin added as such or as a constituent of tonka beans, or tonka extract. See Revenue Ruling 56–627, C. B. 1956–2, 1043, prohibiting the use thereof in rectified spirits and in wines. Flavors for food products, including beverages,

are classified as foods by the Food and Drug Administration. However, medicines, medicinal preparations, and flavors and flavoring extracts for use in products other than food or beverages, such as tobacco flavors, are not classified as food by the Food and Drug Administration. Therefore, benefit of drawback of tax on the distilled spirits used in the production of such preparations will not be denied because of the presence of coumarin, tonka beans, or tonka extract therein.

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26 CFR 197.105: Drawback.

For availability of drawback of tax on distilled spirits used in the production of medicines, medicinal preparations, and flavors and flavoring extracts for use in products other than food or beverages, containing coumarin, tonka beans or tonka extract therein. See Rev. Rul. 58–350, page 974.

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26 CFR 197.130: Nature of records. Rev. Rul. 58–428
(Also Sections 5008, 5082; Part III-C, Sections 3, 5(e); 27 CFR 1.21, 5.30.)

A manufacturer of flavoring extracts may under specified conditions, manufacture and distribute to prospective customers engaged in the manufacture of cordials and other liquors one-ounce samples of flavoring extracts, together with one-ounce samples of finished products flavored with these extracts.

Advice has been requested whether a manufacturer of flavoring extracts may be permitted to manufacture and distribute one-ounce samples of flavoring extracts, together with one-ounce samples of finished products in which the flavors might be used, to prospective customers engaged in the manufacture of cordials and other liquors.

Section 5082 of the Internal Revenue Code of 1954, in defining a rectifier, provides in part "every person who, without rectifying, purifying, or refining distilled spirits, shall, by mixing such spirits, wine, or other liquor with any material, manufacture any spurious, imitation, or compound liquors for sale * * * shall be regarded as a rectifier, and as being engaged in the business of rectifying." If the sample finished products to be distributed to prospective purchasers of the extracts were to be sold, the nonbeverage manufacturer would fall within the above definition of a rectifier. However, since such sample products will not be manufactured for sale, the proposed operations would not make the flavoring extract manufacturer a rectifier as defined in section 5082 of the Code.

Section 5008(b)(1) of the Code provides that no person shall transport, possess, buy, sell, or transfer any distilled spirits, unless the immediate container thereof has affixed thereto in such manner as to be broken on opening the container, a stamp evidencing the tax or indicating compliance with the provisions of Chapter 51 of the Code. However, section 5008(b)(1)(F) makes such provision inapplicable to distilled spirits not intended for sale or for use in the manufacture or production of any article intended for sale. Since the sample cordials and other liquor samples proposed to be produced by the

flavoring extract manufacturer will not be offered for sale or for use in the manufacture or production of any article intended for sale, the containers of such products would not be required to have strip stamps affixed thereto.

Section 3 of the Federal Alcohol Administration Act provides, in part, that it shall be unlawful, except pursuant to a basic permit, to engage in the business of distilling distilled spirits, rectifying or blending distilled spirits, or bottling distilled spirits. Since the operations in question do not constitute engaging in the business of rectifying or bottling distilled spirits, these permit provisions do not apply to such operations. Similarly, since the labeling provisions of section 5(e) of the Act are applicable only to a person "engaged in business" as a distiller, rectifier, etc., bottles containing the sample finished products need not be labeled in accordance with such provisions.

In view of the above, it is held that, if the sample finished products are not for sale, the extract manufacturers are not required to qualify as rectifiers under section 5082 of the Code and will not incur liability for special tax as rectifiers under section 5081 of the Code. The rectification tax would not apply to the sample finished products since they are manufactured for sample purposes only. In order to show that the provisions of sections 5008 and 5021 of the Code are not applicable to such products, the sample finished products, that is, the sample liqueurs, cordials, etc., made by the extract manufacturer to illustrate the use of his flavoring extracts, must be labeled "Sample—Not for Sale." It is also desirable for internal revenue purposes that the samples be labeled to show the nature of the contents and the name and address of the extract manufacturer. No strip stamps are required since the samples are not for sale.

No permit as a rectifier under the Federal Alcohol Administration Act is necessary and the sample finished products need not be labeled in accordance with the regulations issued under such Act. However, section 1263 of Title 18 of the United States Code, 62 Stat. 761, provides that whoever knowingly ships into any place within the United States, any package of or package containing any spirituous, etc., liquor, or any compound containing any spirituous liquor, etc., fit for use for beverage purposes shall be subject to a fine and/or imprisonment unless such package is so labeled on the outside cover as to plainly show the name of the consignee, the nature of its contents, and the quantity contained therein. Such requirement should be observed.

The extract manufacturer must keep a separate record of the quantity of distilled spirits used in the sample finished products, together with the names and addresses of the customers to whom furnished. The quantity of distilled spirits used in such products should be entered in column 1, line 7 (Used not Subject to Drawback) of part 4 of the supporting data of the drawback claim. Samples of the drawback flavoring extracts must represent flavoring extracts eligible under the requirements of the Regulations relating to Drawback on Distilled Spirits Used in Manufacturing Nonbeverage Products.

SUBCHAPTER B.—DISTILLERIES

PART I.—ESTABLISHMENT

SECTION 5175.—NOTICE OF BUSINESS OF DISTILLER

26 CFR 216.75: Application, Form 517.

Omission from application of detailed description of buildings not used in connection of denaturing bonded warehouse operations. See Rev. Rul. 58–513, below.

26 CFR 220.140: Notice, Form 27–A. Rev. Rul. 58–513
(Also Sections 216.75, 221.150, 230.75.)
(Also Sections 5231, 5271, 5301; 225.150, 235.155, 182.105.)

> Detailed descriptions, other than the nature of use, type of construction, and general dimensions, of buildings or rooms on bonded or registered premises not used in connection with the production, storage, etc., of the product for which established, may be omitted from the respective forms of application of proprietors of industrial alcohol plants, distilleries, warehouses, etc. All regular and permanent equipment, apart from the listing of specific equipment required by the forms, should be listed as required by the instructions on the forms. Only a general description and the location of such equipment are necessary.

Advice has been requested whether the proprietor of an industrial alcohol plant may be relieved from showing on Form 1431, Application by Proprietor of Industrial Alcohol Plant, Bonded Warehouse, or Denaturing Plant, a detailed description of certain buildings located on bonded premises which are not used in the actual manufacture and storage of alcohol. Advice has also been requested whether such proprietors may be relieved from listing certain equipment on the form.

The pertinent sections of Chapter 51 of the Internal Revenue Code of 1954 and the regulations relating to distilled spirits require that persons desiring to establish industrial alcohol plants, bonded warehouses, distilleries, rectifying plants, etc., must file an application for a permit to operate, showing, among other things, a description of the premises, including buildings, rooms, and equipment. The following forms are prescribed for such use:

Form 27–A	Notice by Distiller
Form 27–B	Rectifier's Notice
Form 27–D	Application by Proprietor of Internal Revenue Bonded Warehouse
Form 27–E	Notice by Proprietor of Taxpaid Bottling House
Form 27½	Fruit Distiller's Notice
Form 571	Application by Proprietor of Distillery Denaturing Bonded Warehouse
Form 1431	Application by Proprietor of Industrial Alcohol Plant, Bonded Warehouse, or Denaturing Plant

It has been determined that the detailed description, on such applications, of buildings which, although located on the bonded or registered premises, are not required for use in the operations for which the premises are established, serves no useful purpose. Similarly, only a general description and the location of equipment, other than the equipment specified on the particular form, is necessary. Accordingly, it is held that only a general description, containing a statement of the nature of use, type of construction, and general dimensions of buildings or rooms, on bonded premises which are not used in connection with the operation for which the premises were established, need be stated on the appropriate forms. All regular and permanent equipment, other than that required to be listed especially by the forms, should be listed as required by the instructions on the forms, but only general description and the location of such equipment need be shown.

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26 CFR 221.150: Notice, Form 27½.

Omission from application of detailed description of buildings not used in connection with production of distilled spirits. See Rev. Rul. 58–513, page 977.

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26 CFR 230.75: Notice, Form 27–E.

Omission from application of detailed description of buildings not used in connection with bottling operations. See Rev. Rul. 58–513, page 977.

SECTION 5176.—DISTILLER'S BOND

26 CFR 170.141: Scope of subpart. T. D. 6316[1]
(Also Part III–B, Section 3150; 26 CFR 170.155.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 170.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Regulations relating to distilled spirits and beer

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 purpose of this Treasury Decision is to provide regulations implementing sections 207 and 210(f) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

PARAGRAPH 1. Section 210(f) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) reads as follows:

SEC. 210(f). CONTINUATION OF DISTILLER'S NOTICE AND BOND.

Notwithstanding any provision of section 5175 or 5176 (a) of the Internal Revenue Code of 1954, the Secretary of the Treasury or his delegate may waive, as to registered distillers or registered fruit

[1] 23 F. R. 7376.

distillers qualified to operate under bond on April 30, 1959, requirements for filing notice and executing new bond on May 1, 1959, if the distiller and the surety have executed consent to continuation of the terms of the existing bond to cover operations from May 1, 1959, to June 30, 1959, both dates inclusive. Nothing in this subsection shall be construed as limiting the authority of the Secretary of the Treasury or his delegate under section 5176 (b) or (c) of the Internal Revenue Code of 1954.

Pursuant to the above provisions of law, the following new subpart, Subpart H, is added to 26 CFR Part 170:

SUBPART H.—WAIVER OF REQUIREMENTS FOR DISTILLLER'S NOTICE AND BOND ON MAY 1, 1959

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170.147 Disposition by assistant regional commissioner.

AUTHORITY: §§ 170.141 to 170.147, incl., issued under sec. 7805, I. R. C., 68A Stat. 917; 26 U. S. C. 7805.

§ 170.141. SCOPE OF SUBPART.—This subpart provides procedures under section 210(f) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) to permit continuation of the terms of existing distillers' bonds to cover operations from May 1, 1959, to June 30, 1959, both dates inclusive.

Definitions

§ 170.142 MEANING OF TERMS.—When used in this subpart, 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 as well. 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.

Director.—The Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Treasury Department, Washington 25, D. C.

Distiller.—The qualified proprietor of a registered distillery or a registered fruit distillery.

I. R. C.—The Internal Revenue Code of 1954.

Registered distillers or registered fruit distillers.—The proprietors of registered distilleries established and operated under 26 CFR Part

220, or the proprietors of registered fruit distilleries established and operated under 26 CFR Part 221.

U. S. C.—The United States Code.

Waiver of Requirements Concerning Distiller's Notice and Bond

§ 170.143 AUTHORITY.—Notwithstanding the provisions of 26 CFR Part 220 or Part 221 which require distillers to file notice and execute new bond annually on the first day of May, assistant regional commissioners may waive the filing of notice and the execution of new bond on May 1, 1959, by a distiller who is qualified to operate on April 30, 1959, if the distiller files the request for waiver and the consent of surety as provided in § 170.144.

§ 170.144 QUALIFICATION FOR WAIVER.—Every distiller who desires a waiver of the requirements for filing notice and new bond on May 1, 1959, shall submit a written request for such waiver to the assistant regional commissioner. The request must be accompanied by the surety's consent to the extension of the term of the bond to cover the period May 1, 1959, to June 30, 1959, both dates inclusive, executed as prescribed in § 170.145. Where the distiller does not have a clear title to the tract of land on which the distillery is situated, or does not own the distilling apparatus and equipment, and has on file a consent on Form 1602 which expires April 30, 1959, a consent on Form 1602 for the period May 1, 1959, to June 30, 1959, both dates inclusive, shall accompany the request for waiver. The Form 1602 shall be executed as provided in 26 CFR Part 220 or 221, as the case may be. Where the distiller has filed an indemnity bond on Form 3–A, in lieu of a consent on Form 1602, the surety's consent on Form 1533 to extension of such bond to cover the period from May 1, 1959 to June 30, 1959, both dates inclusive, executed as prescribed in § 170.145, shall also accompany the request for waiver.

Consent of Surety on Distiller's Bond (or Indemnity Bond)

§ 170.145 EXECUTION.—Consents of surety submitted under the provisions of this subpart must be executed on Form 1533, in duplicate, by the distiller and the surety, in accordance with the instructions in the notice on the form. The Form 1533 must properly identify the bond affected thereby and contain the following statement of purpose:

To continue in effect the terms and conditions of said bond (including all extensions or limitations of such terms and conditions previously consented to and approved) to cover operations from May 1, 1959, to June 30, 1959, both dates inclusive.

§ 170.146 AUTHORITY TO APPROVE.—Assistant regional commissioners are authorized to approve consents of surety required under this subpart.

§ 170.147 DISPOSITION BY ASSISTANT REGIONAL COMMISSIONER.—Where the assistant regional commissioner approves the consent of surety, he will notify the distiller in writing that he is authorized to operate his distillery from May 1, 1959, to June 30, 1959, both dates inclusive, and will furnish him a copy of the approved consent of surety, Form 1533. The assistant regional commissioner will for-

ward to the Director one copy of the letter of notification to the distiller, and forward to the Commissioner of Accounts one copy of each such consent of surety.

PAR. 2. Section 207 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) reads as follows:

SEC. 207. BEER LOST BY REASON OF FLOODS OF 1951 OR HURRICANES OF 1954.

(a) AUTHORIZATION.—The Secretary of the Treasury or his delegates shall pay (without interest) to the person specified in subsection (b) an amount equal to the amount of the internal revenue tax paid under section 3150(a) of the Internal Revenue Code of 1939 on any fermented malt liquor which was lost, rendered unmarketable, or condemned by a duly authorized health official of the United States or of a State, by reason of the floods of 1951 or the hurricanes of 1954.

(b) CONDITIONS.—The payment provided by subsection (a) shall be made only if—

(1) such fermented malt liquor was lost, rendered unmarketable, or condemned while in the possession of (A) the person who paid such tax, or (B) a dealer selling fermented malt liquor at wholesale or retail;

(2) the person paying the tax, or a dealer specified in paragraph (1) (B), files a claim for such payment with the Secretary of the Treasury or his delegate within 6 months after the effective date of this section; and

(3) the person filing such claim furnishes proof establishing to the satisfaction of the Secretary of the Treasury or his delegate (A) that the internal revenue tax on such fermented malt liquor was fully paid, (B) that such fermented malt liquor was lost, rendered unmarketable, or condemned, by reason of the floods of 1951 or the hurricanes of 1954, (C) in the case of fermented malt liquor rendered unmarketable or condemned, that such liquor has been destroyed, (D) that the claimant was not indemnified against loss of the tax by any valid claim of insurance or otherwise, and (E) if the claimant was not the possessor of the fermented malt liquor at the time it was so lost, rendered unmarketable, or condemned, (i) that such claimant has either reimbursed such possessor for the full cost of such fermented malt liquor, or has replaced for such possessor the full equivalent thereof, without receiving payment or credit of any kind in respect of the tax on such fermented malt liquor, and (ii) that such possessor was not indemnified against loss of the tax by any valid claim of insurance of otherwise (other than by such reimbursement or replacement by the claimant).

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

Pursuant to the above provisions of law, the following new subpart, Subpart I, is added to 26 CFR Part 170:

SUBPART I.—BEER LOST BY REASON OF THE FLOODS OF 1951 OR HURRICANES OF 1954

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170.165 Penalties.

AUTHORITY: §§ 170.155 to 170.165 incl., issued under sec 7805, I. R. C., 68A Stat. 917; 26 U. S. C. 7805.

§ 170.155 SCOPE OF SUBPART.—This subpart prescribes the requirements necessary to implement section 207 of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress), concerning payments which may be made by the United States of amounts equal to the internal revenue tax paid on fermented malt liquor which was lost, rendered unmarketable, or condemned by reason of the floods of 1951 or the hurricanes of 1954.

Definitions

§ 170.156 MEANING OF TERMS.—When used in this subpart, 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 singluar, and vice versa, and words importing the masculine gender shall include the feminine as well. 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.

Beer or fermented malt liquor.—All kinds and types of liquors produced by the fermentation of malt, wholly or in part, or from any substitute therefor.

Claimant.—The person to whom payment may be made, as provided in § 170.158, and, in an instance where the beer has been replaced, such person and the possessor shall join in the claim.

Full equivalent.—A quantity of beer, expressed in barrels of 31 gallons and fractions of barrels, equal to the quantity lost, rendered unmarketable, or condemned.

Health authority.—Any health official having authority to authorize the condemnation of beer.

Person paying tax.—The person, such as a brewer or importer, who originally paid the internal revenue tax on the beer under section 3150(a) of the Internal Revenue Code of 1939.

Possessor.—The person in whose possession the beer was held at the time it was lost, rendered unmarketable, or condemned, as specified in § 170.157.

Tax.—The amount of internal revenue tax paid on the beer under section 3150(a) of the Internal Revenue Code of 1939. From April 1, 1944 to October 31, 1951, the rate of such tax was $8.00 per barrel;

from November 1, 1951, through the calendar year 1954, the rate of such tax was $9.00 per barrel.

Payments

§ 170.157 Circumstances Under Which Payment May Be Made.—Assistant regional commissioners are authorized to allow payment (without interest) of an amount equal to the amount of tax paid on beer which was lost, rendered unmarketable, or condemned by health authorities, by reason of the floods of 1951 or the hurricanes of 1954. Such payment may be made only if the beer was lost, rendered unmarketable, or condemned while in the possession of the person paying the tax or in the possession of a dealer selling beer at wholesale or retail and if a valid claim for payment is timely filed as provided in § 170.159.

§ 170.158 Persons to Whom Payment May Be Made.—Claims may be filed by and payment may be made to any of the possessors referred to in § 170.157. Claims may also be filed by and payment made to (a) the person paying the tax, or (b) a dealer selling beer at wholesale or retail who has either reimbursed such possessor for the full cost of the beer or has replaced the full equivalent thereof for such possessor without receiving payment or credit of any kind in respect of the tax on such beer.

Claims Procedure

§ 170.159 Execution and Filing of Claim.—A claim for payment shall be executed on Form 843 in accordance with such instructions thereon as are applicable, and must be filed with the assistant regional commissioner of the internal revenue region in which the beer was lost, rendered unmarketable, or condemned, within 6 months after the day following the date of enactment of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress). Any claim filed after the specified 6-month period will be rejected.

§ 170.160 Return of Claim for Completion.—The regulations in this subpart contemplate that claims will be filed (a) where the possessor has been reimbursed for the cost of beer or has received the full equivalent of the beer before the filing of the claim, and (b) where the completion of the claim is to await determination, as provided in § 170.163, of the quantity of beer lost, rendered unmarketable, or condemned, and the quantity to be replaced or for which reimbursement is to be made. In the event of (b), the claim will be returned to the claimant, on completion of such determination, for insertion of the necessary data.

§ 170.161 Claimant to Furnish Satisfactory Proof.—The claimant shall furnish proof establishing to the satisfaction of the assistant regional commissioner that:

(a) The internal revenue tax on the beer was fully paid.

(b) The beer was lost, rendered unmarketable, or condemned by a duly authorized health official, by reason of the floods of 1951 or the hurricanes of 1954.

(c) The beer, if rendered unmarketable or condemned, has been destroyed.

(d) The claimant was not indemnified against loss of the tax by any valid claim of insurance or otherwise.

(e) If the claimant was not the possessor of the beer at the time it was so lost, rendered unmarketable, or condemned, (1) that such claimant has either reimbursed such possessor for the full cost of such beer, or replaced for such possessor the full equivalent thereof, without receiving payment or credit of any kind in respect of the tax on such beer, and (2) that neither the claimant nor the possessor was indemnified against loss of the tax by any valid claim of insurance or otherwise (other than by such reimbursement or replacement by the claimant).

§ 170.162 Supporting Evidence.—The claimant shall support his claim with any evidence (such as inventories, statements, invoices, bills, records, stamps, and labels) that he is able to submit, relating to the quantity of taxpaid beer on hand at the time of the flood or hurricane and averred to have been lost, rendered unmarketable, or condemned as a result thereof.

§ 170.163 Reimbursement or Replacement.—The reimbursement of the full cost of the beer or the physical replacement of the beer for a possessor and the completion by the claimant of the claim may be delayed until determination has been made by the assistant regional commissioner as to the quantity of beer lost, rendered unmarketable, or condemned, by reason of a flood or hurricane, as provided in § 170.164. The findings of the assistant regional commissioner in this respect may be made available to the claimant and the possessor. The claim shall be fully completed with respect to evidence of reimbursement or replacement before being further processed by the assistant regional commissioner as provided in § 170.164. Nothing in this section shall be construed as extending the 6-month period provided by law for the original filing of claims under this subpart.

§ 170.164 Action by Assistant Regional Commissioner.—The assistant regional commissioner will date stamp and examine each claim filed under this subpart and will cause such investigation to be made as may be necessary to determine the quantities of beer lost, rendered unmarketable, or condemned, by reason of a flood or hurricane, and the validity of the claim. The claim will then be processed by him in accordance with existing procedures.

Penalties

§ 170.165 Penalties.—Penalties are provided in sections 7206 and 7207 of the Internal Revenue Code for the execution under the penalties of perjury of any false or fraudulent statement in support of any claim and for the filing of any false or fraudulent document under this subpart.

Because sections 207 and 210(f) of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress) are effective on the day following the date of enactment of the Act, it is found that

it is impractical and contrary to the public interest to issue this Treasury decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act (60 Stat. 238; 5 U. S. C. 1003) or subject to the effective date limitation of section 4(c) of such Act. Accordingly, this Treasury decision shall be effective on the day following the date of enactment of the Excise Tax Technical Changes Act of 1958 (H. R. 7125—85th Congress).

(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).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved September 17, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 22, 1958, 8:51 a. m., and published in the issue of the Federal Register for September 23, 1958, 23 F. R. 7376.)

PART II.—OPERATION

SECTION 5194.—TRANSFER OF SPIRITS AT REGISTERED DISTILLERS

26 CFR 225.377: Prohibited mingling in storage tanks.

For the commingling of homogeneous vodka, see Rev. Rul. 58–415, below.

Procedure and use of oldest entry date where spirits are mingled in a warehouse storage tank or transferred between warehouse storage tanks. See Rev. Rul. 58–450, page 1016.

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26 CFR 225.631: Mingling in gauging tank of spirits for taxpayment.

For the commingling of homogeneous vodka, see Rev. Rul. 58–415, below.

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26 CFR 230.190: Mingling of different spirits prohibited. Rev. Rul. 58–415

(Also Sections 225.377, 225.631, 235.697.)

Vodka produced by the same distiller or rectifier, or by two or more distillers or rectifiers, from neutral spirits derived from the same class of materials (such as grain) which are not otherwise heterogeneous and regardless of the period of storage, will be presumed to be homogeneous and may be dumped together for convenience in bottling at a taxpaid bottling house or rectifying plant under the provisions of section 230.190 of the Regulations relating to the Bottling of Taxpaid

Spirits and section 235.697 of the Regulations relating to the Rectification of Spirits and Wines, without being subject to the rectification tax.

Vodka produced by the same distiller from neutral spirits derived from the same class of materials (such as grain) which are homogeneous except for seasons and years, will be eligible for mingling in warehouse storage tanks in an Internal Revenue bonded warehouse under section 225.377 of the Regulations relating to the Warehousing of Distilled Spirits.

Vodka produced by the same distiller or by two or more distillers from neutral spirits derived from the same class of materials (such as grain) will be presumed to be homogeneous and may be mingled in warehouse gauging tanks for convenience in taxpayment under the provisions of section 225.631 of the regulations, applicable to the mingling of neutral spirits.

For a similar procedure which applies to gin, see Revenue Ruling 54–510, C. B. 1954–2, 562.

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26 CFR 235.697: Mingling of different spirits prohibited.

For the commingling of homogeneous vodka, without being subject to the rectification tax. See Rev. Rul. 58–415, page 985.

SECTION 5197.—DISTILLER'S RECORDS AND RETURNS

26 CFR 220.758: Records at taxpaid premises. Rev. Rul. 58–429

(Also Section 5114, 194.210; Part III(c), Section 5c, 27 CFR 6.29.)

> The provisions of the regulations requiring distillers, warehousemen, rectifiers, bottlers, or wholesalers, to keep daily records of the receipt and disposition of distilled spirits, and requiring retailers to keep records of the receipt of distilled spirits, apply to distilled spirits given and received as a bonus and to the disposition of "salesmen's samples."

Advice has been requested as to the record keeping requirements covering distilled spirits disposed of as salesmen's samples or given as bonuses.

Some wholesalers have been reporting as "salesmen's samples" quantities of distilled spirits that were disposed of to retail dealers as a "bonus" in connection with quantity purchases of distilled spirits. Such "bonus" quantities were delivered to the retail customer either by the wholesaler through his salesmen or by the sales representative of one of the wholesaler's suppliers, or were disposed of by the wholesaler to the representative of his supplier with the understanding that the sales representative would in turn pass them on to the retailer. In many instances the "bonus" quantity was not invoiced to the retailer, nor was any record of its receipt kept by the retailer.

The Regulations relating to the Production of Distilled Spirits, the Production of Brandy, the Warehousing of Distilled Spirits, the Bottling of Taxpaid Spirits, and the Rectification of Spirits and

Wines, provide that the distiller, warehouseman, rectifier, or bottler, as the case may be, must keep daily records of the receipt and disposition of distilled spirits for each of the premises maintained by him for the receipt, storage, and disposition of taxpaid distilled spirits and to render monthly reports thereof. Similar provisions as to wholesale liquor dealers appear in sections 194.210, 194.222, and 194.233, of the Regulations relating to Liquor Dealers. Section 194.229 of the regulations provides that a retailer shall keep records of all liquors received by him, showing the quantities thereof, from whom received, and the receiving dates. These regulations implement sections 5114, 5124, 5197(a)(2) and 5285(b) of the Internal Revenue Code of 1954. Sections 5621, and 5692 of the Code provide certain specific penalties with respect to refusing or neglecting to keep the records or to render the summaries of such records required by the foregoing sections of law. The penal and forfeiture provisions of sections 5686(b) and 7302 of the Code are also applicable to any violations of these provisions.

The records required of a liquor dealer are an integral part of the control necessary in administering the internal revenue laws relating to distilled spirits. Such records must show all required information, including, in the case of a wholesale dealer, the name and address of the person to whom he gave or sold the distilled spirits. Falsification of these records or failure by a liquor dealer to correctly report distilled spirits, whether or not disposed of, or received, as "bonuses," or sold or given to a sales representative of the wholesaler's supplier for any purpose, will render the dealer liable to the penalty and forfeiture provisions referred to above. A sales representative of a wholesale liquor dealer's supplier who becomes a party to such falsification of records may, under section 2 of Title 18 of the United States Code, also be punishable.

Where a sales representative procures stocks of distilled spirits that are to be paid for by his principal, either in cash or by credit, for delivery to retailers as a "bonus," or inducement to purchase, such quantities must be reported as received and sent out by his principal in accordance with the requirements of the appropriate regulations referred to above. Of course, if such stocks are sold to retailers, occupational tax, as well as recordkeeping liability, will be involved.

Any noncompliance with the regulations, as described herein, renders the wholesaler or the sales representative's principal, as the case may be, liable to the penalty provisions of section 5621 of the Code for the failure to keep records and may, in addition, jeopardize his basic permit under the Federal Alcohol Administration Act.

It has long been a practice in the wholesale trade for salesmen to carry small quantities of their wares as samples in order that the trade might compare their products with competitive brands as to packaging, taste, and quality. In this connection, reference is made to the recognition given the distribution as samples of one pint or less of distilled spirits to retailers under section 6.29 of the Regulations relating to Inducements Furnished to Retailers, issued pursuant to the Federal Alcohol Administration Act. It is recognized that the reporting in detail of small quantities of distilled spirits actually distributed to prospective purchasers as bona fide samples would be burdensome and would serve little purpose from a control standpoint.

A wholesaler is considered in substantial compliance with the requirements of the regulations if he reports distilled spirits so distributed as disposed of as "salesmen's samples" showing the name of the salesman who received them, without showing the ultimate disposition of such spirits by the salesman, provided, of course, that the spirits so reported are in fact used in good faith as samples by the salesman. Similarly, where a sales representative procures small quantities of distilled spirits from his principal's customers or other wholesale or retail dealers, for use as bona fide samples in his contacts with the trade, neither the principal nor the sales representative is required to maintain records of the receipt and disposition or to render reports of such distilled spirits so used. However, the wholesaler from whom the spirits are procured is not relieved from recording and reporting his disposition of the spirits to the sales representative or his principal, as the case may be.

PART III.—GENERAL PROVISIONS RELATING TO DISTILLERIES AND DISTILLED SPIRITS

SECTION 5212.—PREVENTION AND DETECTION OF FRAUD

26 CFR 182.405: Gauging of alcohol.

Extent of application of the procedure for sampling of bulk spirits at the time of gauge. See Rev. Proc. 58–11, page 1122.

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26 CFR 220.536: Gauging of spirits.

Extent of application of the procedure for sampling of bulk spirits at the time of gauge. See Rev. Proc. 58–11, page 1122.

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26 CFR 225.632: Gauge and taxpayment.

Extent of application of the procedure for sampling of bulk spirits at the time of gauge. See Rev. Proc. 58–11, page 1122.

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26 CFR 230.253: Illustration of marks.

For procedure with respect to placing individual cases of distilled spirits into an outside carton. See Rev. Rul. 58–524, page 992.

SECTION 5214.—REGULATION OF TARIFF IN CONTAINERS OF DISTILLED SPIRITS

26 CFR 175.34: Indicia for domestic liquor bottles. Rev. Rul. 58–351

The exportation of empty bottles, bearing the Federal penalty clause against re-use but not the full indicia as provided by section 175.34 of the Regulations relating to Traffic in Containers of Distilled Spirits, for use abroad, will be allowed since these bottles are not authorized liquor bottles.

Advice has been requested whether empty bottles bearing only a part of the indicia for liquor bottles required by regulations may be exported for use abroad.

Section 175.34 of the Regulations relating to Traffic in Containers of Distilled Spirits provides that bottles must be permanently marked, in either the bottom or the body of each liquor bottle, with the permit number of the manufacturer, the year of manufacture, a symbol and number assigned to represent the name of the bottler procuring the bottles, and be similarly marked on the neck, shoulder, or side of each such bottle with the words, "Federal Law Forbids Sale or Reuse of This Bottle."

Empty bottles bearing the full indicia, as provided under section 175.34 of the regulations, may not be exported except for the purpose of packaging distilled spirits for importation into the United States or for rebottling spirits previously exported in indicia bottles as provided in section 175.101 of the regulations. See also Revenue Ruling 54–288, C. B. 1954–2, 465.

In Revenue Ruling 58–318, C. B. 1958–1, 590, it is held that empty bottles bearing the re-use clause but not the identifying indicia do not fulfill the requirements for a liquor bottle under the regulations. Accordingly, empty bottles bearing only the penalty clause against re-use are not liquor bottles for purposes of the regulations and Revenue Ruling 54–288, *supra*, and may be exported for use abroad.

SECTION 5216.—MASH, WORT AND VINEGAR; VINEGAR FACTORIES

Search without warrant for illicit spirits. See Ct. D. 1826, page 1005.

SECTION 5217.—EXEMPTIONS RELATING TO NATIONAL EMERGENCY TRANSFERS

26 CFR 171.280: Termination of regulations. T. D. 6302[1]

TITLE 26—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER C, PART 171.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Regulations contained in Subpart G, "National Emergency Transfers of Distilled Spirits," (26 CFR (1939) Part 171) amended to conform to Public Law 85–517.

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:

Section 3183 of the Internal Revenue Code of 1939 permitted the use of beverage distilled spirits for industrial purposes and made pro-

[1] 23 F. R. 5562.

vision for appropriate safeguards and controls with respect to the withdrawal and movement of such spirits. The provisions of section 3183 of the Internal Revenue Code of 1939 were implemented by Treasury Decision 5864 [C. B. 1951–2, 248] approved November 2, 1951, which added subpart G "National Emergency Transfers of Distilled Spirits" to 26 CFR (1939) Part 171. The provisions of section 3183 of the Internal Revenue Code of 1939 were reenacted without material change as section 5217 of the Internal Revenue Code of 1954. Such regulations are prescribed under and made applicable to section 5217 of the Internal Revenue Code of 1954, insofar as such regulations are not inconsistent with the Internal Revenue Code of 1954, by virtue of section 7807(a) of the Internal Revenue Code of 1954 and Treasury Decision 6091 [C. B. 1954–2, 47], approved August 16, 1954.

Public Law 85–517, approved July 11, 1958 [C. B. 1958–3, 75] amends section 5217 of the Internal Revenue Code of 1954 by changing the termination date for such section to July 11, 1960.

In order to reflect in such regulations the new termination date, section 171.280 is amended by striking in the first sentence the date, "July 11, 1958" and inserting in lieu thereof the date, "July 11, 1960".

Because these amendments merely extend the termination date of the regulations, it is found impracticable and contrary to the public interest to comply with the public rulemaking and effective date requirements of section 4 (a) and (c) of the Administrative Procedure Act (60 Stat. 238; 5 U. S. C. 1003).

(This Treasury Decision is issued under the authority contained in 68A Stat. 641; 26 U.S.C. 5217.)

RUSSELL C. HARRINGTON,
Commissioner.

Approved July 16, 1958.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on July 22, 1958, at 8:52 a. m. and published in the issue of the Federal Register for July 23, 1958, 23 F. R. 5562.)

SUBCHAPTER C.—INTERNAL REVENUE BONDED WAREHOUSES

PART I.—ESTABLISHMENT

SECTION 5231.—AUTHORITY TO ESTABLISH

26 CFR 225.150: Application, Form 27–D.

Omission from application of detailed description of buildings not used in connection with storage operations. See Rev. Rul. 58–513, page 977.

PART II.—OPERATION

SECTION 5248.—WITHDRAWAL OF SPIRITS WITHOUT PAYMENT OF TAX

26 CFR 182.630b: Reciprocating foreign countries.

Listing of foreign countries for which alcohol may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Proc. 58–13, page 1124.

26 CFR 225.861: Reciprocating foreign countries.

Listing of foreign countries for which distilled spirits may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Proc. 58–13, page 1124.

SUBCHAPTER D.—RECTIFYING PLANTS

PART I.—ESTABLISHMENT

SECTION 5271.—NOTICE OF BUSINESS OF RECTIFIER

26 CFR 235.155: Notice, Form 27–B.

Omission from application of detailed description of buildings not used in connection with rectifying operations. See Rev. Rul. 58–513, page 977.

PART II.—OPERATION

SECTION 5282.—RECTIFICATION OF SPIRITS

26 CFR 235.570: Determining proof of sweetened spirits, wines, etc. Rev. Rul. 58–352

Permission may be granted by Assistant Regional Commissioner, Alcohol and Tobacco Tax, to rectifiers to use the pycnometer distillation procedure in the determination of obscuration of proof provided the specific gravity before and after distillation is determined with the pycnometer. This procedure will be authorized only in those cases where the regional laboratory of the Internal Revenue Service has determined that the "solids method" as provided in section 235.570 of the Regulations relating to the Rectification of Spirits and Wines produces results which are inaccurate by 0.1 degree of proof or more.

26 CFR 235.791: Illustration of marks. Rev. Rul. 58–524
(Also Section 5212; 230.253.)

The proprietor of a rectifying plant desires to package three bottles of distilled spirits in an individual case, bearing the required marks and brands, and place four such cases in a shipping case, bearing a Government panel showing all required information including the serial numbers of the individual cases contained therein. *Held*, small cases of distilled spirits securely sealed as commercial packages for subsequent individual sale by liquor dealers may be packaged by the proprietor of a taxpaid bottling house or a rectifying plant in shipping cases for convenience in handling. The small cases must be marked as indicated by section 235.791 of the Regulations relating to Rectification of Spirits and Wines or section 230.253 of the Regulations relating to Bottling of Tax-paid Spirits, as the case may be. The shipping case must also be completely marked, except that in lieu of a separate serial number therefor the serial numbers appearing on the small cases should be restated thereon. For example, "Contains four cases of three 4/5-quart each, Serial Nos. 1–4." The bottom flaps of the inner cases need not be sealed if they are sufficiently secured by interlocking construction as to prohibit removal of the bottles.

SUBCHAPTER E.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, DENATURING PLANTS, AND DENATURATION

PART I.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, AND DENATURING PLANTS

SECTION 5301.—ESTABLISHMENT OF INDUSTRIAL ALCOHOL PLANTS

26 CFR 182.105: Application, Form 1431.

Omission from application of detailed description of industrial alcohol plants and bonded warehouses. See Rev. Rul. 58–513, page 977.

SECTION 5303.—ESTABLISHMENT OF INDUSTRIAL ALCOHOL DENATURING PLANTS

26 CFR 182.707: Denaturants not required to be tested. Rev. Rul. 58–447

Revenue Ruling 55–128, C. B. 1955–1, 589, contains a list of imitation essential oils and aromatic substances, denaturing grade, which have been approved as denaturants by the National Office for use in lieu of the natural oils.

Imitation Lavender Oil No. 940–A, Denaturing Grade, manufactured by S. B. Penick & Company, a synthetic oil lavender, has been approved for use in lieu of the natural oil of lavender. Accordingly, Revenue Ruling 55–128, *supra*, as modified by Revenue Ruling 56–240, C. B. 1956–1, 747, and Revenue Ruling 56–352, C. B. 1956–2, 1038, is

further modified by adding thereto, under the heading of "oil of Lavender," the following:

S. B. Penick & Company, New York, N. Y.	Imitation Lavender Oil No. 940–A, D. G., Penick.	Esters as Linalyl Acetate—45% minimum, and Essential Oils, Isolates and Aromatics (Exclusive of Linalyl Acetate)—55% maximum.

Revenue Ruling 55–128, *supra*, is also modified to refer to the "Director, Alcohol and Tobacco Tax Division," instead of the "Commissioner," in keeping with a similar amendment to section 182.707 of the Industrial Alcohol Regulations.

PART II.—DENATURATION

SECTION 5331.—WITHDRAWAL FROM BOND FREE OF TAX

26 CFR 182.754: General — Rev. Rul. 58–430

The holder of a permit to deal in specially denatured alcohol, under section 5304 of the Internal Revenue Code of 1954, may, as vendor, take constructive receipt of specially denatured alcohol and have the shipment made directly from the denaturing plant or another bonded dealer to a specially denatured alcohol user, provided the terms of his bond are extended to cover such specially denatured alcohol shipment and appropriate notation is made on the withdrawal permits, notices of shipment, and reports covering such transactions.

Advice has been requested whether the holder of a permit to deal in specially denatured alcohol may take constructive possession of specially denatured alcohol to be shipped from any qualified denaturing plant or bonded dealer's premises directly to qualified specially denatured alcohol users under withdrawal permits, Form 1485, Application and Withdrawal Permit of User to Procure Specially Denatured Alcohol, naming the holder of the permit as the vendor.

The holder of a permit to deal in specially denatured alcohol, under section 5304 of the Internal Revenue Code of 1954, may take constructive receipt of specially denatured alcohol, as the vendor, and have the shipment made directly from the denaturing plant or another bonded dealer to the specially denatured alcohol user, provided the following conditions are complied with:

1. The qualified dealer in specially denatured alcohol taking constructive receipt of the alcohol must file a consent of surety on his bond, Form 1475, Bond of Dealer in Specially Denatured Alcohol, extending the terms thereof to cover the constructive receipt of specially denatured alcohol by him and the shipment thereof directly from the denaturing plant or another bonded dealer to the specially denatured alcohol user. Such dealer must also obtain a withdrawal permit, Form 1477, Application and Withdrawal Permit of Bonded Dealer to Procure Specially Denatured Alcohol, as required by section 182.806 of the Industrial Alcohol Regulations, which must

be received by the denaturer or dealer from whom he is to procure the specially denatured alcohol before shipments thereof may be made.

2. The withdrawal permit, Form 1485, issued to the specially denatured alcohol user must show the dealer as the vendor and must contain a statement to the effect that shipment is to be made direct from the denaturing plant and/or bonded dealer named therein. The name and address of the denaturing plant and/or bonded dealer may be shown by affixing a gummed sticker to each copy of the withdrawal permit. Shipments of specially denatured alcohol may not be made until the withdrawal permit, Form 1485, has been delivered by the vendor named therein to the denaturer or the bonded dealer who is to make the shipment to the user and who is to record such shipment on the withdrawal permit.

3. Form 1473, Notice of Shipment of Specially Denatured Alcohol, must show the shipment from the denaturing plant and/or bonded dealer to the actual user and must contain the statement that the shipment is made for the account of the specially denatured alcohol dealer taking constructive receipt of the specially denatured alcohol.

4. An additional copy of Form 1473 covering the shipment must be prepared and furnished to the specially denatured alcohol dealer for his records.

5. Shipments of specially denatured alcohol must be reported on Form 1468–D, Denatured Alcohol Produced and Disposed of at Denaturing Plant, or Form 1478, Bonded Dealer's Report of Specially Denatured Alcohol, followed by a notation that shipment was made for the account of the specially denatured alcohol dealer.

6. Form 1478 filed by the specially denatured alcohol dealer taking constructive receipt of the alcohol must show the constructive receipt and shipment thereof followed by an explanatory notation that the shipment was made direct from the denaturing plant of (*Name and address of denaturer*) and/or bonded dealer (*Name and address of bonded dealer*).

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26 CFR 182.836: General. Rev. Rul. 58–416
(Also Section 212.30.)

Citric acid may be used by specially denatured alcohol users in the manufacture of bay rum, alcoholado, or alcoholado type toilet waters, to prevent clouding of the finished product.

The Internal Revenue Service has found it advisable to provide a means for preventing the clouding of bay rum, alcoholado, or alcoholado type toilet waters resulting from the use of tartar emetic therein.

Treasury Decision 6274, C. B. 1957–2, 960, amended the Regulations relating to Formulas for Denatured Alcohol by requiring bay rum, alcoholado, or alcoholado type toilet waters made with specially denatured alcohol to contain 32 grains of tartar emetic or 0.5 avoirdupois ounce of sucrose octa-acetate in each gallon of finished product. It has been found that when tartar emetic is used, a cloudiness will result from use of slightly alkaline water or from the presence of alkalies in glass containers. In either instance, clouding may occur on standing.

The presence of even a trace of citric acid seems to eliminate any such clouding. However, since water will in some instances be more than slightly alkaline, the use of one-fourth grain of citric acid per fluid ounce of the finished product is proposed.

Permittees now holding approved formulas for the manufacture of alcoholado or bay rum containing tartar emetic who elect to add citric acid to the product to prevent clouding need not submit new formulas on Form 1479–A, Formula for Preparation Made with Specially Denatured Alcohol, indicating such use. However, any formulas submitted in the future for these products in which citric acid is to be used must show such use.

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26 CFR 182.857: To whom may be sold. Rev. Rul. 58–448

Section 182.857 of the Regulations relating to Industrial Alcohol requires that sales of rubbing alcohol compound to purchasers by retail druggist must be made through a registered pharmacist who will, at the time of sale, write or stamp across the brand label in contrasting colors the words "Sold by" followed by his (the pharmacist's) name and the address of the retail drug store where the sale is made. *Held*, under the provisions of section 182.857 of the regulations, where it is evident that the purchaser intends to use the product for external purposes and not for resale, rubbing alcohol compound manufactured with specially denatured alcohol may be sold in customary retail quantities by responsible employees of a retail druggist under the general supervision of the registered pharmacist whose name is written or stamped on the brand label.

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26 CFR 212.15: General. Rev. Rul. 58–598
(Also Sections 212.46, 212.57, 212.65.)

> The Director, Alcohol and Tobacco Tax Division, has authorized the use of certain substitute denaturants in specially denatured alcohol Formula No. 36, prescribed additional authorized uses for Formula No. 36, and has prescribed new specifications for denaturants in specially denatured alcohol Formula No. 40.
> Rev. Rul. 58–290, C. B. 1958–1, 596, modified.

The Director, Alcohol and Tobacco Tax Division, has been asked to authorize the use of certain substitute denaturants and additional uses for certain formulas of specially denatured alcohol.

Section 5331 of the Internal Revenue Code of 1954 provides in part that the character and quantity of the denaturing materials used shall be prescribed by the Secretary of the Treasury or his delegate.

Section 212.15 of the Regulations relating to Formulas for Denatured Alcohol provides in part that the Director, Alcohol and Tobacco Tax Division, may authorize, in his discretion, the use of any formula of specially denatured alcohol for uses not specifically authorized.

Section 212.65 of the Regulations relating to Formulas for Denatured Alcohol provides as follows:

Denaturants prescribed in this part shall comply with the specifications set forth in this subpart: Provided, That, in order to meet requirements of national defense or for other valid reason, the Director, Alcohol and Tobacco Tax Division, may authorize variations from such specifications or authorize the use of substitute denaturants where such variation or substitution will not jeopardize the revenue.

In accordance with the above regulations the Director, Alcohol and Tobacco Tax Division, has authorized the use of certain substitute denaturants in specially denatured alcohol Formula No. 36, prescribed specifications for such denaturants, permitted variations on certain other denaturants in specially denatured alcohol Formula No. 40, and has authorized new uses for specially denatured alcohol Formula No. 36, as follows:

Formula No. 36

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 may be substituted for the prescribed 3 gallons of strong ammonia solution, U.S.P., now required to be added to each 100 gallons of ethyl alcohol. Basic data concerning caustic soda are as follows:

BASIC DATA

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 gollons of ethyl alcohol will contain not less than 8.76 lbs. of sodium hydroxide, anhydrous basis.

Color. A 2 percent solution of the sodium hydroxide in water shall be water-white.

Purity. 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 diluate 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 hydrochloric acid shall be required to neutralize the sample of diluted 50 percent caustic soda, and not less than 36.5 ml. of hydrochloric acid shall be required to neutralize the sample of diluted 73 percent caustic soda.

1 ml. of 0.25 N hydrochloric acid=0.01 g. of sodium hydroxide (anhydrous).

Additional Authorized Uses:

(1) As a solvent:
141. Shampoos.
142. Soap and bath preparations.
450. Cleaning solutions (including household detergents).
(2) As a raw material:
579. Other chemicals.

Formula No. 40

In addition to the previously approved quantities of denaturants, the following quantities may be used:

To every 100 gallons of ethyl alcohol, add 1½ avoirdupois ounces of brucine (alkaloid), brucine sulfate, N.F. IX, or quassin and ⅛ gallon of *tert*-butyl alcohol.

AMENDED BASIC DATA FOR QUASSIN

Optical Assay

When 1 gram of quassin, denaturing grade, 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 (for convenience of solution initially dissolve the quassin in a small amount of 95 percent alcohol).

Revenue Ruling 58–290, C. B. 1958–1, 596, which provides, in part, that when one gram of quassin, denaturing grade, is dissolved in 10,000 milliliters of water, the absorbance of the solution in a one centimeter cell at a wavelength of 258 millicrons shall not be less than 0.550, is hereby modified. See also Revenue Ruling 58–561, page 998, this Bulletin, authorizing the use of 1½ avoirdupois ounces of boric acid, U. S. P., as a substitute denaturant for 1½ avoirdupois ounces of brucine (alkaloid) or brucine sulfate in the production of specially denatured alcohol Formula No. 40, and Revenue Procedure 57–27, C. B. 1957–2, 1097, specifying the responsibilities of the denaturer concerning the use of brucine (alkaloid) or brucine sulfate in the production of specially denatured alcohol Formula No. 40.

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26 CFR 212.16: Formula No. 1. Rev. Rul. 58–449

Section 212.16(e) of the Regulations relating to Formulas for Denatured Alcohol provides, in part, that special industrial solvents must be shipped in containers having a capacity of 50 gallons or more. *Held*, such restriction on shipments of solvents does not prohibit the shipment of special industrial solvents in smaller containers to prospective customers for the purpose of sample evaluation and not for sale. Accordingly, special industrial solvents manufactured with specially denatured alcohol may be shipped in containers of less than 50 gallons to industrial accounts for such sample purposes.

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26 CFR 212.30: Formula No. 23–A.

Use of citric acid in the manufacture of bay rum, alcoholado, or alcoholado type toilet waters. See Rev. Rul. 58–416, page 994.

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26 CFR 212.37: Formula No. 27–B. Rev. Rul. 58–594

Section 212.37 of the Regulations relating to Formulas for Denatured Alcohol prescribes the addition of 100 pounds of medicinal soft soap, U. S. P., and one gallon of lavender oil, U. S. P., to every

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100 gallons of alcohol in specially denatured alcohol Formula No. 27–B. U. S. P. Soft Soap (about 50 percent soap and 50 percent water) is very viscous and hard to handle, but if the ratio is changed to effect a larger percentage of soap and a lesser percentage of water during the initial stages of mixing it becomes less viscous and dissolves more freely in the alcohol. *Held*, the requirements of the regulations may be met in the formulation of specially denatured alcohol Formula No. 27–B 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 ethyl alcohol and, after mixing, by adding thereto 33.5 pounds of water and again mixing.

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26 CFR 212.46: Formula No. 36.

For the use of substitute denaturants in Specially Denatured Alcohol Formula for additional uses of the formula. See Rev. Rul. 58–598, page 995.

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26 CFR 212.57: Formula No. 40. Rev. Rul. 58–561
(Also Section 212.65)

Section 212.57 of the Regulations relating to Formulas for Denatured Alcohol prescribes the use of brucine (alkaloid) or brucine sulfate in specially denatured alcohol Formula No. 40. However, as a result of a critical shortage of brucine and in accordance with the provisions of section 212.65 of the regulations, the use of 1½ avoirdupois ounces of boric acid, U. S. P., is authorized as a substitute denaturant for 1½ avoirdupois ounces of the brucine (alkaloid) or brucine sulfate required in the production of specially denatured alcohol Formula No. 40.

The substitution will cause the formulation for Formula No. 40 to appear as follows:

To every 100 gallons of alcohol add:
1½ avoirdupois ounces of brucine (alkaloid) or brucine sulfate, N. F. IX;
1½ avoirdupois ounces of boric acid, U. S. P.; and
⅛ gallon of *tert*-butyl alcohol.

For a substitute formula previously approved, see Revenue Ruling 58–290, C. B. 1958–1, 290, which holds that quassin, denaturing grade, may be used as a substitute for brucine (alkaloid) or brucine sulfate in the manufacture of specially denatured alcohol Formula No. 40.

For new specifications for denaturants in Specially Denatured Alcohol Formula No. 40. See Rev. Rul. 58–598, page 995.

26 CFR 212.65: General.

For use of boric acid, U. S. P., in lieu of brucine in specially denatured alcohol Formula No. 40, Rev. Rul. 58–561, above.

For variations from prescribed specifications for denaturants and use of substitute denaturants. See Rev. Rul. 58–598, page 995.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATION

SECTION 5362.—REMOVALS OF WINE FROM BONDED PREMISES

26 CFR 240.691: Reciprocating foreign countries.

Listing of foreign countries for which wines may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft. See Rev. Proc. 58–13, page 1124.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.527: Removal of excessive color in white wine.

For the conditions to be met by winemakers desiring to participate in an experimental study for removing excess color from white wines, See Rev. Proc. 58–21, page 1138.

26 CFR 240.529: Materials authorized for treatment of wine. Rev. Rul. 58–461

The use of the following materials, in addition to those specifically authorized by section 240.529 of the Wine Regulations, is considered to be consistent with good commercial practice and, accordingly, such materials have been approved for use by proprietors of bonded wine cellars in the production, cellar treatment, or finishing of wine, within the general limitations of section 240.524 of the regulations or more specifically shown herein, or given in the sections referred to:

Material	Use	Reference or Limitation
Aferrin 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.
Antifoam "A" Antifoam AF Emulsion	To reduce the foam in fermenters.	Section 240.524, 26 CFR.
AMA Special Gelatine Solution	To clarify wine.	Section 240.524, 26 CFR.

Material	Use	Reference or Limitation
Diatomaceous earths or similar products (which do not contain active chemical ingredients or which have not been so treated that they may alter the character of the wine).		
Ascorbic acid Iso-ascorbic acid	To prevent darkening of color and deterioration of 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.
Calcium carbonate	To reduce the excess natural acids in high acid wine.	The natural or fixed acids may not be reduced below five parts per 1,000. Section 250.524, 26 CFR.
Granular cork	To treat wines stored in redwood and concrete tanks.	Not more than 10 pounds per 1,000 gallons of wine.
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.
Oak chips (uncharred and untreated)	To treat wines.	Section 240.524, 26 CFR.
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.
Pectinol Pectizyme	To clarify wine.	One pound per 100 gallons of wine. Section 240.524, 26 CFR.
Polyvinylpyrrolidone (known as PVP)	To clarify and stabilize wine.	The wine after treatment must contain less than one-hundredth of one percent (0.01) of polyvinylpyrrolidone. Section 240.524, 26 CFR.
Sodium bisulfite	As a sterilizing or preserving agent.	Section 240.523, 26 CFR.
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 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. Section 240.524, 26 CFR.

Material	Use	Reference or Limitation
Anion Exchange Resins:		
Amberlite IR–45 Duolite A–7 (Tartex 180) Duolite A–30 (Tartex 181) SAF Anion Exchange	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 fixed acids are not reduced below 5 gram per liter; 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 original character of the wine is not altered.
Cation Exchange Resins:		
Amberlite IR–120H	To stabilize wines.	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 or any wine contained in the wash water during the "sweetening off" process should be discarded or used solely for distilling material.
Amberlite IR–120 Duolite C–3 Na (Tartex 160) Duolite C–20 Na (Tartex 161) Duolite C–25 Na (Tartex 162) SAF Cation Exchange	To exchange sodium ions for undesirable metallic ions.	
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.

Material	Use	Reference or Limitation
Non-Ionic and Conditioned Resins:		
Duolite S-30 (Tartex 260) After special conditioning— Duolite A-7 Duolite A-30 Amberlite IRA-401	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 pH of the wine may not be changed more than 0.2 pH units nor the acidity more than 0.5 gram per liter; and the original character of the wine may not be altered.

Proprietors of bonded wine cellars who desire to use any of the above materials must file notice, in triplicate, with the Assistant Regional Commissioner, Alcohol and Tobacco Tax, as prescribed by section 240.530 of the Wine Regulations.

Materials previously approved which are not specifically covered either by the Wine Regulations or by this Revenue Ruling are no longer authorized for use in the production, cellar treatment, or finishing of wine.

Since this Revenue Ruling contains a complete list of materials approved for the treatment of wine in addition to those listed in section 240.529 of the Wine Regulations, the following Revenue Rulings are hereby superseded:

Revenue Ruling 55–603, C. B. 1955–2, 709;
Revenue Ruling 56–9, C. B. 1956–1, 750;
Revenue Ruling 56–64, C. B. 1956–1, 751;
Revenue Ruling 56–341, C. B. 1956–2, 1042;
Revenue Ruling 56–415, C. B. 1956–2, 1042;
Revenue Ruling 56–551, C. B. 1956–2, 1043;
Revenue Ruling 56–626, C. B. 1956–2, 1043;
Revenue Ruling 57–175, C. B. 1957–1, 608;
Revenue Ruling 57–306, C. B. 1957–2, 967;

Revenue Ruling 57–417, C. B. 1957–2, 968;
Revenue Ruling 57–430, C. B. 1957–2, 968;
Revenue Ruling 58–39, C. B. 1958–1, 598; and
Revenue Ruling 58–108, C. B. 1958–1, 599.

For the conditions to be met by winemakers desiring to participate in an experimental study for removing excess color from white wines. See Rev. Proc. 58–21, page 1138.

For the use of cation exchange resin "Permutit Q" in a continuous column process for the stabilization of wines. See Rev. Rul. 58–596, below.

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26 CFR 240.530: Notice. Rev. Rul. 58–595

The use of "Pectinase" to clarify wine in amounts not exceeding one pound per 100 gallons of wine is considered as being consistent with good commercial practice and may be approved for use by winemakers for this purpose by Assistant Regional Commissioners, Alcohol and Tobacco Tax, pursuant to the provisions of section 240.530 of the Wine Regulations.

Revenue Ruling 58–461, page 999, this Bulletin, containing a list of materials which have been approved for treatment of wine, is hereby amplified. See also the amplification contained in Rev. Rul. 58–596, below.

(Also Section 240.529.) Rev. Rul. 58–596

The use of cation exchange resin "Permutit Q" in a continuous column process for the stabilization of wines is considered as being consistent with good commercial practice and may be approved for use by winemakers by the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax, pursuant to the provisions of section 240.530 of the Wine Regulations. The cation exchange 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 over-all change in the pH of the wine before and after treatment with the cation exchange resin shall not be greater than 0.2 pH units.

Revenue Ruling 58–461, page 999, this Bulletin, containing a list of materials that have been approved for the treatment of wine, is amplified to include "Permutit Q" cation exchange resin. See also the amplification contained in Rev. Rul. 58–595, above.

SECTION 5383.—AMELIORATION AND SWEETENING LIMITATIONS FOR NATURAL GRAPE WINES

26 CFR 240.361: Materials. Rev. Rul. 58–597

Revenue Ruling 55–215, C. B. 1955–1, 599, provides, in part, that wine produced in conformity with the provisions of section 240.365 of

the Wine Regulations may be sweetened by a winemaker who is not the producer of the wine, pursuant to section 240.368 of such regulations. It is now further held that a natural wine produced under the provisions of section 240.361 of the regulations may be sweetened in permanent storage by the receiving winemaker who is not the producer with pure dry sugar or concentrated or unconcentrated grape juice provided the wine after sweetening does not have a sugar solids content in excess of ten percent by weight and the alcohol content thereof is less than fourteen percent by volume.

Revenue Ruling 55–215, *supra*, is hereby amplified.

SECTION 5386.—SPECIAL NATURAL WINES

26 CFR 240.45: Special natural wine. Rev. Rul. 58–431
(Also Part III–C, Section 5(e); 27 CFR 4.21.)

> The term "natural" may not be used on labels to designate grape wines produced under section 5386 of the Internal Revenue Code of 1954 since such wines do not conform to the standard for natural grape wine prescribed in section 4.21(a) of the Regulations relating to the Labeling and Advertising of Wine.

Advice has been requested whether grape wines produced under section 5386 of the Internal Revenue Code of 1954 may bear labels containing the word "natural" in connection with the designation of the wine.

Section 5386 of the Code defines special natural wines in part as the products made from a base of natural wine exclusively, with the addition of natural herbs, spices, fruit juices, aromatics, essences, and other natural flavorings in such quantities or proportions as to enable such products to be distinguished from any natural wine not so treated.

Section 4.21(a), Class 1, of the Regulations relating to the Labeling and Advertising of Wine, issued pursuant to the Federal Alcohol Administration Act, establishes the standard of identity for grape wine and provides in part that "grape wine containing no added grape brandy or alcohol may be further designated as 'natural'." Grape wine as defined in such section means a standard wine without the addition of any material except as may occur in normal cellar treatment.

Wines must be designated on labels in conformity with the standards of identity set forth in the Regulations relating to the Labeling and Advertising of Wine. Therefore, the word "natural" may not be used to describe any wine to which spirits have been added or any wine to which flavoring materials have been added "in such quantities or proportions as to enable such products to be distinguished from any natural wine not so treated," as is required in the case of wines produced under the provisions of section 5386 of the Code.

SUBCHAPTER I.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 5552.—INSTALLMENT OF METERS, TANKS, AND OTHER APPARATUS

26 CFR 245.30: Meters required.

For the use of the Potter Flow Meter by brewers in measuring beer. See Rev. Proc. 58–22, page 1140.

SECTION 5555.—RECORDS, STATEMENTS, AND RETURNS

26 CFR 251.133: General requirements.

For instructions on the preparation of Form 338, Wholesale Liquor Dealer's Monthly Report, by a person who qualifies both as wholesaler and importer. See Rev. Proc. 58–19, page 1133.

26 CFR 251.136: Filing.

For instructions on the preparation of Form 338, Wholesale Liquor Dealer's Monthly Report, by a person who qualifies both as wholesaler and importer. See Rev. Proc. 58–19, page 1133.

SUBCHAPTER J.—PENALTIES, SEIZURES, AND FORFEITURES RELATING TO LIQUORS

PART I.—PENALTY, SEIZURE, AND FORFEITURE PROVISIONS APPLICABLE TO DISTILLING, RECTIFYING, AND DISTILLED AND RECTIFIED PRODUCTS

SECTION 5601.—PENALTY AND FORFEITURE FOR POSSESSION OF UNREGISTERED STILL OR DISTILLING APPARATUS

(Also Sections 5008, 5216, 5681.) Ct. D. 1826

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

1. UNLAWFUL SEARCH AND SEIZURE—POSSESSION OF UNREGISTERED STILL—ADMISSIBILITY OF EVIDENCE.

A search of petitioner's house at night, resulting in the seizure of an illicit still and other distilling apparatus, made without a warrant by Federal agents who had probable cause to believe that petitioner's house contained contraband materials used in the commission of a crime was unlawful. The admission by the trial court of evidence obtained in the search was reversible error. It is a settled doctrine that probable cause for belief that certain articles subject to seizure are in a dwelling cannot of itself justify a search without a warrant.

2. DECISION REVERSED.

Decision of United States Court of Appeals for the Fifth Circuit, 245 F. 2d 32, reversed.

SUPREME COURT OF THE UNITED STATES

Roy Jones, Petitioner, v. *United States of America.*

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

[June 30, 1958.]

MR. JUSTICE HARLAN delivered the opinion of the Court.

After a trial without a jury in the Federal District Court for the Northern District of Georgia, petitioner was found guilty of various violations of the federal liquor laws, stemming from and including the possession of an unregistered still. See 26 U. S. C. (Supp. V) §§ 5601, 5216, 5008, 5681. His claim is that some of the evidence used against him at the trial should have been suppressed because it was obtained by an unlawful search and seizure by federal officers, and that its admission vitiates his conviction. The importance of maintaining strict standards for the admissibility of evidence so challenged in the federal courts led us to grant certiorari. 355 U. S. 810.

Federal alcohol agents received information on April 30, 1956, that petitioner's farmhouse near Dawsonville, Georgia, was the site of an illicit distillery in current operation. Investigating this lead, the agents discovered spent mash, a product resulting from the distilling of alcohol out of mash, in a hollow behind petitioner's house. The running mash emerged from a concealed rubber hose which, when traced as far as was consistent with caution, led close to petitioner's home. On May 1, four federal agents and one state officer returned to this vicinity. The officers observed mash still emerging from the hose, detected the distinctive odor of hot mash from the direction of the house, and heard coming from within the house the sounds of voices and of a blower burner, commonly used in that area to heat distilleries.

At 2 a. m. on May 2, the officers abandoned their watch and returned to the nearby city of Gainesville. During the day, Federal Agent Langford obtained from the United States Commissioner there a *daytime* search warrant for petitioner's house on the basis of an affidavit describing what had been discovered and asserting the officer's belief that the house sheltered an illicit distillery. Late that afternoon, but still in daylight, the five officers resumed their surveillance of the house. Rather than execute the daytime warrant at once, they decided to make further observations to determine which parties were implicated in the operations and whether any vehicles were being used.

About 9 p. m., after darkness had set in, a truck entered petitioner's yard and retreated out of the officers' sight behind the house. Loud noises were heard, and when the truck shortly thereafter sought to regain the public road in front of the house, it became stuck in petitioner's driveway. The officers arrested the two men in the truck and seized what turned out to be 413 gallons of nontaxpaid liquor. At that time a passenger car carrying petitioner's wife and children drove into the yard. The wife rushed to the house and reached the doorway before the federal officers who were then advancing towards it. She sought to block entry by placing her arms across the door, and when informed by Langford of his identity as a federal officer, she demanded to see his search warrant. Langford said that a warrant was not required, and the officers brushed past Mrs. Jones into the house, seizing from the hands of her young boy a shotgun which he was brandishing in an apparent effort to prevent entry.

In the house at that time, in addition to Mrs. Jones and the children, were petitioner's father and brother. The officers did not arrest any of them, but immediately engaged in a general search of the house. The evidence later admitted against petitioner at the trial, including a boiler, fuel burner, and 15 barrels, was seized in rear rooms and in the attic. Petitioner was arrested when he returned to his house about one hour after the search had been completed.

Petitioner moved before trial to suppress the use in evidence of the articles seized in his home. During the hearing on this motion, the Government conceded that by the time petitioner's house was searched the daytime search warrant had expired, and it disclaimed any intention on the part of the federal officers to execute it. Rather it urged that ". . . it is the reasonableness of the search which is under question." Federal Agent Evans testified that he thought a nighttime search warrant could be dispensed with because ". . . the crime was being committed in our presence, at least I assumed we had probable cause for

that."[1] And Agent Langford explained his position by stating: ". . . I thought we had sufficient evidence to go in the premises without a search warrant."[2] The court, in denying the motion to suppress, entered findings of fact and conclusions of law wherein it stated:

> "The Court finds that the facts and circumstances within the knowledge of the officers were sufficient in themselves to warrant a man of reasonable caution in the belief that an offense was being committed and therefore the Court finds that probable cause for the search existed at the time the search was made."

Since this was so, and since ". . . a cautious man [would have been warranted] in the belief that [petitioner] was guilty of the offense of operating an illicit distillery in his home . . .," the court deemed the search reasonable, and hence justified, despite the failure of the officers to obtain a nighttime warrant, and despite their ability, under the circumstances, to have sought such a warrant before entering the house. In so holding, the District Court relied upon *United States* v. *Rabinowitz*, 339 U. S. 56. The Court of Appeals affirmed on the basis of the findings of the district judge. 245 F. 2d 32.

Although it must be recognized that the basis of the two lower court decisions is not wholly free from ambiguity, a careful consideration of the record satisfies us that the search and seizure were considered to have been justified because the officers had probable cause to believe that petitioner's house contained contraband materials which were being utilized in the commission of a crime, and not because the search and seizure were incident to petitioner's arrest. So viewed the judgments below cannot be squared with the Fourth Amendment to the Constitution of the United States[3] and with the past decisions of this Court.

It is settled doctrine that probable cause for belief that certain articles subject to seizure are in a dwelling cannot of itself justify a search without a warrant. *Agnello* v. *United States*, 269 U. S. 30, 33,[4] *Taylor* v. *United States*, 286 U. S. 1, 6. The decisions of this Court have time and again underscored the essential purpose of the Fourth Amendment to shield the citizen from unwarranted intrusions into his privacy. See, *e. g.*, *Johnson* v. *United States*, 333 U. S. 10, 14; *McDonald* v. *United States*, 335 U. S. 451, 455; cf. *Giordenello* v. *United States*, decided today, *ante*, p. 480. This purpose is realized by Rule 41 of the Federal Rules of Criminal Procedure, which implements the Fourth Amendment by requiring that an impartial magistrate determine from an affidavit showing probable cause whether information possessed by law-enforcement officers justifies the issuance of a search warrant. Were federal officers free to search without a warrant merely upon probable cause to believe that certain articles were within a home, the provisions of the Fourth Amendment would become empty phrases, and the protection it affords largely nullified.

The facts of this case impressively bear out these observations, for it is difficult to imagine a more severe invasion of privacy than the nighttime intrusion into a private home that occurred in this instance. The Criminal Rules specifically deal with searches of this character by restricting nighttime warrants to situa-

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[1] This witness further testified: "Q. What crime did you see committed inside the house before you went inside to search the place? A. I didn't see any crime. Q. What crime did you say was committed in your presence? A. The one I saw was the transporting of the whiskey out through his yard. Q. Through his yard? A. Yes, sir. Q. You stopped that truck, didn't you? A. Yes, sir. Q. You arrested the occupants of that truck, did you not? A. Yes, sir. Q. Neither one of the occupants of that truck fled into that house, did they? A. No, sir. Q. So you had no knowledge that anyone else was even in the house, had you? A. If you mean by 'knowledge,' did I see anyone else inside the house, no, sir."

[2] On cross-examination, Langford testified: "Q. Mrs. Jones did ask you not to come in, did she not? A. That is correct. Q. Mrs. Jones asked you, did she or not ask you to wait until her husband got there? A. I believe she did, yes." These answers amplified his earlier testimony: "Q. . . . Then you didn't wait until Mr. Jones, himself, came home, did you? A. I did not. Q. Yet they were his premise? That is correct."

[3] "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

[4] In *Agnello* the Court said: "Save in certain cases as incident to arrest, there is no sanction in the decisions of the courts, federal or state, for the search of a private dwelling house without a warrant. Absence of any judicial approval is persuasive authority that it is unlawful. . . . Belief, however well founded, that an article sought is concealed in a dwelling house furnishes no justification for a search of that place without a warrant. And such searches are held unlawful notwithstanding facts unquestionably showing probable cause." 269 U. S., at 33.

tions where the affidavits upon which they are issued ". . . are *positive* that the property is . . . in the place to be search . . ." Rule 41 (c). (Italics added.) This rule is hardly compatible with a principle that a search without a warrant can be based merely upon probable cause.

The case of *United States* v. *Rabinowitz, supra,* upon which the District Court relied, has no application here. There federal agents, without a search warrant explored the office of the defendant and thereby obtained evidence used against him at trial. But immediately after entering the office and before their search, the agents executed a warrant they had previously obtained for the defendant's arrest. The Court stressed that the legality of the search was entirely dependent upon an initial valid arrest. 339 U. S., at 60. The exceptions to the rule that a search must rest upon a search warrant have been jealously and carefully drawn, and search incident to a valid arrest is among them. See, *e. g., United States* v. *Jeffers,* 342 U. S. 48, 51; *Brinegar* v. *United States,* 338 U. S. 160; *Johnson* v. *United States, supra,* at 14–15. None of these exceptions obtains in this case.

The Government, however, for the first time now maintains that the search and seizure were justifiable as incident to petitioner's lawful arrest. Its argument is: The federal agents involved in this search had authority under federal law to arrest without a warrant upon probable cause to believe that a person had committed a felony. From the the record it is "rational" to infer that the federal agents entered petitioner's house with the purpose of arresting him, upon probable cause to believe that he was guilty of a felony and that he was then in the house. Consequently, the agents' entry was justified and, once in the house, while searching for petitioner, they could properly seize all contraband material in plain sight. The fact that petitioner was not found should not vitiate the legality of the seizures.

These contentions, if open to the Government here, would confront us with a grave constitutional question, namely, whether the forceful nighttime entry into a dwelling to arrest a person reasonably believed within, upon probable cause that he had committed a felony, under circumstances where no reason appears why an arrest warrant could not have been sought, is consistent with the Fourth Amendment. But we do not consider this issue fairly presented by this case, for the record fails to support the theory now advanced by the Government. The testimony of the federal officers makes clear beyond dispute that their purpose in entering was to search for distilling, equipment, and not to arrest petitioner. See notes 1 and 2, *supra,* pp. 3, 4.[5]

Since the evidence obtained through this unlawful search was admitted at the trial, the judgment of the Court of Appeals must be

Reversed.

MR. JUSTICE BLACK concurs in the result.

MR. JUSTICE CLARK with whom MR. JUSTICE BURTON joins, dissenting, in a separate opinion.

PART IV.—PENALTY, SEIZURE, AND FORFEITURE PROVISIONS COMMON TO LIQUORS

SECTION 5681.—PENALTY AND FORFEITURE FOR FAILURE TO POST OR UNLAWFULLY POSTING SIGNS OF DISTILLERS, RECTIFIERS OR WHOLESALE LIQUOR DEALERS

Search without warrant for illicit spirits. See Ct. D. 1826, page 1005.

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[5] We cannot accept the suggestion that the entry was justified since it was made to disarm petitioner's young son of the shotgun. The record plainly enough reveals that this was but a passing episode in the course of the entry, and that the officers immediately proceeded to a search of the entire house.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION
CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6423.—CONDITIONS TO ALLOWANCE IN THE CASE OF ALCOHOL AND TOBACCO TAXES

26 CFR 170.85: Scope of regulations in this subpart. T. D. 6323 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I. SUBCHAPTER E, PART 170.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Application of section 6423, Internal Revenue Code of 1954, as amended, to regulations applying to the refund or credit of tax on distilled spirits, wines, and beer.

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 19, 1958, a notice of proposed rule making with respect to the amendment of the regulations in 26 CFR Part 170 was published in the Federal Register (23 F. R. 4412). The proposed amendments would implement the provisions of section 6423 of the Internal Revenue Code of 1954, as amended, which impose certain limitations on the refund or credit of tax paid or collected on articles taxed under part I, subchapter A, of chapter 51 of the Internal Revenue Code of 1954, as amended, or by any corresponding provision of prior internal revenue laws.

In accordance with the notice, interested parties were afforded an opportunity to submit written data, views, or arguments pertaining thereto. No written comments were received within the period of 30 days prescribed in the notice. However, in order to promote uniformity and efficiency within the Treasury Department, it was found desirable to require claims for credit or refund of taxes collected by collectors of customs, to which the provisions of section 6423 of the Internal Revenue Code of 1954 as amended are applicable, to be filed with assistant regional commissioners (alcohol and tobacco tax) rather than with the collector of customs. As a result, the regulations as so published are hereby adopted as set forth below:

Section 6423 of the Internal Revenue Code of 1954, as amended, reads as follows:

SEC. 6423. CONDITIONS TO ALLOWANCE IN THE CASE OF ALCOHOL AND TOBACCO TAXES.

(a) CONDITIONS.—No credit or refund shall be allowed or made, in pursuance of a court decision or otherwise, of any amount paid or collected as an alcohol or tobacco tax unless the claimant establishes (under regulations prescribed by the Secretary or his delegate)—

[1] The publication of this Treasury Decision in 23 F. R. 7885, dated October 11, 1958, contains (1) instructions for modifying the notice of proposed rulemaking published in 23 F. R. 4412, dated June 19, 1958, 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.

(1) that he bore the ultimate burden of the amount claimed; or

(2) that he has unconditionally repaid the amount claimed to the person who bore the ultimate burden of such amount; or

(3) that (A) the owner of the commodity furnished him the amount claimed for payment of the tax, (B) he has filed with the Secretary or his delegate the written consent of such owner to the allowance to the claimant of the credit or refund, and (C) such owner satisfies the requirements of paragraph (1) or (2).

(b) FILING OF CLAIMS.—No credit or refund of any amount to which subsection (a) applies shall be allowed or made unless a claim therefor has been filed by the person who paid the amount claimed, and, except as hereinafter provided in this subsection, unless such claim is filed after April 30, 1958, and within the time prescribed by law, and in accordance with regulations prescribed by the Secretary or his delegate. All evidence relied upon in support of such claim shall be clearly set forth and submitted with the claim. Any claimant who has on or before April 30, 1958, filed a claim for any amount to which subsection (a) applies may, if such claim was not barred from allowance on April 30, 1958, file a superseding claim after April 30, 1958, and on or before April 30, 1959, conforming to the requirements of this section and covering the amount (or any part thereof) claimed in such prior claim. No claim filed before May 1, 1958, for the credit or refund of any amount to which subsection (a) applies shall be held to constitute a claim for refund or credit within the meaning of, or for purposes of, section 7422(a); except that any claimant who instituted a suit before June 15, 1957, for recovery of any amount to which subsection (a) applies shall not be barred by this subsection from the maintenance of such suit as to any amount claimed in such suit on such date if in such suit he establishes the conditions to allowance required under subsection (a) with respect to such amount.

(c) PERIOD NOT EXTENDED.—Any suit or proceeding, with respect to any amount to which subsection (a) applies, which is barred on April 30, 1958, shall remain barred. No claim for credit or refund of any such amount which is barred from allowance on April 30, 1958, shall be allowed after such date in any amount.

(d) APPLICATION OF SECTION.—This section shall apply only if the credit or refund is claimed on the grounds that an amount of alcohol or tobacco tax was assessed or collected erroneously, illegally, without authority, or in any manner wrongfully, or on the grounds that such amount was excessive. This section shall not apply to—

(1) any claim for drawback,

(2) any claim made in accordance with any law expressly providing for credit or refund where a commodity is withdrawn from the market, return to bond, or lost or destroyed, and

(3) any amount claimed with respect to a commodity which has been lost, where a suit or proceeding was instituted before June 15, 1957.

(e) MEANING OF TERMS.—For purposes of this section—

(1) ALCOHOL OR TOBACCO TAX.—The term "alcohol or tobacco tax" means—

(A) any tax imposed by chapter 51 (other than part II of subchapter A, relating to occupational taxes) or by chapter 52 or by any corresponding provision of prior internal revenue laws, and

(B) in the case of any commodity of a kind subject to a tax described in subparagraph (A), any tax equal to any such tax, any additional tax, or any floor stocks tax.

(2) TAX.—The term "tax" includes a tax and an exaction denominated a 'tax", and any penalty, addition to tax, additional amount, or interest applicable to any such tax.

(3) ULTIMATE BURDEN.—The claimant shall be treated as having borne the ultimate burden of an amount of an alcohol or tobacco tax for purposes of subsection (a)(1), and the owner referred to in subsection (a)(3) shall be treated as having borne such burden for purposes of such subsection, only if—

(A) he has not, directly or indirectly, been relieved of such burden or shifted such burden to any other person,

(B) no understanding or agreement exists for any such relief or shifting, and

(C) if he has neither sold nor contracted to sell the commodities involved in such claim, he agrees that there will be no such relief or shifting, and furnishes such bond as the Secretary or his delegate may require to insure faithful compliance with his agreement.

Pursuant to the above provisions of law, the following new subpart is added immediately following subpart D of part 170 of chapter 26 of the Code of Federal Regulations:

SUBPART E—APPLICATION OF SECTION 6423, INTERNAL REVENUE CODE OF 1954, AS AMENDED, TO REFUND OR CREDIT OF TAX ON DISTILLED SPIRITS, WINES, AND BEER

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GENERAL

§ 170.85 Scope of Regulations in This Subpart.—The regulations in this subpart relate to the limitations imposed by section 6423, I. R. C., on the refund or credit of tax paid or collected in respect to any article of a kind subject to a tax imposed by part I, subchapter A of chapter 51, I. R. C., or by any corresponding provision of prior internal revenue laws.

§ 170.86 Meaning 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.

Article.—The commodity in respect to which the amount claimed was paid or collected as a tax.

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.

Claimant.—Any person who files a claim for a refund or credit of tax under this subpart.

Director.—The Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Treasury Department, Washington 25, D. C.

I. R. C.—Internal Revenue Code of 1954, as amended.

Owner.—A person who, by reason of a proprietary interest in the article, furnished the amount claimed to the claimant for the purpose of paying the tax.

Person.—An individual, a trust, estate, partnership, association, company, or corporation.

Regional commissioner.—The regional commissioner in a region.

Tax.—Any tax imposed by part I, subchapter A of chapter 51, I. R. C., or by any corresponding provision of prior internal revenue laws, and in the case of any commodity of a kind subject to a tax under such part, any tax equal to any such tax, any additional tax, or any floor stocks tax. The term includes an exaction denominated a "tax", and any penalty, addition to tax, additional amount, or interest applicable to any such tax.

§ 170.87 Applicability to Certain Credits or Refunds.—The provisions of this subpart apply only where the credit or refund is claimed on the grounds that an amount of tax was assessed or collected erroneously, illegally, without authority, or in any manner wrongfully, or on the grounds that such amount was excessive. This subpart does not apply to:

(a) any claim for drawback,

(b) any claim made in accordance with any law expressly providing for credit or refund where an article is withdrawn from the market, returned to bond, or lost or destroyed,

(c) any amount claimed with respect to an article which has been lost, where a suit or proceeding was instituted before June 15, 1957, and

(d) any claim based solely on errors in computation of the quantity of an article subject to tax or on mathematical errors in computation of the amount of the tax due, or to any claim in respect of tax collected or paid on an article seized and forfeited, or destroyed, as contraband.

Any suit or proceeding, with respect to any amount to which the provisions of this subpart would apply, which was barred on April 30, 1958, shall remain barred, and no claim for credit or refund of any such amount which was barred from allowance on April 30, 1958, shall be allowed after such date in any amount.

§ 170.88 Ultimate Burden.—For the purposes of this subpart, the claimant, or owner, shall be treated as having borne the ultimate burden of an amount of tax only if:

(a) he has not, directly or indirectly, been relieved of such burden or shifted such burden to any other person,

(b) no understanding or agreement exists for any such relief or shifting, and

(c) if he has neither sold nor contracted to sell the articles involved in such claim, he agrees that there will be no such relief or shifting, and furnishes bond as provided in § 170.94.

§ 170.89 Conditions to Allowance of Credit or Refund.—No credit or refund to which this subpart is applicable shall be allowed or

made, pursuant to a court decision or otherwise, of any amount paid or collected as a tax unless a claim therefor has been filed, as provided in this subpart, by the person who paid the tax and the claimant, in addition to establishing that he is otherwise legally entitled to credit or refund of the amount claimed, establishes:

(a) that he bore the ultimate burden of the amount claimed, or

(b) that he has unconditionally repaid the amount claimed to the person who bore the ultimate burden of such amount, or

(c) that (1) the owner of the article furnished him the amount claimed for payment of the tax, (2) he has filed with the assistant regional commissioner the written consent of such owner to the allowance to the claimant of the credit or refund, and (3) such owner satisfies the requirements of paragraph (a) or (b).

§ 170.90 Requirements on Persons Intending to File Claim.—Any person who, having paid the tax with respect to an article, desires to claim refund or credit of any amount of such tax to which the provisions of this subpart are applicable must:

(a) file a claim, as provided in § 170.91,

(b) comply with any other provisions of law or regulations which may apply to the claim, and

(c) if, at the time of filing the claim, neither he nor the owner has sold or contracted to sell the articles involved in the claim, file a bond on Form 2490, as provided by § 170.94.

CLAIM PROCEDURE

§ 170.91 Execution and Filing of Claim.—Claims to which this subpart is applicable shall be executed on Form 843 (original only) in accordance with instructions on the form and shall (except as hereinafter provided) be filed with the district director of internal revenue for the district where the tax was paid, who will refer such claims to the assistant regional commissioner (alcohol and tobacco tax) for the region. Claims for credit or refund of taxes collected by collectors of customs, to which the provisions of section 6423, I. R. C., are applicable and which Customs regulations (19 CFR Part 24) require to be filed with the assistant regional commissioner of the region in which the claimant is located, shall be executed and filed in accordance with applicable Customs regulations and this subpart. Allegations pertaining to the bearing of the ultimate burden relate to additional conditions which must be established for a claim to be allowed and are not in themselves legal grounds for allowance of a claim. There shall also be attached to the form and made a part of the claim the supporting data required by § 170.92. All evidence relied upon in support of such claim shall be clearly set forth and submitted with the claim.

§ 170.92 Data To Be Shown in Claim.—Claims to which this subpart is applicable, in addition to the requirements of § 170.91, must be set forth or contain the following:

(a) A statement that the claimant paid the amount claimed as a "tax" as defined in this subpart.

(b) If the claim is a superseding claim covering an amount (or any part thereof) claimed in a claim filed on or before April 30, 1958, a statement setting forth the place of filing of such claim,

the date of filing thereof, the amount claimed, and information showing that such prior claim was not barred from allowance on April 30, 1958.

(c) Full identification (by specific reference to the form number, the date of filing, the place of filing, and the amount paid on the basis of the particular form or return) of the tax forms or returns covering the payments for which refunds or credit is claimed.

(d) The written consent of the owner to the allowance of the refund or credit to the claimant (where the owner of the article in respect of which the tax was paid furnished the claimant the amount claimed for the purpose of paying the tax).

(e) If the claimant (or owner, as the case may be) has neither sold nor contracted to sell the articles involved in the claim, a statement that the claimant (or owner, as the case may be) agrees not to shift, directly or indirectly in any manner whatsoever, the burden of the tax to any other person.

(f) If the claim is for refund of a floor stocks tax, or of an amount resulting from an increase in rate of tax applicable to an article, a statement as to whether the price of the article was increased on or following the effective date of such floor stocks tax or rate increase, and, if so, the date of the increase, together with full information as to the amount of such price increase.

(g) Specific evidence (such as relevant records, invoices, or other documents, or affidavits of individuals having personal knowledge of pertinent facts) which will satisfactorily establish the conditions to allowance set forth in § 170.89.

The assistant regional commissioner may require the claimant to furnish as a part of the claim such additional information as he may deem necessary.

§ 170.93 Time for Filing Claim.—(a) *General.*—Except as provided in subsection (c) credit or refund of any amount of tax to which the provisions of this subpart apply shall not be made unless the claimant files a claim therefor after April 30, 1958, and within the time prescribed by law and in accordance with the provisions of this subpart, and no claim filed before May 1, 1958, for the credit or refund of any amount of tax to which this subpart is applicable shall be held to constitute a claim for refund or credit within the meaning of, or for the purposes of, section 7422(a), I. R. C.

(b) *Superseding claims.*—Any claimant who on or before April 30, 1958, filed a claim for any amount to which this subpart applies may, if such claim was not barred from allowance on April 30, 1958, file a superseding claim after April 30, 1958, and on or before April 30, 1959, conforming to the requirements of this subpart and covering the amount (or any part thereof) claimed in such prior claim.

(c) *Suits instituted before June 15, 1957.*—Any claimant who instituted a suit before June 15, 1957, for recovery of any amount to which this subpart applies, shall not be barred by this section from the maintenance of such suit as to any such amount claimed in such suit on such date if in such suit he establishes the conditions to allowance in this subpart with respect to such amount.

BONDS

§ 170.94 Bond, Form 2490.—Each claim for a refund or credit of tax on articles which the claimant or owner, as the case may be, has neither sold nor contracted to sell at the time of filing of the claim must be accompanied by a bond on Form 2490. The bond shall be executed by the claimant or the owner of the articles, as the case may be, in accordance with the provisions of this subpart and the instructions printed on the form. Such bond shall be conditioned that there will be no relief or shifting of the ultimate burden of the tax to any other person. The penal sum shall not be less than the amount of tax claimed on all articles which have not been sold or contracted for sale at the time of filing of the claim. Bonds required by this subpart shall be given with corporate surety or with collateral security. A separate bond must be filed for each claim.

§ 170.95 Corporate Surety.—Surety bonds required by this subpart may be given only with corporate sureties holding certificates of authority from and subject to the limitations prescribed by the Secretary of the Treasury as set forth in Treasury Department Form 356—Revised. Powers of attorney and other evidence of appointment of agents and officers to execute bonds on behalf of corporate sureties are required to be filed with, and passed on by, the Commissioner of Accounts, Surety Bonds Branch, Treasury Department.

§ 170.96 Deposit of Securities in Lieu of Corporate Surety.—In lieu of corporate surety, the principal may pledge and deposit securities which are transferable and are guaranteed as to both interest and principal by the United States, in accordance with the provisions of 31 CFR Part 225.

§ 170.97 Authority To Approve Bonds.—Assistant regional commissioners are authorized to approve all bonds required by this subpart.

§ 170.98 Termination of Liability.—Bonds on Form 2490 will be terminated by the assistant regional commissioner on receipt of satisfactory evidence that the person giving the bond has disposed of the articles covered by the bond and that he bore the ultimate burden of the amount claimed and that no understanding or agreement exists whereby he will be relieved of such burden or shift such burden to another person.

§ 170.99 Release of Pledged Securities.—Securities of the United States, pledged and deposited as provided by § 170.96, shall be released only in accordance with the provisions of 31 CFR Part 225. When the assistant regional commissioner is satisfied that they may be released, he shall fix the date or dates on which a part or all of such securities may be released. At any time prior to the release of such securities, the assistant regional commissioner may, for proper cause, extend the date of release for such additional length of time as he deems necessary.

PENALTIES

§ 170.100 Penalties.—It is an offense punishable by fine and imprisonment for anyone to make or cause to be made any false or fraudulent claim upon the United States, or to make any false or fraudulent

statements, or representations, in support of any claim, or to falsely or fraudulently execute any documents required by the provisions of the internal revenue laws, or any regulations made in pursuance thereof.

Because the provisions of Public Law 85–323 apply to certain claims for refund or credit of tax filed by taxpayers after April 30, 1958, it is found that it is impracticable and 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 is made effective as of May 1, 1958.

(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).)

RUSSELL C. HARRINGTON,
Commissioner.

Approved October 8, 1958.

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

(Filed by the Division of the Federal Register on October 10, 8:49 a. m., and published in the issue of the Federal Register for October 11, 1958, 23 F. R. 7885.)

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 225.412: Determining date of original entry. (Also 225.1171; Section 5194; 225.377.) — Rev. Rul. 58–450

Neutral spirits mingled in an internal revenue bonded warehouse storage tank, or transferred between warehouse storage tanks covered by a single Form 1520, Report of Spirits Gauged, involving two or more original entry dates, may be given the original entry date of the oldest spirits included, provided the spirits so combined are limited to spirits of the same season of production and the proprietor requests the procedure on Form 2323, Consolidation of Packaged Distilled Spirits, appropriately modified.

Advice has been requested whether neutral spirits of the same season of production mingled in a warehouse storage tank, or transferred between warehouse storage tanks covered by a single Form 1520, Report of Spirits Gauged, involving two or more original entry dates, may be given the original entry date of the oldest spirits so mingled or transferred.

Section 225.377 of the Regulation relating to the Warehousing of Distilled Spirits makes provision for the mingling of distilled spirits, including neutral spirits, within specified limitations. Section 225.412 of the regulations provides that where distilled spirits are

deposited in a warehouse storage tank on different dates, each lot so deposited and mingled shall retain its date of original entry for the purpose of determining the period of storage in bond and withdrawals shall be considered to be made on a first-in first-out basis.

Section 225.1171 of the regulations provides that the Director, Alcohol and Tobacco Tax Division, may approve methods of operation other than those provided for in the regulations where it is shown that variations from the requirements are necessary, will not hinder the effective administration thereof, will not jeopardize the revenue, and where such variations are not contrary to any provisions of law.

While the recording of only the date of the oldest neutral spirits contained in a storage tank or transferred between storage tanks might advance the ultimate withdrawal date of part of the spirits as much as six months, the procedure would result in considerable simplification of the records, thus proving advantageous both to the Government and the industry. It is held that such procedure may be permitted under section 225.1171 of the regulations.

Accordingly, where neutral spirits are mingled in a warehouse storage tank, or transferred between warehouse storage tanks pursuant to a single Form 1520, and involve two or more original entry dates, the original entry date of the oldest spirits included may be used for all of the neutral spirits so mingled or transferred, provided the spirits so combined are limited to spirits of the same season of production. However, before such procedure may be adopted, the warehouseman must make application under section 225.1172 of the regulations in view of the requirements of section 225.412 thereof. In addition, once the authority is obtained by the warehouseman to vary the requirements, a specific request must be made on Form 2323, Consolidation of Packaged Distilled Spirits, appropriately modified, in respect to each such mingling of neutral spirits, for approval by the storekeeper-gauger. For the procedure applicable to distilled spirits other than neutral spirits see Revenue Ruling 58–208, C. B. 1958–1, 603.

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26 CFR 225.1171: Exceptions to method of operation.

Procedure and use of oldest entry date where spirits are mingled in a warehouse storage tank or transferred between warehouse storage tanks. See Rev. Rul. 58–450, page 1016.

SUBPART B.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939

Rulings and decisions published in Part III, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1939 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954, the Federal Alcohol Administration Act, or other public laws.

SUBTITLE B.—MISCELLANEOUS TAXES

CHAPTER 26.—LIQUOR

SUBCHAPTER D.—FERMENTED LIQUORS

SECTION 3150.—TAX

26 CFR 170.155: Scope of subpart.

Requirements prescribed for relief in respect of taxes paid on beer lost in the floods of 1951 and hurricanes of 1954. See T. D. 6316, page 978.

SUBPART C.—RULINGS AND DECISIONS UNDER THE FEDERAL ALCOHOL ADMINISTRATION ACT

Rulings and decisions published in Part III, Subpart C, 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 1.21: Domestic producers, rectifiers, blenders, and warehousemen.

Application to nonbeverage manufacturers who distribute samples of finished products to prospective customers engaged in the manufacture of liqueurs, cordials, etc. See Rev. Rul. 58–428, page 975.

SECTION 5(c).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: COMMERCIAL BRIBERY

27 CFR 6.29: Samples.

For the requirements and penalties attached to keeping of daily records of the receipt and disposition of distilled spirits which apply to "salesmen's samples" or "bonuses," see Rev. Rul. 58–429, page 986.

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

27 CFR 4.21: The standards of identity. T. D. 6319 [1]
(Also Section 5(f); 4.64.)

TITLE 27—INTOXICATING LIQUORS.—CHAPTER I, PART 4.—REGULATIONS NO. 4 LABELING AND ADVERTISING OF WINE

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:

Notice of public hearing to be held in Washington, D. C., on November 27, 1956, and in San Francisco, California, on December 4, 1956, with respect to certain proposals to amend Regulations No. 4, Relating to Labeling and Advertising of Wine, was published in the Federal Register on October 12, 1956 (21 F. R. 7804). Upon the conclusion of the said hearing and after consideration of all relevant material submitted by interested persons in connection therewith regarding the proposals, the following amendments to Regulations No. 4 (27 CFR Part 4) are hereby adopted:

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[1] 23 F. R. 7698.

PARAGRAPH 1. In order to make certain changes in the regulations to correspond with the wine taxing provisions of the Internal Revenue Code of 1954:

(A) Section 21, class 1(a) (27 CFR 4.21(a)(1)) is amended by adding immediately following subparagraph (2), a new subparagraph reading as follows:

(3) In the case of domestic wine, in accordance with section 5383 of the Internal Revenue Code.

(B) The proviso at the end of the first paragraph of section 21, class 4(a) (27 CFR 4.21(d)(1)) is amended to read as follows:

PROVIDED, That a domestic product may be ameliorated or sweetened in accordance with the provisions of section 5384 of the Internal Revenue Code and any product other than domestic may be ameliorated before, during, or after fermentation by adding, separately or in combination, dry sugar, or such an amount of sugar and water solution as will not increase the volume of the resulting product more than 35 percent, but in no event shall any product so ameliorated have an alcoholic content, derived by fermentation, of more than 13 percent by volume, or a natural acid content, if water has been added, of less than 5 parts per thousand, or a total solids content of more than 22 grams per 100 cubic centimeters.

(C) The proviso at the end of the first paragraph of section 21, class 5(a) (27 CFR 4.21(e)(1)) is amended to read as follows:

PROVIDED, That a domestic product may be ameliorated or sweetened in accordance with the provisions of section 5384 of the Internal Revenue Code and any product other than domestic may be ameliorated before, during, or after fermentation by adding, separately or in combination, dry sugar, or such an amount of sugar and water solution as will increase the volume of the resulting product, in the case of wines produced from loganberries, currants, or gooseberries, having a normal acidity of 20 parts or more per thousand, not more than 60 percent, and in the case of other fruit wines, not more than 35 percent, but in no event shall any product so ameliorated have an alcoholic content, derived by fermentation, of more than 13 percent by volume, or a natural acid content, if water has been added, of less than 5 parts per thousand, or a total solids content of more than 22 grams per 100 cubic centimeters.

(D) The proviso at the end of the first paragraph of section 21, class 6(a) (27 CFR 4.21(f)(1)) is amended to read as follows:

PROVIDED, That a domestic product may be ameliorated or sweetened in accordance with sub-part T of 26 CFR, Part 240, and any product other than domestic may be ameliorated before, during, or after fermentation by adding, separately or in combination, dry sugar or such an amount of sugar and water solution as will not increase the volume of the resulting product more than 35 percent, but in no event shall any product so ameliorated have an alcoholic content, derived by fermentation of more than 13 percent by volume, or a natural acid content, if water has been added, of less than 5 parts per thousand, or a total solids content of more than 22 grams per 100 cubic centimeters.

These amendments are of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 2. Section 21, class 2(c) (27 CFR 4.21(b)(3)) is amended by deleting the words "all the words in any such further designation shall be equally conspicuous and shall appear in direct conjunction with and in lettering approximately one-half the size of the words 'sparkling wine' ", and inserting in lieu thereof the following wording:

all the words in such further designation shall appear in lettering of substantially the same size and such lettering shall not be substantially larger than the words "sparkling wine".

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 3. In order to permit the statement of net contents to be omitted from the label if permanently marked on the sides, front, or back of the bottles, the first sentence of section 37(d) (27 CFR 4.37(d)) is amended to read as follows:

(d) The net contents need not be stated on any label if the net contents are displayed by having the same blown, etched, sand-blasted, marked by underglaze coloring, or otherwise permanently marked by any method approved by the Director, in the sides, front, or back of the bottle, in letters and figures in such manner as to be plainly legible under ordinary circumstances, and such statement is not obscured in any manner in whole or in part.

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 4. In order to prohibit any accentuation of alcoholic content statements as well as to provide for a minimum size of type for such statements, the last sentence of section 38(b) (27 CFR 4.38(b)) is amended to read as follows:

Alcoholic content statements, whether required or optional, on labels on containers having a capacity of 1 gallon or less shall be in readily legible script, type, or printing not smaller than 6-point Gothic caps, except in the case of containers having a capacity of less than one-half pint, in which case such script, type, or printing need not be as large as 6-point Gothic caps, but shall be readily legible under ordinary conditions. Alcoholic content statements shall not appear in script, type or printing larger or more conspicuous than 8-point Gothic caps on labels on containers having a capacity of 1 gallon or less and shall not be set off with a border or otherwise accentuated.

This amendment shall become effective 90 days after publication in the Federal Register.

PAR. 5. In order to prohibit the use of the word "unfortified" on wine labels, section 39(a)(7) (27 CFR 4.39(a)(7) is amended to read as follows:

(7) Any statement, design, device, or representation (other than a statement of alcoholic content in conformity with section 36) which tends to create the impression that a wine is "unfortified" or has been "fortified", or contains distilled spirits, or has intoxicating qualities, except that a statement of composition, if required to appear as the designation of a product not defined in these regulations, may include a reference to the type of distilled spirits employed therein.

This amendment is to be effective 90 days after publication in the Federal Register.

PAR. 6. In order to permit the appearance of the vintage date on labels of imported champagne even though packaged in bottles containing more than 1 gallon, section 39(b)(3) (27 CFR 4.39(b)(3)) is amended by inserting the following parenthetical phrase in the first sentence immediately following the words "In the case of imported wine, the year of vintage may be stated if such wine was bottled prior to importation in containers of 1 gallon or less,":

(except that the year of vintage may be stated in the case of champagne whether or not bottled in containers of 1 gallon or less.)

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 7. In order to authorize the Director, Alcohol and Tobacco Tax Division, to require under certain circumstances a certificate of origin and identity for imported wine and a certificate as to authenticity of vintage dates in the case of imported wine bottled prior to importation in containers of 1 gallon or less:

(A) Section 39(b)(3) (27 CFR 4.39(b)(3)) is amended by changing the period at the end of this subparagraph to a colon and inserting the following proviso:

PROVIDED, That in the case of imported wine bottled prior to importation in containers of 1 gallon or less, the year of vintage may be stated only when the invoice is accompanied by a certificate identical with that required above in the case of wine bottled in the United States in containers of 1 gallon or less, if the issuance of such a certificate with respect to such wine has been authorized by the foreign Government concerned.

(B) Section 39(f) (27 CFR 4.39(f)) is amended by inserting the following new subparagraph at the end thereof:

(3) If imported wines are covered by a certificate of origin and/or a certificate of vintage date issued by a duly authorized official of the appropriate foreign government, the label, except where prohibited by the foreign government, may refer to such certificate or the fact of such certification, but shall not be accompanied by any additional statements relating thereto. The reference to such certificate or certification shall be substantially in the following form: "This product accompanied at the time of the importation by a certificate issued by the ———— government (name of government) indicating that the product is ———— (class and type as stated on the label), and (if label bears a statement of vintage date) that the wine is of the vintage of ————" (year of vintage stated on the label).

(C) There is inserted a new section numbered 45 immediately following section 40 (27 CFR 4.40), reading as follows:

§ 4.45 CERTIFICATES OF ORIGIN AND IDENTITY.—Imported wine shall not be released from customs custody for consumption unless the invoice is accompanied by a certificate of origin issued by a duly authorized official of the appropriate foreign government, if the issuance of such certificates with respect to such wine has been authorized by the foreign government concerned, certifying as to the identity of the wine and that the wine has been produced in compliance with the laws of the respective foreign government regulating the production of such wine for home consumption.

These amendments shall become effective 90 days after publication in the Federal Register.

PAR. 8. In order to permit dates of establishment of businesses or brand names to appear on labels other than in direct conjunction with the name of the company or brand name to which they refer, section 39(e) (27 CFR 4.39(e)) is amended to read as follows:

(e) STATEMENT OF MISCELLANEOUS DATES.—No date, except as provided in subsections (b) and (c) hereof with respect to statement of vintage year and bottling date, shall be stated on any label unless in addition thereto and in direct conjunction therewith in the same size and kind of printing, there shall be stated an explanation of the significance thereof such as "established" or "founded in". If any such date refers to the date of establishment of any business or brand name, it shall not be stated, in the case of containers of a capacity of 1 gallon or less, in any printing, type, or script larger than 8-point Gothic caps, and shall be stated in direct conjunction with the name of the person, company, or brand name to which it refers if the Director finds that this is necessary in order to prevent confusion as to the person, company, or brand name to which the establishment date is applicable.

This amendment is of a liberalizing nature and shall become effective on the date of publication in the Federal Register.

PAR. 9. In order to eliminate the requirement that an "Affidavit for Release of Distilled Spirits, Wine, or Malt Beverages under the Federal Alcohol Administration Act" on Form 1652 be deposited with the appropriate customs officer at the port of entry before imported wine may be released from customs custody:

(A) Section 40(b) (27 CFR 4.40(b)) is amended to read:

(b) CERTIFICATE OF LABEL APPROVED.—No imported wine shall be released from customs custody unless there shall have been deposited with the appropriate customs officer at the port of entry the original or a photostatic copy of a "Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1649). Such certificate shall be issued by the Director upon application made on the form designated "Application for Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1647), properly filled out and certified to by the importer or transferee in bond.

(B) Section 40(c) (27 CFR 4.40(c)) is amended to read:

(c) RELEASE.—If the original or photostatic copy of the "Certificate of Label Approval under the Federal Alcohol Administration Act" (Form 1649) bears the signature of the Director, then the brand or lot of imported wine bearing labels identical with those shown thereon may be released from customs custody.

These amendments relieved a restriction presently contained in the regulations and shall become effective on the date of publication in the Federal Register.

PAR. 10. In order to prohibit the use of the word "unfortified" in advertisements for wine, section 64(a)(8) (27 CFR 4.64(a)(8)) is amended to read as follows:

Any statement, design, device, or representation which relates to alcoholic content or which tends to create the impression that a wine is "unfortified" or has been "fortified", or contains distilled spirits, or has intoxicating qualities, except that a statement of composition, if required to appear as a designation of a product not defined in these regulations, may include a reference to the type of distilled spirits employed therein.

This amendment is to be effective 90 days after publication in the Federal Register.

(This Treasury Decision is issued pursuant to and under the authority contained in 49 Stat. 981, as amended; 27 U. S. C. 205).

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved, October 1, 1958.

NELSON P. ROSE.
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 3, 1958, 8:50 a. m., and published in the issue of the Federal Register for October 4, 1958, 23 F. R. 7698.)

Use of word "natural" on labels for wines produced as natural sweet wines under section 5386 of the Code. See Rev. Rul. 58–431, page 1004.

27 CFR 5.30: General.

Application to sample bottles of finished products furnished by extract manufacturers to prospective customers engaged in the manufacture of liqueurs, cordials, etc. See Rev. Rul. 58–428, page 975.

SECTION 5(f).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: ADVERTISING

27 CFR 4.64: Prohibited statements.

Prohibited use of the term "unfortified" in advertisements for wine. See T. D. 6319, page 1019.

SECTION 8.—INTERLOCKING DIRECTORATES

Rev. Rul. 58–562

An officer or director of a parent corporation engaged in business as a distiller or rectifier would not be required to file an interlocking directorate application under section 8 of the Federal Alcohol Administration Act in order to take a similar position with a subsidiary corporation engaged in a totally unrelated business.

Advice has been requested whether a person who is an officer or director for a parent corporation, which is engaged in business as a distiller, would be required to file an interlocking directorate application under section 8 of the Federal Alcohol Administration Act if he took a position as an officer or director of a subsidiary corporation which is engaged in a totally unrelated business.

Section 8(a) of the Federal Alcohol Administration Act provides, in part, as follows:

> Except as provided in subsection (b), it shall be unlawful for any individual to take office, after the date of the enactment of this Act, as an officer or director of any company, if his doing so would make him an officer or director of more than one company engaged in business as a distiller, rectifier, or blender of distilled spirits, or of any such company and of a company which is an affiliate of any company engaged in business as a distiller, rectifier, or blender of distilled spirits, or of more than one company which is an affiliate of any company engaged in business as a distiller, rectifier, or blender of distilled spirits, unless, prior to taking such office, application made by such individual * * * has been granted and after due showing has been made to him that service by such individual as officer or director of all the foregoing companies of which he is an officer or director together with service in the company with respect to which application is made will not substantially restrain or prevent competition in interstate or foreign commerce in distilled spirits * * * :

Section 8 of the Act does not contemplate the filing of an application on the part of officers and directors unless their taking office would result in a connection between two corporations (or groups of corporations) which are engaged in business as a distiller, rectifier or blender of distilled spirits. Viewed in the light of the evident purpose of the statute to control interlocking directorates in the distilling, rectifying, and distilled spirits blending business, individuals taking

office in subsidiary corporations not engaged in these enterprises, even though presently holding office in a company, or subsidiary company, engaged in the business of distilling, rectifying, or blending distilled spirits, could have no effect on the monopolistic trend against which the statutory provision is aimed.

Accordingly, it is held that where an individual holds office in a parent corporation engaged in business as a distiller, rectifier, or blender, and seeks to take office in a subsidiary corporation which is engaged in a totally unrelated business, no interlocking directorate application need be filed under section 8 of the Federal Alcohol Administration Act. For the same reason, where an individual holds office in a non-liquor subsidiary corporation and seeks to take office in a parent corporation (or another subsidiary) engaged in business as a distiller, rectifier, or blender, no interlocking directorate application need be filed under section 8 of the Federal Alcohol Administration Act.

PART IV

TAX CONVENTIONS

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PART IV

TAX CONVENTIONS

UNITED STATES-AUSTRALIA INCOME TAX CONVENTION [1]

A convention between the United States and the Commonwealth of Australia for the avoidance of double taxation and the prevention of fiscal evasion with respect to income taxes was signed at Washington, D. C., on May 14, 1953. The Senate of the United States, on July 9, 1953, advised and consented to ratification of the tax convention without reservation. The convention was ratified by the President on July 23, 1953, and was ratified by the Commonwealth of Australia on December 14, 1953. The instruments of ratification were exchanged at Canberra, Australia, on December 14, 1953. The convention was proclaimed by the President on December 22, 1953, and is effective for taxable years beginning on or after January 1, 1953.

The texts of the convention and transmittal letter read as follows:

DEPARTMENT OF STATE,
Washington, June 1, 1953.

The PRESIDENT,
The White House:

The undersigned, the Acting Secretary of State, has the honor to lay before 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 the Commonwealth of Australia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on May 14, 1953.

This convention, together with one relating to taxes on the estates of deceased persons and one relating to taxes on gifts, was formulated as a result of technical discussions between representatives of this Government and representatives of the Government of Australia, wherein an effort was made to determine the bases upon which conventions between the two Governments might be concluded for the purpose of eliminating double taxation, as far as practicable, and establishing certain procedures for mutual administrative cooperation for the effective enforcement of the convention.

The Department of State and the Department of the Treasury cooperated in the negotiation of the convention submitted herewith, after public announcement of the contemplated negotiations. It has the approval of both Departments.

The income-tax convention with Australia has the same basic objectives as similar conventions which have been entered into by the United States with a number of other countries. In principle and substance the provisions of the convention with Australia are consistent with, if not identical to, provisions in one or more of the income-tax conventions now in force between the United States and foreign countries, namely, Canada, Denmark, Finland, France, Ireland, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the Union of South Africa, and the United Kingdom, as well as an income-tax convention with Greece, which has been approved by the Senate but which has not yet entered into force.

[1] The full text of the convention is published herein, supplementing partial publication in T. D. 6108, C. B. 1954-2, 614.

As stated in previous reports with respect to tax conventions with other countries, it is realized that the imposition and collection of taxes upon the same income by both the United States and a foreign country often result in double taxation of a severe character. It is believed that income-tax conventions constitute an important step toward the removal of this undesirable impediment to international trade and economic development. The convention with Australia establishes a satisfactory basis for the acomplishment of this objective in the mutual interest of the two countries and for the direct benefit of he taxpayers of both countries.

The negotiation and conclusion of conventions regarding double taxation have been strongly supported by both the taxpayers and the tax authorities. This has been made clear in all of the hearings which have been held by the Senate Committee on Foreign Relations with respect to tax conventions. (See, for example, the committee's reports during the 80th Cong., recommending approval, subject to certain reservations, of the conventions with the Netherlands and Denmark; S. Ex. Rept. No. 10, 80th Cong., 2d sess. and S. Ex. Rept. No. 11, 80th Cong., 2d sess.)

The provisions of the income-tax convention with Australia are believed to be in harmony with the policies expressed by the Senate in approving tax conventions.

The convention would be applicable (art. I), so far as United States taxes are concerned, only to the Federal inome taxes. It would not apply to taxes imposed by the several States of the United States, the District of Columbia, or the Territories or possessions of the United States. So far as Australian taxes are concerned, the convention would apply to the Commonwealth income tax and social services contribution, including the tax at the further rates of tax payable in respect of income from property and the additional tax assessed in respect of the undistributed amount of the distributable income of a private company.

Article II defines numerous terms or expressions found in the convention and contains also the usual provision to the effect that in applying the provisions of the convention any term not otherwise defined shall, unless the context otherwise requires, have the meaning which that term has under the tax laws of the country imposing the tax. As usual, a comprehensive definition of "permanent establishment" is included.

Articles III and IV express the principles affecting the determination of amount and the taxation of business income derived by enterprises of one of the countries from sources within the other country. The principle of "permanent establishment" as applied to business income is adopted as in other tax conventions of the United States. The principle found in section 45 of the Internal Revenue Code is also adopted in regard to the adjustment of accounts as between interlocking businesses.

Article V contains the provisions regarding reciprocal exemption from taxation of earnings derived from the operation of registered ships or aircraft. These provisions being consistent with the principle embodied in section 212(b) and 231(d) of the Internal Revenue Code, as amended, apply only to business income from such operations, having no application to corporate dividends.

Article VI provides, on a reciprocal basis, for exemption from Australian tax of dividends paid by a United States corporation, not managed and controlled in Australia, to a stockholder who is not a resident of Australia, regardless of the percentage of gross income, where such dividends are derived by that corporation from sources in Australia.

Article VII relates to taxation of dividends and contains provisions whereby the rate of tax at the source is reduced to 15 percent in the case of all dividends. There is no provision, such as that which will be found in certain other tax conventions, for reducing to 5 percent the tax upon subsidiary dividends paid to the parent company.

Article VIII is related to VI and VII and was included in order to confirm that Australia's imposition of undistributed profits tax as applied to a "private company" would not be disturbed. Since United States law imposes a tax on undistributed profits of certain corporations, the provisions were made reciprocal.

Article IX contains the provisions regarding exemption, upon specified conditions, from taxation in respect of earned income derived as compensation for labor or personal services, including professional services. The policy expressed by the Senate in connection with such provisions was taken into consideration, so that there is no limitation with respect to services performed by entertainers.

Article X contains the provisions regarding reciprocal exemption in the case of royalties for the use, production or reproduction of, or for the privilege of

using, producing or reproducing, a literary, dramatic, musical or artistic work, but the provisions do not apply to royalties in relation to motion picture films or the reproduction by any means of images or sound produced directly or indirectly from those films.

Article XI contains provisions, along the lines of those in existing tax conventions, respecting income from real-property and natural-resource royalties.

Article XII exempts penisons, both private and governmental, from taxation at the source. Similar provisions are in other tax conventions.

Article XIII, in harmony with the principle expressed in provisions of other tax conventions, provides for exemption in regard to the remuneration of professors or teachers, upon specified conditions.

Article XIV provides for reciprocal exemption of religious, scientific, educational, and charitable organizations. Income derived from sources within one of the countries by such an institution of the other country would be exempt from tax by the country from which the income was derived. Provisions along the same line are contained in the income tax conventions with Canada and the Union of South Africa. Each country is left free to impose its tax on business income or like income of such institutions.

Article XV is the credit article, wherein the principles of the United States tax system are adopted with respect to credit for taxes paid to a foreign government. There is provision for a credit against United States tax of income tax paid to Australia. Taken together with article XX, it is the effect of this provision that section 131 of the Internal Revenue Code, as in effect on the day of signature of the convention, will be applicable to allowance of credit for Australian tax. The provision respecting credit against Australian tax is analogous to that in article XII(2) of the convention of the United States with the United Kingdom as applied to United Kingdom tax. Article XV also expresses the principle, as found in the Internal Revenue Code, that for purposes of credit earned income is derived from the country in which services are rendered. Australia retains its power of taxing (1) film rentals from sources in Australia and (2) insurance premiums paid for risks assumed on property located in Australia. It is provided that where a penalty is imposed by either country, such penalty will not be recognized as a tax for which or against which credit is allowed. This is consistent with a principle recognized in United States law. The United States retains full control over taxation of its own citizens, residents, and corporations.

Article XVI relates to assistance in the collection of taxes. It is limited to the collection by one country of such tax imposed by the other country as will insure that the exemption or reduced rate of tax granted under article VII (dividends) and article X (royalties) shall not be enjoyed by persons not entitled to those benefits. The scope and effect of this article are in accord with the policy expressed by the Senate in approving a number of income-tax conventions in 1952 and as embodied in certain reservations. A provision of the kind in article XVI is necessary in order to apply effectively at the source in the United States the reduced rates of tax or exemptions provided by the convention.

Article XVII contains provisions assuring taxpayers a right to lodge a claim when they can show that double taxation has resulted or is likely to result, contrary to the terms of the convention.

Article XVIII relates to the reciprocal exchange of information by the taxation authorities necessary for carrying out the provisions of the convention or for the prevention of fraud or, in general, to prevent fiscal evasion in regard to the taxes covered by the convention. Similar provisions are contained in conventions with certain other countries. As usual, provision is made against disclosure to unauthorized persons of information so exchanged and against disclosure of any trade process.

Article XIX confirms that the taxation authority of each country may communicate directly with the taxation authority of the other country for the purpose of giving effect to the convention.

Article XX, placing certain limitations on the application of the convention, should be read principally in conjunction with article XV, the credit article. The provision in clause (a), that the convention shall not be construed as restricting in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the countries in determining the tax payable to that country, is a standard provision to be found in other tax conventions. Clause (b) confirms the understanding that the convention shall not affect the

operation of Australian law relating to film business controlled abroad and insurance with nonresidents. Australia retains its tax on film rentals and insurance premiums and the permanent establishment principle is made inapplicable to such items in the case of a taxpayer having no such establishment in Australia.

Article XXI provides for ratification and prescribes that the convention shall become effective, as to United States tax, on January 1 of the year in which the exchange of instruments of ratification takes place and, as to Australian tax, for the year of income commencing on July 1 next succeeding the date on which the convention becomes effective for United States tax. It is provided also that the convention shall continue in effect indefinitely, but may be terminated by either party by the giving of a notice of termination to the other party on or before June 30 in any year after 1955. The termination, in such case, would be effective, as to United States tax, on and after January 1 next following the giving of the notice and, as to Australian tax, for the year of income commencing on July 1 next succeeding the date on which the convention ceases to be effective for United States tax, and for all subsequent years.

Respectfully submitted,

WALTER B. SMITH,
Under Secretary.

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE COMMONWEALTH OF AUSTRALIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the Commonwealth of Australia, 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:

Mr. Walter Bedell Smith, Acting Secretary of State of the United States of America, and

The Government of the Commonwealth of Australia:

Sir Percy C. Spender, K. B. E., Q. C., Ambassador Extraordinary and Plenipotentiary of the Commonwealth of Australia,

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 this Convention are—

(a) In Australia:

The Commonwealth income tax and social services contribution, including the tax at the further rates of tax payable in respect of income from property and the additional tax assessed in respect of the undistributed amount of the distributable income of a private company (hereinafter referred to as "Australian tax");

(b) In the United States:

The Federal income taxes, including surtaxes and excess profits taxes (hereinafter referred to as "United States tax").

(2) This Convention shall also apply to any other tax of a substantially similar character imposed by either Contracting State after the date of signature of this Convention.

ARTICLE II

(1) In this Convention, unless the context otherwise requires—

(a) the terms "one of the Contracting States" and "the other Contracting State" mean the United States or Australia, as the context requires;

(b) the term "Australia" means the Commonwealth of Australia and includes the Territories of Papua, New Guinea and Norfolk Islands;

(c) the term "United States" means the United States of America and when used in a geographical sense includes only the States thereof, the Territories of Alaska and Hawaii, and the District of Columbia;

(d) the term "tax" means Australian tax or United States tax, as the context requires;

(e) the terms "resident of one of the Contracting States" and "resident of the other Contracting State" mean a United States resident or an Australian resident, as the context requires;

(f) the term "Australian resident" means any person (other than a citizen of the United States or a United States corporation) who is a resident of Australia and not resident in the United States for the purposes of United States tax, but a corporation (other than a United States corporation) which is a resident of Australia shall not be deemed to be resident in the United States even though that corporation is engaged in trade or business within the United States;

(g) the term "United States resident" means any individual who is resident in the United States for the purposes of United States tax and not a resident of Australia, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not a resident of Australia;

(h) the term "resident of Australia" has the meaning which it has under the laws of Australia relating to Australian tax;

(i) the terms "enterprise of one of the Contracting States" and "enterprise of the other Contracting State" mean a United States enterprise or an Australian enterprise, as the context requires;

(j) the term "Australian enterprise" means an industrial or commercial enterprise or undertaking carried on by an Australian resident;

(k) the term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a United States resident;

(l) the term "company" has the meaning which it has under Australian law relating to Australian tax;

(m) the term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States;

(n) the term "industrial or commercial profits" includes the profits of an industrial or commercial enterprise or undertaking but does not include income in the form of dividends, interest, rent, royalties, management charges, remuneration for personal services, or income from the operation of ships or aircraft;

(o) the term "permanent establishment" means a branch, agency, management or fixed place of business and includes a factory, workshop, mine, oil well, office or agricultural or pastoral property, or the use or installation of substantial equipment or machinery by, for, or under contract with, an enterprise of one of the Contracting States. Where an enterprise or a resident of one of the Contracting States—

(i) carries on business dealings in the other Contracting State through a bona fide commission agent or broker acting in the ordinary course of his business as such and receiving remuneration in respect of those dealings at the rate customary in the class of business in question; or

(ii) maintains in that other State a fixed place of business exclusively for the purchase of goods or merchandise; or

(iii) has a subsidiary corporation which is engaged in trade or business in that other State, whether through a permanent establishment or otherwise; or

(iv) has an agent in that other State (other than an agent who has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of that enterprise, or regularly fills orders on its behalf from a stock of goods or merchandise located in that other State),

that enterprise or resident shall not, merely by reason thereof, be deemed to have a permanent establishment in that other State;

(p) the term "taxation authority" 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 Australia, the Commissioner of Taxation or his authorized representative.

(2) In the application of the provisions of this 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 State relating to the taxes which are the subject of this Convention.

ARTICLE III

(1) An Australian 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 in the United States. If it is so engaged, United States tax may be imposed upon the entire income of that enterprise from sources within the United States.

(2) A United States enterprise shall not be subject to Australian tax in respect of its industrial or commercial profits unless it is engaged in trade or business in Australia through a permanent establishment in Australia. If it is so engaged, Australian tax may be imposed upon the entire income of that enterprise from sources within Australia.

(3) There shall be allowed in determining the industrial or commercial profits attributable to a permanent establishment in one of the Contracting States all expenses of a type allowed as a deduction by that State and which are reasonably attributable to the permanent establishment, including executive and general administrative expenses so attributable, except that, in the case of Australia, there shall be applied the principle underlying section 38 of the Australian Income Tax and Social Services Contribution Assessment Act 1936–1953.

(4) Where an enterprise of one of the Contracting States is engaged in trade or business in the other Contracting State through a permanent establishment in that other State, there shall be attributed to that permanent establishment the industrial or commercial profits which that enterprise might be expected to derive in that other State if it were an independent enterprise engaged in the same or similar activities and its dealings with the enterprise of which it is a permanent establishment were dealings at arm's length with that enterprise or an independent enterprise; and the profits so attributed shall be deemed to be income of that permanent establishment and shall be taxed accordingly.

(5) If the information available to the taxation authority of the Contracting State concerned is inadequate to determine the profits to be attributed to the permanent establishment, nothing in this Article shall affect the application of any law of that State in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that State: *Provided*, That the discretion shall be exercised or the estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this Article.

(6) No portion of any profits arising from the sale of goods or merchandise by an enterprise of one of the Contracting States shall be attributed to a permanent establishment in the other Contracting State by reason of the mere purchase by that enterprise of the goods or merchandise within that other Contracting State.

ARTICLE IV

(1) 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 operative between the two enterprises in their commercial or financial relations which differ from those which might be expected to operate between independent enterprises dealing at arm's length with one another,

then, if by reason of those circumstances profits which might be expected to accrue to one of the enterprises do not accrue to that enterprise, there may be included in the profits of that enterprise the profits which would have accrued to it if it were an independent enterprise engaged in the same or similar activities and its dealings with the other enterprise were dealings at arm's length with that enterprise or an independent enterprise.

(2) Profits included in the profits of an enterprise of one of the Contracting States under paragraph (1) of this Article shall, subject to the provisions of Article XX of this Convention, be deemed to be income of that enterprise and shall be taxed accordingly.

(3) If the information available to the taxation authority of the Contracting State concerned is inadequate to determine, for the purposes of paragraph (1) of this Article, the profits which might be expected to accrue to an enterprise, nothing in this Article shall affect the application of any law of that State in relation to the liability of that enterprise to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that State: *Provided*, That the discretion shall be exercised or the estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this Article.

ARTICLE V

(1) Profits which an Australian resident derives from operating ships or aircraft registered in Australia shall be exempt from United States tax.

(2) Profits which a citizen of the United States who is not a resident of Australia or a United States corporation which is not a resident of Australia derives from operating ships or aircraft registered under the laws of the United States shall be exempt from Australian tax.

ARTICLE VI

(1) A dividend paid to a United States resident by a United States corporation which is not a resident of Australia shall be exempt from Australian tax.

(2) A dividend paid to an Australian resident by a company which is a resident of Australia (other than a United States corporation) shall be exempt from United States tax.

ARTICLE VII

(1) The amount of Australian tax on dividends paid by a company which is a resident of Australia to a United States resident who is liable for United States tax thereon and is not engaged in trade or business in Australia through a permanent establishment in Australia shall not exceed 15 per centum of the dividend.

(2) The rate of United States tax on dividends derived from sources within the United States by an Australian resident who is liable for Australian tax thereon and is not engaged in trade or business in the United States through a permanent establishment in the United States shall not exceed 15 per centum.

ARTICLE VIII

Any additional tax assessable—

(a) in respect of the undistributed amount of the distributable income of a company which is a private company for purposes of Australian tax; or

(b) under the laws of the United States with respect to undistributed profits of corporations,

as the case may be, shall be the amount which would have been assessable if Articles VI and VII had not been included in this Convention.

ARTICLE IX

(1) An individual who is an Australian resident shall be exempt from United States tax on remuneration or other income received, in respect of personal (including professional) services performed in the United States, on or after the effective date of this Convention if—

(a) during the taxable year in which the services are performed he is present in the United States for a period or periods not exceeding in the aggregate 183 days; and

(b) the services are performed for or on behalf of an Australian resident.

(2) An individual who is a United States resident shall be exempt from Australian tax on remuneration or other income received, in respect of personal (including professional) services performed in Australia, on or after the effective date of this Convention if—

(a) during the year of income in which the services are performed he is present in Australia for a period or periods not exceeding in the aggregate 183 days; and

(b) the services are performed for or on behalf of a United States resident.

(3) In determining, for the purposes of this Article, whether a person for, or

on behalf of, whom services are performed is a resident of one of the Contracting States that person shall not be considered a resident of the other Contracting State solely by reason of the fact that he is engaged in trade or business in that other State through a permanent establishment in that other State.

ARTICLE X

Royalties (not being royalties in relation to motion picture films or the reproduction by any means of images or sound produced directly or indirectly from those films) for the use, production or reproduction of, or for the privilege of using, producing or reproducing, a literary, dramatic, musical or artistic work in which copyright subsists, being royalties derived from sources within one of the Contracting States by a resident of the other Contracting State not engaged in trade or business in the former State through a permanent establishment in that State, shall be exempt from tax by the former State.

ARTICLE XI

A resident of one of the Contracting States deriving from sources within the other Contracting State—

(a) royalties in respect of the exploitation of mines, quarries or other natural resources; or

(b) rentals from real property,

may elect for any taxable year to be subject to the tax of the other State on a net basis as if that resident were engaged in trade or business within the other State through a permanent establishment in that State.

ARTICLE XII

(1) A pension (including a Government pension) and an annuity, derived from sources within one of the Contracting States by a resident of the other Contracting State, shall be exempt from tax by the former State.

(2) The term "annuity" means a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in consideration of money paid.

ARTICLE XIII

Where a professor or teacher, who is a resident of one of the Contracting States, is temporarily present in the other Contracting State for the purpose of teaching during a period not exceeding two years at a university, college, school or other educational institution in that other State, remuneration derived by him for so teaching for that period shall be exempt from tax by that other State.

ARTICLE XIV

Income derived from sources within one of the Contracting States by a religious, scientific, educational, or charitable organization of the other Contracting State shall be exempt from taxation by the State from which the income is derived if, within the meaning of the laws of that State, that organization would, if established in that State, be exempt in respect of that income, and if within the meaning of the laws of the other State it would be exempt in respect of income derived from sources within that other State.

ARTICLE XV

(1) Subject to section 131 of the United States Internal Revenue Code as in effect on the date of signature of this Convention, Australian tax shall be allowed as a credit against United States tax.

(2) Subject to any provisions of the law of Australia which may from time to time be in force and which—

(a) relate to the allowance of a credit against Australian tax of tax payable outside Australia; and

(b) do not affect the general principle of this paragraph,

United States tax payable in respect of income derived by a resident of Australia from sources in the United States shall be allowed as a credit against Australian tax payable in respect of that income.

(3) For the purposes of this Article—

(a) profits, remuneration or other income in respect of personal (including professional) services performed in one of the Contracting States shall be deemed to be income derived from sources in that State;

(b) subject to the provisions of paragraph (1) of this Article, an amount included in taxable income under Division 14 or 15 of Part III. of the Australian Income Tax and Social Services Contribution Assessment Act 1936–1953, or that Act as amended from time to time, or the corresponding provisions of a statute substituted for that Act, shall be deemed to be income derived from sources in Australia; and

(c) the terms "Australian tax" and "United States tax" do not include any tax payable in Australia or the United States which represents a penalty imposed under the law of either Contracting State relating to the taxes which are the subject of this Convention.

ARTICLE XVI

Each Contracting State shall, so far as it is practicable to do so, collect, and pay to the other Contracting State, amounts equivalent to amounts due to the other Contracting State by way of taxes which are the subject of this Convention, being amounts the collection of which is necessary in order to ensure that the benefit of exemptions from tax, or of reductions in rates of tax, provided for by this Convention is not received by persons not entitled to that benefit.

ARTICLE XVII

Where a taxpayer shows proof that the action of the taxation authority of one of the Contracting States has resulted, or is likely to result, in double taxation contrary to the provisions of this Convention, he shall be entitled to present the facts to the State of which he is a citizen or a resident, or, if the taxpayer is a corporation or other entity, to the State in which it is created or organized and, should the taxpayer's claim be deemed worthy of consideration, the taxation authority of that State shall endeavor to come to an agreement with the taxation authority of the other State with a view to avoidance of the double taxation in question.

ARTICLE XVIII

(1) The taxation authorities of the Contracting States shall exchange such information (being information available under the respective taxation laws of the Contracting States) as is necessary for carrying out the provisions of this Convention or for the prevention of fraud or for the administration of statutory provisions against avoidance of the taxes which are the subject of this Convention.

(2) Any information so exchanged shall be treated as secret and shall not be disclosed to any persons other than those (including a Court or a reviewing authority) concerned with the assessment or collection of the taxes, which are the subject of this Convention, or the determination of appeals in relation thereto.

(3) No information shall be exchanged which would disclose any trade secret or trade process.

ARTICLE XIX

The taxation authority of each Contracting State may communicate directly with the taxation authority of the other Contracting State for the purpose of giving effect to the provisions of this Convention.

ARTICLE XX

The provisions of this Convention shall not—

(a) be construed as restricting 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 payable to that State; or

(b) affect the operation of Divisions 14 and 15 of Part III of the Australian Income Tax and Social Services Contribution Assessment Act 1936–1953, or that Act as amended from time to time, relating to film business controlled abroad and insurance with non-residents, or the corresponding provisions of any statute substituted for that Act.

ARTICLE XXI

(1) This Convention shall be ratified and the instruments of ratification shall be exchanged at Canberra as soon as possible.

(2) This Convention shall become effective—

(a) in the case of United States tax, on the first day of January in the year in which the exchange of instruments of ratification takes place; and

(b) in the case of Australian tax, for the year if income commencing on the first day of July next succeeding the date upon which this Convention becomes effective in the case of United States tax.

(3) This Convention shall continue in effect indefinitely but either Contracting State may, on or before the thirtieth day of June in any year after 1955, give to the other Contracting State notice of termination and, in that event, this Convention shall cease to be effective—

(a) in the case of United States tax, on and after the first day of January next following the giving of that notice of termination; and

(b) in the case of Australian tax, for the year of income commencing on the first day of July next succeeding the date on which this Convention ceases to be effective in the case of United States tax, and for all subsequent years.

IN WITNESS WHEREOF the above-mentioned Plenipotentiaries have signed the present Convention and have affixed thereto their seals.

DONE at Washington, in duplicate, on the fourteenth day of May, one thousand nine hundred and fifty-three.

For the Government of the United States of America:

WALTER BEDELL SMITH [SEAL]

For the Government of the Commonwealth of Australia:

PERCY C. SPENDER [SEAL]

UNITED STATES-AUSTRIA INCOME TAX CONVENTION

T. D. 6322[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER G, PART 516.—AUSTRIA

Release or refund of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax at source in the case of residents of Austria and of Austrian corporations or other entities, as affected by the income tax convention between the United States and Austria proclaimed by the President of the United States on October 23, 1957.

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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[1] 23 F. R. 7841.

§ 516.1 INTRODUCTORY.—(a) *Pertinent provisions.*—The income tax convention between the United States and the Republic of Austria, signed on October 25, 1956 [C. B. 1957-2, 985], hereinafter referred to as the convention, provides in part as follows, effective on and after January 1, 1957:

ARTICLE I

(1) The taxes referred to in this Convention are:

(a) In the case of the United States of America: The federal income taxes, including surtaxes.

(b) In the case of the Republic of Austria: The Einkommensteuer (income tax), the Koerperschaftsteuer (corporation tax) and the Beitrag vom Einkommen zur Foerderung des Wohnbaues und fuer Zwecke des Familienlastenausgleiches (housing reconstruction and family allowance contribution).

(2) The present Convention shall also apply to any other income or profits tax of a substantially similar character which may be imposed by one of the contracting States after 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 means the States, the Territories of Alaska and Hawaii, and the District of Columbia;

(b) The term "Austria" means the Republic of Austria;

(c) The term "enterprise of one of the contracting States" means, as the case may be, a United States enterprise or an Austrian enterprise;

(d) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on in the United States by a natural person (including an individual in his individual capacity or as a member of a partnership) resident in the United States or by a United States corporation or other entity; the term "United States corporation or other entity" means a corporation or other entity created or organized under the law of the United States or of any State or Territory of the United States;

(e) The term "Austrian enterprise" means an industrial or commercial enterprise or undertaking carried on in Austria by a natural person (including an individual in his individual capacity or as a member of a partnership) resident in Austria or by an Austrian corporation; the term "Austrian corporation" means a corporation or other entity created or organized under the law of Austria;

(f) The term "permanent establishment" means a branch, office, factory, workshop, a warehouse, a merchandising establishment, a mine, oil well or other place of exploitation of the ground or soil, a construction or assembly project or the like, the duration of which exceeds or will likely exceed twelve months, or other fixed place of business; but does neither include the casual and temporary use of mere storage facilities, nor an agent or employee unless the agent or employee has full power for the negotiation and concluding of contracts on behalf of an enterprise and also habitually exercises this power in that other State or has a stock of merchandise belonging to the enterprise of the other State from which he regularly fills orders on behalf of the enterprise. 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 commission agent, broker, custodian or other independent agent, 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 and merchandise shall not of itself constitute such fixed place of business a permanent establishment of the enterprise. The maintenance within the territory of one of the contracting States by an enterprise of the other contracting State of a warehouse for convenience of delivery and not for purposes of display shall not of itself constitute a permanent establishment within that territory. The fact that a corporation of one con-

tracting 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;

(g) The term "competent 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 Austria, the Federal Ministry of Finance.

(2) For the purpose of the present Convention:

(a) Dividends paid by a corporation of one of the contracting States shall be treated as income from sources within such State.

(b) Interest paid by one of the contracting States, including any local government thereof, or by an enterprise of one of the contracting States not having a permanent establishment in the other contracting State shall be treated as income from sources within the former State.

(c) Income from real property (including gains derived from the sale or exchange of such property, but not including interest from mortgages or bonds secured by real property) and royalties in respect of the operation of mines, oil wells, or other natural resources shall be treated as income derived from the contracting State in which such real property, mines, oil wells or other natural resources are situated.

(d) Compensation for labor or personal services (including the practice of liberal professions) shall be treated as income from sources within the contracting State where are rendered the services for which such compensation is paid.

(e) Royalties for using, or for the right to use, in one of the contracting States, patents, copyrights, designs, trademarks and like property shall be treated as income from sources within such State.

(3) In the application of the provisions of this Convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which the term has under its own tax laws. For the purposes of this Convention the term "residence" in Austria shall include the customary place of abode therein.

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ARTICLE VI

The rate of tax imposed by one of the contracting States upon dividends received from sources within such State by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall not exceed 50 percent of the statutory rate of tax imposed on such dividends by such former Sate but such rate of tax shall not exceed 5 percent if the shareholder is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and if not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. Such reduction of the rate to five percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

ARTICLE VII

Interest received from sources within one of the contracting States, on bonds, notes, debentures, securities or on any other form of indebtedness (exclusive of interest on debts secured by mortgages) by a resident or corporation or other entity of the other contracting State shall, in an amount not exceeding fair and reasonable consideration on indebtedness, be exempt from tax by the former State if such resident, corporation or other entity has no permanent establishment in such former State.

ARTICLE VIII

(1) Royalties and other amounts received as consideration for the right to use literary, musical or other copyrights, artistic and scientific works, patents, designs, plans, secret processes and formulae, trademarks, and other like property and rights (including rentals and like payments for the use of

industrial, commercial or scientific equipment but not including motion picture film rentals) by a resident or a corporation or other entity of one of the contracting States from sources within the other contracting State shall, in an amount not exceeding fair and reasonable consideration for such right to use, be exempt from taxation by such other State if the recipient has no permanent establishment situated in such other State.

(2) The rate of tax imposed by one of the contracting States upon motion picture film rentals received from sources within such contracting State by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall not exceed 50 percent of the statutory rate of tax imposed on such rentals but in any case shall not exceed 10 percent of the amount of such rentals.

ARTICLE IX

(1) Income from real property (including gains derived from the sale or exchange of such property and interest on mortgages secured by such property) and royalties in respect of the operation of mines, oil wells or other natural resources shall be taxable in the contracting State in which such property, mines, oil wells or other natural resources are situated.

(2) Where a resident or corporation or other entity of one of the contracting States derives any income coming within the scope of paragraph (1) from property within the other contracting State, the recipient 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, corporation or other entity were engaged in trade or business within such other State through a permanent establishment therein.

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ARTICLE XI

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(2) Private pensions and private life annuities which are from sources within one of the contracting States and are paid to individuals residing in the other contracting State shall be exempt from taxation by 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.

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ARTICLE XIV

(1) Dividends and interest paid by an Austrian corporation (other than a United States corporation) shall be exempt from United States tax where the recipient is a non-resident alien or a foreign corporation.

* * * * * * *

ARTICLE XVI

(1) The competent authorities of the contracting States shall exchange such information (being information available under the respective taxation laws of the contracting States) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the like 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 any trade process.

(2) In no case shall the provisions of this Article be construed so as to impose upon either of the contracting States the obligation to carry out administrative measures at variance with the regulations and practice of either contracting State or which would be contrary to its sovereignty, security or public policy or to supply particulars which are not procurable under its own legislation or that of the State making application.

ARTICLE XVII

* * * * * * *

(2) Should any difficulty or doubt arise as to the interpretation or application of the present Convention or its relationship to Conventions of the contracting States with third States the competent authorities of the contracting States may settle the question by mutual agreement.

ARTICLE XVIII

(1) The provisions of this Convention shall not be construed to deny or affect in any manner the right of diplomatic and consular officers to other or additional exemptions now enjoyed or which may hereafter be granted to such officers.

(2) The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance now or hereafter granted by the laws of one of the contracting States in the determination of the tax imposed by such State.

* * * * * * *

ARTICLE XIX

(1) The competent authorities of the two contracting States may prescribe regulations necessary to carry into effect the present Convention within the respective States.

(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 XX

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Vienna as soon as possible. The Convention shall have effect on and after the first day of January of the calendar year in which such exchange takes place.

(2) The present Convention shall remain in force indefinitely, but may be terminated by either of the contracting States, provided that at least six months' prior notice of termination has been given through diplomatic channels. 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.

§ 516.2 DIVIDENDS; GENERAL RULE.—(a) *Paid by an Austrian corporation.*—Dividends paid on or after January 1, 1957, by an Austrian corporation which is not a United States corporation are exempt from United States tax under the provisions of Article XIV (1) of the convention if the recipient is a nonresident alien or a foreign corporation.

(b) *50 percent of statutory rate.*—(1) *In general.*—Article VI of the convention provides that the rate of United States tax imposed upon dividends received from sources within the United States on or after January 1, 1957, by a nonresident alien individual who is a resident of Austria, or by an Austrian corporation or other entity, shall not exceed 50 percent of the statutory rate of tax imposed on such dividends by the United States if such alien, corporation, or other entity has not had a permanent establishment in the United States at any time during the taxable year in which such dividends are

received. This subparagraph does not apply to dividends falling within the scope of paragraph (a) or (c) of this section.

(2) *Personal services.*—If a nonresident alien individual who is a resident of Austria performs personal services within the United States during the taxable year, but has at no time during such year a permanent establishment within the United States, he is entitled to the reduced rate of tax on dividends prescribed by subparagraph (1) of this paragraph, even though under the provisions of section 871(c) of the Internal Revenue Code of 1954 he has engaged in trade or business within the United States during such year by reason of his having performed personal services therein.

(c) *Dividends paid by a related corporation.*—(1) *Rate of 5 percent.*—Under the provisions of Article VI of the convention, dividends received from sources within the United States on or after January 1, 1957, by an Austrian corporation which controls, directly or indirectly, at the time the dividend is paid, 95 percent or more of the entire voting power in the corporation paying the dividend are subject to United States tax at a rate not in excess of 5 percent if (i) not more than 25 percent of the gross income of the paying corporation for the 3-year period immediately preceding the taxable year in which the dividend is paid consists of dividends and interest (other than dividends and interest received by such paying corporation from its own subsidiary corporations, if any), (ii) the relationship between the paying corporation and the Austrian corporation has not been arranged or maintained primarily with the intention of securing the reduced rate of 5 percent, and (iii) the Austrian corporation at no time during the taxable year in which such dividends are received has had a permanent establishment within the United States. This subparagraph does not apply to dividends falling within the scope of paragraph (a) of this section.

(2) *Information to be filed with Commissioner.*—Any corporation (hereinafter referred to as the claimant) which claims or contemplates claiming that dividends paid or to be paid by it are subject to a rate of United States tax not in excess of 5 percent shall file the following information with the Commissioner of Internal Revenue as soon as practicable: (i) the date and place of its organization; (ii) the number of outstanding shares of stock of the claimant having voting power and the voting power thereof; (iii) the person or persons beneficially owning such stock of the claimant and their relationship to the Austrian corporation; (iv) the amounts by years (for the 3-year period immediately preceding the taxable year in which the dividend is paid) of the gross income of the claimant, of the interest and dividends included in such gross income, and of the interest and dividends received by the claimant from its own subsidiary corporation, if any; and (v) the relationship between the claimant and the Austrian corporation receiving the dividend.

(3) *Notification by Commissioner.*—As soon as practicable after such information is filed, the Commissioner will determine whether the dividends concerned qualify under Article VI of the convention for a rate of tax not in excess of 5 percent and will notify the claimant of his determination. If the dividends do qualify for such re-

duced rate, this notification may also authorize the release, pursuant to § 516.9(a)(3), of excess tax withheld from the dividends concerned.

(d) *Withholding of United States tax from dividends.*—(1) *Exempt from withholding.*—No withholding of United States tax is required in the case of dividends paid by an Austrian corporation which, in accordance with paragraph (a) of this section, are exempt from United States tax.

(2) *50 percent of statutory rate.*—(i) *In general.*—Withholding of tax at source on or after January 1, 1958, in the case of dividends (other than dividends falling within the scope of subparagraph (1) or (3) of this paragraph) received from sources within the United States by a nonresident alien or by a foreign corporation or other entity, whose address is in Austria, shall, to the extent withholding of United States tax is required, be at the rate of 50 percent of the statutory rate 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.

(ii) *Effect of address in Austria.*—For the purposes of this subparagraph, every nonresident alien whose address is in Austria shall be deemed by United States withholding agents to be a nonresident alien individual who is a resident of Austria not having a permanent establishment within the United States; and every foreign corporation or other entity whose address is in Austria shall be deemed by such withholding agents to be an Austrian corporation or other entity not having a permanent establishment within the United States.

(iii) *Reduced rate applicable to owner only.*—This subparagraph is based on 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 recipient who is not the owner, see § 516.3.

(iv) *Statutory rate.*—As used in this subparagraph, the term "statutory rate" means the rate (30 percent as of the date of approval of this Treasury decision) prescribed with respect to dividends by chapter 3 of the Internal Revenue Code of 1954 as though the convention had not come into effect.

(v) *Nonresident alien.*—The term "nonresident alien", as used in this subparagraph, includes nonresident alien individuals, fiduciaries, and partnerships.

(3) *Rate of 5 percent.*—If, in accordance with paragraph (c)(3) of this section, the Commissioner of Internal Revenue has notified the claimant corporation that the dividends qualify under Article VI of the convention for a rate of tax not in excess 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, 1958, to any dividends subsequently paid by such corporation and received by the Austrian corporation, unless (i) the stock ownership of the claimant corporation materially changes, (ii) the character of the income of the claimant corporation materially changes, or (iii) the Commissioner determines that the relationship between the two corporations concerned is being maintained primarily with the intention of securing the reduced rate of United States tax. In such instance, if such change in stock ownership or character of income occurs, the claim-

ant corporation shall promptly notify the Commissioner of the then existing facts with respect thereto. The continued application of the rate not in excess of 5 percent is also dependent upon the continued fulfillment of paragraph (c)(1)(iii) of this section.

(4) *Evidence 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 Austria 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.

§ 516.3 DIVIDENDS RECEIVED BY ADDRESSEE NOT ACTUAL OWNER.—(a) *Additional tax to be withheld.*—(1) *Nominee or representative.*—If the recipient in Austria of any dividend from which tax has been withheld at a reduced rate pursuant to § 516.2(d)(2) is a nominee or representative through whom the dividend is received by a person other than one described in § 516.2(b), such nominee or representative 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 amount which has been withheld at the source.

(2) *Fiduciary or partnership.*—If a fiduciary or a partnership with an address in Austria receives, otherwise than as a nominee or representative, a dividend from which United States tax has been withheld at a reduced rate pursuant to § 516.2(d)(2), such fiduciary or partnership 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 § 516.2(b). The amount of the additional tax is to be calculated in the same manner as under subparagraph (1) of this paragraph.

(3) *Released amounts of tax.*—If any amount of United States tax is released pursuant to § 516.9(a)(2) by the withholding agent in the United States with respect to a dividend paid to such a person (nominee, representative, fiduciary, or partnership) with an address in Austria, the latter 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 reduced rate prescribed by § 516.2(d)(2) had been withheld at source from such dividend.

(b) *Returns filed by Austrian withholding agents.*—The amounts withheld pursuant to paragraph (a) of this section by any withholding agent in Austria shall be deposited, without converting the amounts into United States dollars, with the Austrian Federal Ministry of Finance on or before the 15th day after the close of the quarter of the calendar year in which the withholding in Austria occurs. The withholding agent making the deposit shall render therewith such appropriate Austrian form as may be prescribed by

the Federal Ministry of Finance. The amounts so deposited should be remitted by the Federal Ministry of Finance by draft in United States dollars, on or before the end of the calendar month in which the deposit is made, to the Director of International Operations, Internal Revenue Service, Washington 25, D. C., U.S.A. The remittance should be accompanied by such Austrian forms as may be required to be rendered by the withholding agent in Austria in connection with the deposit.

§ 516.4 INTEREST.—(a) *Paid by Austrian corporation.*—Interest paid on or after January 1, 1957, by an Austrian corporation which is not a United States corporation is exempt from United States tax under the provisions of Article XIV (1) of the convention if the recipient is a nonresident alien or a foreign corporation. Such exempt interest is not subject to the withholding of United States tax at source.

(b) *Other interest.*—Interest on bonds, notes, debentures, securities, or on any other form of indebtedness, including interest on obligations of the United States and its instrumentalities but not including interest on debts secured by mortgages, which is received from sources within the United States on or after January 1, 1957, by a nonresident alien individual who is a resident of Austria, or by an Austrian corporation or other entity, is exempt, in an amount not exceeding a fair and reasonable consideration on the indebtedness, from United States tax under the provisions of Article VII of the convention if such alien, corporation, or other entity at no time during the taxable year in which such interest is received has a permanent establishment in the United States. This paragraph does not apply to the interest which is exempt from United States tax in accordance with paragraph (a) of this section.

(c) *Personal services.*—If a nonresident alien individual who is a resident of Austria performs personal services within the United States during the taxable year, but has at no time during such year a permanent establishment in the United States, he is entitled to the interest exemption prescribed by paragraph (b) of this section even though under the provisions of section 871(c) of the Internal Revenue Code of 1954 he has engaged in trade or business within the United States during such year by reason of his having performed personal service therein.

(d) *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, 1958, in the case of coupon bond interest to which paragraph (b) of this section applies, the nonresident alien individual who is a resident of Austria, or the Austrian corporation or other entity, shall, for each issue of bonds, file Form 1001–A 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)). It shall contain a statement that the owner (*a*) is a resident of Austria, or is an Austrian 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 contemplated by Article VII of the convention, insofar as it concerns coupon bond interest, is applicable only to the owner of the interest. The person presenting the coupon, or on whose behalf it is presented, shall, for the purpose of the exemption from 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–A, shall be executed.

(iii) *Disposition of form.*—The original and duplicate of Form 1001–A shall be forwarded by the withholding agent to the Director of International Operations, 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) *Notification by letter.*—To avoid withholding of United States tax at source on or after January 1, 1958, in the case of interest (other than coupon bond interest) to which paragraph (b) of this section applies, the nonresident alien individual who is a resident of Austria, or the Austrian 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 VII 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. It shall contain a statement (*a*) that the owner is neither a citizen nor a resident of the United States but is a resident of Austria, or, in the case of a corporation or other entity, that the owner is an Austrian corporation or other entity, and (*b*) that the owner has at no time during the current taxable year had a permanent establishment in the United States.

(ii) *Use of letter for release of excess tax.*—If the letter is also to be used as authorization for the release, pursuant to § 516.9(a)(5), of excess tax withheld from such interest, it shall also contain a statement (*a*) that, at the time when the interest was received 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 Austria, or, in the case of a corporation or other entity, the owner was an Austrian corporation or other entity, and (*b*) that the owner at no time during the taxable year in which such interest was received had a permanent establishment in the United States.

(iii) *Manner of filing letter.*—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. For this purpose, the first such period shall commence with the beginning of the calendar year in which the interest is first paid on or after January 1, 1958. 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 VII 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 letter.*—Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the Director of International Operations, Internal Revenue Service, Washington 25, D. C.

(3) *Reasonableness of consideration.*—For purposes of this paragraph, the withholding agent may, unless he has information to the contrary, presume that the interest represents a fair and reasonable consideration on the indebtedness involved.

§ 516.5 Patent and Copyright Royalties and Film Rentals.—(a) *Items exempt from tax.*—(1) *In general.*—Royalties and other amounts received from sources within the United States on or after January 1, 1957, by a nonresident alien individual who is a resident of Austria or by an Austrian corporation or other entity, as consideration for the right to use literary, musical or other copyrights, artistic and scientific works, patents, designs, plans, secret processes and formulae, trademarks, and other like property and rights (including rentals and like payments for the use of industrial, commercial, or scientific equipment but not including motion picture film rentals) are, in an amount not exceeding a fair and reasonable consideration for such right, exempt from United States tax under the provisions of Article VIII (1) of the convention if such alien, corporation, or other entity has not had a permanent establishment in the United States at any time during the taxable year in which such items are received.

(2) *Exemption from withholding of United States tax.*—(i) *Notification by letter.*—To avoid withholding of United States tax at source on or after January 1, 1958, in the case of the items of income to which this paragraph applies, the nonresident alien individual who is a resident of Austria, or the Austrian corporation or other entity, shall notify the withholding agent by letter in duplicate that the income is exempt from United States tax under the provisions of Article VIII (1) of the convention.

(ii) *Manner of filing letter.*—The provisions of § 516.4(d)(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, are equally applicable with respect to the income falling within the scope of this paragraph.

(iii) *Reasonableness of consideration.*—For purposes of this subparagraph, the withholding agent may, unless he has information to the contrary, presume that the royalty or other like amount represents a fair and reasonable consideration for the right involved.

(b) *Motion picture film rentals.*—(1) *Reduced rate.*—Under Article VIII (2) of the convention, the rate of United States tax imposed upon motion picture film rentals received from sources within the United States on or after January 1, 1957, by a nonresident alien individual who is a resident of Austria, or by an Austrian corporation or other entity, shall not exceed the lesser of (i) 50 percent of the statutory rate of tax imposed on such rentals by the United States or (ii) 10 percent of the gross amount of such rentals, if such alien, corporation, or other entity at no time during the taxable year in which such rentals are received has a permanent establishment in the United States.

(2) *Reduction in rate of withholding of United States tax.*—(i) *Notification by letter.*—To secure withholding of United States tax at source on or after January 1, 1958, at the reduced rate (10 percent, as of the date of approval of this Treasury decision, of the gross amount of the rentals) in the case of the motion picture film rentals to which this paragraph applies, the nonresident alien individual who is a resident of Austria, or the Austrian corporation or other entity, shall notify the withholding agent by letter in duplicate that the rentals are subject to United States tax at the reduced rate under the provisions of Article VIII (2) of the convention.

(ii) *Manner of filing letter.*—The provisions of § 516.4(d)(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, are equally applicable with respect to the rentals falling within the scope of this paragraph except that the release of excess tax withheld from such rentals shall be made in accordance with § 516.9(a)(6).

§ 516.6 Private Pensions and Private Life Annuities.—(a) *Exemption from tax.*—Private pensions and private life annuities which are from sources within the United States and are paid on or after January 1, 1957, to a nonresident alien individual who is a resident of Austria are exempt from United States tax under the provisions of Article XI (2) of the convention.

(b) *Exemption from withholding of United States tax.*—(1) *Notification by letter.*—To avoid withholding of United States tax at source on or after January 1, 1958, in the case of the items of income to which this section applies, the nonresident alien individual who is a resident of Austria shall notify the withholding agent by letter in duplicate that the income is 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 the owner of the income, and shall contain a statement that the owner, an individual, is neither a citizen nor a resident of the United States but is a resident of Austria.

(2) *Use of letter for release of tax.*—If the letter is also to be used as authorization for the release, pursuant to § 516.9(a)·(5), of excess tax withheld from such items of income, it shall also contain a statement that the owner was, at the time when the income was paid from which the excess tax was withheld, neither a citizen nor a resident of the United States but was a resident of Austria.

(3) *Manner of filing letter.*—The letter of notification shall constitute authorization for the payment of such items of income without withholding of United States tax at source unless the Commissioner of Internal Revenue subsequently notifies the withholding agent that the tax shall be withheld with respect to payments of such items of income made after receipt of such notice. If, after filing a letter of notification, the owner of the income ceases to be eligible for the exemption from United States tax granted by the convention in respect to such income, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of 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 letter.*—Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the Director of International Operations, Internal Revenue Service, Washington 25, D. C.

(c) *Definitions.*—As used in this section, the term "pensions" means periodic payments made in consideration for services rendered or by way of compensation for injuries received, and the term "life annuities" 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. Neither term includes retired pay or pensions paid by the United States or by any State or Territory of the United States.

§ 516.7 SOURCES OF INCOME.—For determining the sources of income for purposes of this Treasury decision (26 CFR 516.1 through 26 CFR 516.12), see sections 861 to 864, inclusive, of the Internal Revenue Code of 1954 and Article II (2) of the convention.

§ 516.8 BENEFICIARIES OF AN ESTATE OR TRUST.—(a) *Entitled to benefit of convention.*—If he otherwise satisfies the requirements of the respective articles concerned, a nonresident alien who is a beneficiary of an estate or trust shall be entitled to the exemption from, or reduction in the rate of, United States tax granted by Articles VI, VII, VIII, and XIV of the convention with respect to dividends, interest, and copyright royalties and other like amounts, to the extent that (1) any amount paid, credited, or required to be distributed by such estate or trust to such beneficiary is deemed to consist of such items, and (2) such items would, without regard to the convention, be includible in his gross income.

(b) *Withholding of United States tax.*—In order to be entitled in such instance to the exemption from, or reduction in rate of, withholding of United States tax, the beneficiary must otherwise satisfy such requirements and shall, where applicable, execute and submit to the fiduciary of the estate or trust in the United States the appropriate letter of notification prescribed in § 516.4(d)(2), § 516.5(a)(2), and § 516.5(b)(2).

(c) *Amounts otherwise includible in gross income of beneficiary.*—For the determination of amounts which, without regard to the con-

vention, are includible in the gross income of the beneficiary, see subchapter J of chapter 1 of the Internal Revenue Code of 1954, and the regulations thereunder (26 CFR 1.641–1 through 26 CFR 1.692–1).

§ 516.9 Release of Excess Tax Withheld at Source.—(a) *Amounts to be released.*—(1) *Dividends and interest paid by Austrian corporation.*—If United States tax at the statutory rate has been withheld on or after January 1, 1958, from dividends and interest paid by an Austrian corporation (other than a United States corporation) to a recipient who is a nonresident alien or a foreign corporation, 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) *Dividends subject to 50 percent of statutory rate.*—If United States tax at the statutory rate has been withheld on or after January 1, 1958, from dividends described in § 516.2(b) and received from sources within the United States 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 Austria, 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 § 516.2(d)(2).

(3) *Dividends subject to 5 percent rate.*—If United States tax at the statutory rate has been withheld on or after January 1, 1958, from dividends which qualify under § 516.2(c)(1) for a rate of tax not in excess of 5 percent, the withholding agent shall, if so authorized in accordance with § 516.2(c)(3), 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 § 516.2(d)(3).

(4) *Coupon bond interest.*—(i) *Substitute form.*—In the case of every taxpayer who furnishes to the withholding agent Form 1001–A clearly marked "Substitute" and executed in accordance with § 516.4(d)(1)(i), where United States tax has been withheld at the statutory rate on or after January 1, 1958, from coupon bond interest exempt under § 516.4(b), 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, if the taxpayer also attaches to such form a letter in duplicate, signed by the owner, or by his trustee or agent, and containing the following:

(*a*) The name and the address of the obligor;

(*b*) The name and the 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 received 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 Austria, or, in the case of a corporation or other entity, the owner was an Austrian corporation or other entity; and

(*d*) A statement that the owner at no time during the taxable year in which the interest was received had a permanent establishment in the United States.

One such substitute form shall be filed in duplicate with respect to each issue of bonds and will serve with respect to that issue to replace all Forms 1001 previously filed by the taxpayer in the calendar year in which the excess tax was withheld and with respect to which such excess is released.

(ii) *Disposition of form.*—The original and duplicate of substitute Form 1001–A (and letter) shall be forwarded by the withholding agent to the Director of International Operations, 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)).

(5) *Interest on noncoupon bonds, royalties, pensions, and annuities.*—If a taxpayer furnishes to the withholding agent the authorization of release prescribed in § 516.4(d)(2)(ii), § 516.5(a)(2)(ii), or § 516.6(b)(2) and United States tax has been withheld at the statutory rate on or after January 1, 1958, from the interest, copyright royalties or other like amounts, pensions, or 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.

(6) *Motion picture film rentals.*—If a taxpayer furnishes to the withholding agent the authorization of release prescribed in § 516.5(b)(2)(ii) and United States tax has been withheld at the statutory rate on or after January 1, 1958, from the motion picture film rentals 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 difference between the tax so withheld and the tax required to be withheld pursuant to § 516.5(b)(2)(i).

(b) *Amounts not to be released.*—The provisions of this section do not apply to excess tax withheld at source which has been paid by the withholding agent to the Director of International Operations.

(c) *Statutory rate.*—As used in this section, the term "statutory rate" means the rate prescribed by chapter 3 of the Internal Revenue Code of 1954 as though the convention had not come into effect.

(d) *Amounts withheld during 1957.*—For provisions respecting the refund of excess tax withheld during the calendar year 1957, see § 516.10.

§ 516.10 Refund of Excess Tax Withheld During 1957.—(a) *In general.*—Where United States tax withheld at the source during the calendar year 1957 from dividends, interest, copyright royalties and the like, motion picture film rentals, private pensions or private life annuities is in excess of the tax imposed under subtitle A (relating to the income tax) of the Internal Revenue Code of 1954, as modified by the convention, a claim by the taxpayer for refund of any overpayment resulting therefrom may be made under section 6402 of such Code and the regulations thereunder.

(b) *Form of claim.*—(1) *Where return previously filed.* If the taxpayer has previously filed an income tax return with the Internal Revenue Service for the taxable year in which an overpayment has resulted because of the application of the convention, he should make a claim for refund of the overpayment by filing Form 843 or an amended return.

(2) *Where no return previously filed.*—If the taxpayer has not previously filed an income tax return with the Internal Revenue Service for the taxable year in which an overpayment has resulted because of the application of the convention, he should make a claim for refund of the overpayment by filing Form 1040NB, Form 1040NB–a, Form 1040B, Form 1120, or Form 1120NB, whichever is applicable, showing the overpayment. Such return will serve as a claim for refund, and it will not be necessary for the taxpayer to file Form 843.

(c) *Information required.*—If the taxpayer's total gross income (including every item of capital gain subject to tax) from sources within the United States for the taxable year in which such overpayment resulted has not been disclosed in an income tax return filed with the Internal Revenue Service prior to the time the claim for refund is made, the taxpayer shall disclose such total gross income with his claim. In the event that securities are held in the name of a person other than the actual or beneficial owner, the name and address of such person shall be furnished with the claim. In addition to such other information as may be required to establish the overpayment, there shall also be included in such claim for refund:

(1) A statement that, at the time when the item or items of income were received (or "paid", in the case of private pensions and private life annuities) from which the excess tax was withheld, (i) the taxpayer was neither a citizen nor a resident of the United States but was a resident of Austria, or, in the case of a corporation or other entity, (ii) the taxpayer was an Austrian corporation or other entity; and

(2) A statement that the taxpayer at no time during the taxable year in which the income was received had a permanent establishment within the United States.

(d) *Exceptions*—(1) *Private pensions and private life annuities.*—If the taxpayer is an individual who during the taxable year of overpayment received income from United States sources consisting exclusively of private pensions or private life annuities entitled to the benefit of Article XI (2) of the convention, the statement specified in paragraph (c) (2) of this section shall not be required.

(2) *Dividends paid by a related corporation.*—As to additional information required in the case of an Austrian corporation claiming the benefit of the 5 percent rate on dividends paid by a related corporation, see § 516.2(c).

§ 516.11 Information To Be Furnished in Ordinary Course.—For provisions relating to the exchange of information under Article XVI of the convention, see § 1.1461–2(d) of the Income Tax Regulations (26 CFR 1.1461–2(d)).

§ 516.12 Taxable Years Beginning in 1956 and Ending in 1957.—If, in the case of a taxable year beginning in 1956 and ending in 1957, a taxpayer has no permanent establishment in the United States at any time during that part of the taxable year which follows December 31, 1956, then he shall, for purposes of this Treasury decision (26 CFR 516.1 through 516.12) be deemed not to have had a permanent establishment in the United States at any time during the taxable year.

Because it is necessary to bring into effect at the earliest practicable date the rules of this Treasury decision respecting release or refund 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 XIX (1) of the convention.)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved October 6, 1958.

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

(Filed by the Division of the Federal Register on October 9, 1958, 8:48 a. m., and published in the issue of the Federal Register for October 10, 1958, 23 F. R. 7841.)

UNITED STATES-GREECE INCOME TAX CONVENTION[1]

A convention between the United States and Greece for the avoidance of double taxation and the prevention of fiscal evasion with respect to income taxes was signed at Athens, Greece, on February 20, 1950, and a Supplementary Protocol was signed at Athens on April 20, 1953. The tax convention and protocol were approved for ratification by the United States Senate on September 17, 1951, with an understanding as to the application of Article XIX, which relates to reciprocal assistance in the collection of taxes. The convention was ratified by the President on December 5, 1951, subject to such understanding. The convention and the protocol were duly ratified by Greece on December 22, 1953. By a second protocol, Greece accepted the understanding and on December 30, 1953, instruments of ratification were exchanged at Athens. The convention and the supplementary protocol were proclaimed by the President on January 15, 1954, and they are effective retroactively for the taxable years beginning on and after January 1, 1953. The convention and the two protocols read as follows:

ARTICLE I

(1) The taxes which are the subject of the present Convention are:

a) In the case of the United States of America: the Federal Income tax, including surtaxes (hereinafter referred to as United States tax).

b) In the case of the Kingdom of Greece: the income tax, including the schedular or analytical tax, the complementary tax and the professional or business tax (hereinafter referred to as Greek tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting State subsequently to the date of signature of the present Convention.

ARTICLE II

(1) In the present Convention, unless the context otherwise requires—

a) The term "United States" means the United States of America and when used in a geographical sense means the States, the Territories of Alaska and Hawaii, and the District of Columbia.

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[1] The full text of the convention is published herein, supplementing partial publication in T. D. 6109, C. B. 1954-2, 638.

b) The term "Greece" means the territories of the Kingdom of Greece.

c) The term "United States Corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

d) The term "Greek Corporation" means a legal entity established under the laws of Greece.

e) The terms "corporations of one Contracting State" and "corporation of the other Contracting State" mean a United States corporation or a Greek corporation, as the context requires.

f) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on in the United States by a citizen or resident of the United States or by a United States corporation.

g) The term "Greek Enterprise" means an industrial or commercial enterprise or undertaking carried on in Greece by a subject or resident of Greece or by a Greek corporation.

h) The terms "enterprise of one of the Contracting States" and "enterprise of the other Contracting State" mean a United States enterprise or a Greek enterprise, as the context requires.

i) The term "permanent establishment", when used with respect to an enterprise of one of the Contracting States, means a branch, factory or other fixed place of business, but does not include an agency unless that agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on behalf of such enterprise. An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business dealings in such other Contracting State through a bona fide commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting States maintains in the other Contracting State a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. When a corporation of one Contracting State has a subsidiary corporation which is a corporation of the other Contracting State or which is engaged in trade or business in such other Contracting State, such subsidiary corporation shall not, merely because of that fact, be deemed to be a permanent establishment of its parent corporation.

j) The term "competent authority" or "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his duly authorized representative; in the case of Greece, the General Director of Direct Taxes, or his duly authorized representative.

(2) In the application of the provisions of the present Convention by either of the Contracting States, any term which is not defined in the present Convention shall, unless the context otherwise requires, have the meaning which that term has under the laws of such Contracting State relating to the taxes which are the subject of the present Convention.

ARTICLE III

(1) An enterprise of one of the Contracting States shall not be subject to taxation by the other Contracting State in respect of its industrial or commercial profits unless it is engaged in trade or business in the other Contracting State through a permanent establishment situated therein. If it is so engaged the other Contracting State may impose the tax only upon the income of such enterprise from sources within such other State.

(2) Where an enterprise of one of the Contracting States is engaged in trade or business in the other Contracting State through a 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 such other Contracting State.

(3) In determining the industrial or commercial profits from sources within 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 former Contracting State by such enterprise.

(4) The competent authorities of the Contracting States may lay down rules by agreement for the appointment of industrial or commercial profits.

ARTICLE IV

Where an enterprise of one of the Contracting States, by reason of its participation in the management, control or capital of an enterprise of the other Contracting State, makes with or imposes on the latter enterprise, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would, but for those conditions, have accrued to one of the enterprises, may be included in the taxable profits of that enterprise.

ARTICLE V

(1) Income which an enterprise of one of the Contracting States derives from the operation of ships or aircraft registered or documented in that State shall be exempt from tax by the other Contracting State. Income derived by such an enterprise from the operation of ships or aircraft not so registered or documented shall be subject to the provisions of Article III.

(2) The present Convention shall be deemed to suspend, for the duration of the Convention as between the Contracting States, the provisions of the arrangement effected by exchange of notes between the United States and Greece, dated February 29, 1928, April 26, 1928, April 2, 1929, and June 10, 1929, providing for relief from double income taxation on shipping profits.[2]

ARTICLE VI

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) received from sources within the United States by a resident or corporation of Greece not engaged in trade or business in the United States through a permanent establishment therein, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States corporation to a Greek corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

(2) Interest (n bonds, securities, notes, debentures, or in any other form of indebtedness) received from sources within Greece by a resident or corporation of the United States not engaged in trade or business in Greece through a permanent establishment therein, shall be exempt from Greek tax but only to the extent that such interest does not exceed 9 percent per annum; but such exemption shall not apply to such interest paid by a Greek corporation to a United States corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

ARTICLE VII

Royalties for the right to use copyrights, patents, designs, secret processes and formulae, trade marks and other analogous property, and royalties (including rentals), (other than those in respect of motion picture films) for the use of industrial, commercial or scientific equipment, derived from sources within one of the Contracting States by a resident or corporation of the other Contracting State not engaged in trade or business in the former State through a permanent establishment therein, shall be exempt from tax by the former State.

ARTICLE VIII

A resident or corporation of one of the Contracting States, deriving from sources within the other Contracting State royalties in respect of the operation of mines, quarries, or other natural resources, or rentals from real property, may elect for any taxable year to be subject to the tax of such other Contracting State on the basis of net income as determined under the laws of such other Contracting State during such taxable year.

[2] Executive Agreement Series 13; 47 Stat. 2608.

ARTICLE IX

Dividends and interest paid by a Greek corporation shall be exempt from United States tax except where the recipient is a citizen, resident or corporation of the United States.

ARTICLE X

(1) A resident of Greece shall be exempt from United States tax upon compensation for labor or personal services (including the practice of 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 Greece, or

b) his compensation received for labor or personal services does not exceed $10,000.

(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 Greece.

(3) The provisions of this Article shall have no application to the income to which Article XI relates.

ARTICLE XI

(1) Wages, salaries and similar compensation and pensions paid by one of the Contracting States or the subdivisions thereof to an individual for services rendered to such State or subdivision shall be exempt from taxation by the other Contracting State.

(2) Private pensions and life annuities derived from within one of the Contracting States by an individual who is a resident of the other Contracting State shall be exempt from taxation by the former Contracting 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 life, 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 who is a resident of one of the Contracting States and who is temporarily present within the other Contracting State for the purpose of teaching, for a maximum period of three years, in a university, college or other educational institution within the other Contracting State, shall be exempt from taxation by such other Contracting State on his remuneration for such teaching for such period.

ARTICLE XIII

Students or business apprentices who are residents of one of the Contracting States but who are temporarily present in the other Contracting States exclusively for the purposes of study or acquiring business experience shall not be taxable by such other Contracting State upon remittances received by them from sources without such other State for the purpose of their maintenance or studies.

ARTICLE XIV

(1) Notwithstanding any provision of the present Convention each of the Contracting States, in determining the taxes, including all surtaxes and complementary taxes, of its citizens, subjects, residents or corporations, may include in the basis upon which such taxes are imposed all items of income taxable under its revenue laws as though this Convention had not come into effect.

(2) Subject to section 131 of the United States Internal Revenue Code, Greek tax shall be allowed as a credit against United States tax.

(3) Greece will allow against Greek tax a credit for the amount of United States tax imposed upon income from sources within the United Sttaes but in an amount not exceeding the amount of the Greek tax imposed upon such income.

ARTICLE XV

(1) The authorities of each of the Contracting States, in accordance with the practices of that State, may prescribe regulations necessary to carry out the provisions of the present Convention.

(2) With respect to the provisions of the present Convention relating to exchange of information and mutual assistance in the collection of taxes, the Contracting States may, in accordance with their respective practices, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amounts subject to collection, and related matters.

ARTICLE XVI

(1) The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the Contracting States in the determination of the taxes imposed by such State.

(2) Should any difficulty or doubt arise as to the interpretation or application of the present Convention, the competent authorities of the Contracting States shall undertake to settle the question by mutual agreement.

(3) The citizens or subjects of one of the Contracting States shall not, while resident in the other Contracting State, be subjected therein to other or more burdensome taxes than are the citizens or subjects of such other Contracting State residing in its territory. The term "citizens" or "subjects", 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. In this Article the word "taxes" means taxes of every kind or description whether national, federal, state, provincial or municipal.

ARTICLE XVII

Where 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, the taxpayer shall be entitled to lodge a claim with the State of which he is a citizen or subject or, if he is not a citizen or subject of either of the Contracting States, with the State of which he is a resident, or, if the taxpayer is a corporation, 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 avoidence of the double taxation in question.

ARTICLE XVIII

The competent authorities of the Contracting States shall exchange such information (being information which such authorities have at their disposal) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than 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 a technical secret, or process relating to trade, industry, business, or a profession.

ARTICLE XIX

(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 and fines not being of a penal character.

(2) In the case of applications for collection 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 collected in that State as though such taxes were taxes finally imposed, due and payable to that State. The State to which application is made shall not be required to enforce executory measures for which there is no provision in the law of the State making the application.

(3) Any application shall be accompanied by documents establishing 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 or subjects, or corporation or other entities of the State to which application is made, except as is necessary to insure that the exemption or reduced rate of tax granted under the convention to such citizens or subjects, or corporations or other entities shall not be enjoyed by persons not entitled to such benefits.

ARTICLE XX

(1) In no case shall the provisions of Article XVIII and XIX be construed so as to impose upon either of the Contracting States the obligation

a) to carry out administrative measures at variance with the regulations and practice of either Contracting State, or

b) to supply information which is not procurable under its own legislation or that of the State making application.

(2) The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it. Nevertheless, such State may refuse to comply with the request for reasons of public policy or if compliance would involve disclosure of a technical secret or process relating to trade, industry, business, or a profession. In such case it shall inform, as soon as possible, the State making the application.

ARTICLE XXI

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Athens as soon as possible.

(2) The present Convention shall become effective on the first day of January of the year in which the exchange of the instruments of ratification takes place. It shall continue effective for a period of five years beginning with that date and indefinitely after that period, but may be terminated by either of the Contracting States at the end of the five-year period or at any time thereafter, provided that at least six months' prior notice of termination has been given, the termination to become effective on the first day of January following the expiration of the six-month period.

Done at Athens, in duplicate, in the English and Greek languages, the two texts having equal authenticity, this 20th day of February, 1950.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

[SEAL] HENRY F. GRADY

FOR THE GOVERNMENT OF THE KINGDOM OF GREECE:

[SEAL] PAN. PIPINELIS

PROTOCOL

With reference to the convention between the United States of America and the Kingdom of Greece for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Athens on February 20, 1950, the undersigned, The Honorable JOHN E. PEURIFOY, Ambassador of the United States of America in Greece, and His Excellency STEPHANOS STEPHANOPOULOS, Minister of Foreign Affairs of Greece, being duly authorized thereto by their respective Governments, have met and, having considered a resolution adopted by the United States Senate with respect to reciprocal assistance in the collection of taxes, have reached an understanding reading as follows:

"It is understood that the application of article XIX 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."

This Protocol shall be considered to be an integral part of the Convention as signed in Athens on February 20, 1950, and shall enter into force on the date on which the Government of the United States of America receives formal notice of the ratification of this Protocol by the Parliament of the Kingdom of Greece.

IN WITNESS WHEREOF, the respective Plenipotentiaries have signed the present Protocol.

DONE at Athens, in duplicate in the English and Greek languages, both texts having equal authenticity, this 20th day of April 1953.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA
JOHN E. PEURIFOY

FOR THE GOVERNMENT OF THE KINGDOM OF GREECE:
STEPHANOS STEPHANOPOULOS

PROTOCOL

The undersigned, the Honorable CAVENDISH W. CANNON, Ambassador of the United States of America in Greece, and His Excellency, ALEXANDER PAPAGOS, Field marshal of Greece Prime Minister, Minister for Foreign Affairs ad interim, being duly authorized by their respective Governments, have met for the purpose of exchanging the instruments of ratification by their respective Governments of the convention between the United States of America and the Kingdom of Greece for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Athens on February 20, 1950, and the respective instruments of ratification of the convention aforesaid having been compared and found to be in due form, the exchange took place this day.

As recited in the ratification on the part of the United States of America, the Senate of the United States of America, in its resolution of September 17, 1951 advising and consenting to the ratification of the convention aforesaid, expressed a certain understanding with respect thereto, as follows:

"It is understood that the application of Article XIX 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".

The text of the said understanding was communicated by the Government of the United States of America to the Government of the Kingdom of Greece. The Government of the Kingdom of Greece has accepted the said understanding by a supplementary protocol signed in Athens on April 20, 1953 and ratified by Legislative Decree N° 2548, of August 16, 1953, promulgated with the advice and consent of the Interim Parliamentary Committee and published in the Greek Government Gazette, Volume I, Folio 231, of August 27, 1953.

Accordingly it is understood by the two Governments that, upon entry into force of the convention aforesaid in accordance with its provisions, Article XIX thereof shall be applied in accordance with the said understanding.

IN WITNESS WHEREOF, the respective Plenipotentiaries have signed the present Protocol of Exchange.

DONE in duplicate, in the English and Greek languages, at Athens this 30th day of December 1953.-

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:
CAVENDISH W. CANNON

FOR THE GOVERNMENT OF THE KINGDOM OF GREECE:
A. PAPAGOS

UNITED STATES-IRELAND INCOME TAX CONVENTION[1]

A convention between the United States and the Republic of Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to income taxes was signed at Dublin, Ireland, on September 13, 1949. The Senate of the United States, on September 17, 1951, advised and consented to ratification of the tax convention subject to reservations relative to the capital gains provisions of article XIV and the exemption from tax on accumulated earnings provisions of article XVI, which reservations Ireland has accepted. The conven-

[1] The full text of the convention is published herein, supplementing partial publication in T. D. 5897, C. B. 1952-1, 89.

tion was ratified by the President, subject to such reservation, on December 13, 1951. The instruments of ratification were exchanged at Washington, D. C., on December 20, 1951. The convention was proclaimed by the President on December 24, 1951, and is effective retroactively for the taxable years beginning on or after January 1, 1951.

The texts of the convention and transmittal letter read as follows:

DEPARTMENT OF STATE,
Washington, January 17, 1950.

The PRESIDENT,
The White House:

The undersigned, the Secretary of State, has the honor to lay before the President, with a view to its transmission to the Senate to receive the advice and consent of that body to ratification, if his judgment approve thereof, a convention between the United States of America and Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Dublin on September 13, 1949.

This convention, together with another relating to taxes on estates of deceased persons, was formulated as a result of technical discussions between representatives of each of the two Governments. As in similar discussions with representatives of other governments, an effort was made to determine the conventional bases upon which double taxation might be avoided and certain procedures for mutual administrative assistance in relation to taxation might be established.

The Department of State and the Treasury Department collaborated in the negotiation of the convention, after public announcement of the contemplated negotiations. It has the approval of both Departments.

It is believed that the income-tax convention with Ireland, if and when brought into force, will establish in the mutual interest of the two countries and of considerable benefit to taxpayers of both countries, a satisfactory basis for the accomplishment of objectives essentially the same as those of income-tax conventions now in force between the United States and other countries, namely, the elimination, as far as practicable, of double taxation with respect to income and the setting up of a system for the exchange of information. Double taxation would be avoided by either or both of two methods, the exemption of items from taxation in one of the countries or the application of the credit principle whereby the taxpayer is allowed against his tax in one of the countries a credit for tax paid in the other country in respect of the same income.

Embodied in the convention are provisions similar to, if not identical with, provisions in force between the United States and a number of other countries concerning such items as business income, dividends, interest, royalties, governmental wages and salaries, compensation for personal services, pensions and life annuities, compensation of visiting professors or teachers, and payments for the maintenance, education, or training of students or business apprentices. The convention with Ireland may be compared in these respects and also in respect of the provisions relating to fiscal administrative cooperation, with existing income-tax conventions of the United States, as follows: With Sweden, March 23, 1939 (54 Stat., pt. 2, 1759); with France, July 25, 1939 (59 Stat., pt. 2, 893), as modified by the convention of October 18, 1946 (S. Ex. A, 80th Cong., 1st sess.) and supplementary protocol of May 17, 1948 (S. Ex. G, 80th Cong., 2d sess.); with Canada, March 4, 1942 (56 Stat., pt. 2, 1399); with the United Kingdom, April 16, 1945, with protocol of June 6, 1946 (60 Stat., pt. 2, 1377); with the Netherlands, April 29, 1948 (S. Ex. I, 80th Cong., 2d sess.); and with Denmark, May 6, 1948 (S. Ex. H, 80th Cong., 2d sess.). Also, comparison may be made with other income-tax conventions now pending in the Senate, as follows: With Belgium, October 28, 1948 (S. Ex. I, 81st Cong., 1st sess.); with New Zealand, March 16, 1948 (S. Ex. J, 80th Cong., 2d sess.); and with the Union of South Afria, December 13, 1946 (S. Ex. O, 80th Cong., 1st sess.).

As might well be expected, the income-tax convention with Ireland follows closely, in substance, terminology, and arrangement, the convention between the United States and the United Kingdom. In fact, through article XXI the numerical arrangement of the articles as to subject matter is identical. Because of the intimate relation between Irish income-tax law and United Kingdom income-tax law it was inevitable that the Irish Government would consider it

essential that its convention with the United States take into account the exemptions from, or credits against, United States tax accorded by the United States convention with the United Kingdom in respect of residents of the United Kingdom. Likewise, as expected, the Irish Government considered it a matter of vital importance that its convention with the United States take into account the provisions of an existing arrangement between Ireland and the United Kingdom under which certain exemptions from United Kingdom tax are conferred upon residents of Ireland deriving income from United Kingdom sources.

Although Ireland has established its complete independence as a republic, its economy remains so closely allied with that of the United Kingdom that, to a major extent, the provisions of the tax convention of the United States with the United Kingdom become an essential ingredient in formulating such a convention with Ireland. Before the Irish Free State was created in 1922, the area comprising that Free State was within the jurisdiction of the United Kingdom income-tax system as an integral part of the United Kingdom. That system was maintained, with only minor variations respecting rates, appeals, and certain other matters, within the Irish Free State. Rates of taxation are lower in Ireland than those prevailing in the United Kingdom.

Probably no further general comment is needed in order to explain why it has been found necessary, in drawing up the convention with Ireland, to make it follow so closely the convention with the United Kingdom. It is a unique situation, not encountered heretofore and not anticipated in the future in negotiations with foreign countries for the conclusion of tax conventions.

With respect to those provisions in the convention with Ireland which are identical with provisions in the convention with the United Kingdom, and that applies to the substantive provisions almost in their entirety, it is believed that a detailed analysis, article by article, of the convention with Ireland is not necessary in the present report. The material printed in Senate Executive D (79th Cong., 1st sess.) and in Senate Executive Report No. 4 (79th Cong., 2d sess.) with respect to the income-tax convention with the United Kingdom applies, in general, to the convention with Ireland, subject to the necessity, of course, of substituting "Ireland" for "United Kingdom" and related substitutions required by the context. A few specific comments regarding certain provisions of the convention with Ireland are, however, presented here.

As in other tax conventions of the United States, article I describes the taxes which are the subject of the convention. In the case of the United States the convention applies only to the Federal income taxes, including surtaxes, and does not apply to taxes imposed by the several States of the United States, the District of Columbia, or the Territories or possessions of the United States, with one exception, namely, the "national treatment" provisions in article XXI giving expression, on a reciprocal basis, to the long-recognized principles relating to equality of treatment in respect of taxation of resident aliens as compared with the taxation of resident nationals.

Article II gives definitions of various terms used in the convention. It will be noted that United States citizens, residents, and corporations are excluded from the definition in (1) (g) of "resident of Ireland." By this means the right of the United States to tax its own citizens, residents, or corporations is reserved. The term "United States" is defined as meaning, in the political sense, the United States of America and, in the geographical sense, the States, the Territories of Alaska and Hawaii, and the District of Columbia. The term "Ireland" is defined simply as meaning the Republic of Ireland.

Articles III, IV, and V relate to the principles affecting the determination of amount, and affecting the taxation, of business income derived by business enterprises of one country from sources within the other country. Article V contains the provisions relating to reciprocal exemption of profits derived from the operation of ships and aircraft.

Article VI relates to the taxation of dividends. In its application to residents of Ireland entitled to exemption from or reduction of United States tax, it is identical to the corresponding provisions in article VI of the convention with the United Kingdom as applied to United Kingdom residents. The relevant Irish low is the same, in principle, as United Kingdom law, whereby the standard tax paid by the corporation is regarded as being paid on behalf of the shareholder. Thereby, no tax at the standard is imposed on the dividend as such. Basic differences between United States and United Kingdom tax concepts as applied to dividends, and related matters, are discussed at some length in the Senate documents above-mentioned relating to the convention with the United Kingdom.

Article VII relates to the reciprocal exemption from taxation of interest derived by residents of one of the countries from sources within the other country. Article VIII relates to the reciprocal exemption from taxation of royalties derived by residents of one of the countries from sources within the other country. Articles VI, VII, and VIII, like the corresponding provisions in the tax conventions of the United States with the United Kingdom, the Netherlands, and Denmark, have the effect of applying the exemptions to nonresident alien individuals who have no permanent establishment within the United States even though such individuals, by reason of the performance of personal services, are deemed to be engaged in trade or business in the United States.

The principle of the United States tax credit is adopted in article XIII. These provisions are similar in principle to provisions in all existing income-tax conventions of the United States. As pointed out hereinbefore, the Irish income-tax system is fundamentally like that of the United Kingdom. Accordingly, article XIII(1) contains as in the case of the United Kingdom convention, a clause which has the effect of neutralizing the decision in *Biddle* v. *Commissioner* (302 U. S. 573), insofar as it would apply to a resident of the United States deriving dividends from an Irish corporation. Because, however, of the existence of the tax arrangement between the United Kingdom and Ireland, under which a resident of one of those countries not resident in the other country, but deriving income from such other country, is exempt from tax imposed by such other country, it has been necessary to add a provision in article XIII(1). If, for example, a citizen of the United States who resides in Ireland but not in the United Kingdom derived dividends from United Kingdom sources, the Irish-United Kingdom convention leaves the taxation of that income to Ireland. No credit would be allowed by the United States under section 131 of the Internal Revenue Code. The third sentence of article XIII(1) of the United States convention with Ireland has been added in order to allow such credit by deeming the income in such a case to be income from sources in Ireland. To this extent the resident of Ireland is accorded a benefit not enjoyed by a resident of the United Kingdom under the United States-United Kingdom convention.

Article XIV contains the capital-gains provision which, by means of Senate reservations, was removed from the conventions with the Netherlands and Denmark. Other existing conventions (United Kingdom, art. XIV; Canada, art. VIII; France, art. II; and Sweden, art. IX) accord the exemption from United States tax when the alien has no permanent establishment within the United States. The Irish authorities were insistent that a provision corresponding to that in article XIV of the convention with the United Kingdom be included.

It was found necessary also to include article XV, corresponding to article XV in the convention with the United Kingdom, article XII of the convention with Canada, and article XII of the convention with the Netherlands, although it does not appear that the presence of the provision, relating to exemption from United States tax on dividends and interest derived from corporations organized under Irish law by a nonresident alien or by a foreign corporation, would have any perceptible effect upon United States revenue. It is considered unlikely that an Irish corporation, a subsidiary of another Irish corporation, would have such an extensive business in the United States as to bring its income within the application of the provision.

Article XVI, relating to United States tax on accumulated or undistributed earnings, profits, income, or surplus, provides in effect that an Irish corporation shall not be subject to tax under section 102 or section 500 of the Internal Revenue Code if, throughout the last half of the taxable year, the control of the corporation is in the hands of residents of Ireland other than a United States citizen, resident, or corporation. Considered in the light of the definition of "resident of Ireland" in article II(1)(g), it is considered that citizens, residents, or corporations of the United States could not invoke article XVI to avoid the imposition of surtax. In view of stringent Irish law respecting the transfer of funds or securities, it is not at all likely that United States citizens, for example, would be inclined to turn over the control of their capital to aliens resident in Ireland in order to avoid surtax under article XVI. The Irish authorities, although informed of the circumstances which led to the elimination from the convention with the Netherlands of a similar provision, were insistent that it be retained in the convention, partly for the sake of conformity to the United Kingdom convention.

In the case of article XVII also, the Irish authorities expressed a keen desire that these provisions be included as in the United Kingdom convention, although they were informed of the situation in regard to article XIV of the Netherlands convention and although it is considered unlikely that there is outstanding any pre-1936 case involving a resident of Ireland and, in any event, the practical effect of the provisions in the convention with Ireland would be insignificant.

The provisions in article XVIII, relating to professors or teachers, and article XIX, relating to students or business apprentices, have their counterparts in existing tax conventions of the United States.

Article XX contains the provisions relating to exchange of information necessary for carrying out the provisions of the convention or for the prevention of fraud or for the administration of statutory provisions against legal avoidance in relation to the taxes covered by the convention.

Article XXII provides for ratification and prescribes that the convention shall, upon the exchange of instruments of ratification, become effective (*a*) as to United States tax, for the taxable years beginning on or after January 1 in the calendar year in which the exchange takes place, and (*b*) as to Irish income tax, Irish surtax, and Irish corporation profits tax, for years of assessments beginning in accordance with the corresponding Irish tax system.

Under article XXIII the convention shall continue in effect indefinitely but may be terminated by either Government by the giving of a notice for that purpose on or before June 30 in any calendar year following the year in which the instruments of ratification are exchanged. As to United States tax, the convention would cease to be effective for taxable years beginning on or after January 1 in the calendar year next following that in which the notice of termination is given. A separate formula is given for the date of termination with respect to each of the categories of Irish tax.

Respectfully submitted.

DEAN ACHESON.

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of Ireland,

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 Plenipotentiaries:

The Government of the United States of America:

George A. Garrett, Envoy Extraordinary and Minister Plenipotentiary of the United States of America at Dublin;

The Government of Ireland:

Patrick McGilligan, Minister for Finance;

Seán MacBride, Minister for External Affairs;

Who, having exhibited their respective 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 Ireland: The income tax (including surtax) and the corporation profits tax (hereinafter referred to as Irish tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequently to the date of signature of the present Convention.

ARTICLE II

(1) In the present Convention, unless the context otherwise requires—

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii, and the District of Columbia.

(b) The term "Ireland" means the Republic of Ireland and the term "Irish" has a corresponding meaning.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting Party" mean the United States or Ireland as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organised in or under the laws of the United States.

(e) The term "Irish corporation" means any kind of juridical person created under the laws of Ireland.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" mean a United States corporation or an Irish corporation as the context requires.

(g) The term "resident of Ireland" means any person (other than a citizen of the United States or a United States corporation) who is resident in Ireland for the purposes of Irish tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in Ireland if its business is managed and controlled in Ireland.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purposes of United States tax and not resident in Ireland for the purposes of Irish tax, and any United States corporation and any partnership created or organised in or under the laws of the United States, being a corporation or partnership which is not resident in Ireland for the purposes of Irish tax.

(i) The term "Irish enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of Ireland.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or an Irish enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties 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. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent or broker acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party 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 Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

(2) For the purposes of Article VI, VII, VIII, IX and XIV a resident of Ireland shall not be deemed to be engaged in trade or business in the United States in any taxable year unless such resident has a permanent establishment situated therein in such taxable year. The same principle shall be applied, *mutatis mutandis*, by Ireland in the case of a resident of the United States.

(3) In the application of the provisions of the present Convention by one of the Contracting Parties any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the present Convention.

ARTICLE III

(1) An Irish 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 all sources within the United States.

(2) A United States enterprise shall not be subject to Irish tax in respect of its industrial or commercial profits unless it is engaged in trade or business in Ireland through a permanent establishment situated therein. If it is so engaged, Irish tax may be imposed upon the entire income of such enterprise from all sources within Ireland.

(3) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party 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 Party, be deemed to be income from sources within the territory of such other Contracting Party.

(4) In determining the industrial or commercial profits from sources within the territory of one of the Contracting Parties of an enterprise of the other Contracting Party, no profits shall be deemed to arise from the mere purchase of goods or merchandise within the territory of the former Contracting Party by such enterprise.

ARTICLE IV

Where an enterprise of one of the Contracting Parties, by reason of its participation in the management, control or capital of an enterprise of the other Contracting Party, 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) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which an individual resident of Ireland or an Irish corporation derives from operating ships documented or aircraft registered under the laws of Ireland, shall be exempt from United States tax.

(2) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which a citizen of the United States not resident in Ireland or a United States corporation derives from operating ships documented or aircraft registered under the laws of the United States, shall be exempt from Irish tax.

(3) This Article shall not be deemed to affect the arrangement between Ireland and the United States, providing for reciprocal exemption of shipping profits from income tax, effected between the Government of the United States and the Government of Ireland by exchange of Notes dated August 24, 1933, and January 8, 1934.

ARTICLE VI

(1) The rate of United States tax on dividends derived from a United States corporation by a resident of Ireland who is subject to Irish tax on such dividends and not engaged in trade or business in the United States shall not exceed 15 per cent: provided that such rate of tax shall not exceed five per cent if such resident is a corporation controlling, directly or indirectly, at least 95 per cent of the entire voting power in the corporation paying the dividend, and not more than 25 per cent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. Such reduction of the rate to five per cent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(2) Dividends derived from sources within Ireland by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such dividends, and (c) not engaged in trade or business in Ireland, shall be exempt from Irish surtax.

(3) Either of the Contracting Parties may terminate this Article by giving written notice of termination to the other Contracting Party, through diplomatic channels, on or before the thirtieth day of June in any calendar year after the calendar year in which the exchange of the instruments of ratification takes place

and in such event paragraph (1) hereof shall cease to be effective as to United States tax on and after the first day of January, and paragraph (2) hereof shall cease to be effective as to Irish tax on and after the 6th day of April, in the calendar year next following that in which such notice is given.

ARTICLE VII

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United States by a resident of Ireland who is subject to Irish tax on such interest and not engaged in trade or business in the United States, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States corporation to a corporation resident in Ireland controlling, directly or indirectly, more than 50 per cent of the entire voting power in the paying corporation.

(2) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within Ireland by a resident of the United States who is subject to United States tax on such interest and not engaged in trade or business in Ireland, shall be exempt from Irish tax; but such exemption shall not apply to such interest paid by a corporation resident in Ireland to a United States corporation controlling, directly or indirectly, more than 50 per cent of the entire voting power in the paying corporation.

ARTICLE VIII

(1) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trade-marks, and other like property, and derived from sources within the United States by a resident of Ireland who is subject to Irish tax on such royalties or other amounts and not engaged in trade or business in the United States, shall be exempt from United States tax.

(2) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trademarks, and other like property, and derived from sources within Ireland by a resident of the United States who is subject to United States tax on such royalties or other amounts and not engaged in trade or business in Ireland shall be exempt from Irish tax.

(3) For the purposes of this Article, the term "royalties" shall be deemed to include rentals in respect of motion picture films.

ARTICLE IX

(1) The rate of United States tax on royalties in respect of the operation of mines or quarries or of other extraction of natural resources, and on rentals from real property or from an interest in such property, derived from sources within the United States by a resident of Ireland who is subject to Irish tax with respect to such royalties or rentals and not engaged in trade or business in the United States, shall not exceed 15 per cent: provided that any such resident may elect for any taxable year to be subject to United States tax as if such resident were engaged in trade or business in the United States.

(2) Royalties in respect of the operation of mines or quarries or of other extraction of natural resources, and rentals from real property or from an interest in such property, derived from sources within Ireland by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such royalties and rentals, and (c) not engaged in trade or business in Ireland, shall be exempt from Irish surtax.

ARTICLE X

(1) Any salary, wage, similar remuneration, or pension, paid by the Government of the United States to an individual (other than a citizen of Ireland who is not also a citizen of the United States) in respect of services rendered to the United States in the discharge of governmental functions, shall be exempt from Irish tax.

(2) Any salary, wage, similar remuneration, or pension, paid by the Government of Ireland to an individual (other than a citizen of the United States who is not also a citizen of Ireland) in respect of services rendered to Ireland in the discharge of governmental functions, 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 by either of the Contracting Parties for purposes of profit.

ARTICLE XI

(1) An individual who is a resident of Ireland shall be exempt from United States tax upon compensation for personal (including professional) services performed during the taxable year within the United States if (a) he is present within the United States for a period or periods not exceeding in the aggregate 183 days during such taxable year, and (b) such services are performed for or on behalf of a person resident in Ireland.

(2) An individual who is a resident of the United States shall be exempt from Irish tax upon profits, emoluments or other remuneration in respect of personal (including professional) services performed within Ireland in any year of assessment if (a) he is present within Ireland for a period or periods not exceeding in the aggregate 183 days during that year, and (b) such services are performed for or on behalf of a person resident in the United States.

ARTICLE XII

(1) Any pension (other than a pension to which Article X applies), and any life annuity, derived from sources within the United States by an individual who is a resident of Ireland shall be exempt from United States tax.

(2) Any pension (other than a pension to which Article X applies), and any life annuity, derived from sources within Ireland by an individual who is a resident of the United States shall be exempt from Irish tax.

(3) The term "life annuity" means a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in consideration of money paid.

ARTICLE XIII

(1) Subject to section 131 of the United States Internal Revenue Code as in effect on the day on which this Convention shall have come into effect, Irish tax shall be allowed as a credit against United States tax. For this purpose, the recipient of a dividend paid by a corporation which is a resident of Ireland shall be deemed to have paid the Irish income tax appropriate to such dividend if such recipient elects to include in his gross income for the purposes of United States tax the amount of such Irish income tax. For the purposes only of this Article, income derived from sources in the United Kingdom by an individual who is resident in Ireland shall be deemed to be income from sources in Ireland if such income is not subject to United Kingdom income tax.

(2) Subject to such provisions (which shall not affect the general principle hereof) as may be enacted in Ireland, United States tax payable in respect of income from sources within the United States shall be allowed as a credit against any Irish tax payable in respect of that income. Where such income is an ordinary dividend paid by a United States corporation, such credit shall take into account (in addition to any United States income tax deducted from or imposed on such dividend) the United States income tax imposed on such corporation in respect of its profits, and where it is a dividend paid on participating preference shares and representing both a dividend at the fixed rate to which the shares are entitled and an additional participation in profits, such tax on profits shall likewise be taken into account in so far as the dividend exceeds such fixed rate.

(3) For the purposes of this Article, compensation, profits, emoluments and other remuneration for personal (including professional) services shall be deemed to be income from sources within the territory of the Contracting Party where such services are performed.

ARTICLE XIV [1]

A resident of Ireland not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

[1] The Government of the United States did not accept this Article.

ARTICLE XV

(1) Dividends and interest paid, on or after the first day of January in the calendar year in which the exchange of instruments of ratification takes place, by an Irish corporation shall be exempt from United States tax except where the receipient is a citizen of or a resident in the United States or a United States corporation.

(2) Dividends and interest paid, on or after the 6th day of April of the first year of assessment specified in Article XXII(2)(b)(i) of this Convention, by a United States corporation shall be exempt from Irish tax except where the recipient is a resident of Ireland.

ARTICLE XVI[1]

An Irish corporation shall be exempt from United States tax on its accumulated or undistributed earnings, profits, income or surplus, if individuals who are residents of Ireland control, directly or indirectly, throughout the latter half of the taxable year, more than 50 per cent of the entire voting power in such corporation.

ARTICLE XVII

(1) The United States income tax liability for any taxable year beginning prior to January 1, 1936, of any individual (other than a citizen of the United States) resident in Ireland, or of any Irish corporation, remaining unpaid on the date of signature of the present Convention, may be adjusted on a basis satisfactory to the United States Commissioner of Internal Revenue: provided that the amount to be paid in settlement of such liability shall not exceed the amount of the liability which would have been determined if—

(a) the United States Revenue Act of 1936 (except in the case of an Irish corporation in which more than 50 per cent of the entire voting power was controlled, directly or indirectly, throughout the latter half of the taxable year, by citizens or residents of the United States), and

(b) Articles XV and XVI of the present Convention,

had been in effect for such year. If the taxpayer was not, within the meaning of such Revenue Act, engaged in trade or business in the United States and had no office or place of business therein during the taxable year, the amount of interest and penalties shall not exceed 50 per cent of the amount of the tax with respect to which such interest and penalties have been computed.

(2) The United States income tax unpaid on the date of signature of the present Convention for any taxable year beginning after the thirty-first day of December, 1935, and prior to the first day of January in the calendar year in which the exchange of instruments of ratification takes place in the case of an individual resident of Ireland, or in the case of any Irish corporation shall be determined as if the provisions of Article XV and XVI of the present Convention had been in effect for such taxable year.

(3) The provisions of paragraph (1) of this Article shall not apply—

(a) unless the taxpayer files with the Commissioner of Internal Revenue on or before the thirty-first day of December of the second calendar year following the calendar year in which the exchange of the instruments of ratification takes place a request that such tax liability be so adjusted and furnishes such information as the Commissioner may require; or

(b) in any case in which the Commissioner is satisfied that any deficiency in tax is due to fraud with intent to evade the tax.

ARTICLE XVIII

A professor or teacher from the territory of one of the Contracting Parties who visits the territory of the other Contracting Party for the purpose of teaching, for a period not exceeding two years, at a university, college, school or other educational institution in the territory of such other Contracting Party shall be exempted by such other Contracting Party from tax on his remuneration for such teaching for such period.

[1] The Government of the United States did not accept this Article.

ARTICLE XIX

A student or business apprentice from the territory of one of the Contracting Parties who is receiving full-time education or training in the territory of the other Contracting Party shall be exempted by such other Contracting Party from tax on payments made to him by persons within the territory of the former Contracting Party for the purposes of his maintenance, education or training.

ARTICLE XX

(1) The taxation authorities of the Contracting Parties shall exchange such information (being information available under the respective taxation laws of the Contracting Parties) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than 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 secret or trade process.

(2) As used in this Article, the term "taxation authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his authorized representative and, in the case of Ireland, the Revenue Commissioners or their authorized representative.

ARTICLE XXI

(1) The nationals of one of the Contracting Parties shall not, while resident in the territory of the other Contracting Party, be subjected therein to other or more burdensome taxes than are the nationals of such other Contracting Party resident in its territory.

(2) The term "nationals" as used in this Article means—

(a) in relation to Ireland, all citizens of Ireland, and

(b) in relation to the United States, United States citizens;

and includes all legal persons, partnerships and associations deriving their status as such from, or created or organized under, the laws in force in any territory of the Contracting Parties to which the present Convention applies.

ARTICLE XXII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington, District of Columbia, as soon as possible.

(2) Upon exchange of ratifications, the present Convention shall have effect—

(a) as respects United States tax, for the taxable years beginning on or after the first day of January in the calendar year in which the exchange of instruments of ratification takes place;

(b) (i) as respects Irish income tax, for the year of assessment beginning on the 6th day of April in the calendar year in which the exchange of instruments of ratification takes place and subsequent years; (ii) as respects Irish surtax, for the year of assessment beginning on the 6th day of April immediately preceding the calendar year in which the exchange of instruments of ratification takes place, and subsequent years; and (iii) as respects Irish corporation profits tax, for any chargeable accounting period beginning on or after the first day of April in the calendar year in which the exchange of instruments of ratification takes place, and for the unexpired portion of any chargeable accounting period current at that date.

ARTICLE XXIII

(1) The present Convention shall continue in effect indefinitely but either of the Contracting Parties may, on or before the 30th day of June in any calendar year following the calendar year in which the exchange of instruments of ratification takes place, give to the other Contracting Party, through diplomatic channels, notice of termination and, in such event, the present Convention shall cease to be effective—

(a) as respects United States tax, for the taxable years beginning on or after the first day of January in the calendar year next following that in which such notice is given:

(b) (i) as respects Irish income tax, for any year of assessment beginning on or after the 6th day of April in the calendar year next following that in which such notice is given; (ii) as respects Irish surtax, for any year of assessment beginning on or after the 6th day of April in the calendar year in which such notice is given; and (iii) as respects Irish corporation profits tax, for any chargeable accounting period beginning on or after the first day of April in the calendar year next following that in which such notice is given and for the unexpired portion of any chargeable accounting period current at that date.

(2) The termination of the present Convention or of any Article thereof shall not the effect of reviving any treaty or arrangement abrogated by the present Convention or by treaties previously concluded between the Contracting Parties.

IN WITNESS WHEREOF the above-named Plenipotentiaries have signed the present Convention and have affixed thereto their seals.

DONE in Dublin, in duplicate, this 13th day of September, 1949.

For the Government of the United States of America:
GEORGE A. GARRETT [SEAL]

For the Government of Ireland:
P. MCGILLIGAN
SEÁN MACBRIDE [SEAL]

UNITED STATES-NEW ZEALAND INCOME TAX CONVENTION [1]

A convention between the United States and New Zealand for the avoidance of double taxation and the prevention of fiscal evasion with respect to income taxes was signed at Washington, D. C., on March 16, 1948. The Senate of the United States, on September 17, 1951, advised and consented to the ratification of the tax convention subject to a reservation as to paragraph (4) of Article IX, relating to the profits of remuneration of public entertainers. The convention was ratified by the President, subject to such reservation, on December 10, 1951. The convention was ratified by New Zealand on April 5, 1951. The instruments of ratification were exchanged at Washington on December 18, 1951. The convention was proclaimed by the President on December 20, 1951, and is effective retroactively for the taxable years beginning on and after January 1, 1951. The convention reads as follows:

ARTICLE I

(1) The taxes which are the subject of the present Convention are—
(a) In New Zealand:
The income-tax and social security charge (hereinafter referred to as New Zealand tax).
(b) In the United States of America:
The Federal income taxes, including surtaxes (hereinafter referred to as United States tax).
(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Government subsequently to the date of signature of the present Convention or by the Government of any territory to which the present Convention is extended under Article XX.

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[1] The full text of the convention is published herein, supplementing partial publication in T. D. 5957, C. B. 1953–1, 238.

ARTICLE II

(1) In the present Convention, unless the context otherwise requires—

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii, and the District of Columbia.

(b) For the purposes of this Convention New Zealand includes all islands and territories within the limits thereof for the time being including the Cook Islands.

(c) The terms "territory of one of the Contracting Governments" and "territory of the other Contracting Government" mean the United States or New Zealand, as the context requires.

(d) The term "tax" means United States tax or New Zealand tax, as the context requires.

(e) The term "person" includes any body of persons, corporate or not corporate.

(f) The term "company" means any body corporate.

(g) The term "United States corporation" means a corporation, association or other like entity created or organized in, or under the laws of, the United States.

(h) The term "New Zealand corporation" means any kind of juridical person created under the laws of New Zealand.

(i) The terms "corporation of one Contracting Government" and "corporation of the other Contracting Government" mean a United States corporation or a New Zealand corporation, as the context requires.

(j) The term "resident of New Zealand" means any person (other than a citizen of the United States or a United States corporation) who is resident in New Zealand for the purposes of New Zealand tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in New Zealand if it is incorporated under the laws of, or if its business is managed and controlled in, New Zealand.

(k) The term "resident of the United States" means any individual who is resident in the United States for the purposes of United States tax and not resident in New Zealand for the purposes of New Zealand tax, and any United States corporation and any partnership created or organized in, or under the laws of, the United States, being a corporation or partnership which is not resident in New Zealand for the purposes of New Zealand tax.

(l) The terms "resident of the territory of one of the Contracting Governments" and "resident of the territory of the other Contracting Government" mean a resident of the United States or a resident of New Zealand, as the context requires.

(m) The terms "United States enterprise" and "New Zealand enterprise" mean, respectively, an industrial or commercial enterprise or undertaking carried on by a resident of the United States and an industrial or commercial enterprise or undertaking carried on by a resident of New Zealand; and the terms "enterprise of one of the Contracting Governments" and "enterprise of the other Contracting Government" mean a United States enterprise or a New Zealand enterprise, as the context requires.

(n) The term "industrial or commercial profits" includes manufacturing, mercantile, mining, financial and farming profits, but does not include income in the form of dividends, interest, rents or royalties, insurance premiums, management charges, or remuneration for personal services.

(o) The term "permanent establishment", when used with respect to an enterprise of one of the Contracting Governments, means a branch, management, factory, mine, farm, or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or regularly fills orders on its behalf from a stock of goods or merchandise.

An enterprise of one of the Contracting Governments shall not be deemed to have a permanent establishment in the territory of the other Contracting Government merely because it carries on business dealings in that territory through a *bona fide* broker or general commission agent acting in the ordinary course of his business as such.

The fact that an enterprise of one of the Contracting Governments maintains a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute that fixed place of business a permanent establishment of the enterprise.

The fact that a corporation of one Contracting Government has a subsidiary corporation which is a corporation of the other Contracting Government or which is engaged in trade or business in the territory of such other Contracting Government (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation. The maintenance within the territory of one of the Contracting Governments by an enterprise of the other Contracting Government of a warehouse for convenience of delivery and not for purposes of display shall not of itself constitute a permanent establishment within that territory even though offers of purchase have been obtained by an agent of the enterprise in that territory and transmitted by him to the enterprise for acceptance.

(2) In the application of the provisions of the present Convention by one of the Contracting Governments any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Government relating to the taxes which are the subject of the present Convention.

ARTICLE III

(1) The industrial or commercial profits of a United States enterprise shall not be subject to New Zealand tax unless the enterprise is engaged in trade or business in New Zealand through a permanent establishment situated therein. If it is so engaged, New Zealand tax may be imposed on the entire income of such enterprise from sources within New Zealand. Nothing in this paragraph shall affect any provisions of the law of New Zealand regarding the taxation of income from the business of insurance.

(2) The industrial or commercial profits of a New Zealand enterprise shall not be subject to United States tax unless the enterprise 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 on the entire income of such enterprise from sources within the United States.

(3) Where an enterprise of one of the Contracting Governments is engaged in trade or business in the territory of the other Contracting Government through a permanent establishment situated therein, there shall be attributed to that 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 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 derived from sources within the territory of such other Contracting Government.

(4) In determining the industrial or commercial profits from sources within the territory of one of the Contracting Governments of an enterprise of the other Contracting Government no profits shall be deemed to arise from the mere purchase of goods or merchandise within the territory of the former Contracting Government by such enterprise.

(5) In the determination of the industrial or commercial profits of the permanent establishment there shall be allowed as deductions all expenses of a type allowed as a deduction by the Contracting Government in whose territory the permanent establishment is situated and which are reasonably applicable to the permanent establishment, including executive and general administrative expenses so applicable.

(6) If the information available to the taxation authority concerned is inadequate to determine the profits to be attributed to the permanent establishment, nothing in this paragraph shall affect the application of the law of either territory in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that territory: Provided that such discretion shall be exercised or such estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this paragraph.

ARTICLE IV

(1) Where
(a) an enterprise of one of the Contracting Governments participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting Government, or
(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the Contracting Governments and an enterprise of the other Contracting Government, 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,

then any profits which would but for those conditions have accrued to one of the enterprises but by reason of these conditions have not so accrued may be included in the profits of that enterprise and taxed accordingly.

(2) If the information available to the taxation authority concerned is inadequate to determine, for the purposes of paragraph (1) of this Article, the profits which might be expected to accrue to an enterprise, nothing in that paragraph shall affect the application of the law of either territory in relation to the liability of that enterprise to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that territory. Provided that such discretion shall be exercised or such estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this paragraph.

(3) For the purpose of this Article an industrial or commercial enterprise or undertaking carried on by a United States citizen resident in New Zealand or by a United States corporation managed and controlled in New Zealand shall be deemed to be a New Zealand enterprise.

ARTICLE V

(1) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which an individual resident of New Zealand or a New Zealand corporation derives from operating ships or aircraft shall be exempt from United States tax.

(2) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which a citizen of the United States not resident in New Zealand or a United States corporation not resident in New Zealand derives from operating ships or aircraft shall be exempt from New Zealand tax.

ARTICLE VI

(1) The rate of United States tax on dividends derived from sources within the United States by a resident of New Zealand not engaged in trade or business within the United States through a permanent establishment therein shall not exceed 15 percent: Provided that such rate of tax shall not exceed 5 percent if such resident is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. Such reduction of the rate to 5 percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(2) In the event that New Zealand should impose at any time tax on dividends derived from sources within New Zealand by a nonresident thereof including a resident of the United States, not engaged in trade or business within New Zealand through a permanent establishment therein at a rate in excess of 15 percent (or 5 percent in cases coresponding to those within the scope of the proviso in paragraph (1) of this Article), either of the Contracting Governments may terminate this Article provided that notice of termination is given in writing, and, in such event, this Article shall cease to be effective as respects United States tax for the taxable years beginning on or after the first day of January next following the date on which such notice is given.

ARTICLE VII

(1) A resident of the territory of one of the Contracting Governments deriving from sources within the territory of the other Contracting Government—

(a) royalties in respect of the operation of mines, quarries or natural resources, or
(b) rentals from real property, or
(c) royalties or other amounts paid as consideration for the use of, or for the privilege of using, any copyright, patent, design, secret process or formula, trademark or other like property,

may elect for any taxable year to be subject to the tax of such other Contracting Government, on a net basis, as if such resident were engaged in trade or business within the territory of such other Contracting Government through a permanent establishment therein during such taxable year.

(2) The provisions of this Article shall not apply to income falling within the scope of Article VIII of the present Convention.

ARTICLE VIII

(1) Rentals in respect of motion picture films derived from sources within the territory of one of the Contracting Governments by a resident of the territory of the other Contracting Government who is not engaged in trade or business through a permanent establishment in the former territory shall be exempt from tax by the former Government.

(2) The provisions of this Article shall not be construed to affect the New Zealand film hire tax or the income-tax imposed by New Zealand on income which is taxable under New Zealand law and which is derived by any person from the business of renting motion picture films.

ARTICLE IX

(1) An individual who is a resident of the United States shall be exempt from New Zealand tax on profits or remuneration in respect of personal (including professional) services performed within New Zealand in any income year if—

(a) he is present within New Zealand 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 person resident in the United States.

(2) An individual who is a resident of New Zealand 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 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 person resident in New Zealand.

(3) For the purposes of this Article a corporation of one Contracting Government shall not be deemed to be a resident of the territory of the other Contracting Government even though it has a permanent establishment in that territory.

(4)[1] The provisions of this Article shall not apply to the profits or remuneration of public entertainers such as stage, motion picture or radio artists, musicians and athletes.

ARTICLE X

(1) Remuneration, wages or salary (other than pensions) paid by the Government of the United States for services rendered to the United States in the discharge of governmental functions to an individual who is a citizen of the United States or who is ordinarily resident in New Zealand solely for the purpose of rendering such services shall be exempt from New Zealand tax.

(2) Remuneration, salary and wages (other than pensions) paid by the Government of New Zealand to an individual (other than a citizen of the United States) for services rendered to New Zealand in the discharge of governmental functions 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 by either of the Contracting Governments for purposes of profit.

[1] The Government of the United States did not accept this paragraph.

ARTICLE XI

Income (other than dividends paid by a company resident in New Zealand) of a person who is a resident of the United States which is exempt from New Zealand tax under any provision of the present Convention shall not be included in that person's total income for the purpose of determining the amount of any New Zealand tax payable in respect of income of that person which is assessable to New Zealand tax.

ARTICLE XII

(1) Dividends paid by a New Zealand corporation shall be exempt from United States tax except where the recipient is a citizen of, or resident in, the United States or a United States corporation.

(2) Dividends paid by a United States corporation shall be exempt from New Zealand tax except where the recipient is resident in New Zealand.

ARTICLE XIII

(1) Subject to section 131 of the United States Internal Revenue Code as in effect on the date of signature of this Convention, New Zealand tax shall be allowed as a credit against United States tax.

(2) If, under the law in force in New Zealand at any time while the present Convention is in effect, New Zealand tax is payable in respect of income from sources within the United States in respect of which United States tax is payable, the United States tax payable (whether directly or by deduction) in respect of any such income shall, subject to such provisions (which shall not affect the general principle hereof) as may be enacted in New Zealand, be allowed as a credit against any New Zealand tax payable in respect of that income. For the purposes of this paragraph the terms "United States tax" and "New Zealand tax" do not include any penalty imposed under the laws of the United States or New Zealand relating to the taxes which are the subject of the present Convention and the term "New Zealand tax" does not include social security charge.

(3) For the purposes of this Article, profits or remuneration for personal (including profesional) services performed in the territory of one of the Contracting Governments shall be deemed to be income from sources within that territory.

ARTICLE XIV

A professor or teacher who is normally a resident of the territory of one of the Contracting Governments and who receives remuneration for teaching, during a period of temporary residence not exceeding two years, at a university, college, school or other educational institution in the territory of the other Contracting Government shall be exempt from tax by such other Government in respect of such remuneration.

ARTICLE XV

A student or business or trade apprentice who is normally resident in the territory of one of the Contracting Governments and who is receiving full-time education or training in the territory of the other Contracting Government shall be exempt from tax by such other Government on payments made to him by persons in the territory of the former Government for the purpose of his maintenance, education, or training.

ARTICLE XVI

(1) The taxation authorities of the Contracting Governments shall exchange such information (being information available under the respective taxation laws of the Contracting Governments) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or for the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than persons (including a court) concerned with the assessment or collection of the taxes which are the subject of the present Convention or the determination of appeals in relation thereto. No information shall be exchanged which would disclose any trade secret or trade process.

(2) The term "taxation authorities" means, in the case of New Zealand, the Commissioner of Taxes or his authorized representative; in the case of the United States, the Commissioner of Internal Revenue or his authorized representative.

ARTICLE XVII

Each of the Contracting Governments may collect such tax imposed by the other Contracting Government as will ensure that the exemption or reduced rate of tax granted under the present Convention by such other Government shall not be enjoyed by persons not entitled to such benefits.

ARTICLE XVIII

(1) Where a person shows proof that the action of the revenue authorities of the Contracting Governments has resulted or may result in double taxation in his case (including for this purpose adjustments as between taxpayers affected by Article IV) in respect of any of the taxes to which the present Convention relates, he shall be entitled to lodge a claim with the Government of which he is a citizen or in whose territory he is resident. If the claim should be deemed worthy of consideration, the taxation authorities of such Government may consult with the taxation authorities of the other Government to determine whether the double taxation in question may be avoided.

(2) The taxation authorities of the two Contracting Governments may prescribe regulations to carry into effect the present Convention within the respective States and rules with respect to the exchange of information.

(3) The taxation authorities of the two Contracting Governments may communicate with each other directly for the purpose of giving effect to the provisions of the present Convention.

ARTICLE XIX

The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the Contracting Governments in the determination of the tax imposed by such Government.

ARTICLE XX

(1) Either of the Contracting Governments may, on the coming into force of the present Convention or at any time while it continues in force, by a written notification of extension given to the other Contracting Government declare its desire that the operation of the present Convention shall extend to all or any of its overseas territories or other territories for which it has international responsibility which impose taxes substantially similar in character to those which are the subject of the present Convention. The present Convention shall apply to the territory or territories named in such notification on the date or dates specified in the notification (not being less than sixty days from the date of the notification) or, if no date is specified in respect of any such territory, on the sixtieth day after the date of the notification, unless prior to the date on which the present Convention would otherwise become applicable to a particular territory, the Contracting Government to whom notification is given shall have informed the other Contracting Government in writing that it does not accept the notification as to that territory. In the absence of such an extension, the present Convention shall not apply to any such territory.

(2) At any time after the expiration of one year from the entry into force of an extension under paragraph (1) of this Article, either of the Contracting Governments may, by written notice of termination given to the other Contracting Government, terminate the application of the present Convention to any territory to which it has been extended under paragraph (1), and in that event the present Convention shall cease to apply, as from the date or dates specified in the notice, which shall not be less than sixty days after the date on which such notice is given, or, if no date is specified, at the expiration of six months after the date of the notice, to the territory or territories named therein, but without affecting its continued application to New Zealand, the United States or to any other territory to which it has been extended under paragraph (1) hereof.

(3) In the application of the present Convention in relation to any territory to which it is extended by notification by the United States or New Zealand, references to the "United States" or, as the case may be, "New Zealand" shall be construed as references to that territory.

(4) The termination in respect of the United States or New Zealand of the present Convention under Article XXII shall, unless otherwise expressly agreed

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by both Contracting Governments, terminate the application of the present Convention to any territory to which the present Convention has been extended by New Zealand or the United States.

ARTICLE XXII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) Upon exchange of instruments of ratification, the present Convention shall have effect—

(a) as respects United States tax, for the taxable years beginning on or after the first day of January in the calendar year in which occurs the exchange of the instruments of ratification.

(b) as respects New Zealand tax, for the year of assessment beginning on the first day of April next following the calendar year in which occurs the exchange of the instruments of ratification.

ARTICLE XXII

The present Convention shall continue effective for a period of two years and indefinitely after that period, but may be terminated by either Contracting Government at the end of such period or at any time thereafter, provided that at least six months' prior notice of termination has been given in writing and, in such event, the present Convention shall cease to be effective—

(a) as respects United States tax, for the taxable years beginning on or after the first day of January next following the expiration of the six-month period,

(b) as respects New Zealand tax, for the years of assessment beginning on or after the first day of April in the second year following the expiration of the six-month period.

DONE at Washington, in duplicate, this 16th day of March, 1948.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

G. C. MARSHALL

Secretary of State of the United States of America

FOR THE GOVERNMENT OF NEW ZEALAND:

[SEAL] W. NASH

Minister of Finance and Minister of Customs for New Zealand

UNITED STATES-UNITED KINGDOM SUPPLEMENTARY INCOME TAX CONVENTION

A supplementary protocol between the United States and 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 amends the United States-United Kingdom income tax convention of April 16, 1945, C. B. 1947–2, 209, as modified by the supplementary protocol of June 6, 1946, and the supplementary protocol of May 25, 1954, C. B. 1957–1, 665. Article I of the supplementary protocol amends article VII of the 1945 convention relating to exemption from taxation, on certain conditions, of royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trademarks, and other like property. Article II of the supplementary protocol amends article XIII of the 1945 convention relating to credits against the tax paid to one country for tax paid to the other country. The Senate of the United States advised and consented to ratification on August 13, 1958. The instruments of ratification were exchanged on October 15, 1958, and the supplementary protocol was ratified by the President on October 22, 1958, and proclaimed by him on October

24, 1958. The supplementary protocol is effective for taxable years beginning on or after January 1, 1956.

The supplementary protocol and transmittal letter read as follows:

DEPARTMENT OF STATE,
Washington, D. C.

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 supplementary protocol between the United States of America and the United Kingdom of Great Britain and Northern Ireland, signed at Washington on August 19, 1957, amending the convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at Washington on April 16, 1945, as modified by the supplementary protocol signed at Washington on June 6, 1946, and the supplementary protocol signed at Washington on May 25, 1954.

The convention of 1945 (S. Ex. D. 79th Cong., 1st sess.; 60 Stat., pt. 2, 1377) and the supplementary protocol of 1946 (S. Ex. F, 79th Cong., 2d sess.; 60 Stat., pt. 2, 1389) were brought into force on July 25, 1946. The supplementary protocol of 1954 (S. Ex. H, 83d Cong., 2d sess.; 6 U. S. T. 37) was brought into force on January 19, 1955.

Article I of the supplementary protocol would amend article VIII of the 1945 convention relating to exemption from taxation, on certain conditions, of royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulas, trademarks, and other like property. Article II of the supplementary protocol would amend article XIII of the 1945 convention relating to credits against the tax paid to one country for tax paid to the other country. In a letter from the Secretary of the Treasury to the Secretary of State relating to this matter the following explanation is given regarding the purpose and effect of the supplementary convention:

Under the existing convention, royalties paid by a United Kingdom licensee to a licensor in the United States for the use of a patent or copyright are exempt from tax in the United Kingdom if the licensor does not have a permanent establishment there. If the licensor does have a permanent establishment there, a tax is imposed by the United Kingdom. However, the tax is not imposed on the licensor as such, and under the United States law no credit is available for the British tax on the royalties, with the result that double taxation ensues.

The proposed supplementary protocol would modify the existing convention so that the exemption of royalties would continue to apply in cases where they are received by a United States enterprise with a permanent establishment in the United Kingdom, provided the royalties are unrelated to the business operations carried on by the permanent establishment. And in those cases where the royalties are not exempt, the United States would give a credit for the British tax. These provisions would, of course, operate on a reciprocal basis.

The negotiation and conclusion of the supplementary protocol carry out the purpose indicated in the President's message of August 10, 1956 (Congressional Record, August 13, 1956, pp. A6471–A6472) whereby approval was withheld with respect to a bill approved by the Congress. The statements in that message are relevant to a consideration of the supplementary protocol. The text of the message, therefore, is quoted in full as follows:

I am withholding my approval of H. R. 7643, an act to amend the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954 with respect to foreign tax credit for United Kingdom income tax paid with respect to royalties and other like amounts. This bill would extend to firms with a permanent establishment in the United Kingdom that receive royalties there a credit for taxes imposed by the United Kingdom on the payor of the royalties. This provision would be retroactive to 1950.

Under the income-tax convention with the United Kingdom royalties received by a United States licensor are not subject to tax in the United Kingdom if the recipient has no permanent establishment there. If it does have a permanent establishment, the royalty is subject to British taxation. The American recipient reports the net amount of royalties from British sources and receives no United States tax credit for the British tax paid. This treatment under the United States law arises from two court decisions (*Trico Products Corp.* (46

B. T. A. 346, affirmed 137 F. (2d) 424, cert. den. 320 U. S. 799, reh. den. 321 U. S. 801); *Irving Air Chute Co. Inc.* (1 T. C. 880, affirmed 143 F. (2d) 256, cert. den. 323 U. S. 773)).

The combined effect of the United States income-tax law and the income-tax convention with the United Kingdom is to produce a different combination of British and United States taxes on the royalties paid some American recipients than on others. However, the United States tax law is not the cause of this difference in treatment. It is caused by the provisions in the convention itself. The appropriate way to correct the situation would be modification of the convention. The Treasury Department currently is conducting discussions on the convention with the British and will add this problem to the agenda.

The present status of royalty payments from the United Kingdom to the United States has been well known to interested parties at least since the convention was adopted in 1945. Many arrangements between licensees and licensors have reflected existing law and the burden of British tax may not rest on United States licensors in such cases. Consequently, to allow the British tax as a credit against the United States tax on a retroactive basis would give a windfall gain to some American licensors.

The proposed change would single out for special relief a small group of taxpayers whose need for relief has not been demonstrated. Tax relief should not be given in this way.

For these reasons, I am constrained to withhold my approval of the bill.

Article III of the supplementary protocol provides for ratification and the exchange of instruments of ratification and specifies the dates on and after which the provisions shall be effective with respect to United States and British taxes.

The protocol has the approval of the Department of State and the Department of the Treasury.

Respectfully submitted.

JOHN FOSTER DULLES.

SUPPLEMENTARY PROTOCOL BETWEEN THE UNITED STATES OF AMERICA AND THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AMENDING THE CONVENTION FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, SIGNED AT WASHINGTON ON THE 16TH APRIL 1945, AS MODIFIED BY THE SUPPLEMENTARY PROTOCOL SIGNED AT WASHINGTON ON THE 6TH JUNE 1946 AND BY THE SUPPLEMENTARY PROTOCOL SIGNED AT WASHINGTON ON THE 25TH MAY 1954

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland,

Desiring to conclude a further supplementary Protocol amending the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed at Washington on the 16th April 1945, as modified by the supplementary Protocol signed at Washington on the 6th June 1946 and by the supplementary Protocol signed at Washington on the 25th May 1954,

Have agreed as follows:

ARTICLE I

Paragraphs (1) and (2) of Article VIII of 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 are hereby amended to read as follows:

"(1) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trade marks and other like property, and derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax on such royalties or other amounts shall be exempt from United States tax (a) if such resident is not engaged in trade or business in the United States through a permanent establishment situated therein or (b) if such resident is so engaged, the royalties or other amounts are not directly associated with the business carried on through that permanent establishment.

"(2) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trade marks and other like property, and derived from sources

within the United Kingdom by a resident of the United States who is subject to United States tax on such royalties or other amounts shall be exempt from United Kingdom tax (a) if such resident is not engaged in trade or business in the United Kingdom through a permanent establishment situated therein or (b) if such resident is so engaged, the royalties or other amounts are not directly associated with the business carried on through that permanent establishment."

ARTICLE II

Paragraph (1) of Article XIII of the said Convention is hereby amended to read as follows:

"(1) Subject to Sections 901 to 905 of the United States Internal Revenue Code as in effect on the 1st day of January 1956, United Kingdom tax shall be allowed as a credit against United States tax. For this purpose

(a) the recipient of a dividend paid by a corporation which is a resident of the United Kingdom shall be deemed to have paid the United Kingdom tax appropriate to such dividend, and

(b) the recipient of any royalty or other amount coming within the scope of Article VIII of the present Convention shall be deemed to have paid any United Kingdom tax legally deducted from the royalty or other amount by the person by or through whom any payment thereof is made,

if the recipient of the dividend or royalty or other amount, as the case may be, elects to include in his gross income for the purposes of United States tax the amount of such United Kingdom income tax."

ARTICLE III

(1) This supplementary Protocol shall be ratified and the instruments of ratification shall be exchanged at London as soon as possible.

(2) This supplementary Protocol shall enter into force upon the exchange of instruments of ratification and shall thereupon have effect—

(a) In the United Kingdom:

(i) as respects income tax and surtax for any year of assessment beginning on or after the 6th April 1956;

(ii) as respects profits tax for any chargeable accounting period beginning on or after the 1st April 1956, and for the unexpired portion of any chargeable accounting period current at that date.

(b) In the United States: As respects taxable years beginning on or after the 1st January 1956.

IN WITNESS WHEREOF the undersigned, being authorized thereto by their respective Governments, have signed this supplementary Protocol and have affixed thereto their seals.

DONE in duplicate at Washington this nineteenth day of August, 1957.

For the GOVERNMENT OF THE UNITED STATES OF AMERICA:

[SEAL] JOHN FOSTER DULLES

For the GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND:

[SEAL] HAROLD CACCIA

PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

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PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

TREASURY DEPARTMENT ORDER 150–47

Delegation of Functions in the Internal Revenue Service

By virtue of the authority vested in me by Reorganization Plan No. 26 of 1950, there are hereby transferred to Deputy Commissioner of Internal Revenue O. Gordon Delk all functions now authorized to be performed by the Commissioner of Internal Revenue. Without limitation this authority includes authority to delegate functions hereby transferred and to amend or cancel existing delegations heretofore made by the Commissioner pursuant to Treasury Department Order No. 150–2, May 15, 1952, and Treasury Department Order No. 129, as revised. In the absence of such cancellation or amendment, those delegations of the Commissioner shall remain in effect.

In the performance of the functions herein delegated, Mr. Delk is designated as Acting Commissioner of Internal Revenue.

This order shall become effective as of 12:01 a. m., October 1, 1958.

Dated: September 27, 1958.

[Seal]

ROBERT B. ANDERSON,
Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 2, 1958, 3:56 p. m., and published in the issue of the Federal Register for October 4, 1958, 23 F. R. 7711.)

TREASURY DEPARTMENT ORDER 150–48

COMMISSIONER OF INTERNAL REVENUE

Delegation of Functions in the Internal Revenue Service

By virtue of the authority vested in me by Reorganization Plan No. 26 of 1950, the functions transferred to Deputy Commissioner of Internal Revenue O. Gordon Delk by Treasury Department Order No. 150–47, dated September 27, 1958, above, are hereby transferred to Commissioner of Internal Revenue Dana Latham. The authority of Mr. Delk to perform functions under Treasury Department Order No. 150–47 shall terminate at 12:00 noon, November 5, 1958, and by virtue of this order such functions shall be performed thereafter by Commissioner Latham.

Dated: November 5, 1958.

[SEAL]

ROBERT B. ANDERSON,
Secretary of the Treasury.

(Filed by the Division of the Federal Register on Nov. 7, 1958, 8:49 a. m., and published in the issue of the Federal Register for Nov. 8, 1958, 23 F. R. 8735.)

TREASURY DEPARTMENT ORDER 165-9
COMMISSIONER OF CUSTOMS

Transfer and delegation of authority to allow drawback of internal revenue tax on domestic alcohol.

By virtue of the authority vested in me by Reorganization Plan No. 26 of 1950 (3 CFR, 1950 Supp., Ch. III) there is hereby transferred from the Commissioner of Internal Revenue and delegated to the Commissioner of Customs the function, authorized by section 313(d) of the Tariff Act of 1930, as amended (19 U. S. C. 1313(d)), of allowing the drawback of an amount equal to the internal revenue tax found to have been paid on domestic alcohol used in the manufacture or production in the United States of flavoring extracts and medicinal or toilet preparations (including perfumery) that have been exported.

The function herein transferred and delegated may be delegated by the Commissioner of Customs to other officers or employees of the Customs Service in such manner as the Commissioner shall direct.

This Order shall be effective January 1, 1959.

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

August 13, 1958.

(Filed by the Division of the Federal Register on August 18, 1958, 8:53 a. m., and published in the issue of the Federal Register for August 19, 1958, 23 F. R. 6362)

TREASURY DEPARTMENT CIRCULAR NO. 848
(SECOND REVISION) [1]

Regulations governing deposits made by employers with Federal Reserve Banks and depositary banks, and certain excise tax deposits.

1. SCOPE OF REGULATIONS.

Pursuant to authority contained in Section 6302(c) of the Internal Revenue Code of 1954; Section 15 of the Federal Reserve Act, as amended (U. S. C. title 12, sec. 391); Section 10 of the Act of June 11, 1942, as amended (U. S. C. title 12, sec. 265); and Section 8 of the Second Liberty Bond Act, as amended (U. S. C. title 31, sec. 771), the following regulations are hereby prescribed, governing the handling and processing of deposits made by employers with Federal Reserve Banks and depositary banks, of (1) income taxes withheld under Chapter 24 of the Internal Revenue Code of 1954; (2) employer taxes and employee taxes under the Federal Insurance Contributions Act, as amended (Chapter 21 of the Internal Revenue Code of 1954); (3) employer taxes and employee taxes under the Railroad Retirement Tax Act (Chapter 22 of the Internal Revenue Code of 1954); and (4) certain Federal excise taxes specified in Section 477.2(b) of Treasury Decision No. 6025, approved July 3, 1953. [C. B. 1953-2,400]

2. DEFINITION OF TERMS.

When used in this circular, the terms listed below shall have the following meaning, unless otherwise expressly stated:

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[1] Forms 469 and 460 (Revised), Forms 450-A, 450, 515, 537-A, and a suggested Form of Memorandum or Counter Receipt are omitted from the publication of this circular.

(a) "Federal Taxes" shall mean (1) income taxes withheld by employers pursuant to Section 3402 of the Internal Revenue Code of 1954; (2) employer taxes under Section 3111 of such Code and employee taxes withheld under Section 3101 of such Code (Social Security employment taxes); (3) employer taxes under Section 3221 of such Code and employee taxes withheld under Section 3201 of such Code (Railroad Retirement taxes); and (4) certain Federal taxes specified in Section 477.2(b) of Treasury Decision No. 6025, approved July 3, 1953;

(b) "Federal Reserve Bank" shall mean any of the several Federal Reserve Banks, as fiscal agent of the United States;

(c) "Depositary for Federal Taxes" shall mean a designated bank or trust company that has qualified, in accordance with the provisions of Department Circular No. 848, dated November 10, 1949, or of any revisions thereof, to receive from employers deposits of Federal Taxes, as defined above, and unless otherwise expressly stated the word "depositary" when used herein shall refer to a "Depositary for Federal Taxes;"

(d) "Depositary receipt" shall mean (1) U. S. Treasury Department Forms 450 and 450–A (Revised February 1958), "Federal Depositary Receipt", for use by employers in making deposits of withheld income taxes and Social Security employment taxes; (2) U. S. Treasury Department Form 515 (Revised February 1958), "Railroad Retirement Depositary Receipt", for use by employers in making deposits of Railroad Retirement taxes; and (3) U. S. Treasury Department Forms 537 and 537–A (Revised February 1958), "Depositary Receipt for Federal Excise Taxes", for use by taxpayers in making deposits of certain Federal excise taxes. Exhibits of these forms have been made a part of this circular. (See Exhibits B, C, D, E, and F.)

(e) "Employer" shall include any taxpayer required or permitted to deposit Federal excise taxes in the manner provided for in this circular.

3. Authorization of Federal Reserve Banks.

Pursuant to the authority contained in Section 6302(c) of the Internal Revenue Code of 1954 and the Federal Reserve Act, as amended, the several Federal Reserve Banks, in their capacity as fiscal agents of the United States, are hereby authorized and directed, subject to the provisions of this circular, to receive from employers or other persons, hereinafter referred to as employers, deposits of Federal Taxes and to perform such other functions as may be prescribed by the Secretary of the Treasury in connection with the handling and processing of such tax deposits. The functions to be performed by Federal Reserve Banks are outlined hereinafter, and will be described in detail, together with the detailed procedure to be followed in performing the required functions, in instructions to the Federal Reserve Banks.

4. Designation of Banks Which May Be Qualified To Act as Depositaries for Federal Taxes.

Pursuant to the authority contained in Section 6302 (c) of the Internal Revenue Code of 1954, all insured incorporated banks, within the meaning of Section 10 of the Act of June 11, 1942, as amended, and all uninsured incorporated banks and trust companies designated as

"Special Depositaries of Public Moneys" under the provisions of the Act of Congress approved September 24, 1917, as amended, are hereby designated, subject to the provisions of this circular, as depositaries and financial agents of the Government for receiving from employers deposits of Federal Taxes. No such bank or trust company shall perform any of the acts covered by this designation until it has qualified, in the manner herein prescribed, to so act. Banks and trust companies that qualify for the purpose of receiving deposits of Federal Taxes from employers will be known as "Depositaries for Federal Taxes."

Banking institutions which have heretofore been designated as depositaries for withheld income taxes, in accordance with the provisions of Department Circular No. 714, as amended, or as depositaries and financial agents of the Government for the performance of certain classes of fiscal duties, will be required to qualify under the terms of this circular in order to act as Depositaries for Federal Taxes. Banking institutions that have qualified as Depositaries for Federal Taxes, in accordance with the provisions of Department Circular No. 848, dated November 10, 1949 and any revisions thereof, will not be required to requalify in accordance with the provisions of this revision of Department Circular No. 848.

Incorporated banks of trust companies located in the territories and insular possessions of the United States, which are not insured banks within the meaning of Section 10 of the Act of June 11, 1942, as amended, but which are otherwise eligible for designation as depositaries or financial agents of the United States, may be specifically designated by the Secretary of the Treasury under the Act of June 19, 1922 (U. S. C. title 31, sec. 473), governing depositaries outside of the continental United States, to act as Depositaries for Federal Taxes, upon qualification substantially in accordance with the provisions of Section 5 hereof. Banks and trust companies located in the Territories of Alaska and Hawaii should transmit applications for such designation to the Federal Reserve Bank of San Francisco, and banks and trust companies located in Puerto Rico, the Virgin Islands, and the Panama Canal Zone should transmit applications for such designation to the Federal Reserve Bank of New York.

5. Qualification of Designated Banks as Depositaries for Federal Taxes.

Any designated bank or trust company which desires to qualify, under the terms of this circular, for receiving from employers deposits for Federal Taxes without compensation for its services, should apply for qualification through the Federal Reserve Bank of the district in which it is located. Such application shall be made on Application-Agreement, Depositary for Federal Taxes (Form No. 469–Revised), shown as Exhibit A of this circular. Copies of this form and instructions regarding the application may be obtained from the Federal Reserve Bank. No designated bank, which has made application for qualification, shall act as a Depositary for Federal Taxes under the terms of this circular until it receives from the Federal Reserve Bank notice of approval of the application. Upon receipt of such notice, each designated bank is hereby authorized to receive deposits of Federal Taxes from employers.

6. PROCEDURE TO BE FOLLOWED BY DEPOSITARIES FOR FEDERAL TAXES. There are outlined below the basic requirements of the procedure that will be observed by qualified Depositaries for Federal Taxes with respect to deposits of Federal Taxes. More detailed instructions will be furnished such depositaries, through the Federal Reserve Banks.

(A) Depositaries shall accept from employers, who desire to make deposits of Federal Taxes with such depositaries, cash or remittances in the form of check, money order, etc., covering the amount of the Federal Taxes, accompanied by an appropriate depositary receipt form on which the employer has inscribed, by pen or by typewriter, his name, address, employer's identification number, and total amount of taxes. Depositaries will not be required to, but may at their own risk, accept from employers funds which are not immediately available to the depositary at the time of deposit. Depositaries shall not accept from employers any type of depositary receipt form, accompanying their remittances, other than the depositary receipt forms prescribed in this circular or those prescribed by Circular No. 848 before this revision. Depositaries shall not accept Treasury Savings Notes as deposits of Federal Taxes under this circular.

(B) If requested to do so by employers, depositaries will issue a memorandum or counter receipt to employers evidencing receipt of funds by the depositary. It is important that memorandum receipts issued by depositaries clearly state that employers must not attach such memorandum receipts to their tax returns as evidence of deposit of taxes, since only official depositary receipts, which have been validated by a Federal Reserve Bank, will be accepted by district directors of internal revenue. A suggested form of memorandum receipt, which shall be provided by the depositaries at their own expense, is shown as Exhibit G of this circular.

(C) Depositaries shall place on each depositary receipt in the space provided on the face thereof: (1) the date on which the tax deposit was *actually received* by the depositary or its branches; and (2) the name and address of the depositary.

(D) Depositaries shall forward *daily* to the Federal Reserve Bank of their district the depositary receipts inscribed by and received from employers, together with payment in funds immediately available at the Federal Reserve Bank point or with advice that funds have been credited in the Treasury Tax and Loan Account of the depositary, covering the aggregate amount of all Federal Tax deposits received during that day. (Regulations governing deposits in Treasury Tax and Loan Accounts are contained in Treasury Department Circular No. 92, Revised). Each transmittal will be accompanied by a transmittal letter in the form prescribed by the Federal Reserve Banks. It is important that the depositary receipts be forwarded daily in order that they may be validated by the Federal Reserve Bank and returned directly to the respective employers without delay, together with a blank depositary receipt for the employer's use in making his next deposit.

(E) Depositaries will establish, prior to transmittal to the Federal Reserve Bank, an adequate record of all deposits received from employers, so that the depositary will be able to identify deposits in

the event depositary receipts are lost in shipment between depositaries and Federal Reserve Banks. For this purpose, it will only be necessary to maintain a record of the date of payment the employer's identification number and the total amount of tax deposit; therefore, copies of memorandum receipts and copies of the depositary's transmittal letter, if individual deposits and employers' identification numbers are listed separately, could be used to provide the necessary information.

7. Issuance of Replacement Receipts; Inquiries From Employers.

In the event a depositary receipt, which has been validated by a Federal Reserve Bank, is lost, stolen, or destroyed before it is forwarded to a district director of internal revenue with the employer's Federal tax return, the employer will be issued a replacement receipt upon proper application and submission of required evidence to the Federal Reserve Bank which validated the receipt. Such issuance of replacement receipts will be governed by requirements and procedure prescribed by the Secretary of the Treasury. Depositaries should instruct employers to execute "Application for Issuance of Replacement Depositary Receipt," indicating thereon the type of taxes, the date and amount of deposit, employer's name, address, and identification number, and the serial number of the validated depositary receipt, and should indicate whether deposit was made with the Depositary for Federal Taxes or directly with the Federal Reserve Bank.

In the event an employer makes inquiry of a depositary with respect to a deposit made with such depositary, for which he has not received a validated depositary receipt from the Federal Reserve Bank, the depositary should furnish the required information, stated in the preceding paragraph, to the Federal Reserve Bank to enable it to investigate the matter.

If a depositary receipt without the employer's identification number inscribed thereon is presented to a depositary by an employer when he makes his deposit of Federal Taxes, the depositary should request him to inscribe the identification number in the space provided. In the event the employer has not been assigned an employer's identification number, the depositary should nevertheless accept the deposit. If the employer has not made application for an identification number to the director of internal revenue for his district, the depositary should request him to do so.

8. Termination of the Qualification of a Depositary for Federal Taxes.

The Secretary of the Treasury may terminate at any time the qualification of any Depositary for Federal Taxes. Failure upon the part of a depositary to comply with the provisions of this circular, and any amendments or supplements thereof, or with instructions issued pursuant thereto, may, in the discretion of the Secretary of the Treasury, constitute grounds for termination of qualification. Likewise, any depositary may terminate its qualification upon formal notice to the Secretary of the Treasury, through the Federal Reserve Bank of its district.

9. Treatment by District Director of Internal Revenue of Validated Depositary Receipts.

Deposits of Federal Taxes made by employers with Depositaries for Federal Taxes and Federal Reserve Banks shall be treated as payment of such taxes to district directors of internal revenue upon the filing of the employer's tax return and the presentation therewith to such district directors of properly executed and validated depositary receipts. District directors of internal revenue will treat all such depositary receipts as Internal Revenue collections, and send them to the Federal Reserve Bank of the district in which the district director's head office is located. Each such transmittal shall be accompanied by an appropriate certificate which shall not include any items other than depositary receipts.

In any case in which a depositary receipt is transmitted by a district director of internal revenue to a Federal Reserve Bank, and it is determined that the employer failed to pay to a depositary or a Federal Reserve Bank the amount stated thereon, the Federal Reserve Bank may return such item to the district director of internal revenue, under procedure prescribed by the Secretary of the Treasury.

10. Functions To Be Performed by Federal Reserve Banks.

The functions to be performed by Federal Reserve Banks, as fiscal agents of the United States, with respect to Federal Taxes, will be prescribed in detailed instructions to such banks. The Federal Reserve Banks will perform such additional functions relating to the deposit of Federal Taxes as may be required from time to time by the Secretary of the Treasury. In general, Federal Reserve Banks will:

(A) Receive directly from employers deposits of Federal Taxes, accompanied by inscribed depositary receipts, and establish appropriate accounting control for such deposits. The requirements upon employers with respect to inscribing depositary receipts and use of the prescribed receipt forms shall be applicable to tax deposits made directly with Federal Reserve Banks.

(B) Be responsible for the qualification of designated banks as Depositaries for Federal Taxes and for the general supervision of depositaries' operations under such qualification.

(C) Receive from depositaries remittances and inscribed depositary receipts, relating to tax deposits made with depositaries by employers, and establish appropriate accounting control for such tax deposits.

(D) Validate depositary receipts, relating to tax deposits made with depositaries, as well as directly with the Federal Reserve Bank, and return such validated receipts to employers, together with blank depositary receipt forms for use by the employers in making their next deposit of Federal Taxes.

(E) Perform the necessary functions to provide for crediting deposits of Federal Taxes in Treasury Tax and Loan Accounts of depositary banks, with respect to deposits of such taxes made by employers with banks acting in their capacity as Depositaries for Federal Taxes.

(F) Receive transmittals of validated depositary receipts from district directors of internal revenue for appropriate credit and clearance in the central accounts of the Treasury Department.

(G) Perform appropriate matching and auditing functions to verify that the tax deposits, represented by the depositary receipts transmitted by district directors of internal revenue, were previously re-

ceived by the Federal Reserve Bank from depositaries or directly from employers.

(H) Issue replacement receipts, referred to in Section 7 hereof, for validated depositary receipts which are lost, stolen, or destroyed.

11. AMENDMENT OR REVOCATION OF REGULATIONS

The Secretary of the Treasury may revoke or amend any or all provisions of this circular at any time or from time to time.

The provisions of this circular shall become effective on July 1, 1958.

JULIAN B. BAIRD,
Acting Secretary of the Treasury.

DELEGATION ORDER NO. 63

(Effective August 4, 1958)

Excess Profits Tax Council; authority in issues arising under section 722, Internal Revenue Code of 1939.

Mimeograph 6800, approved April 28, 1952 [C. B. 1952–1, 150], is hereby revoked.

RUSSELL C. HARRINGTON,
Commissioner.

Approved August 4, 1958.

FRED C. SCRIBNER,
Acting Secretary of the Treasury.

DELEGATION ORDER NO. 64

(Effective August 4, 1958)

Authority in issues arising under section 722

Pursuant to the authority vested in me as Commissioner of Internal Revenue, it is hereby ordered:

1. The Director of the Appellate Division is authorized exclusively to exercise final authority within the Internal Revenue Service with respect to all issues arising under section 722 of the Internal Revenue Code of 1939 in cases not docketed in the Tax Court of the United States, whether before or after issuance of a statutory notice.

2. With respect to all issues arising under section 722 of the Internal Revenue Code of 1939 in cases docketed in the Tax Court of the United States, in conformity with the provisions of Delegation Order No. 60—Chief Counsel's Order No. 1958–5, dated April 17, 1958 [C. B. 1958–1, 681], the Director of the Appellate Division is authorized exclusively to represent the Commissioner in the functions comparable to those delegated in standard-issue cases to the Regional Appellate Division in that joint Order.

3. The functions herein delegated may be redelegated by the Director of the Appellate Division only.

4. The instructions contained in this Order are intended to supplement the instructions contained in Delegation Order No. 60—Chief Counsel's Order No. 1958–5, dated April 17, 1958; and to supersede IR–Mim. 19, dated August 18, 1952 [C. B. 1952–2, 212], and other prior instructions to the extent that such instructions are inconsistent herewith.

RUSSELL C. HARRINGTON,
Commissioner.

(Filed by the Division of the Federal Register on Aug. 21, 1958, 8:55 a. m., and published in the issue of the Federal Register for Aug. 22, 1958, 23 F. R. 6932.)

DELEGATION ORDER NO. 65

CHIEF COUNSEL'S ORDER NO. 1958–10

(Effective August 6, 1958)

Revocation of Commissioner's Reorganization Order No. 2

Commissioner's Reorganization Order No. 2, dated May 15, 1952, as revised and amended, relating to delegation of certain functions to Regional Commissioners and Regional Counsel, issued pursuant to the authority of Treasury Department Order No. 150–2, is hereby revoked.

RUSSELL C. HARRINGTON,
Commissioner.

ARCH M. CANTRALL,
Chief Counsel.

Approved August 5, 1958.

JOHN K. CARLOCK,
Acting General Counsel for The Treasury Department.

Approved August 6, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on Aug. 21, 1958, 8:55 a. m., and published in the issue of the Federal Register for Aug. 22, 1958, 23 F. R. 6532.)

DELEGATION ORDER NO. 66

CHIEF COUNSEL'S ORDER NO. 1958–11

(Effective August 6, 1958)

Authorities of Regional Appellate Division and of Regional Counsel in Protested Cases and in Tax Court Cases.

Pursuant to the authority vested in the undersigned, it is ordered that:

1. (a) In each case in which a taxpayer has protested the determination of liability made by the office of a District Director of Internal Revenue or by the office of the Director of International Operations, the Regional Commissioner is authorized exclusively to represent the Commissioner (1) in the determination of liability for income,

profits, estate, and gift tax in cases not docketed in the Tax Court of the United States, whether before or after issuance of a statutory notice; and (2) in the determination of liability for the excise and employment taxes designated in paragraph 5 of this Order. In each region the Assistant Regional Commissioner (Appellate), as Chief of the Appellate Division of the region, is authorized and each Associate Chief of the Appellate Division is authorized to represent the Regional Commissioner in the determination of tax liability in any such case; and each Assistant Chief is authorized and each Special Assistant to the Chief is authorized to represent the Regional Commissioner in the determination of tax liability in any such case in which the net deficiency or the net overassessment determined by the District Director or by the Director of International Operations does not exceed $50,000 and the determination of the Appellate Division does not involve a net overassessment in excess of $50,000.

(b) The authorities delegated in subparagraph (a) of this paragraph are subject to the exceptions set forth in paragraph 3 of this Order and, except as provided in paragraph 4, they may not be redelegated.

2. (a) In each income, profits, estate, and gift tax case docketed in the Tax Court, in conformity with the provisions of Delegation Order No. 60—Chief Counsel's Order No. 1958–5, dated April 17, 1958 [C. B. 1958–1, 681], the Regional Commissioner is authorized exclusively to represent the Commissioner in the functions delegated to the Regional Appellate Division in that joint Order. In each region the Assistant Regional Commissioner (Appellate), as Chief of the Appellate Division of the region, is authorized and each Associate Chief of the Appellate Division is authorized to represent the Regional Commissioner in the performance of those functions; and each Assistant Chief is authorized and each Special Assistant to the Chief is authorized to represent the Regional Commissioner in the performance of those functions in any such case in which the net deficiency or net overassessment determined in the statutory notice does not exceed $50,000 and the basis of disposition does not involve a net overassessment in excess of $50,000.

(b) The authorities delegated in subparagraph (a) of this paragraph are subject to the exceptions set forth in paragraph 3 of this Order and they may not be redelegated.

3. The authorities delegated by this Order to the Regional Commissioners do not include authority to:

(a) Eliminate the ad valorem fraud penalty in any case not docketed in the Tax Court, except with the concurrence of Regional Counsel;

(b) Act in any case in which a recommendation for criminal prosecution is pending, except with the concurrence of Regional Counsel; nor

(c) Modify any decision of the Excess Profits Tax Council with respect to any issue arising under section 722 of the Internal Revenue Code of 1939, except with the concurrence of the Director of the Appellate Division or his delegate.

4. In any case not docketed in the Tax Court in which a statutory notice was issued by the office of a District Director, the Assistant

Regional Commissioner (Appellate) may relinquish the jurisdiction of the Appellate Division by waiver to the office of that District Director. Similarly, the Assistant Regional Commissioner (Appellate) for the region which includes Washington, D. C., may relinquish the jurisdiction of the Appellate Division by waiver to the office of the Director of International Operations in any case in which the office of that Director issued the statutory notice. No such waiver shall be made in any case in which criminal prosecution has been recommended and not finally disposed of; nor in any case in which the determination in the statutory notice includes the ad valorem fraud penalty. Notwithstanding any such waiver, upon filing of a petition with the Tax Court, jurisdiction shall revest in the Appellate Division.

5. The excise and employment taxes subject to the provisions of this Order include any Federal excise or employment tax:

(a) Under the Internal Revenue Code of 1939, except any tax imposed by:

(1) Chapter 8, 15, 23, 26, or 27A.
(2) Subchapter B of Chapter 25;
(3) Part V, VI, VII, or VIII of Subchapter A of Chapter 27;
(4) Subchapter B of Chapter 28, insofar as it relates to liquor and tobacco; or
(5) Chapter 9A, insofar as it relates to distilled spirits, wines, cordials, or fermented malt liquors.

(b) Under the Internal Revenue Code of 1954, except any tax imposed by:

(1) Chapter 35 of Subtitle D;
(2) Subchapter A, Chapter 39 of Subtitle D;
(3) Subtitle E; or
(4) Subchapter D, Chapter 78 of Subtitle F, insofar as it relates to liquor and tobacco.

6. (a) In the performance of his functions under this Order, each Regional Counsel shall be subject to the general supervision and control of the Chief Counsel. With the approval of the Chief Counsel, Regional Counsel may redelegate any function by this Order vested in Regional Counsel. The Chief Counsel may delegate any function vested in him by this Order.

(b) The Regional Counsel will consider all memoranda prepared in the Regional Appellate Division recommending the issuance of statutory notices, prior to the issuance of such statutory notices by the Regional Appellate Division.

7. The instructions contained in this Order are intended to supplement the instructions contained in Delegation Order No. 60—Chief Counsel's Order No. 1958–5, dated April 17, 1958 [C. B. 1958–1, 681], and supersede other prior instructions to the extent that such other prior instructions are inconsistent herewith.

RUSSELL C. HARRINGTON,
Commissioner.
ARCH M. CANTRALL,
Chief Counsel.

(Filed by the Division of the Federal Register on Aug. 21, 1958, 8:55 a. m. and published in the issue of the Federal Register for Aug. 22, 1958, 23 F. R. 6531.)

DELEGATION ORDER NO. 67

(Effective October 1, 1958)

Signing Acting Commissioner's name

Pursuant to the authority vested in me by Treasury Department Order No. 150–47, dated September 27, 1958 page 1085, this Bulletin, it is hereby directed that, effective October 1, 1958, and until further notice, all authorizations to sign the name or on behalf of Russell C. Harrington, Commissioner of Internal Revenue, are amended to authorize the signing of the name or on behalf of O. Gordon Delk, Acting Commissioner of Internal Revenue.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

(Filed by the Division of the Federal Register on October 22, 1958, 8:49 a. m. and published in the issue of the Federal Register for October 23, 1958, 23 F. R. 8162.)

DELEGATION ORDER NO. 67 (REVISED)

(Effective November 5, 1958)

Signing the Commissioner's name or on his behalf

Effective at 12 noon on November 5, 1958, all outstanding authorizations to sign the name of, or on behalf of, former Commissioner Harrington, and more recently Acting Commissioner Delk, are hereby amended to authorize the signing of the name of, or on behalf of, Dana Latham, Commissioner of Internal Revenue.

This Order supersedes Delegation Order No. 67, issued October 1, 1958, above.

DANA LATHAM,
Commissioner.

(Filed by the Division of the Federal Register on November 17, 1958, 8:46 a. m., and published in the issue of the Federal Register for November 18, 1958, 23 F. R. 8968.)

(Also Part I, Sections 1371, 6037.) T. D. 6317 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 18.—TEMPORARY REGULATIONS RELATING TO CERTAIN INCOME TAX MATTERS UNDER THE TECHNICAL AMENDMENTS ACT OF 1958

Temporary rules relating to election of small business 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:

The following rules, prescribed under the Technical Amendments Act of 1958, 72 Stat. 1606, relate to certain elections or other actions by taxpayers under the provisions of such Act.

[1] 23 F. R. 7484.

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 Technical Amendments Act of 1958. More comprehensive rules with respect to the subjects 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 with respect to certain small business corporations and their shareholders making an election under the provisions of subchapter S, as added by section 64 of the Technical Amendments Act of 1958, the following regulations are hereby adopted:

§ 18.1–1 ELECTION OF CERTAIN SMALL BUSINESS CORPORATIONS.—(a) *In general.*—Section 64 of the Technical Amendments Act of 1958 (72 Stat. 1650) amends the Internal Revenue Code of 1954 by adding at the end of chapter 1 a new subchapter S, comprising sections 1371 through 1377, and by adding a new section 6037, relating to information returns. Subchapter S permits a "small business corporation" (as defined in section 1371(a)) to elect under section 1372(a) (with the consent of all its shareholders) not to be subject to the income tax imposed by chapter 1. The election may be made only if the corporation is a domestic corporation; is not a member of an affiliated group of corporations (as defined in section 1504); and does not have (1) more than one class of stock, (2) more than 10 shareholders, (3) a shareholder (other than an estate) who is not an individual, or (4) a shareholder who is a nonresident alien. An election under section 1372(a) may be made only with respect to a taxable year beginning after December 31, 1957, and ending after September 2, 1958. The election shall be effective for the taxable year of the corporation for which it is made and for all succeeding taxable years unless it is terminated under section 1372(e). The taxable income of an electing small business corporation, to the extent that it exceeds dividends distributed in money out of earnings and profits of the taxable year, is taxed directly to the shareholders to the extent that it would have constituted a dividend if it had been distributed on the last day of the corporation's taxable year.

(b) *Manner of making election.*—(1) *In general.*—The election under section 1372(a) should be made by the corporation by filing Form 2553, containing the information required by such form, and by filing, in the manner provided in subparagraph (3) of this paragraph, a statement of the consent of each shareholder of the corporation. If the Form 2553 is not available, the election may be made by filing a statement containing the information required by Form 2553. Copies of Form 2553 or a description of the information required by such form will be furnished by district directors upon request. The election shall be signed by the person or persons who are authorized to sign the return required under section 6037 and shall be filed with the district director with whom such return is to be filed.

(2) *Time of making election.*—(i) Except as provided in subdivision (ii) of this subparagraph, the election under section 1372(a) and subparagraph (1) of this paragraph shall be filed for any taxable year either (*a*) during the first calendar month of such taxable year, or (*b*) during the calendar month preceding such first calendar month.

(ii) For any taxable year of a corporation which begins after December 31, 1957, and before September 3, 1958, and which ends after September 2, 1958, the election under section 1372(a) and subparagraph (1) of this paragraph shall be made on or before December 1, 1958, or on or before the last day of the corporation's taxable year, whichever is earlier. An election for such taxable year may be made, however, only if the corporation has been a small business corporation (as defined in section 1371(a)) on each day after September 2, 1958, and before the day of election.

(3) *Statement of shareholder consent.*—(i) An election under section 1372(a) shall be valid only if all persons who are shareholders of the corporation on

the first day of the corporation's taxable year, or on the day of election (whichever is later) consent to such election. Such shareholder consent shall be in the form of a statement signed by the shareholders in which each such shareholder consents to the election of the corporation under section 1372(a). The statement shall set forth the name and address of the corporation and of each shareholder, the number of shares of stock owned by each shareholder, and the date (or dates) on which such stock was acquired. The consents of all shareholders shall be attached to the election of the corporation filed with the district director. If the election is made before the first day of the corporation's taxable year, the consents of persons who become shareholders after the date of election and on or before such first day shall be filed with the district director with whom the election was filed as soon as practicable after such first day. In the case of a consent filed after the date of election, a copy of the consent shall be filed with the return required to be filed under section 6037. In no event will an election under section 1372(a) be valid if the consents are filed after the last day prescribed for making the election.

(c) *New shareholders.*—Section 1372(e)(1) provides that an election under section 1372(a) shall terminate if any person who was not a shareholder on the first day of the first taxable year for which the election is effective, or on the day on which the election is made (whichever is later), becomes a shareholder and does not consent to the election under section 1372(a). Such termination shall be effective for the taxable year of the corporation in which such person becomes a shareholder and for all succeeding taxable years of such corporation. Any such consent by a new shareholder shall be made in a statement filed with the district director with whom the election was filed. Such statement of consent shall be filed within a period of 30 days beginning on the day on which such person becomes a new shareholder. Such statement shall state that such person consents to the election under section 1372(a) and shall contain the name and address of the corporation and of such person, the number of shares of stock owned by such person, the date on which such shares were acquired, and the name and address of each person from whom such shares were acquired. A copy of the consent of a new shareholder shall be filed with the return required to be filed under section 6037 for the taxable year to which such consent applies.

(d) *Revocation of election.*—Under section 1372(e)(2) an election under section 1372(a) may be revoked by the corporation (with the consent of all its shareholders) for any taxable year of the corporation after the first taxable year for which the election is effective. Such revocation shall be made by the corporation by filing a statement that the corporation revokes the election made under section 1372(a). The statement shall be signed by the person or persons who are authorized to sign the return of the corporation required under section 6037 and shall be filed with the district director with whom the election was filed. In addition, there shall be attached to the statement of revocation a statement of consent, signed by each person who is a shareholder of the corporation on the day on which such statement of revocation is filed, in which each such shareholder consents to the revocation by the corporation of the election under section 1372(a). Such revocation, if made before the close of the first month of the corporation's taxable year, shall be effective for the taxable year in which the revocation is made and for all succeeding taxable years of the corporation. If the revocation is made after the close of the first month of the corporation's taxable year, such revocation shall be effective for the taxable year of the corporation following that in which the revocation is made and for all succeeding taxable years of the corporation.

(e) *Return of electing small business corporation.*—Section 6037 of the 1954 Code requires that every electing small business corporation (as defined in section 1371(b)) shall make a return for each taxable year for which the election is effective. The return shall be filed on such form as shall be prescribed therefor and shall contain the information required by section 6037 and by such form. The return shall be signed by the person or persons who are authorized to sign a return under section 6062 and shall be filed with the district director with whom the income tax return of the corporation would be filed if the corporation were subject to the tax imposed by chapter 1. The return required under section 6037 shall be filed on or before the 15th day of the third month following the close of the taxable year of the corporation.

Because the time for making the election provided in section 1372 will in some cases expire in less than 15 days, it is found impracticable to issue this Treasury Decision with notice and public procedure thereon under section (4) (a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in sections 1372, 6037, and 7805 of the Internal Revenue Code of 1954 (72 Stat. 1650 and 1656, 68A Stat. 917; 26 U. S. C. 1372, 6037, and 7805).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved September 22, 1958.

NELSON P. ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 25, 1958, 8:47 a. m., and published in the issue of the Federal Register for September 26, 1958, 23 F. R. 7484.)

(Also Part I, Section 7805.) T. D. 6320 [1]

TITLE 26—INTERNAL REVENUE 1954.—CHAPTER I, SUBCHAPTER D, PART 40.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Introduction and explanation of regulations relating to retailers and manufacturers excise taxes imposed by chapters 31 and 32 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:

The following regulations consisting of a portion of the introductory provisions of the regulations relating to taxes imposed by chapters 31 and 32 of the Internal Revenue Code of 1954, as amended, and certain provisions of subtitle F of the Code having special application to these taxes, are hereby prescribed. These regulations are intended to serve as introductory and explanatory material for the Manufacturers and Retailers Excise Tax Regulations, portions of which will be separately published from time to time.

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MANUFACTURERS AND RETAILERS EXCISE TAXES

Subpart A—Introduction

Section
40.0–1 Introduction.
40.0–2 General definitions and use of terms.
40.0–3 Scope of regulations.
40.0–4 Extent to which the regulations in this part supersede prior regulations.

AUTHORITY: §§ 40.0–1 to 40.0–4, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

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[1] 23 F. R. 7840.

SUBPART A—INTRODUCTION

§ 40.0-1 INTRODUCTION.—(a) *In general.*—The regulations in this part (Part 40, Subchapter D, Chapter I, Title 26 (1954), Code of Federal Regulations) are designated "Manufacturers and Retailers Excise Tax Regulations." The regulations relate to the taxes imposed by chapters 31 and 32 of the Internal Revenue Code of 1954, as amended, and to certain related administrative provisions of subtitle F of such Code. Chapter 31 of the Code imposes a tax on the sale at retail of articles specified in such chapter and chapter 32 of the Code imposes a tax on the sale by the manufacturer, producer, or importer of articles specified in that chapter. References in these regulations to the "Internal Revenue Code" or the "Code" are references to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. References to a section or other provision of law are references to a section or other provision of the Internal Revenue Code, as amended, unless otherwise indicated.

(b) *Division of regulations.*—The regulations in this part (26 CFR Part 40) are divided into 14 subparts. Subpart A contains provisions relating to the arrangement and numbering of the sections of the regulations in this part, general definitions and use of terms, scope of regulations, and the extent to which the regulations in this part supersede prior regulations relating to the excise taxes imposed by chapters 31 and 32 of the Internal Revenue Code. The other subparts of the regulations in this part and the subject matter to which they relate are as follows:

Subpart B—Jewelry and related items.
Subpart C—Furs.
Subpart D—Toilet preparations.
Subpart E—Luggage, handbags, etc.
Subpart F—Special fuels.
Subpart G—Special provisions applicable to retailers taxes.
Subpart H—Motor vehicles, tires, tubes, tread rubber, gasoline, and lubricating oil.
Subpart I—Refrigeration equipment, electric, gas, and oil appliances, and electric light bulbs.
Subpart J—Radio and television sets, phonographs, phonograph records, and musical instruments.
Subpart K—Sporting goods, photographic equipment, and firearms.
Subpart L—Business machines, pens, mechanical pencils and lighters, and matches.
Subpart M—Special provisions applicable to manufacturers taxes.
Subpart N—Refunds and other administrative provisions of special application to retailers and manufacturers taxes.

(c) *Arrangement and numbering.*—Each section of the regulations in Subpart B through Subpart N of this part is preceded by the section, subsection, or paragraph of the Internal Revenue Code which it interprets. The sections of the regulations can readily be distinguished from sections of the Code since—

(1) The sections of the regulations are printed in larger type;
(2) The sections of the regulations are preceded by a section symbol and the part number, arabic numeral 40 followed by a decimal point (§ 40.); and
(3) The sections of the Code are preceded by "SEC.".

Each section of the regulations setting forth law or regulations is designated by a number composed of the part number followed by a decimal point (40.) and the number of the corresponding provision of the Internal Revenue Code. In the case of a section setting forth regulations, this designation is followed by a hyphen (-) and a number identifying such section.

§ 40.0–2 General Definitions and Use of Terms.—As used in the regulations in this part, unless otherwise expressly indicated—

(a) The terms defined in the provisions of law contained in the regulations in this part shall have the meanings so assigned to them.

(b) The Internal Revenue Code of 1954 means the Act approved August 16, 1954 (68A Stat.), entitled "An Act to revise the internal revenue laws of the United States", as amended.

(c) District director means district director of internal revenue.

(d) Calendar quarter means a period of 3 calendar months ending on March 31, June 30, September 30, or December 31.

§ 40.0–3 Scope of Regulations.—The regulations in this part relate to the taxes imposed on the sale at retail, or the sale by the manufacturer, producer, or importer, of the articles referred to in Subparts B through L (see paragraph (b) of § 40.0–1) and have application as provided in the following paragraphs:

(a) *Subpart B*—[Reserved]
(b) *Subpart C*—[Reserved]
(c) *Subpart D*—[Reserved]
(d) *Subpart E*—[Reserved]
(e) *Subpart F*—[Reserved]
(f) *Subpart G*—[Reserved]
(g) *Subpart H*—[Reserved]
(h) *Subpart I*—[Reserved]
(i) *Subpart J*—[Reserved]
(j) *Subpart K*—[Reserved]
(k) *Subpart L*—[Reserved]
(l) *Subpart M*—[Reserved]
(m) *Subpart N*—[Reserved]

§ 40.0–4 Extent to Which the Regulations in This Part Supersede Prior Regulations.—The regulations in this part, with respect to the subject matter within the scope thereof, supersede the following regulations and such regulations as prescribed and made applicable to Internal Revenue Code of 1954 by Treasury Decision 6091, signed August 16, 1954 (19 F. R. 5167, August 17, 1954) [C. B. 1954–2, 47].

Taxes on Gasoline, Lubricating Oil and Matches	Regulations 44 (1944 Edition, as amended), 26 CFR (1939) Part 314
Excise Tax on Sales by the Manufacturer	Regulations 46 (1940 Edition, as amended), 26 CFR (1939) Part 316
Excise Tax on Sale of Pistols and Revolvers	Regulations 47 (Revised October 1928, as amended), 26 CFR (1939) Part 302
Retailers Excise Taxes	Regulations 51 (1941 Edition, as amended), 26 CFR (1939) Part 320
Excise Tax on Diesel Fuel	Regulations 119, 26 CFR (1939) Part 324

Because this Treasury Decision relates primarily to the division and arrangement of the regulations to be issued with respect to the taxes

imposed by chapters 31 and 32 of the Internal Revenue Code of 1954, as amended, and certain provisions of subtitle F of such Code, and does not interpret the applicable provisions of law nor prescribe procedural requirements, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved October 3, 1958.

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

(Filed by the Division of the Federal Register on October 9, 1958, 8:48 a. m., and published in the issue of the Federal Register for October 10, 1958, 23 F. R. 7840.)

(Also Part I, Section 6166.) T. D. 6321[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER B, PART 24.—TEMPORARY REGULATIONS RELATING TO CERTAIN ESTATE TAX MATTERS UNDER THE SMALL BUSINESS TAX REVISION ACT OF 1958

Temporary regulations relating to extension of time for payment of estate tax where estate consists largely of an interest in a closely held business.

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 Small Business Tax Revision Act of 1958, 72 Stat. 1676, relate to certain elections by executors under the provisions of such Act.

The rules set forth herein are temporary rules designed to inform executors as to how, when, and where to make the election permitted under section 206 of the Small Business Tax Revision Act of 1958. More comprehensive rules with respect to the election will be incorporated in subsequent regulations under the Act. Rules with respect to other acts required or permitted by other provisions of the Act will be covered by subsequent regulations.

In order to prescribe temporary rules under section 6166 of the Internal Revenue Code of 1954, as added by section 206(a) of the Small Business Tax Revision Act of 1958, with respect to the manner in which an executor may elect to pay in installments the portion of the estate tax attributable to the inclusion in a decedent's gross estate of an interest in a closely held business, the following regulations are hereby adopted.

§ 24.1–1 EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS.—(a) *In general.*—Section 6166 provides that under certain conditions

[1] 23 F. R. 7816.

where an interest in a closely held business is included in the gross estate of a decedent who was a citizen or resident of the United States at the time of his death, the executor may elect to pay in installments part or all of the Federal estate tax imposed by section 2001. See section 6166 for the definition of an interest in a closely held business, the limitation placed on the amount which may be paid in installments, the number of installments in which the tax may be paid, and the circumstances under which the privilege of paying the tax in installments will terminate. The election shall be exercised by filing notice of election to pay the tax in installments with the district director.

(b) *Where due date of return is after September 2, 1958.*—If the due date of the return is after September 2, 1958, an election to pay the estate tax in installments will apply both to the tax shown on the return and to any deficiency in tax assessed in connection therewith. The notice of election to pay the tax in installments shall be filed on or before the due date of the return. See § 20.6075–1 of this chapter (Estate Tax Regulations) for the due date of the return. However, if the due date for filing the return is after September 2, 1958, but before November 3, 1958, the election will be considered as timely made if the notice of election is filed with the district director on or before November 3, 1958.

(c) *Where due date of return is on or before September 2, 1958.*—If the due date of the return is on or before September 2, 1958, an election by the executor to pay estate tax in installments will apply only to a deficiency in tax assessed after September 2, 1958. See § 20.6075–1 of this chapter (Estate Tax Regulations) for the due date of the return. The notice of election to pay the deficiency in installments shall be filed not later than 60 days after the issuance of notice and demand by the district director for the payment of the deficiency. The election described in this paragraph may be made only if the decedent died after August 16, 1954.

(d) *Form of notice of election.*—The notice of election to pay the estate tax in installments may be in the form of a letter addressed to the district director. The executor shall state in the notice the amount of tax which he elects to pay in installments, and the total number of installments (including in a case described in paragraph (b) of this section the installment due 15 months after the date of the decedent's death, and including in a case described in paragraph (c) of this section those installments the dates for payment of which would have arrived within the meaning of section 6166(i)) in which he elects to make the payment of such tax. The properties in the gross estate which constituted the decedent's interest in a closely held business should be listed in the notice, and identified by the schedule and item number at which they appear on the estate tax return. The notice should set forth the facts which formed the basis for the executor's conclusion that the estate qualifies for the payment of the estate tax in installments.

Because the election provided in section 6166 must in some cases be exercised within 60 days after the enactment of section 6166, it is found impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure

Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in sections 6166 and 7805 of the Internal Revenue Code of 1954 (72 Stat. 1681, 68A Stat. 917; 26 U. S. C. 6166 and 7805).)

LEO SPEER,
Acting Commissioner of Internal Revenue.

Approved October 3, 1958.

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

(Filed by the Division of the Federal Register on October 8, 1958, 8:50 a. m., and published in the issue of the Federal Register for October 9, 1958, 23 F. R. 7816.)

(Also Part I, Section 7805.) T. D. 6327 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER D, PART 42.—FACILITIES AND SERVICES EXCISE TAXES

Introduction and explanation of Regulations relating to facilities and services excise taxes imposed by chapter 33 of the Internal Revenue Code of 1954, as amended, and certain changes in style and form of the regulations relating to the tax on transportation of persons.

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 in paragraph 1 consisting of a portion of the introductory provisions of the regulations relating to taxes imposed by chapter 33 of the Internal Revenue Code of 1954, as amended, and certain provisions of subtitle F of the Code having special application to these taxes are hereby prescribed. These regulations are intended to serve as introductory and explanatory material for the Facilities and Services Excise Tax Regulations, portions of which will be separately published from time to time. The Facilities and Services Excise Tax Regulations (26 CFR Part 42) are amended as provided in paragraphs 2 to 4, inclusive, to prescribe style and form changes in Subpart D thereof, relating to the tax on the transportation of persons, which was prescribed by Treasury Decision 6206, 21 F. R. 7525, October 2, 1956 [C. B. 1956-2, 846].

PARAGRAPH 1. The following introductory provisions of the Facilities and Services Excise Tax Regulations are hereby prescribed:

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FACILITIES AND SERVICES EXCISE TAXES

Subpart A—Introduction

Section
42.0-1 Introduction.
42.0-2 General definitions and use of terms.
42.0-3 Scope of regulations.
42.0-4 Extent to which the regulations in this part supersede prior regulations.

AUTHORITY: §§ 42.0-1 to 42.0-4, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

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[1] 23 F. R. 8057.

FACILITIES AND SERVICES EXCISE TAXES

Subpart A—Introduction

§ 42.0–1 INTRODUCTION.—(a) *In general.*—The regulations in this part (Part 42, Subchapter D, Chapter I, Title 26 (1954) Code of Federal Regulations) are designated "Facilities and Services Excise Tax Regulations". The regulations relate to the taxes imposed by chapter 33 of the Internal Revenue Code of 1954, as amended, and to certain related administrative provisions of subtitle F of such Code. Chapter 33 of the Code imposes a tax on amounts paid for certain specified facilities and services. References in these regulations to the "Internal Revenue Code" or the "Code" are references to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. References to a section or other provision of law are references to a section or other provision of the Internal Revenue Code, as amended, unless otherwise indicated.

(b) *Division of regulations.*—The regulations in this part (26 CFR Part 42) are divided into 9 subparts. Subpart A contains provisions relating to the arrangement and numbering of the sections of the regulations in this part, general definitions and use of terms, scope of regulations, and the extent to which the regulations in this part supersede prior regulations relating to the excise taxes imposed by chapter 33 of the Internal Revenue Code. The other subparts of the regulations in this part and the subject matter to which they relate are as follows:

Subpart B—Admissions and dues
Subpart C—Communications
Subpart D—Transportation of persons
Subpart E—Transportation of property
Subpart F—Transportation of oil by pipeline
Subpart G—Safe deposit boxes
Subpart H—Special provisions applicable to services and facilities taxes
Subpart I—Refund and other administrative provisions of special application to facilities and services taxes

(c) *Arrangement and numbering.*—Each section of the regulations in Subpart B through Subpart I of this part is preceded by the section, subsection, or paragraph of the Internal Revenue Code which it interprets. The sections of the regulations can readily be distinguished from the sections of the Code since—

(1) The sections of the regulations are printed in larger type;

(2) The sections of the regulations are preceded by a section symbol and the part number, arabic numeral 42, followed by a decimal point (§ 42.); and

(3) The sections of the Code are preceded by "Sec.".

Each section of the regulations setting forth law or regulations is designated by a number composed of the part number followed by a decimal point (42.) and the number of the corresponding provision of the Internal Revenue Code. In the case of a section setting forth regulations, this designation is followed by a hyphen (-) and a number identifying such section.

§ 42.0–2 GENERAL DEFINITIONS AND USE OF TERMS.—As used in the regulations in this part, unless otherwise expressly indicated—

(a) The terms defined in the provisions of law contained in the regulations in this part shall have the meanings so assigned to them.

(b) The Internal Revenue Code of 1954 means the Act approved August 16, 1954 (68A Stat.), entitled "An Act to revise the internal revenue laws of the United States", as amended.

(c) District director means district director of internal revenue.

(d) Calendar quarter means a period of 3 calendar months ending on March 31, June 30, September 30, or December 31.

§ 42.0–3 Scope of Regulations.—The regulations in this part relate to the taxes imposed on the amounts paid for the facilities or services referred to in Subparts B through G (see paragraph (b) of § 42.0–1) and have application as provided in the following paragraphs:

(a) *Subpart B*—[Reserved]

(b) *Subpart C*—[Reserved]

(c) *Subpart D.*—The regulations in Subpart D of this part apply to amounts paid on or after October 1, 1956, for transportation of persons commencing on or after such date.

(d) *Subpart E*—[Reserved]

(e) *Subpart F*—[Reserved]

(f) *Subpart G*—[Reserved]

(g) *Subpart H*—[Reserved]

(h) *Subpart I*—[Reserved]

§ 42.0–4 Extent to Which the Regulations in This Part Supersede Prior Regulations.—The regulations in this part, with respect to the subject matter within the scope thereof, supersede the following regulations and such regulations as prescribed and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, 19 F. R. 5167, Aug. 17, 1954 [C. B. 1954–2, 47].

Safe deposit boxes, transportation of oil by pipeline, telephone, telegraph, radio and cable messages and services, and transportation of persons.	Regulations 42 (1942 edition, as amended), 26 CFR (1939) Part 130.
Admissions, dues, and initiation fees	Regulations 43 (1941 edition, as amended), 26 CFR (1939) Part 101.
Transportation of property	Regulations 113 (1943 edition, as amended), 26 CFR (1939) Part 143.

Par. 2. Section 42.4261.0–1 is hereby stricken.

Par. 3. The historical notes appearing at the end of the statutory provisions in §§ 42.4261, 42.4262(a), 42.4262(b), 42.4262(c), 42.4263(a), 42.4263(b), 42.4263(c), 42.4263(d), 42.4264(a), 42.4264(b), 42.4264(c), 42.4264(d), 42.4264(e), 42.4264(f), and 42.4291 are amended:

(A) By striking the historical note following the statutory provisions in § 42.4261 and inserting in lieu thereof:

[Sec. 4261 as amended by secs. 1 and 4(b), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644, [C. B. 1956–2, 1180]]

(B) By striking the historical note following the statutory provisions in § 42.4262(a) and inserting in lieu thereof:

[Sec. 4262(a) as added by sec. 3, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644)]

(C) By striking the historical note following the statutory provisions in § 42.4262(b) and inserting in lieu thereof:

[Sec. 4262(b) as added by sec. 3, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644)]

(D) By striking the historical note following the statutory provisions in § 42.4262(c) and inserting in lieu thereof:

[Sec. 4262(c) as added by sec. 3, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644)]

(E) By striking the historical note following the statutory provisions in § 42.4263(a) and inserting in lieu thereof:

[Sec. 4262(b), redesignated sec. 4263(a) by sec. 2, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644); and as amended by Act of Aug. 7, 1956 (Pub. Law 1015, 84th Cong., 70 Stat. 1077) [C. B. 1956-2, 1207]]

(F) By striking the historical note following the statutory provisions in § 42.4263(b) and inserting in lieu thereof:

[Sec. 4262(c), redesignated sec. 4263(b) by sec. 2, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644)]

(G) By striking the historical note following the statutory provisions in § 42.4263(c) and inserting in lieu thereof:

[Sec. 4262(d), redesignated sec. 4263(c) by sec. 2, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644)]

(H) By striking the historical note following the statutory provisions in § 42.4263(d) and inserting in lieu thereof:

[Sec. 4262(e), redesignated sec. 4263(d) by sec. 2, Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 644)]

(I) By striking the historical note following the statutory provisions in § 42.4264(a) and inserting in lieu thereof:

[Sec. 4264(a) as added by sec. 4(a), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 645)]

(J) By striking the historical note following the statutory provisions in § 42.4264(b) and inserting in lieu thereof:

[Sec. 4264(b) as added by sec. 4(a), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 645)]

(K) By striking the historical note following the statutory provisions in § 42.4264(c) and inserting in lieu thereof:

[Sec. 4264(c) as added by sec. 4(a), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 645)]

(L) By striking the historical note following the statutory provisions in § 42.4264(d) and inserting in lieu thereof:

[Sec. 4264(d) as added by sec. 4(a), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 645)]

(M) By striking the historical note following the statutory provisions in § 42.4264(e) and inserting in lieu thereof:

[Sec. 4264(e) as added by sec. 4(a), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 645)]

(N) By striking the historical note following the statutory provisions in § 42.4264(f) and inserting in lieu thereof:

[Sec. 4264(f) as added by sec. 4(a), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 645)]

(O) By striking the historical note following the statutory provisions in § 42.4291 and inserting in lieu thereof:

[Sec. 4291 as amended by sec. 4(c), Act of July 25, 1956 (Pub. Law 796, 84th Cong., 70 Stat. 646)]

PAR. 4. The second sentence of § 42.4261–1 is amended to read:

For the definition of the term "taxable transportation" see section 4262 and §§ 42.4262(a)–1 and 42.4262(b)–1.

Because this Treasury Decision relates primarily to the division and arrangement of the regulations issued or to be issued with respect to the taxes imposed by chapter 33 of the Internal Revenue Code of 1954, as amended, and certain provisions of subtitle F of such Code, and does not interpret the applicable provisions of law nor prescribe procedural requirements, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved October 15, 1958.

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

(Filed by the Division of the Federal Register on October 17, 1958, 8:50 a. m., and published in the issue of the Federal Register for October 18, 1958, 23 F. R. 8057.)

(Also Part I, Section 1361.) T. D. 6332 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 18.—TEMPORARY REGULATIONS RELATING TO CERTAIN INCOME TAX MATTERS UNDER THE TECHNICAL AMENDMENTS ACT OF 1958

Temporary rules relating to revocation of election under section 1361 of the 1954 Code.

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 section 63 of the Technical Amendments Act of 1958 (72 Stat. 1649), relate to revocation of elections made under section 1361 of the Internal Revenue Code of 1954, pertaining to unincorporated business enterprises electing to be treated as domestic corporations for income tax purposes.

The rules set forth herein are temporary rules designed to inform taxpayers as to how, when, and where a statement of revocation of the election under section 1361 may be made. More comprehensive rules with respect to the application of section 1361 will be incorporated in subsequent regulations under that section. The inclusion in this Treasury Decision of rules relating to revocation of an election is intended to assist taxpayers in the performance of such act before the publication of regulations under section 1361.

In order to prescribe temporary rules with respect to the revocation under section 63 of the Technical Amendments Act of 1958 of an election made under section 1361, the following regulations are hereby adopted:

§ 18.1–2 REVOCATION OF ELECTION PERMITTING CERTAIN PROPRIETORSHIPS AND PARTNERSHIPS TO BE TAXED AS DOMESTIC CORPORA-

[1] 23 F. R. 8606.

TIONS.—(a) *In general.*—Section 63 of the Technical Amendments Act of 1958 (72 Stat. 1649), approved September 2, 1958, provides that a statement of election to be taxed as a domestic corporation under section 1361 of the Internal Revenue Code of 1954 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 or is filed in accordance with the provisions of Treasury Decision 6124 (Temporary Rules (26 CFR 1954)) [C. B. 1955–1, 719] such statement of election shall be treated as a valid election, except as provided in paragraph (e) of this section, relating to statements of election withdrawn with the permission of the Internal Revenue Service. Under section 63, however, any such election made on, before, or after September 2, 1958, may be revoked (notwithstanding any provision to the contrary in section 1361) after September 2, 1958, and on or before the last day of the third month following the month in which 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 such revocation shall be effective only if made in accordance with the provisions of paragraph (b) of this section. A revocation under this section may be made notwithstanding that the enterprise has been completely liquidated as contemplated in section 1361(l), or that the enterprise has actually been incorporated.

(b) *Manner of revoking election.*—(1) The election shall be revoked by filing within the time prescribed in subparagraph (2) of this paragraph, (i) a statement that the partners or the proprietor, 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 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 corporation income tax returns of the enterprise 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 state the names and addresses

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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. If an amended income tax return is 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 such return. The amended income tax and partnership returns shall be filed as if there had been no election made under section 1361, and 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 (d)(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.

(c) *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 (d)(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 (b)(3) of this section.

(d) *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 a section 1361 enterprise (but only to the extent of the increase in tax determined in accordance with subparagraph (5) of this paragraph) shall not expire until after the expiration date specified in subparagraph (4) of this paragraph.

(2) If credit or refund of any overpayment attributable to a section 1361 enterprise (but only to the extent of the decrease in tax determined in accordance with subparagraph (5) of this paragraph) 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 overpay-

ment may nevertheless be allowed or made if claim therefor is filed on or before such expiration date.

(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 regulations under section 1361 of the 1954 Code are published in the Federal Register; or

(ii) If the election is revoked pursuant to paragraph (b) of this section, the day on which an effective revocation is made.

(5) For purposes of this section, the increase or decrease in tax over the tax previously determined (as defined in section 1314(a)) for any taxable year shall be that amount which results from the correct treatment of all items which pertain to the enterprise, and for this purpose items of income, deduction, or credit completely unrelated to the enterprise shall not be taken into account. For example, the failure to claim an allowable deduction for a dependency exemption or the improper taking of such exemption 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 pursuant to paragraph (b) of this section, 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 but for a revocation of such election). On the other hand, if the election is not revoked, it may be necessary to make adjustments to the taxable income of the enterprise, for example, due to failure to report items of income or to claim deductions, or adjustments in items of income or deduction allocable to a proprietor or partner, for example, personal holding company income or dividend distributions. Moreover, items which have been taken into account in filing the corporation return, Form 1120, for the enterprise, 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.

(e) *Exception.*—The provisions of this section do not apply to—

(1) Any statement of election filed in accordance with Treasury

Decision 6124 which 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).

(f) *Elections under section 1361.*—Elections under section 1361 should continue to be made in accordance with the requirements of Treasury Decision 6124 [C. B. 1955–1, 719] with respect to information required in the statement of election and the time, manner, and place of filing such statement. However, those provisions of Treasury Decision 6124 which relate to the perfection of an election under section 1361 are hereby revoked.

Because the election under section 1361 of the 1954 Code may be revoked at any time after September 2, 1958, in accordance with regulations under section 63 of the Technical Amendments Act of 1958 and because of the need for temporary rules under which such a revocation can be made, it is found 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 63 of the Technical Amendments Act of 1958 (72 Stat. 1649) and section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved October 30, 1958.

Fred C. Scribner, Jr.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 11, 1958, at 8:47 a. m., and published in the issue of the Federal Register for November 4, 1958, 23 F. R. 8606.)

(Also Part I, Sections 179, 213, 403, 455, 1034.) T. D. 6335[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 18.—TEMPORARY REGULATIONS RELATING TO CERTAIN INCOME TAX MATTERS UNDER THE TECHNICAL AMENDMENTS ACT OF 1958

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 Technical Amendments Act of 1958, 72 Stat. 1606, relate to certain elections or other actions by taxpayers under the provisions of such Act.

[1] 23 F. R. 8979.

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 Technical Amendments Act of 1958. More comprehensive rules with respect to the subjects 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 Technical Amendments Act of 1958, the following regulations are hereby adopted:

§ 18.1–3 Additional First-Year Depreciation Allowance for Small Business—(a) *In general.*—Section 204 of the Small Business Tax Revision Act of 1958 (72 Stat. 1679) amends the Internal Revenue Code of 1954 by adding a new section 179, relating to additional first-year depreciation allowance for small business. Section 179(a) provides that in the case of "section 179 property" the term "reasonable allowance" as used in section 167(a), relating to the deduction for depreciation, may, at the election of the taxpayer, include an allowance of 20 percent of the cost (subject to certain limitations) of such property for the first taxable year for which a deduction is allowable under section 167(a) with respect to such property. An election under section 179(a) may be made only with respect to a taxable year ending after June 30, 1958. For a definition of what constitutes "section 179 property", see section 179(d). The election under section 179(c) applies only to "section 179 property" to the extent the cost of such property for such taxable year does not exceed $10,000, or, in the case of a husband and wife filing a joint return under section 6013 for the taxable year, $20,000. The taxpayer shall select the cost (or fractional part of the cost) of one or more items of "section 179 property" qualifying for the election in the taxable year in an amount not in excess of the applicable limitation.

(b) *Time and manner of making election.*—The election provided by section 179(c) with respect to "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 date prescribed by law for filing the return (including any extensions of time) for such taxable year. The statement shall indicate that the taxpayer has elected the provisions of section 179(a), and shall set forth the following information with respect to the property subject to the election:

(1) Description of property.
(2) Date property acquired.
(3) Estimated useful life at date of acquisition.
(4) How and from whom the property was acquired.
(5) Total cost of each item of property with respect to which election is made.
(6) Portion of cost of property selected.

The selection made by the taxpayer with respect to such property shall 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.

(c) *Consent to revoke election.*—An election made under section 179 and this section with respect to any property shall be binding with respect to such property for the taxable year for which the election is made, and for all subsequent taxable years, unless consent to revoke the election is obtained from the Commissioner. No application for consent to revoke an election under section 179 will be accepted before the date of publication in the Federal Register of the regulations under section 179. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to apply for such consents in the case of taxable years which end after June 30, 1958, and before the date of publication of regulations under section 179.

(d) *Affiliated group.*—Taxpayers which constitute an affiliated group as defined in section 179 (d) (7) shall be treated as one taxpayer for the purpose of the limitation under section 179 (b). In the case of an affiliated group the allowance for additional first-year depreciation may, in accordance with an agreement entered into by the members of the group, be taken by any one such member or divided among them in any portion. Any member of such group that is allowed any portion of the deduction under section 179 shall file a statement in accordance with paragraph (b) of this section. Such statement shall include, in addition to the information required under paragraph (b) of this section, the names of the other members of the affiliated group and a description of the manner in which the deduction under section 179 has been divided among them.

(e) *Records.*—Any taxpayer who elects the additional allowance under section 179 with respect to "section 179 property" shall reflect the adjustment to basis required by section 179 (d) (8) in the records which he is required to keep under § 1.167(a)–7 of the Income Tax Regulations (part 1 of this chapter).

§ 18.1–4 Increase in Limitation on Medical Deduction for a Taxpayer or his Spouse who has Attained age 65 and is Disabled.—(a) *Meaning of disability.*—(1) Section 17 of the Technical Amendments Act of 1958 (72 Stat. 1613) amended section 213 by adding a new subsection (g). For taxable years beginning after December 31, 1957, section 213(g) provides for an increase in the maximum limitation on the medical deduction for a taxpayer or his spouse who has attained the age of 65 and is disabled. An individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. In determining whether an individual's impairment makes him unable to engage in any substantial gainful activity, primary consideration shall be given to the nature and severity of his impairment. Consideration shall also be given to other factors such as the individual's education, training, and work experience. The substantial gainful activity to which section 213(g) refers is the activity, or a comparable activity, in which the individual customarily engaged prior to the arising of the disability (or prior to retirement if the individual was retired at the

time the disability arose). In the case of a taxpayer's spouse whose primary activity is housekeeping, housekeeping shall be considered her substantial gainful activity for purposes of section 213(g).

(2) Whether or not the impairment in a particular case constitutes a disability is to be determined with reference to all the facts in the case. The following are examples of impairments which would ordinarily be considered as preventing substantial gainful activity:

(i) Loss of use of two limbs;

(ii) Certain progressive diseases which have resulted in the physical loss or atrophy of a limb, such as diabetes, multiple sclerosis, or Buerger's disease;

(iii) Diseases of the heart, lungs, or blood vessels which have resulted in major loss of heart or lung reserve as evidenced by X-ray, electrocardiogram, or other objective findings, so that despite medical treatment breathlessness, pain, or fatigue is produced on slight exertion, such as walking several blocks, using public transportation, or doing small chores;

(iv) Cancer which is inoperable and progressive;

(v) Damage to the brain or brain abnormality which has resulted in severe loss of judgment, intellect, orientation, or memory;

(vi) Mental disease (e. g., psychosis or severe psychoneurosis) requiring continued institutionalization or constant supervision of the individual;

(vii) Loss or diminution of vision to the extent that the affected individual has a central visual acuity of no better than 20/200 in the better eye after best correction, or has a limitation in the fields of vision such that the widest diameter of the visual fields subtends an angle no greater than 20 degrees;

(viii) Permanent and total loss of speech;

(ix) Total deafness uncorrectible by a hearing aid.

The existence of one or more of those impairments (or of an impairment of greater severity) will not, however, in and of itself always permit a finding that an individual is disabled as defined in section 213(g). Any impairment, whether of lesser or greater severity, must be evaluated in terms of whether it does in fact prevent the individual from engaging in his customary or any comparable substantial gainful activity.

(3) In order to meet the requirements of section 213(g), an impairment must be expected either to continue for a long and indefinite period or to result in death. Ordinarily a terminal illness because of disease or injury would result in disability. Indefinite is used in the sense that it cannot reasonably be anticipated that the impairment will, in the foreseeable future, be so diminished as no longer to prevent substantial gainful activity. For example, an individual who suffers a bone fracture which prevents him from working for an extended period of time will not be considered disabled, if his recovery can be expected in the foreseeable future.

(4) Impairments which are remediable do not constitute a disability within the meaning of section 213(g). An individual will not be deemed disabled if, with reasonable effort and safety to himself, the impairment can be diminished to the extent that the individual will not be prevented by the impairment from engaging in his customary or any comparable substantial gainful activity.

(b) *Manner of proving the existence of disability.*—Any taxpayer whose medical expenses are in excess of the maximum limitations of section 213(c) and who seeks to apply the provisions of section 213(g) must submit the information required by § 1.213–1(h) of the Income Tax Regulations (part 1 of this chapter) and must establish that he or his spouse, as the case may be, has sustained an impairment as described in paragraph (a) of this section and that by reason of such impairment, he or his spouse, as the case may be, is unable, with his training, education, and work experience, to engage in his customary or any comparable substantial gainful activity, within the meaning of paragraph (a) of this section. For the first taxable year for which the taxpayer seeks the application of section 213(g), there must be submitted with his income tax return a doctor's statement as to any impairment upon which the taxpayer relies. There must also be submitted with the return a statement by the taxpayer with respect to the effect of the impairment upon his substantial gainful activity. For subsequent taxable years, the taxpayer may, in lieu of such statements, submit a statement declaring the continued existence (without substantial diminution) of the impairment and its continued effect on his substantial gainful activity.

§ 18.1–5 Taxation of Employee Annuities.—(a) *In general.*—Section 403(b) of the Internal Revenue Code of 1954, as added by section 23(a) of the Technical Amendments Act of 1958 (72 Stat. 1620), limits the extent to which an employee of an employer described in section 501(c)(3) and exempt from tax under section 501(a) may exclude from gross income employer contributions to purchase annuity contracts for the employee. The employer contributions are excluded from the employee's income to the extent that the aggregate of such contributions does not exceed an exclusion allowance provided in section 403(b). In computing such exclusion allowance, it is necessary to determine the number of years of service of an employee. For this purpose, the number of years of service of an employee shall be determined in accordance with the rules set forth in this section.

(b) *Full-time employee for full year.*—(1) Each full year during which an individual was employed full-time shall be considered as one year of service. In determining whether an individual is employed full-time, the amount of work which he is required to perform shall be compared with the amount of work which is normally required of individuals holding the same position with the same employer and who generally derive the major portion of their personal service income from such position.

(2) (i) In measuring the amount of work required of individuals holding a particular position, any method that reasonably and accurately reflects such amount may be used. For example, the number of hours of classroom instruction is only an indication of the amount of work required, but it may be used as a measure.

(ii) In determining whether positions with the same employer are the same, all of the facts and circumstances concerning the positions shall be considered, including the work performed, the methods by which compensation is computed, and the descriptions (or titles) of the positions. For example, an assistant professor employed in the English department of a university will be considered a full-time em-

ployee if the amount of work that he is required to perform is the same as the amount of work normally required of assistant professors of English at that university who derive the main portion of their personal service income from such position.

(iii) In case an individual's position is not the same as another with his employer, the rules of this paragraph shall be applied by considering the same position with similar employers or similar positions with the same employer.

(3) A full year of service for a particular position means the usual annual work period of individuals employed full-time in that general type of employment at the place of employment. For example, if a doctor employed by a hospital works throughout the 12 months of a year except for a one-month vacation, such doctor will be considered as being employed for a full year, if doctors at that hospital work 11 months of the year with a one-month vacation. Similarly, if the usual annual work period at a university consists of the fall and spring semesters, an instructor at that university who teaches those semesters will be considered as working a full year.

(c) *Other employees.*—(1) For purposes of section 403(b), an individual shall be treated as having a fraction of a year of service for each year during which he was a full-time employee for part of the year or for each year during which he was a part-time employee for the entire year or for a part of the year. However, in computing the exclusion allowance under section 403(b), any employee shall be treated as having at least one year of service.

(2) In determining the fraction which represents the fractional year of service for an individual employed full time for part of a year, the numerator shall be the number of weeks (or months) during which the individual was a full-time employee in a position, and the denominator shall be the number of weeks (or months) which is considered under paragraph (b) (3) of this section as the usual annual work period for that position. For example, if an instructor is employed full time by a university for the 1958 fall semester (which lasts from October 1958 through January 1959), and the academic year of the university is 8 months long, ending in May 1959, then he is considered as having completed $\frac{4}{8}$ of a year of service.

(3) In determining the fraction which represents the fractional year of service of an individual who is employed part time for a full year, the numerator shall be the amount of work required to be performed by the individual, and the denominator shall be the amount of work normally required of individuals who hold the same position. The amount of work required to be performed by the individual and the amount of work normally required of individuals holding the same position shall be determined in accordance with the principles of paragraph (b) of this section. Thus, if a practicing physician teaches one course at a local medical school 3 hours per week for two semesters and other faculty members at that medical school teach 9 hours per week each semester, then the practicing physician is considered as having completed $\frac{3}{9}$ of a year of service.

(4) In determining the fraction representing the fractional year of service of an individual who is employed part time for part of a year, it is necessary to compute the fractional year of service if the individual were a part-time employee for a full year, and the frac-

tional year of service if the individual were a full-time employee for the part of a year. The two fractions shall be multiplied and the product is the fractional year of service of such individual who is employed part time for part of a year. For example, if an attorney who is a specialist in a subject teaches a course in that subject for 3 hours per week for one semester at a nearby law school, and the full-time instructors at that law school teach 12 hours per week for two semesters, then the fractional part of a year of service for such part-time instructor is computed as follows: The fractional year of service if the instructor were a part-time employee for a full year is $\frac{3}{12}$, (number of hours employed divided by the usual number of hours of work required for that position); the fractional year of service if the instructor were a full-time employee for part of a year is $\frac{1}{2}$ (period worked or one semester, divided by usual work period, or 2 semesters). These fractions are multiplied to obtain the fractional year of service: $\frac{3}{12}$ times $\frac{1}{2}$, or $\frac{3}{24}$ ($\frac{1}{8}$).

§ 18.1–6 Prepaid Subscription Income.—(a) *Manner of making election not requiring consent.*—Section 455 permits taxpayers to elect to include prepaid subscription income in gross income for the taxable years during which the liability exists to furnish or deliver a newspaper, magazine, or other periodical. An election not requiring consent may be made for the first taxable year beginning after December 31, 1957, in which the taxpayer receives prepaid subscription income in the trade or business. Such election shall be applicable to all prepaid subscription income received in connection with the trade or business for which the election is made; except that the taxpayer may include in gross income for the taxable year of receipt the entire amount of any prepaid subscription income if the liability from which it arose is to end within 12 months after the date of receipt. An election made under this section shall not apply to any prepaid subscription income received before the first taxable year for which the election is made. The election shall be made by a statement attached to the income tax return for the first taxable year to which the election is applicable. Such statement shall indicate that the taxpayer has elected under the provisions of section 455(c)(3)(B) to report prepaid subscription income in accordance with the provisions of section 455, and shall also show:

(1) The method of accounting used by the taxpayer in the particular trade or business,

(2) The total amount of prepaid subscription income,

(3) The periods over which the liability described in section 445(d)(2) extends,

(4) The amount of such income applicable to each such future period, and

(5) The method of allocation.

In any case in which prepaid subscription income is received from more than one trade or business, the statement shall set forth the required information with respect to each trade or business subject to the election. The return and statement must be filed not later than the date prescribed by law for filing the return (including any extensions of time) for the taxable year for which the election is made.

(b) *Scope of election.*—(1) *In general.*—An election made under paragraph (a) of this section shall be binding for the taxable year

for which the election is made and for all subsequent taxable years, unless consent to revoke the election is obtained from the Commissioner. Any application for consent to revoke an election under section 455 will not be accepted before the date of publication in the Federal Register of regulations under section 455.

(2) *Liability extending for 12 months or less.*—Under paragraph (a) of this section, a taxpayer may include income from prepaid subscriptions where the liability does not extend beyond a 12-month period either in the taxable years during which the liability exists or in the taxable year received. However, an election under this section to include such income in the taxable years during which the liability exists is binding, and the method so adopted must be used by the taxpayer for the taxable year for which adopted and for all subsequent taxable years. That is, an election with respect to such income is revocable only with the consent of the Commissioner.

(c) *Consent to make election at any time.*—An application for consent under section 455(c)(3)(A) will not be accepted before the date of publication in the Federal Register of regulations under section 455. Such regulations, however, will provide a reasonable period of time within which tapayers will be permitted to apply for such consents in the case of taxable years which begin after December 31, 1957, and end before the date of such publication.

(d) *Treatment of prepaid subscription income under an established accounting method.*—Notwithstanding paragraphs (a), (b), and (c) of this section, any taxpayer who, for taxable years beginning before January 1, 1958, has reported for income tax purposes prepaid subscription income under an established and consistent method or practice of deferring such income may continue to report such income for all subsequent taxable years to which this section applies in accordance with such method or practice. Except as provided in paragraph (a) of this section, a change in such method or practice may be made only in accordance with § 1.446–1 of the Income Tax Regulations (part 1 of this chapter).

§ 18.1–7 Sale or Exchange of Residence.—(a) *Election to treat condemnation of property as sale.*—(1) Paragraph (2) of section 1034(i) of the Internal Revenue Code of 1954, as added by section 46(b) of the Technical Amendments Act of 1958 (72 Stat. 1641), permits a taxpayer to elect to treat the seizure, requisition, or condemnation of his principal residence, or the sale or exchange of such residence under threat or imminence thereof, if occurring after December 31, 1957, as the sale of such residence for purposes of section 1034 (relating to sale or exchange of residence). A taxpayer may thus elect to have section 1034 apply, rather than section 1033 (relating to involuntary conversions), in determining the amount of gain realized on the disposition of his old residence that will not be recognized and the extent to which the basis of his new residence acquired in lieu thereof shall be reduced. The election, once made, shall be irrevocable.

(2) If the taxpayer elects to be governed by the provisions of section 1034, section 1033 will have no application. Thus, a taxpayer who elects under section 1034(i)(2) to treat the seizure, requisition, or condemnation of his principal residence, or the sale or exchange of such residence under threat or imminence thereof, as a sale for

purposes of section 1034, must satisfy the requirements of section 1034 and § 1.1034–1 of the Income Tax Regulations (part 1 of this chapter). For example, such a taxpayer must replace his old residence with a new residence which he uses as his principal residence, within a period beginning one year before the date of disposition of his old residence, and ending one year after such date. In the case of a new residence the construction of which was commenced by the taxpayer within such period, the period shall not expire until 18 months after the date of disposition of the old residence.

(b) *Time and manner of making election.*—The election under section 1034(i)(2) shall be made in a statement attached to the taxpayer's income tax return for the taxable year during which the disposition of his old residence occurs. The statement shall indicate that the tapayer elects under section 1034(i)(2) to treat the disposition of his old residence as a sale for purposes of section 1034, and shall show:

(1) The basis of the old residence;

(2) The date of its disposition;

(3) The adjusted sales price of the old residence, if known; and

(4) The purchase price, date of purchase, and date of occupancy of the new residence if it has been acquired prior to the time of making the election.

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 Technical Amendments Act of 1958, 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 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U. S. C. 7805).)

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved November 13, 1958.

Fred C. Scribner, Jr.,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on Nov. 18, 1958, 8:51 a. m. and published in the issue of the Federal Register for Nov. 19, 1958, 23 F. R. 8979.)

(Also Part I, Section 4056.) Rev. Proc. 58–10

A simplified Export Exemption Certificate is acceptable as proof of export with respect to sales to citizens and/or residents of Mexico who purchase articles, otherwise subject to retailers excise tax, from retailers whose places of business are located in United States counties contiguous to (actually touching) the Mexican border.

Revenue Procedure 57–32, C. B. 1957–2, 1104, superseded.

Section 1. Purpose.

The purpose of this Revenue Procedure is to announce the acceptability of a simplified Export Exemption Certificate as proof of export

with respect to sales to citizens and/or residents of Mexico who purchase articles, otherwise subject to the retailers excise tax, from retailers whose places of business are located in United States counties contiguous to (actually touching) the Mexican border.

SEC. 2. BACKGROUND.

.01 United States consuls in Mexico issue border crossing cards to Mexico citizens and/or residents of Mexico which permit them to enter and leave the United States. These cards are issued for a period of six years but they limit each visit to 72 hours. Such persons make many small purchases from dealers whose places of business are located in counties contiguous to the Mexican border. The articles purchased are for use or consumption in Mexico and include jewelry, furs, luggage, and toilet preparations. These articles are not mailed or shipped to a foreign destination, but are carried by the purchasers back to Mexico upon their return on foot, by private automobile, or by common carrier.

.02 Under the provisions of section 4056 of the Internal Revenue Code of 1954, the retailers excise tax does not apply to the sale of any article for export and in due course so exported. S. T. 936, C. B. 1949–1, 260, and S. T. 939, C. B. 1951–2, 216, set forth various types of evidence which retailers generally may retain, for tax exemption purposes, as proof of export of taxable articles.

SEC. 3. USE OF SIMPLIFIED EXPORT EXEMPTION CERTIFICATE.

.01 Because of the large volume of small sales of taxable articles to citizens and/or residents of Mexico by retailers whose places of business are located in counties that are contiguous to the Mexican border, the exempt character of certain sales may be established by the use of a special form of sales ticket. To be acceptable as proof of export, the sales ticket must show the name of the seller, the date of the sale, and must be imprinted or stamped with a certificate properly filled in, substantially as follows:

> I hereby certify that the merchandise listed upon this sales ticket is purchased by me, a citizen and/or resident of Mexico, for export to Mexico and in due course will be exported to Mexico prior to use.
>
> ---
> (Signature of Purchaser)
>
> ---
> (Address)
>
> ---
> (Immigration or Document Number)
>
> ---
> (Issued at)

.02 The simplified Export Exemption Certificate may be used only by retail dealers whose places of business are located in counties contiguous to the Mexican border. Its use is limited to sales where the amount of the retailers excise tax, if applied to a sales transaction with an individual purchaser, would not exceed $20. It will not be accepted as proof of export in counties that do not touch the Mexican border or in counties which are contiguous to the Mexican border where the amount of the retailers excise tax, if applied to a sales transaction with an individual purchaser, would exceed $20.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

Since the simplified Export Exemption Certificate is hereby being authorized for use by retailers whose places of business are in United States counties contiguous to the Mexican border, this Revenue Procedure supersedes Revenue Procedure 57–32, C. B. 1957–2, 1104, in which a similar procedure was limited to retail dealers in United States cities located on the Mexican border.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III–A, Section 5212; 182.405, 220.536, 225.632.)

Rev. Proc. 58–11

Sampling of bulk distilled spirits at the time of gauge for taxpayment as a means of checking the accuracy of proof determination.
Revenue Procedure 57–36, C. B. 1957–2, 1109 and Revenue Procedure 58–4, C. B. 1958–1, 687, clarified.

SECTION 1. PURPOSE.

The purpose of the Revenue Procedure is to clarify the scope of Revenue Procedure 57–36, C. B. 1957–2, 1109, to make clear that the prescribed procedures apply whenever bulk spirits are proofed for taxpayment or withdrawal on the original gauge, regardless of whether the spirits are being withdrawn for industrial or beverage purposes.

SEC. 2. BACKGROUND.

Analysis of information from various sources indicates a need for emphasizing that the sampling program is designed for use at industrial alcohol plants and bonded warehouses as well as at distilleries and internal revenue bonded warehouses, and that sampling procedures apply to receiving tanks and cisterns when removals, either taxpaid or for subsequent withdrawal on the original gauge, are made from the receiving or cistern room of the producing plant.

SEC. 3. EXTENT OF APPLICATION.

The procedures prescribed in Revenue Procedure 57–36, *supra*, and Revenue Procedure 58–4, C. B. 1958–1, 687, shall be used in registered distilleries, fruit distilleries, internal revenue bonded warehouses, industrial alcohol plants, and industrial alcohol bonded warehouses. They apply whenever spirits, including alcohol in tanks, are proofed for taxpayment or for subsequent withdrawal on the original gauge.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure clarifies Revenue Procedure 57–36, C. B. 1957–2, 1109, and Revenue Procedure 58–4, C. B. 1958–1, 687.

SEC. 5. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to the number thereof and should 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 5703; 270.194, 275.183.)

Rev. Proc. 58-12

This Revenue Procedure contains a list of the foreign countries in which United States internal revenue tobacco products tax stamps may be affixed to tobacco products prior to exportation to the United States.

Revenue Ruling 55-680, C. B. 1955-2, 475, and Revenue Ruling 57-196, C. B. 1957-1, 427, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to list the foreign countries in which, pursuant to the provisions of section 270.194 of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers) and section 275.183 of the Regulations relating to Manufactured Tobacco (Manufacturers, Importers, and Dealers), United States internal revenue tobacco products tax stamps may be affixed to packages of tobacco products manufactured in such foreign countries, prior to exportation to the United States.

SEC. 2. BACKGROUND.

Sections 270.194 and 275.183 of the regulations provide that internal revenue stamps in payment of the tax on imported cigars, cigarettes, and manufactured tobacco may be affixed to such products in the foreign country in which manufactured, provided the laws of such foreign country grant a like privilege in respect to the affixture of its revenue stamps in the United States to similar products manufactured in the United States and exported to such foreign country.

SEC. 3. LIST OF FOREIGN COUNTRIES.

The foreign countries (and those dominions, colonies, etc.) in which United States internal revenue tobacco products tax stamps may be affixed to their tobacco products prior to exportation to he United States are as follows:

Algeria
Austria
Bahamas
Barbados
Bermuda
British Guiana
British Honduras
Burma, Union of
Canada
Costa Rica
Cuba (except cigar stamps)
Denmark
Dominican Republic
Egypt
England
France
Germany, Federal Republic of
Haiti
Honduras
India
Indonesia
Iraq
Ireland
Israel
Italy
Jamaica
Japan
Leeward Islands, British
Mexico
Netherlands
Northern Ireland
Philippine Republic
Saudi Arabia
Scotland
Sweden
Switzerland
Tobago
Trinidad
Turkey
Union of South Africa
Windward Islands, British

Cigar stamps may not be forwarded to Cuba for affixture to cigars produced in that country for export to the United States, since Cuba

does not permit its cigar stamps to be affixed to cigars in the United States before exportation to Cuba.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Ruling 55-680, C. B. 1955-2, 475, and Revenue Ruling 57-196, C. B. 1957-1, 427, which contained similar lists of reciprocating foreign countries.

SEC. 5. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D. C., attention O:AT:T.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III-A, Sections 5053, 5062, 5248, 5362; 245.197, 252.4, 182.630b, 225.861, 240.691.)

Rev. Proc. 58-13

Nicaragua and El Salvador have been added to the list of foreign countries to which the reciprocal privileges may be extended. Rev. Rul. 58-319, C. B. 1958-1, 593, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the addition of Nicaragua and El Salvador to the list of foreign countries to which the reciprocal privileges provided by section 309 of the Tariff Act of 1930, as amended, 46 Stat. 690, as amended, 19 U. S. C. 1309, may be extended.

SEC. 2. BACKGROUND.

Under the provisions of section 309 of the Tariff Act of 1930, as amended, *supra*, and sections 5053 and 5056 of the Internal Revenue Code of 1954, and applicable regulations of the Internal Revenue Service, alcohol, distilled spirits, beer, and wine may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in foreign countries and actually engaged in foreign trade or trade between the United States and its possessions, where trade by foreign aircraft is permitted. Such privilege is extended in respect of aircraft registered in a foreign country only if the Secretary of the Treasury shall have been advised by the Secretary of Commerce that he has found that such foreign country allows, or will allow, substantially reciprocal privileges in respect to aircraft registered in the United States.

SEC. 3. NICARAGUA AND EL SALVADOR.

In addition to those countries listed in Revenue Ruling 58-319, C. B. 1958-1, 593, the Secretary of Commerce has found and has advised the Secretary of the Treasury that the countries of Nicaragua and El Salvador extends to aircraft registered in the United States and engaged in foreign trade, privileges substantially reciprocal to

those given aircraft registered in Nicaragua and El Salvador and engaged in foreign trade.

SEC. 4. COMPLETE LIST OF FOREIGN COUNTRIES.

The complete list of foreign countries to which reciprocal privileges may be extended is as follows:

Australia	Ecuador	Mexico
Bahama Islands	El Salvador	Netherlands
Belgium	France	Nicaragua
Bermuda	Germany, Federal	Norway
Brazil	Republic of	Peru
Canada	Israel	Spain
Costa Rica	Italy	Sweden
Denmark	Japan	Switzerland
Dominican Republic	Lebanon	United Kingdom

SEC. 5. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Ruling 58–319, *supra*.

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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. 58–14

Where, during the course of an examination of, or an informal conference concerning, an income, estate, gift, excise, or employment tax case, a taxpayer or his representative requests that an issue be referred to the National Office for technical advice but the examining officer or conferee is of the opinion the circumstances do not warrant such action, the matter shall be referred to the Chief, Audit Division, for a decision in the case.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedure to be followed where, during the course of an examination of, or an informal conference on, a tax return in the office of a District Director of Internal Revenue, the taxpayer or his representative requests that an issue be referred to the National Office for technical advice but the examing officer or conferee is of the opinion the circumstances do not warrant such action.

SEC. 2. BACKGROUND.

.01 In certain instances, during the course of examinations and informal conferences on tax returns, taxpayers or their representatives request that an issue be referred to the National Office for advice prior to the determination of tax by the District Director of Internal Revenue.

.02 Mimeograph 6293, C. B. 1948–2, 59, provides, in effect, that when, during the course of an examination of a tax return, it is decided that the case involves an issue requiring technical advice from the National Office, the taxpayer or his representative should, except as provided in paragraph 4, be advised (1) that it is proposed to refer the issue to Washington for advice, and (2) that if the taxpayer or

his representative so desires, a hearing will be granted in Washington, if there is doubt as to the correctness of the taxpayer's position. The exception stated in paragraph 4 of the mimeograph is that this procedure will not be applicable to matters primarily of internal concern, or in instances where it would be prejudicial to the interests of the Internal Revenue Service.

SEC. 3. PROCEDURE.

.01 During the course of an examination or an informal conference, the taxpayer or his representative may request that an issue be referred to the National Office for technical advice on the grounds that a lack of uniformity exists as to the disposition of that issue, or that the issue is so unusual or complex as to warrant consideration by a National Office specialist. If in the opinion of the examining officer or conferee, the circumstances do not warrant such action, the taxpayer or his representative will be so informed. The taxpayer or his representative will also be advised that if he desires he may, within a specified time, submit a statement of the facts, law and argument with respect to the issue, and the reasons why he believes the issue should be referred to the National Office for advice.

.02 Statements submitted by a taxpayer or his representative will be forwarded through appropriate channels to the Chief, Audit Division, and will be accompanied by a brief statement prepared by the examining officer or conferee, setting forth his views as to why the issue does not warrant referral to the National Office. It will be the responsibility of the Chief, Audit Division, to determine on the basis of the statements submitted, whether advice should be requested from the National Office prior to a determination of the issue. If the Chief, Audit Division, determines that advice from the National Office will not be requested, he will inform the taxpayer, in writing, of his decision.

SEC. 4. SCOPE.

The provisions of this Revenue Procedure apply with respect to issues involved in income, estate, gift, excise, and employment tax cases pending in the offices of the District Director of Internal Revenue.

SEC. 5. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Operations) for the attention of O:A:PPr.

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26 CFR 601.702: Publication and public inspection.
(Also Part I, Section 6103.)
(Also Part II, Section 55(b); Regulation 118, 39.55–1.)

Rev. Proc. 58–15

The charge for preparing abstracts of Federal income tax returns and documents for State governments will be increased to the rate of $2.50 per hour effective January 1, 1959.

Revenue Ruling 54–349, C. B. 1954–2, 122, modified.

Revenue Ruling 54–349, C. B. 1954–2, 122, relates to the inspection by State governments of Federal income tax returns and related documents, the furnishing to State governments of copies of such returns and documents, and the furnishing to State governments of abstracts of data from such returns and documents. Section 4.03 of Revenue Ruling 54–349, *supra*, provides that charges will be made for abstract service at the rate of $1.50 per hour for time spent preparing the abstracts.

This rate was established a number of years ago, at which time it bore an adequate relation to the expense incurred in furnishing the service. Since that time there has been an increase in the expense and the charge is now considerably out of line with the actual cost of furnishing this service. Accordingly, with respect to all transcripts prepared on or after January 1, 1959, the rate will be $2.50 per hour.

Revenue Ruling 54–349, C. B. 1954–2, 122, is hereby modified to reflect the increased change of $2.50 per hour for the preparation of abstracts of Federal income tax returns and documents for State governments.

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26 CFR 601.502: Qualifications for conferences. Rev. Proc. 58–16

A person enrolled to practice before the Treasury Department is required to report certain information concerning contingent fee agreements.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to implement the procedure prescribed in Department Circular 230 (Revised), C. B. 1952–2, 275, concerning information to be furnished to the Treasury Department in situations where a person enrolled to practice before the Department enters into a contingent fee agreement with a client.

SEC. 2. BACKGROUND.

The laws and regulations governing the recognition of attorneys, agents and other persons representing claimants before the Treasury Department are contained in Department Circular No. 230, Revised. Section 10.2(y), of those regulations, relating to fee agreements, states as follows:

"(y) (1) No enrolled person shall exact from his client a manifestly unreasonable fee, whether contingent or otherwise, in any matter before the Treasury Department. The reasonableness of a fee in any case is within limits a matter of judgment and depends upon all the facts and circumstances thereof, including the complexity and difficulty of the case, the amount of time and labor required for its proper preparation and presentation, the amount involved, and the professional standing and experience of the attorney or agent.

"(2) A wholly contingent fee agreement shall not be entered into with a client by an enrolled person unless the financial status of the client is such that he would otherwise be unable to obtain the services of an attorney or agent. Partially contingent fee agreements are permissible where provision is made for the payment of a minimum fee, substantial in relation to the possible maximum fee, which minimum fee is to be paid and retained irrespective of the outcome of the proceeding. Such minimum fee need not be paid in advance, if provision for its payment is made irrespective of the outcome of the case. The payment of or agreement to pay a nominal minimum fee will not satisfy the requirements of this subparagraph.

"(3) Whenever an enrolled attorney or agent shall enter into a contract to represent a client before the Treasury Department on a wholly or partially

contingent basis, he shall file with the Office of Director of Practice a signed statement to that effect, containing the terms of the contract as they relate to compensation.

"(4) When a power of attorney is filed with the Treasury Department it shall be the duty of the attorney or agent filing the same to file therewith a statement as follows:

"(Date) _____

"(Place) _____

"This is to certify that I (have) (have not) entered into a contingent or partially contingent fee agreement for the representation of_____

_____

(name of client, principal, or taxpayer)

before the Treasury Department in the matter of_____

_____

(income, estate, gift or other taxes, or other matter)

under the terms of a power of attorney filed with the Treasury Department on _____, 19__, and (in case of a contingent or partially contingent fee agreement has been made) that a report of such fee agreement (has) (has not) been made to the Office of Director of Practice.

_____

"(Signature of Attorney or Agent)

This requirement shall not be applicable to powers of attorney wherein the authority granted is limited to the filing of tax or information returns."

SEC. 3. PROCEDURE.

.01 The provisions of the above-cited regulations require that an enrolled person report directly to the Office of Director of Practice the terms as related to compensation of any contingent or partially contingent fee agreement made in a Treasury Department matter. Such report should include the following information:

1. Name and address of claimant.
2. Identification of matter before Treasury Department.
3. Amount of minimum or retaining fee to be retained regardless of the outcome of the proceedings.
4. Percentage of contingent fee.
5. Amount involved or in issue on which such percentage is based.

.02 The Office of the Director of Practice has held that the minimum or retainer fee shall not fall below ten percent of the maximum fee in order to satisfy the requirements of subparagraph two, section 10.2(y), with respect to the relationship between the minimum and maximum fees.

.03 The Treasury Department does not attempt to advise an enrollee the specific terms of a fee agreement as such agreement is a matter of private contract between the enrollee and his client. However, it is the duty of the Office of the Director of Practice, under the provisions of the regulations, to determine whether a proper relationship exists between an enrollee and his client.

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26 CFR 601.602: Forms and instructions. (Also Part I, Section 6051.) Rev. Proc. 58-17

Substitutes for Form W-2, Withholding Tax Statement-1959, may be privately printed with slight variations in format and used without specific approval of the Internal Revenue Service, provided they meet specified conditions with respect to physical characteristics, use of additional copies, and additional information, if any, to state or local taxing authorities.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the policy of the Internal Revenue Service relating to the acceptance of substitutes for Form W-2, Withholding Tax Statement-1959, 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 specific approval of the Internal Revenue Service if the conditions enumerated in section 3 are met.

.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 x 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 for a state or local taxing authority is prepared, it may be placed in the third position 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.

.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 captions are used to identify such amounts. The identification number assigned by the Social Security Administration to the State (prefix 69) should be shown in addition to the employer identification number assigned by the Internal Revenue Service for income tax withholding purposes.

SEC. 5. SUBSTITUTES NOT MEETING ABOVE CONDITIONS.

Proposed substitute forms which do not meet the conditions stated above and requests for submission of punched card Forms W-2 should be forwarded by letter to the Commissioner of Internal Revenue, Attention: O:C:P, Washington 25, D. C., for approval.

SEC. 6. REPRODUCTION PROOFS.

Reproduction proofs of the official Form W-2 are available upon the request of any employer who desires to use reproductions of such form. Requests for reproduction proofs should be addressed to the Commissioner of Internal Revenue, Attention: C:Ad:O:P, Washington 25, D. C.

(Also Part I, Section 6213;
26 CFR 301.6213-1.)

Rev. Proc. 58-18

Where an advance payment of a tax deficiency can be assessed, such assessment shall be consistent with any designation of the payment as to tax and interest which may have been made by the taxpayer. An advance payment which is not assessed will be treated as a deposit made in the nature of a cash bond for the payment of taxes thereafter found to be due.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the establishment of a new policy of the Internal Revenue Service with respect to advance payments of tax deficiencies created as the result of audit action as authorized and required by the Internal Revenue Codes of 1954 and 1939.

SEC. 2. BACKGROUND.

Many difficulties have arisen in the past in connection with advance payments of tax deficiencies, resulting in numerous suits and conflicting decisions by the courts. The enactment of the Internal Revenue Code of 1954, specifically section 6213(b)(3), and the conclusion of the United States Court of Appeals, in the case of *James G. McConkey* v. *Commissioner*, 199 Fed. (2d) 892, certiorari denied, 345 U. S. 924, enabled the Service to re-examine the procedure being followed with respect to such payments and to take steps to avoid future conflicts.

Section 6213(b)(3) of the Code provides, in effect, that any amounts paid as a tax or in respect of a tax may be assessed upon receipt, notwithstanding the restrictions on assessment imposed by subsection (a) of such section. In the *McConkey* case, which involved a tax deficiency imposed under the 1939 Code, the court stated that if a taxpayer chooses to pay any additional amount proposed to be assessed against him as a deficiency before the Commissioner of Internal Revenue has made an official determination that there is a deficiency, he has forfeited the statutory remedy afforded him of proceeding in the Tax Court of the United States and has instead elected to pursue the alternative remedy of payment and suit for refund.

SEC. 3. SCOPE.

The provisions of this Revenue Procedure are applicable to all advance payments of tax deficiencies made after the effective date of this Revenue Procedure under both the 1939 Code and the 1954 Code.

SEC. 4. GENERAL.

.01 An advance payment made after the mailing of a statutory notice of deficiency (90-day letter), which is made by a taxpayer as a payment in respect of the proposed deficiency, will be assessed upon receipt or as soon thereafter as is practicable. Such assessment shall be consistent with any designation of the payment as to tax and interest which may have been made by the taxpayer. An advance payment which is made after the mailing of the statutory notice of deficiency does not deprive the Tax Court of the United States of jurisdiction over the deficiency.

.02 An advance payment made before the mailing of a statutory notice of deficiency (90-day letter), which is made by a taxpayer as a payment in respect of a pending deficiency, may also be assessed upon receipt or as soon thereafter as is practicable, provided the District Director of Internal Revenue is in a position to ascertain the amount of the deficiency. As in the case of advance payments made after the mailing of a statutory notice of deficiency, the assessment shall be consistent with any designation of the payment as to tax and interest which may have been made by the taxpayer. If the amount paid or any portion thereof is designated by the taxpayer as a payment of deficiency and such payment satisfies the entire deficiency, no statutory notice of deficiency will be mailed, since several courts have held that under these circumstances the Tax Court of the United States has no jurisdiction. Where less than the total deficiency is paid and assessed such assessment will be taken into account in determining the amount for which a statutory notice of deficiency must be mailed.

.03 Advance payments received before the mailing of a statutory notice of deficiency will not be assessed in any case where the District Director is unable to ascertain the amount of the deficiency at the time the payment is received. An advance payment which is not assessed will be treated as a deposit made in the nature of a cash bond for the payment of taxes thereafter found to be due. As such it will have no effect on the computation of interest or on the running of the period of limitation for filing a claim for refund and the taxpayer will be placed on notice by certified mail as to the status of the payment. At such time as the amount of the deficiency is determined, an assessment will be made and the advance payment will be applied as a payment of tax and/or interest made on the date of the assessment. Upon request by the taxpayer, the deposit will be returned to him, without interest, at any time prior to assessment of the deficiency. In this event the case will be processed as though no payment had ever been made.

SEC. 5. INTEREST.

.01 The running of interest on any amount of the deficiency which is satisfied by the application of the advance payment will generally be terminated on the date of the assessment. However, in any case in which a waiver of the restrictions on assessment has been filed with respect to an amount covered by an advance payment, the running of interest on such amount will be terminated on the date of the assessment of the deficiency as shown in such waiver, or 30 days after the waiver is filed, whichever is the earlier. Interest will be assessed at the same time as the tax in all cases.

.02 The assessment of an advance payment of interest only will not affect the running of interest on the deficiency.

.03 No interest will be allowed on advance payments or portions thereof which are returned to taxpayers prior to assessment.

.04 Advance payments which are applied against assessed tax or interest will be treated in the same manner as any other assessed amount and the allowance of interest on any resulting overpayment is mandatory under the provisions of section 6611 of the 1954 Code and section 3771 of the 1939 Code.

SEC. 6. PRIOR PAYMENTS.

Advance payments received by District Directors prior to the effective date of this Revenue Procedure will be processed in accordance with the procedure in effect at the time the payment was received.

SEC. 7. EFFECTIVE DATE.

This Revenue Procedure is effective December 1, 1958.

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26 CFR 601.310: Forms. (Also Part III–A, Sections 5114, 5555; 194.233, 251.133, 251.136.)

Rev. Proc. 58–19

Where an importer takes actual physical possession of distilled spirits, and the importer is also a wholesale liquor dealer, and the premises where he receives and sends out spirits as an importer are the same premises where he receives and sends out spirits as a wholesale liquor dealer, he should submit a single report on Form 338, Wholesale Liquor Dealer's Monthly Report, covering the combined operations. If, however, the premises where he conducts business as an importer are not the same premises where he conducts business as a wholesale liquor dealer, but the locations are such as to make it advantageous for him to keep all records at one premises, it will be necessary for him, in order to keep a single record and submit one report on Form 338 covering both import and domestic transactions, to apply to and receive the permission of the assistant regional commissioner so to do.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to clarify the policy of the Internal Revenue Service with respect to the preparation of Form 338, Wholesale Liquor Dealer's Monthly Report, by those persons who are qualified as importers and as wholesalers.

SEC. 2. BACKGROUND.

In recent years several amendments (Treasury Decision 6151, C. B. 1955–2, 713, and Treasury Decision 6224, C. B. 1957–1, 556) have been made to the Regulations relating to Liquor Dealers and to the Importation of Distilled Spirits, Wines, and Beer, to simplify record-keeping and reporting requirements. It has been determined that the interests of the Government are served by records showing physical movement and physical possession of spirits without regard to ownership. It has also been found that Customs records provide means for tracing alcoholic liquors from the original importer to the person responsible for their release from Customs custody.

As a result, the importation regulations were amended to provide that importers (except where they receive imported spirits at a taxpaid premises operated in connection with a distillery or bonded warehouse or at a taxpaid bottling house or rectifying plant) shall keep records and render reports of the physical receipt and disposition of liquors in accordance with the Regulations relating to Liquor Dealers.

Persons who receive and dispose of distilled spirits both as importers and as wholesale liquor dealers have not been consistent in preparing their monthly reports. In some instances separate reports have been submitted on Form 338 to cover import and wholesale operations, respectively, while in other instances both operations have been reported on a single Form 338 by the importer-wholesaler.

SEC. 3. INSTRUCTIONS.

A separate report of the quantities of distilled spirits received and disposed of by wholesale liquor dealers serves no purpose. Therefore, an importer who takes actual physical possession of distilled spirits and who is also a wholesale liquor dealer, and whose importing business is conducted on the premises where he receives and sends out distilled spirits as a wholesale liquor dealer, should submit one monthly report on Form 338 covering all receipts and dispositions of distilled spirits during the month for which the report is rendered.

If the same importer's place of business is other than the premises where he receives and disposes of distilled spirits as a wholesale liquor dealer, and the locations are such as to make it advantageous for him to keep all his records at one place, it will be necessary for him to apply to, and receive the permission of the assistant regional commissioner before he may maintain a single record and submit one report on Form 338 covering both import and domestic transactions. If he wishes the record to be maintained at his wholesale liquor dealer premises, the application should be filed in accordance with section 194.233 of the Regulations relating to Liquor Dealers; if he wishes the record to be maintained at his place of business as an importer, the application should be filed in accordance with section 251.136 of the Regulations dealing with Importation of Distilled Spirits, Wines, and Beer.

SEC. 4. INQUIRIES.

Inquiries with respect to this Revenue Procedure should refer the number thereof and should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.702: Publication and Public Inspection.
(Also Sections 501, 6104; 1.501(a)-1, 301.6104-1.)

Rev. Proc. 58-20

Under specified conditions, public inspection may be permitted of certain applications for exemption filed by organizations described in sections 501(c) and 501(d) of the Internal Revenue Code of 1954 and held to be exempt under section 501(a) of the Code.

SECTION 1. PURPOSE.

This Revenue Procedure states the procedures for public inspection of certain applications for exemption filed by organizations which have been held to be exempt from income tax under section 501(a) of the Internal Revenue Code of 1954 and corresponding provisions of prior revenue laws.

SEC. 2. SCOPE.

This Revenue Procedure applies only to disclosures affecting organizations described in sections 501(c) and 501(d) of the Code and corresponding provisions of prior revenue laws. It does not apply to stock bonus, pension, or profit-sharing trusts described in section 401(c) of the Code and held to be exempt under section 501(a) of the Code.

SEC. 3. BACKGROUND.

.01 Section 75(a) of the Technical Amendments Act of 1958, approved September 2, 1958, amended section 6104 of the Code, relating to the publicity of information required from certain exempt organizations and certain trusts, by inserting a new subsection (a) relating to the inspection of applications for tax exemption. Section 6104(a) as added to the Code provides for the inspection of certain applications for income-tax exemption under section 501(a) and of the papers submitted in support of such applications. The added provision is effective November 3, 1958, the sixtieth day after enactment.

SEC. 4. RESPONSIBILITY FOR ADMINISTRATION.

.01 On and after November 3, 1958, each District Director of Internal Revenue will permit public inspection, in the manner and to the extent provided in section 6 hereof, of a copy of the exemption application filed in his district after September 2, 1958, by any organization described in section 501(c) or (d) of the Code which has been determined to be exempt from tax after such date. Each District Director will also, upon written request of any person, furnish a statement as to the exempt status of any organization in his district whose application is open for public inspection, setting forth (a) the subsection and paragraph of section 501 of the Code (or the corresponding provisions of prior law) under which the organization has been held to qualify for exemption; and (b) whether the organization is currently held to be exempt.

.02 The Director of the Public Information Division, National Office, will permit public inspection, in the manner and to the extent prescribed in section 6 hereof, of the exemption application, together with supporting documents, filed by any organization described in section 501(c) or (d) of the Code (or corresponding provisions of prior revenue laws), which has been determined to be exempt for any taxable year. The Director of that Division will also furnish, upon receipt of a written request, a statement as to the exempt status of any organization whose application is open to public inspection, setting forth (a) the subsection and paragraph of section 501 of the Code (or the corresponding provisions of prior law) under which any such organization has been held to qualify for exemption; and (b) whether the organization is currently held to be exempt.

.03 The Assistant Commissioner (Technical) will make determinations under section 6104(a)(1)(B) of the Code with regard to the withholding of certain information from public inspection and will inform the appropriate District Directors of Internal Revenue and the Director of Public Information Division, National Office, of such determinations in order to insure that information which should be withheld is not made available for public inspection.

SEC. 5. DEFINITIONS.

.01 For purposes of this Revenue Procedure, the term "application for exemption" means the application form (or letter of application if no form is prescribed) filed by an organization for the purpose of establishing its claim for exemption and all statements and documents required by the application form or the Income Tax Regula-

tions to be submitted with and as a part of the application. The term does not include a request for a ruling whether a proposed transaction is a prohibited transaction under section 503 of the Code.

.02 For purposes of this Revenue Procedure, the term "supporting document" means any statement or document submitted by an organization with respect to its application for exemption, which is not specifically required by the application form or by the applicable Income Tax Regulations to be submitted with and as a part of the exemption application.

.03 The following documents are included in the term "application for exemption" and will be available for public inspection at the office of a District Director and at the National Office in Washington, D. C., *provided*, however, such documents do not contain information which the National Office determines shall be withheld from public inspection in accordance with the procedures outlined in section 7, below:

(1) The official application form (Form 1023, 1024, 1025, or 1026) filed by the organization whose application is open to public inspection, together with any continuation sheet, supplemental schedule, articles of incorporation, by-laws, financial statement, or other paper or exhibit required by the application form or Income Tax Regulations to be submitted with the application.

(2) In cases in which an official application form is not prescribed, any letter which has been filed as an application for exemption by such an organization, together with a copy of the articles of incorporation, declaration of trust, or other similar instrument setting forth the powers and activities of the organization, the by-laws or other code of regulations, financial statement, and statements showing the character of the organization, the purpose for which it was organized, its actual activities, sources and disposition of income and receipts, and whether or not any of its income or receipts is credited to surplus or may inure to the benefit of any private shareholder or individual.

(3) In the case of a mutual insurance company, copies of the policies or certificates of membership issued by such company.

(4) In the case of a title holding company described in section 501(c)(2) of the Code, if the organization for which title is held has not been specifically notified in writing that it is held to be exempt under section 501(a) of the Code, the statements or documents which would be considered to be included in the application for exemption of the organization for which title is held.

(5) In the case of a state-chartered credit union described in section 501(c)(14) of the Code, a statement indicating the state and date of incorporation and showing that the state credit union law with respect to loans, investments, and dividends, if any, is being complied with.

.04 The following documents are included in the term "supporting document" and will not be available for public inspection at the office of the District Director: exhibits (including books, pamphlets, leaflets, or other printed material), legal briefs, statements of contention, or other papers which the organization may, on its own initiative, supply but which are not specifically required by the application form or Income Tax Regulations.

SEC. 6. RULES FOR INSPECTION.

.01 A request to inspect an application for exemption must be in writing. The request must specify the name and address of each organization whose application it is desired to inspect. If inspection at the National Office is desired, the request should be addressed to the Commissioner of Internal Revenue, Washington 25, D. C., attention: Director, Public Information Division. If inspection at a district office of an application filed after September 2, 1958, is desired, the request should be addressed to the District Director with whom the application was filed.

.02 The person making the request will be notified of the date on which the application or applications he desires to examine will be available for his inspection. Inspection will be made only in the presence of an internal revenue officer or employee and only during the regular hours of business of the office. The Director of the Public Information Division, National Office, or the District Director may limit the number of applications to be made available to any person on a given date.

.03 Inspection in the office of the District Director will extend only to a copy of the "application for exemption" as defined in section 5, except any material which the National Office determines shall be withheld from public inspection or which is under consideration for purposes of such determination. See section 7, below.

.04 Inspection in the National Office will extend to the "application for exemption" and to "supporting documents" as defined in section 5, except any material which the National Office determines shall be withheld from public inspection or which is under consideration for purposes of such determination. See section 7, below.

.05 The information to be disclosed will be made available on an inspection basis only. Notes may be taken and copies may be made manually, but not photographically. Facsimiles of such information will not be furnished by the Internal Revenue Service to the public.

SEC. 7. WITHHOLDING OF INFORMATION.

.01 Any organization which has filed an application for exemption may request in writing that information in such application or any supporting document relating to a trade secret, patent, process, style of work, or apparatus of the organization, not be disclosed. The request shall identify the matter desired to be withheld by reference to the document, page, paragraph, and line, and shall set forth the reasons why the organization considers that the information is of the type which should be withheld from public inspection. In the case of an application filed before November 3, 1958, the request should be addressed to the Commissioner of Internal Revenue, attention: Public Information Division, Washington 25, D. C. In the case of an application filed after November 2, 1958, the request should be filed with the office with which the organization filed the documents containing the material desired to be withheld.

.02 During the period of time necessary for consideration of the organization's request, public inspection of the material will not be permitted.

.03 If the National Office determines that the information desired to be withheld relates to a trade secret, patent, process, style of work, or

apparatus of the organization, and that its public disclosure would be detrimental to the organization, the organization will be notified of such determination. The information will thereafter be withheld from public inspection. If the National Office determines that the information does not qualify for withholding from public inspection, the organization will be so notified. The information will then be withheld from public inspection for 30 days. If during such period the organization protests the determination, the information will be withheld for a further period pending consideration of the organization's protest and final determination thereon by the National Office.

.04 The material to be withheld from inspection on the basis of an organization's request will consist solely of the material covered by the request and determined to be withheld by the National Office.

.05 Information in applications for exemption and supporting documents will also be withheld from public inspection if the National Office determines that public disclosure of such information would adversely affect the national defense.

SEC. 8. UNAVAILABILITY OF CERTAIN EXEMPTION APPLICATIONS.

Exemption applications with respect to which rulings were issued by the National Office prior to January 1, 1948, and which have been destroyed pursuant to Congressional authority are not available for inspection.

SEC. 9. EFFECTIVE DATE.

This Revenue Procedure is effective November 3, 1958.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. (Also Part III-A, Section 5382; 240.527, 204.529.)

Rev. Proc. 58-21

Proprietors of bonded wineries and bonded wine cellars are invited by the Internal Revenue Service to participate in an experimental study for removing excess color from white wines.

Revenue Procedure 57-35, C. B. 1957-2, 1108, suspended until further notice.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce an experimental study for removing excess color from white wines, other than vermouth, and the conditions to be met by winemakers desiring to participate.

SEC. 2. BACKGROUND.

Revenue Procedure 57-35, C. B. 1957, 1108, holds that the use of activated carbon or other filtering aids and devices in the treatment and production of special natural wines (or the wine-producing material) indicated that color and other characteristics of the wine may have been removed. Accordingly, a minimum color of not less than 1.0 Lovibond in a one-half inch cell was established unless it was shown that the requirements of the Wine Regulations had been complied with in all respects. Subsequent to the issuance of Revenue Procedure 57-35, members of the wine industry represented to the

Alcohol and Tobacco Tax Division that white wines of a color of less than 1.0 Lovibond scale could be achieved in regular white wine production procedures and that the treatment of white wine with activated carbon to remove excess color to a degree of less than 1.0 Lovibond scale would not remove color or other characteristics of the wine to any extent prohibited by law.

SEC. 3. EXPERIMENTAL STUDY AND DURATION.

In order to determine a practical application of the regulations in regard to the removal of excess color from such white wines with the use of activated carbon, it has been decided that the Alcohol and Tobacco Tax Division will engage in an experimental study jointly with the wine industry, effective immediately, and to expire June 30, 1959. On or before June 30, 1959, the data obtained from the study will be correlated and evaluated by the Division.

SEC. 4. PROCEDURE.

Any proprietor desiring to engage in this experiment should file with his Assistant Regional Commissioner, Alcohol and Tobacco Tax, in duplicate, an application for continuing authority to use activated carbon under section 240.527 of the Wine Regulations. Such application should contain all information required by the regulations and also:

(a) Indicate the length of time that the carbon will be in contact with the wine.
(b) State approximate temperature of wine during treatment.
(c) Describe or explain any unusual factors of the treatment.
(d) Explicitly specify the quantity of activated carbon to be used, such as 8 pounds per 1,000 gallons will be used, or 5 to 8 pounds per 1,000 gallons will be used.

A separate application for each batch of wine to be treated will not be required.

SEC. 5. SAMPLES.

During the trial period, samples as needed will be taken both by the Government and by the proprietor for the purpose of determining the effect of the use of activated carbon and the amount of color removed, as well as for comparative tests of other characteristics of the wine.

SEC. 6. CONDITIONS.

Proprietors participating in this experimental study shall conform with the following conditions:

(a) Nine pounds of activated carbon per 1,000 gallons of wine, including any activated carbon used in the basic wine-producing material, is the absolute maximum which may be used.
(b) Wine treated with activated carbon must have a color of not less than 0.6 Lovibond in a one-half inch cell; however, if a proprietor can achieve in regular production of wine a color of less than 0.6 Lovibond scale, without the use of carbon, such procedure may be properly followed.
(c) The 0.6 Lovibond restriction applies whenever carbon is used on bonded winery premises; it would not apply to carbon treatment of wine spirits on distilling premises.

(d) The proprietor must keep commercial records which shall show for each batch of wine or basic wine-producing material treated with carbon the exact details of such treatment including the kind of juice, by grape variety, and the kind of carbon used.

(e) Where wine is treated under this experiment and is later transferred in bond, a notation will be made on Form 703, Transfer of Wine in Bond, by the consignor and in the records of the consignee as to the quantity of activated carbon used for the treatment prior to shipment. A second treatment may be made if the total use of activated carbon does not exceed 9 pounds per 1,000 gallons of wine, i. e., if 5 pounds of activated carbon per 1,000 gallons were used in the first treatment, not more than 4 pounds of activated carbon per 1,000 gallons could be used in the second treatment.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

The provisions of Revenue Procedure 57–35, C. B. 1957–2, 1108, are hereby made inapplicable during the experimental period established by this Revenue Procedure.

SEC. 8. 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 tax, qualification requirements, and regulations.
(Also Part III–A, Section 5552; Section 245.30.)

Rev. Proc. 58–22

The Potter Flow Meter has been approved by the Internal Revenue Service for use by brewers in measuring beer.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to advise brewers and others concerned that the Potter Flow Meter has been approved for measuring beer in breweries.

SEC. 2. BACKGROUND.

After a series of tests and evaluations, the Potter Flow Meter manufactured by The Potter Aeronautical Corporation, Union, New Jersey, has been approved for measuring beer. The basic meter consists of two components: (1) the rotor or sensing element which generates electrical pulses as the rotor is turned by the flowing liquid, and (2) the electronic counter which receives the pulses, counts them and translates the results into barrels, tenths, hundredths, and thousandths of a barrel. In conjunction with the basic meter there is incorporated a maximun security system, designated as Sy 81–4000, which consists of a solenoid valve to prevent slow flows below which the counter will not register, a shield to protect against outside electronic influences, provisions against tampering with the electronic system, and provisions against electronic failure of any of the com-

ponent parts. All wiring between the component parts must be in a sealed conduit. These security features must be incorporated into any Potter Flow Meter used by a brewer for use in measuring beer transferred to a bottling tank.

SEC. 3. USE OF POTTER FLOW METERS.

The Potter Flow Meter is now approved for use by brewers to measure beer transferred to bottling tanks only. Until this meter has been evaluated for use in racker lines and for use in direct bottling lines, its use for measuring beer in racker lines and in direct bottling lines is not approved.

SEC. 4. CALIBRATION OF POTTER FLOW METERS BEFORE INSTALLATION.

Until further notice, all Potter Flow Meters to be used for measuring beer transferred to bottling tanks must have the calibration confirmed in the Alcohol and Tobacco Tax Division Meter Testing Laboratory, Washington 25, D. C., before the meter is installed in the brewery.

SEC. 5. METERS PREVIOUSLY APPROVED.

Approved meters currently in use for measuring beer in breweries are the Figure 786 Xacto Meter manufactured by Bowser, Inc., Fort Wayne, Indiana, the Pittsburgh Beer Meter manufactured by the Pittsburgh Equitable Meter Division, Rockwell Manufacturing Company, Pittsburgh, Pennsylvania, and the Figure 486 Xacto Meter manufactured by Bowser, Inc.

SEC. 6. 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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